

ACTION ON DECISION

Subject: Patel v. Commissioner
138 T.C. No. 23 (June 27, 2012)
Docket No. 11694-09

Issue: Whether a finding that the state of the law is uncertain at the time of the filing of a return, without a finding regarding whether the taxpayer made reasonable inquiry as to the state of the law, is an appropriate factor in determining whether the taxpayer acted with reasonable cause and in good faith for purposes of avoiding an accuracy-related penalty.

Discussion: Taxpayers Upen G. and Avanti D. Patel purchased property in Virginia in 2006 with the intention to demolish the house on the property and construct a new one. Taxpayers' real estate agent informed them that the local fire department had a program through which the fire department acquired houses for purposes of conducting training exercises by burning the houses and extinguishing the fires. Taxpayers completed all of the necessary paperwork to participate in the program, and hired a construction company to remove the remaining debris. In October 2006, the fire department conducted training exercises and destroyed the house on taxpayers' property. Taxpayers claimed a noncash charitable deduction of \$339,504 for the claimed contribution of the property to the fire department. The Commissioner disallowed the deduction and determined an income tax deficiency and accuracy-related penalty under section 6662.

In the Tax Court, the Commissioner filed a motion for partial summary judgment that taxpayers were not entitled to the charitable contribution deduction and were liable for the accuracy-related penalty on the alternative grounds of negligence or substantial understatement of income tax. In response to the motion, taxpayers denied their liability for the tax and penalty, stating that they had complied with the law and, with respect to the penalty, had acted with reasonable cause and good faith by relying on Scharf v. Commissioner, T.C. Memo. 1973-265. In a reviewed opinion, the Tax Court granted the Commissioner's motion on the contribution issue, but did not uphold the penalty, finding that taxpayers fell within the "reasonable cause exception" under section 6664(c). In determining that taxpayers were not entitled to the charitable deduction, the court found that any reliance on Scharf was "unfounded." The court previously held in Rolfs v. Commissioner, 135 T.C. 471, 487 (2010), aff'd, 668 F.3d 888 (7th Cir. 2012) that the Scharf standard was superseded by the quid pro quo standard for charitable deductions articulated by the Supreme Court in United States v. American Bar Endowment, 477 U.S. 105, 118 (1986). Significant also was the fact that Congress amended section 170 to disallow a deduction for contributions of partial interests in property, such as that in Scharf, for contributions made after 1969. Although finding reliance on Scharf was

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“unfounded,” the court held that taxpayers acted with reasonable cause and good faith “given all the facts and circumstances, including the uncertain state of the law” and, accordingly, taxpayers were not liable for the section 6662 penalty. Slip. op. at 39.

We disagree with the court’s conclusion that the uncertain state of the law is a factor that supports a finding of reasonable cause and good faith, without any consideration of taxpayers’ investigation of the contemporaneous state of the law, including their failure to obtain competent professional advice. Treasury Regulation section 1.6664-4(b) provides for a “facts and circumstances” approach in determining the reasonable cause and good faith exception to the accuracy-related penalties, but a taxpayer’s reasonable cause and good faith must be evaluated in the context of the taxpayer’s knowledge, efforts and actions. A taxpayer cannot act in good faith and have reasonable cause on the basis of the unsettled state of the law if the taxpayer was unaware of the state of the law and did not make reasonable attempts to become aware.

Accordingly, the Service will not follow Patel insofar as it holds that the uncertain state of the law, without a finding regarding a taxpayer’s efforts to determine the state of the law, is a factor in determining whether a taxpayer has demonstrated reasonable cause and good faith for purposes of avoiding the accuracy-related penalties.

Recommendation: Nonacquiescence.

/s/

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