Tax Notes Today

Oct. 24, 2011

HAWKINS TO FLAG ADVISERS OF CLIENTS WITH SUCCESSFUL REASONABLE CAUSE DEFENSE

Amy Elliott

IRS Office of Professional Responsibility Director Karen Hawkins said she has asked Appeals officers to consider making a referral to her office when they abate a taxpayer's section 6662 penalty based on a successful reliance on adviser defense when the underlying adjustment for the position is nevertheless sustained, so that she can investigate the competence of the adviser who issued the opinion relied on by the taxpayer.

Speaking October 21 on a panel titled "What Is Your Tax Opinion Worth in Light of *Canal Corporation*?" at a Real Estate session of the American Bar Association Section of Taxation meeting in Denver, Hawkins said that if Appeals officers "have been convinced that the taxpayer truly relied [on the opinion] at the same time that they still think the adjustment is warranted, I want to take a look at that adviser for competence and for whether they did their due diligence or not."

Hawkins added that reasonable minds can differ on whether the result in *Canal* was correct, but she stressed that her focus is not about punishment. "My focus is about fitness to practice and whether a particular practitioner is behaving in a way that makes me concerned," she said. (For *Canal Corp. v. Commissioner*, 135 T.C. 99 (Aug. 5, 2010), see *Doc 2010-17535* or *2010 TNT 151-9*.)

Michael J. Desmond, a partner with Bingham McCutchen LLP, said he would have expected that if Appeals thought a taxpayer's reasonable basis defense was good, the adviser would be in the clear. "It seems to me intuitively that if Appeals recognizes -- because the case has been developed through Exam -- that there is a basis for a reasonable cause defense, then that's a good practitioner," he said. "They have been independent. They have done their due diligence. Otherwise, it would have been rejected and it would go forward to stat notice with penalties attached to it."

But Hawkins said that isn't usually what happens in Appeals. "For the most part, what you often see is the same practitioner that's in Appeals arguing the defense is not the one that gave the advice," she said. "Not always, but that's usually one of the best defenses: Bring somebody new in and point to the adviser to say, 'The devil made me do that.'"

Christopher S. Rizek of Caplin & Drysdale took issue with that comment. "You can't say that and then threaten people with material limitation conflict every time

they follow on by representing the taxpayer," he said. "You just said that if it's the same person, it's going to be a material limitation conflict, and now you're saying that if it's not the same person, that's a problem."

Hawkins responded that she never said it was a conflict. "I just said I wanted to take a look."

Richard M. Lipton, a partner with Baker & McKenzie LLP, said he thinks *Canal* was wrongly decided on the penalty issue. He said the case meets the three-point standard in *106 Ltd. v. Commissioner*, which he said is the correct standard. "You have to have a competent adviser. You have to have accurate and necessary information -- all of which was present here. And you have to show good faith reliance," he said. (For *106 Ltd. v. Commissioner*, 136 T.C. 67 (Jan. 10, 2011), see *Doc 2011-585* or *2011 TNT 7-10*.)

Lipton added that he thinks *Southgate Master Fund LLC v. United States* -- in which the district court held and the Fifth Circuit affirmed that there was no penalty -- was wrongly decided because the three-point standard wasn't met in that case. (For *Southgate Master Fund LLC v. United States*, No. 09-11166 (5th Cir. Sept. 30, 2011), see *Doc 2011-20779* or *2011 TNT 191-13*.)

Hawkins said she isn't looking at whether an adviser wins or loses the reasonable cause argument, adding, "Those are crapshoots from my point of view." She said she is concerned about competence, due diligence, and conflicts of interest.