Graev v. Commissioner, 147 T. C. No. 16, 2016 U. S. Tax Ct. LEXIS 33 (U. S. Tax Ct. 2016) (including reporter, court, and year)

In Graev v. Commissioner, the U. S. Tax Court ruled that the IRS's inclusion of a 20% accuracy-related penalty in a notice of deficiency complied with statutory requirements, despite the absence of written supervisory approval for the initial determination of the penalty. The court held that the penalty's assessment would be premature to consider without an actual assessment, and affirmed the penalty on grounds of substantial understatement of income tax, while reversing the 40% valuation misstatement penalty. This case underscores the importance of procedural compliance in tax penalty assessments and impacts the IRS's practices in asserting penalties.

Parties

Lawrence G. Graev and Lorna Graev, the petitioners, were the taxpayers who challenged the IRS's determination of tax deficiencies and penalties. The respondent was the Commissioner of Internal Revenue, representing the IRS. The Graevs filed their petition in the U. S. Tax Court, contesting the IRS's notice of deficiency issued on September 22, 2008, which determined deficiencies in their 2004 and 2005 tax returns.

Facts

In 2004, Lawrence Graev purchased property in New York City and donated a facade conservation easement to the National Architectural Trust (NAT). The Graevs claimed charitable contribution deductions on their 2004 and 2005 tax returns for this donation. The IRS, after examining the returns, determined deficiencies and assessed both a 40% gross valuation misstatement penalty under section 6662(h) and an alternative 20% accuracy-related penalty under section 6662(a). The IRS's examining agent obtained approval for the 40% penalty but not the 20% penalty, which was later suggested by a Chief Counsel attorney and included in the notice of deficiency without further approval. The Graevs challenged the penalties, asserting that the IRS failed to comply with the supervisory approval requirement under section 6751(b).

Procedural History

The IRS issued a notice of deficiency to the Graevs on September 22, 2008, which included both the 40% and 20% penalties. The Graevs timely filed a petition with the U. S. Tax Court on December 19, 2008. The IRS later conceded the 40% penalty but maintained the alternative 20% penalty. The Tax Court issued an opinion in Graev I, sustaining the disallowance of the charitable contribution deductions. The court then addressed the procedural requirements for the 20% penalty in the current case, focusing on compliance with sections 6751(a) and 6751(b).

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Issue(s)

Whether the IRS's notice of deficiency complied with the requirement under section 6751(a) to include a computation of the 20% penalty?

Whether the IRS's failure to obtain written supervisory approval for the initial determination of the 20% penalty under section 6751(b) barred its assessment?

Whether the Graevs were liable for the 20% accuracy-related penalty under section 6662(a) due to a substantial understatement of income tax?

Rule(s) of Law

Section 6751(a) requires the IRS to include with each notice of penalty information with respect to the name of the penalty, the section of the Code under which the penalty is imposed, and a computation of the penalty.

Section 6751(b)(1) prohibits the assessment of any penalty unless the initial determination of such assessment is personally approved in writing by the immediate supervisor of the individual making such determination or a higher level official designated by the Secretary.

Section 6662(a) imposes a 20% accuracy-related penalty on any portion of an underpayment of tax due to negligence or substantial understatement of income tax.

Holding

The Tax Court held that the IRS's notice of deficiency complied with section 6751(a) by including the 20% penalty as an alternative with a computation, albeit reduced to zero to avoid stacking with the 40% penalty. The court also held that the issue of compliance with section 6751(b)(1) was premature since no penalty had yet been assessed. Finally, the court sustained the 20% accuracy-related penalty under section 6662(a) on the basis of the Graevs' substantial understatement of income tax.

Reasoning

The court reasoned that the notice of deficiency clearly informed the Graevs of the 20% penalty and its computation, satisfying section 6751(a). Regarding section 6751(b)(1), the court found that the statute requires written supervisory approval before the assessment is made, which had not occurred at the time of the case. The court rejected the Graevs' argument that the lack of approval invalidated the penalty, citing that the statute does not specify a consequence for noncompliance and that the Graevs were not prejudiced by the lack of approval. On the merits of the 20% penalty, the court found that the Graevs had a substantial understatement of income tax due to disallowed charitable contribution deductions and that they failed to establish reasonable cause, substantial authority, or adequate disclosure to

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avoid the penalty.

Disposition

The court sustained the 20% accuracy-related penalty under section 6662(a) and entered a decision under Rule 155, reflecting the holdings in both Graev I and the current case.

Significance/Impact

This case is significant for clarifying the procedural requirements for penalty assessments under sections 6751(a) and 6751(b). It impacts IRS practices by emphasizing the necessity of written supervisory approval before assessment and the importance of including penalty computations in notices of deficiency. The decision also underscores the importance of taxpayers' compliance with disclosure and substantiation requirements to avoid accuracy-related penalties. The case has been influential in subsequent litigation concerning the IRS's procedural compliance with penalty assessments.

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