Legg v. Commissioner of Internal Revenue, 145 T. C. 344 (U. S. Tax Court 2015)

In Legg v. Commissioner, the U. S. Tax Court ruled that the IRS complied with procedural requirements for assessing penalties under Section 6751(b). The court held that an examination report, which included an alternative position of a 40% gross valuation misstatement penalty, constituted an 'initial determination' despite the primary position being a 20% penalty. This decision clarifies the timing and nature of supervisory approval needed for penalty assessments, impacting how the IRS and taxpayers approach penalty disputes.

Parties

Brett E. Legg and Cindy L. Legg, as petitioners, challenged the Commissioner of Internal Revenue, as respondent, in the U. S. Tax Court regarding the imposition of accuracy-related penalties for tax years 2007, 2008, 2009, and 2010.

Facts

In 2007, petitioners donated a conservation easement valued at $1,418,500 to a Colorado trust and claimed a charitable contribution deduction. The IRS examined their returns for 2007-2010 and determined that the donation did not satisfy the legal requirements for a charitable contribution deduction or, alternatively, that the correct value was zero. The IRS proposed penalties under Section 6662(a) at 20% and, alternatively, under Section 6662(h) at 40% for a gross valuation misstatement. The examiner's report, which included both positions, was signed by the examiner's immediate supervisor. After a notice of deficiency, the parties stipulated the value of the easement at $80,000, confirming a gross valuation misstatement, but disagreed on the applicability of the 40% penalty.

Procedural History

The IRS conducted an examination of petitioners' tax returns and issued an examination report on September 16, 2011, which proposed adjustments to their charitable contribution deductions and assessed penalties. Petitioners protested these findings, leading to a review by the IRS Appeals Office, which issued its report on October 24, 2013, affirming the examiner's findings. The Appeals Officer's immediate supervisor approved the report. On the same date, the IRS issued a notice of deficiency assessing the 40% gross valuation misstatement penalty. Petitioners challenged the penalty in the U. S. Tax Court, which considered whether the IRS's determination of the 40% penalty complied with Section 6751(b).

Issue(s)

Whether the IRS's determination of a 40% gross valuation misstatement penalty under Section 6662(h) complied with the supervisory approval requirement of Section 6751(b), given that the examination report included the 40% penalty as an

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alternative position.

Rule(s) of Law

Section 6751(b)(1) of the Internal Revenue Code requires that no penalty be assessed unless the initial determination of such assessment is personally approved in writing by the immediate supervisor of the individual making the determination. Section 6662(h) imposes a 40% penalty for gross valuation misstatements when the value of property claimed on a return is 200% or more of the amount determined to be the correct value.

Holding

The U. S. Tax Court held that the IRS's determination of the 40% gross valuation misstatement penalty was proper because the examination report, which included the 40% penalty as an alternative position, constituted an 'initial determination' under Section 6751(b).

Reasoning

The court reasoned that the phrase 'initial determination' is not defined in the Code or regulations but interpreted it as relating to the beginning of the penalty assessment process. The court found that the examination report, although calculating penalties at 20% based on the primary position, included a detailed analysis of the applicability of the 40% penalty as an alternative position. This analysis, approved in writing by the examiner's immediate supervisor, satisfied the requirements of Section 6751(b). The court also considered the legislative intent behind Section 6751(b), which is to ensure taxpayers understand the penalties imposed upon them. The examination report clearly explained the basis for the 40% penalty, fulfilling this intent even though it was an alternative position. The court rejected petitioners' argument that the calculation of penalties at 20% negated the initial determination of the 40% penalty, emphasizing that the report's conclusion on the 40% penalty met the statutory requirements.

Disposition

The court ruled in favor of the Commissioner, finding that the IRS satisfied the procedural requirements of Section 6751(b). The decision was to be entered under Rule 155, indicating that the court upheld the imposition of the 40% gross valuation misstatement penalty.

Significance/Impact

Legg v. Commissioner clarifies the procedural requirements for IRS penalty assessments, particularly regarding the timing and nature of supervisory approval under Section 6751(b). The decision establishes that an 'initial determination' can include an alternative position in an examination report, provided it is approved by

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the examiner’s immediate supervisor. This ruling has significant implications for both the IRS and taxpayers in penalty disputes, as it sets a precedent for the validity of alternative penalty positions in examination reports. It may affect future cases involving the imposition of penalties, especially in situations where multiple penalty positions are considered during the examination process.

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