11 T.C. 442 (1948)

A taxpayer's reliance on a non-expert accountant, without further inquiry or disclosure of pertinent facts on tax returns, does not constitute reasonable cause for failing to file personal holding company returns, even if the taxpayer acted in good faith.

Summary

Hermax Co. was assessed penalties for failing to file personal holding company tax returns. The company argued that its failure was due to reasonable cause because it relied on a public accountant to prepare its returns. The accountant, who wasn't a tax law expert, incorrectly determined that Hermax wasn't a personal holding company after consulting with another colleague. The Tax Court held that the company's reliance on a non-expert accountant without any officer of the company consulting about the issue was not reasonable cause for failing to file the required returns, thus upholding the penalties.

Facts

Hermax Co. was incorporated in 1943 to hold and manage real estate owned by the Ringel family. Herman Ringel and his family owned all the company's stock. A public accountant, Imhoff, who had long handled the Ringels' books and taxes, was tasked with preparing Hermax's tax returns. Imhoff concluded, after a brief consultation with a colleague, that Hermax was not a personal holding company. The question of the company's status was never discussed with its officers. The company's income consisted entirely of rents, but the tax returns did not disclose the source of those rents. The returns answered "No" to whether the corporation was a personal holding company.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Hermax Co.'s personal holding company surtax for 1943-1945 and imposed penalties for failure to file timely personal holding company returns. Hermax Co. conceded its status as a personal holding company but contested the penalties, arguing reasonable cause. The Tax Court upheld the Commissioner's determination and imposed the penalties.

Issue(s)

Whether the failure of Hermax Co. to file personal holding company returns was due to reasonable cause, thus exempting it from penalties under Section 291(a) of the Internal Revenue Code.

Holding

No, because the company did not demonstrate ordinary business care and prudence

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in determining its tax obligations by relying on a non-expert accountant without disclosing relevant information or making further inquiry.

Court’s Reasoning

The court reasoned that Hermax Co.’s president, an intelligent businessperson, delegated tax responsibilities to an accountant who wasn’t an expert in federal tax law. The accountant’s consultation with a colleague did not elevate the level of expertise, as they only considered one aspect of the personal holding company rules. The company’s officers never consulted anyone about the personal holding company status. The Tax Court distinguished this case from others where reliance on experts constituted reasonable cause, emphasizing that Imhoff was a public accountant primarily employed to keep books and lacked specialized tax expertise. Furthermore, the tax returns did not fully disclose the relevant facts needed to determine personal holding company status. The court emphasized that ignorance of the law, especially tax law, is generally not an excuse. As the court stated,

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