INTERNAL REVENUE SERVICE

NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

Number: **201448032**
Release Date: 11/28/2014

UIL: 9999.98-00

September 5, 2014

E.O. Exams Programs and Review
Internal Revenue Service
Attn: EO Mandatory Review
MC 4920 DAL
1100 Commerce Street
Dallas, TX 75242

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification Number:

Tax Years Involved:

Date of Conference:

LEGEND:

Foundation =
Corporation =
Founder =
Year =
Year1 =
Date =

ISSUE:

Should the first-tier excise taxes under I.R.C. § 4943 on Foundation's holding of stocks in a for-profit business for the years at issue be abated in accordance with § 4962?

FACTS:

Foundation is classified as a private foundation under § 509. Foundation was initially funded with shares in a for-profit corporation, Corporation, by its founder, Founder. For three years ending in the most recent tax year in issue, additional Corporation stock was granted to Foundation by Founder's brother. By Year, the ownership percentages were as follows:

	Year	Year1
Foundation	%	%
Substantial Contributors	%	%
Board Members	%	%
Family Members	%	%
Total Disqualified and Foundation	%	%

The directors of Foundation and Corporation are identical.

In Year, the tax preparer for Foundation analyzed the business holdings of Foundation and its disqualified persons and outlined them in a memorandum. The memorandum sought to determine if Foundation held excess business holdings for the prior tax year. The document concluded that the substantial contributors to Foundation and the family members thereof owned over seventeen percent of the stock of the corporation, but slightly miscalculated the total stock attributable to Foundation. The memorandum then misinterpreted the percentage allowable under § 4943(c)(2) to conclude, incorrectly, that Foundation had no excess business holdings for the prior tax year. As the analysis concluded, albeit incorrectly, Foundation had no excess business holdings, the memorandum had no reason to discuss the five-year period to dispose of gifts, bequests, etc., allowed by § 4943(c)(6). The internal memorandum ends with the note that the excess business holdings of Foundation should be evaluated annually.

The tax preparer discussed the analysis with Foundation's Treasurer and provided a copy of the memorandum for Foundation's files.

When preparing the return for Foundation's Year tax year the tax preparer relied upon the analysis in the prior memorandum in order to determine that Foundation had no excess business holdings. Foundation did not change its holdings and did not report any excess business holdings on its Year return. When preparing the returns for Year1, Foundation's tax preparer assigned new individuals to the task. The new individuals performed a new analysis of Foundation's business holdings, discovered the earlier errors, and found that Foundation had excess business holdings in Year and Year1. Foundation filed the appropriate returns for Year1 and amended its returns for Year.

To correct Foundation's excess business holdings position, Foundation made an installment sale of all of the stocks originally granted by Founder back to the corporation for the full value determined under a qualified valuation of the stock.

Foundation has submitted a Form 4720 for both the Year and Year1 tax years seeking abatement of the first tier tax under § 4943 for both years.

LAW:

I.R.C. § 507(d)(2) provides that a substantial contributor means any person who contributed or bequeathed an aggregate amount of more than $5,000 to the private foundation, if such amount is more than two percent of the total contributions and bequests received by the foundation.

I.R.C. § 4943(a) imposes a ten percent tax on the value of any "excess business holdings" of a private foundation.

I.R.C. § 4943(c)(1) defines "excess business holdings" as the amount of stock which the foundation would have to dispose of to a person other than a disqualified person in order for the remaining holdings of the foundation to be "permitted holdings."

I.R.C. § 4943(c)(2) defines "permitted holdings" as twenty percent of the voting stock of any incorporated business enterprise reduced by the percentage of the voting stock owned by all disqualified persons.

I.R.C. § 4946(a)(1) provides that a "disqualified person," with respect to a private foundation, includes a substantial contributor, as defined under § 507(d)(2), a foundation director or officer, and any spouse, ancestor, child, grandchild, great grandchild, and any spouse of a child, grandchild, or great grandchild of that contributor, director, or officer.

I.R.C. § 4962(a) provides that if it is established to the satisfaction of the Secretary that:

1. a taxable event was due to reasonable cause and not to willful neglect, and
2. such event was corrected within the correction period for such event, then any qualified first tier tax imposed with respect to such event (including interest) shall not be assessed and, if assessed, the assessment shall be abated and, if collected, shall be credited or refunded as an overpayment.

I.R.C. § 4963(a) provides that, "If any taxable event is corrected during the correction period for such event, then any second tier tax imposed with respect to such event (including interest, additions to the tax, and additional amounts) shall not be assessed, and if assessed the assessment shall be abated, and if collected shall be credited or refunded as an overpayment."

I.R.C. § 4963(e)(1) defines "correction period" as "the period beginning on the date on which such event occurs and ending 90 days after the date of mailing under § 6212 of a notice of deficiency."

Treas. Reg. § 53.4963-1(e) provides that the correction period with respect to any taxable event shall begin with the date on which the taxable event occurs and shall end 90 days after the date of mailing of a notice of deficiency under § 6212 with respect to the second tier tax imposed with respect to the taxable event. Subparagraph (3) provides that the correction period may be extended by any period which the Commissioner determines is reasonable and necessary to bring about correction of the taxable event.

In United States v. Boyle, 469 U.S. 241 n.3 (1985), the Supreme Court described "willful neglect" "as meaning a conscious, intentional failure or reckless indifference." To show reasonable cause, the taxpayer must "demonstrate that he exercised 'ordinary business care and prudence.'" Boyle, 469 U.S. at 246 (quoting Treas. Reg. § 301.6651-1(c)(1). Additionally, the court stated, "This case is not one in which a taxpayer has relied on the erroneous advice of counsel concerning a question of law. Courts have frequently held that "reasonable cause" is established when a taxpayer shows that he reasonably relied on the advice of an accountant or attorney that it was unnecessary to file a return, even when such advice turned out to have been mistaken." Citing United States v. Kroll, 547 F.2d 393, 395-396 (CA7 1977); Commissioner v. American Assn. of Engineers Employment, Inc., 204 F.2d 19, 21 (CA7 1953); Burton Swartz Land Corp. v. Commissioner, 198 F.2d 558, 560 (CA5 1952); Haywood Lumber & Mining Co. v. Commissioner, 178 F.2d, at 771; Orient Investment & Finance Co. v. Commissioner, 83 U.S.App.D.C., at 75, 166 F.2d, at 603; Hatfried, Inc. v. Commissioner, 162 F.2d, at 633-635; Girard Investment Co. v. Commissioner, 122 F.2d, at 848; Dayton Bronze Bearing Co. v. Gilligan, 281 Fed. 709, 712 (CA6 1922). This Court also has implied that, in such a situation, reliance on the opinion of a tax adviser may constitute reasonable cause for failure to file a return. Citing Commissioner v. Lane-Wells Co., 321 U.S. 219, 64 S.Ct. 511, 88 L.Ed. 684 (1944). The court goes on to state, "When an accountant or attorney *advises* a taxpayer on a matter of tax law, such as whether a liability exists, it is reasonable for the taxpayer to rely on that advice. Most taxpayers are not competent to discern error in the substantive advice of an accountant or attorney. To require the taxpayer to challenge the attorney, to seek a "second opinion," or to try to monitor counsel on the provisions of the Code himself would nullify the very purpose of seeking the advice of a presumed expert in the first place."

In Woodsum v. Commissioner, 136 T.C. 585 (2011), the court determined that there was no reasonable cause for the failure to report $3.4 million in income when the taxpayer had provided its tax preparer with all of the information for it to know that the taxpayer had earned that income. The court noted that the tax preparers failure to report the income on the return does not constitute professional advice on which the taxpayer could rely for not reporting the income.

Hans Mannheimer Charitable Trust v. Commissioner, 93 T.C. 35 (1989), involved the imposition of taxes under § 4945 for failure to exercise the expenditure responsibilities under § 4945(h). The court stated: "The initial tax is a spur designed to remind the foundation that it has been remiss. Subsequent compliance with the rules enables the foundation to avoid the real whip of § 4945(b)(1), but cannot undo the punishment for its initial infraction." The court determined that even if no expenditures were used inappropriately, failure to comply with the regulations and file the appropriate paperwork warranted imposition of the first-tier tax under § 4945.

In Rembusch v. Commissioner, 38 T.C.M. (CCH) 310 (1979), the court held the taxpayer has the burden of showing that a failure to file timely returns was due to reasonable cause and not willful neglect. A mere showing that the delinquency in filing the returns was not due to willful neglect is not sufficient and that there must also be reasonable cause.

In de Belaieff v. Commissioner, 15 T.C.M. (CCH) 1426 (1956), the court held ignorance of the law does not constitute reasonable cause. The taxpayer had shown that failure to file returns was not due to willful neglect, but to ignorance of the law. The taxpayer received advice from her attorneys regarding the tax treatment of income items, which was correct at the time of the advice. Subsequently, for the years at issue, there was a change in the law that made them taxable, but taxpayer continued to treat the items as nontaxable. The court found that even though taxpayer had legal representation, the failure by the attorneys to provide advice and the failure by the taxpayer to seek advice, did not constitute reasonable cause.

H.R. Rep. No. 432 (Pt. 2), 98th Cong., 2d Sess. 1472 (1984), and S. Rep. No. 169 (Vol. 1), 98th Cong., 2d Sess. 591 (1984), provide that where the foundation or foundation manager can establish that there was reasonable cause for such a violation and that there was no willful neglect of the rules, the Internal Revenue Service is to have discretionary authority to relieve the foundation or manager from the first-tier penalty tax, provided that the violation is corrected in the manner required in order to avoid liability for second-tier taxes. A violation which was merely due to ignorance of the law cannot qualify for such abatement.

Delegation Order No. 7-11 (11-08-2007) delegates authority to abate substantial first-tier excise taxes to the Director, Exempt Organizations. "Substantial qualified first-tier tax amount" is described as a sum exceeding $200,000 for all such tax payments or deficiencies (excluding interest, other taxes, and penalties) involving all related parties and transactions arising from chapter 42 taxable events within the statute of limitations as determined by the key district office involved. See IRM 1.2.46.12(2), (3).

ANALYSIS:

For first tier tax to be abated under § 4962, the tax assessed must be from a taxable event due to reasonable cause and not to willful neglect, and the taxable event was corrected within the correction period for such event.

Abatement of taxes under § 4962 requires that the failure to comply with the tax law was due to (1) reasonable cause, (2) not from willful neglect, and (3) that taxpayer correct its non-compliance within the applicable correction period. There is no contention that Foundation acted with willful neglect or that it has not corrected in the appropriate correction period. However, it is not enough to show that the mistake was merely not due to willful neglect, Foundation must also show that it was due to reasonable cause. Rembusch, 38 T.C.M. (CCH) 310. Section 4962 does not define "reasonable cause." Other Code sections and the regulations, including § 53.4945-1(a)(2)(v), indicate that the standard should be "ordinary business care and prudence." Under § 301.6651-1(c) and other provisions that impose a reasonable cause standard, determining whether reasonable cause was shown requires consideration of all the facts and circumstances. The Supreme Court, in Boyle, 469 U.S. at 246, states that to show reasonable a taxpayer must demonstrate that it acted with "ordinary business care and prudence." The Court goes on to clarify that "When an accountant or attorney advises a taxpayer on a matter of tax law, such as whether a liability exists, it is reasonable for the taxpayer to rely on that advice." Boyle, 469 U.S. at 251.

Foundation claims that its error was due to reasonable cause based on the tax advice of its tax preparer. In the year before Year Foundation's tax preparer drafted a memorandum stating that Foundation did not have excess business holdings. The prepared advice was not based on the five-year period for disposal provided for gifts under § 4943(c)(6), which was still in effect. The written analysis by the tax preparer concluded that the amount of the holdings did not constitute excess business holdings and were thus permissible. This analysis gave no indication that Foundation's excess business holdings position would change without any change to the actual share holdings. Thus, Foundation had professional advice, before to the date it would need to reduce its excess business holdings, that it did not have excess business holdings due to not reaching, what it believed to be the applicable holdings. Based on the written advice of the tax preparer Foundation believed it had no need to reduce its business holdings. This tax advice was provided with full knowledge of the facts as demonstrated by email exchanges between Foundation and the preparer.

In the first year in question, Foundation's tax preparer again relied on the analysis of the prior year's memorandum. Relying on this memorandum the tax preparer examined the nearly identical tax holdings of Foundation and came to the same erroneous conclusion, which the tax preparer provided to Foundation. When preparing Foundation's Year1 tax filings Foundation's tax preparer performed a new analysis with new individuals. It was at this time that the tax preparer informed Foundation it had excess business holdings for both Year and Year1. Foundation states that it reasonably relied upon the advice of its tax preparer to mistakenly carry excess business holdings.

It is necessary to examine other parts of Chapter 42 to define "reasonable cause" since it is not defined within § 4962 or its regulations. Section 53.4955-1(b)(7) provides language to interpret reasonable written advice when evaluating the reasonable cause of a foundation manager for agreeing to a political expenditure. This section provides that such agreement is done with reasonable cause if the opinion addresses itself to the facts and applicable law. A written opinion is not considered reasoned if it does nothing more than recite the facts and express a conclusion. The written advice of counsel in this case addresses the facts and the applicable law for this case. The written advice incorrectly concludes that Foundation should be below the 35 percent limit rather than the 20 percent limit. It should not be incumbent upon Foundation to validate the analysis of the professional tax preparer who has full information when it has received specific advice relating to the conclusions used in the preparation of its taxes. Foundation had specific communications with its tax preparer on this topic and knew that the preparer provided a specific analysis which cites both the law and the facts in the relevant case. There was no information in the written advice that put Foundation on notice as to the erroneous conclusion. Therefore, Foundation should be considered to have reasonable cause to continue with its status quo level of business holdings until it had been advised otherwise.

Foundation's excess business holdings were not performed with willful neglect and they have been corrected. Foundation also had reasonable cause to maintain its business holding level since it received written advice from a professional tax preparer that addressed both the facts and the law relating to this issue for Foundation. H.R. Rep. No. 432 discussing the enactment of § 4962 states that the reasoning behind the abatement rule is that all strict impositions of Chapter 42 taxes were not necessary in order to enforce compliance with the letter and spirit of the rules. Abating the first-tier taxes in this case is consistent with that reasoning.

Based on the foregoing:

The § 4943 taxes on excess business holdings should be abated under § 4962 since Foundation sought the advice of a well-respected tax preparer, had specific conversations with that preparer regarding its stock holdings, and received specific advice from that preparer noting that there were no excess business holdings.

A copy of this memorandum is to be given to Foundation. Section 6110(k)(3) of the Internal Revenue Code provides that it may not be used or cited as precedent.

-END-