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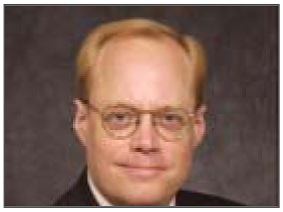

Robert W. Wood

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Can IRS Add Penalties When You Rely On Professionals?

One of the tried and true defenses to IRS penalties is that you relied on tax advice from your lawyer or accountant. But does it work? Not always.

Logo of the Internal Revenue Service (Photo credit: Wikipedia)

In *SAS Investment Partners, Schmidt Financial Group, Inc., Tax Matter Partner v. Commissioner*, the Tax Court said no to this argument—twice. One tax lawyer was a promoter who benefited financially from the transaction. That gave him a conflict of interest so his advice wasn't independent. The other lawyer wasn't provided full and accurate information by his client so that tax advice didn't count either.

How do you get out of penalties based on the advice of a tax professional? You must prove that:

- the adviser was a competent professional with sufficient expertise;
- the taxpayer provided necessary and accurate information to the adviser; and
- the taxpayer actually relied in good faith on the adviser's judgment.

Sanford Schmidt's fact pattern was less than pristine. He engaged in [Son of BOSS] tax shelter transactions and claimed huge tax losses. Erwin Mayer (a tax lawyer with the now defunct Jenkens & Gilchrist law firm) gave Schmidt a redacted opinion letter containing general legal analysis but no specific facts.

Schmidt had it reviewed by Albert Grasso, Schmidt's personal and corporate attorney. Grasso said the deal was legit and that another client had done a similar deal the IRS hadn't challenged. It wasn't clear whether Grasso revealed that he too was engaging in a Jenkens & Gilchrist Son of BOSS transaction—for a trust of which he was trustee!

Schmidt paid Jenkens & Gilchrist $75,000 for structuring and closing the deal. Schmidt knew this fee was based on the expected tax savings, another no-no. Schmidt received an opinion intended to prevent penalties if the IRS attacked the transaction.

The IRS disallowed it, determining that SAS (an entity created just for the deal) should be disregarded for tax purposes. When the IRS added penalties, Schmidt claimed he relied on professionals. But the Tax Court agreed with the IRS they didn't count.

Why? Schmidt (and his entity) couldn't rely on Mayer's advice or the Jenkens & Gilchrist opinion because they were shelter promoters and Schmidt knew it. There was no question Mayer was a promoter and no question Schmidt was aware of it. Even if Schmidt did rely on Mayer, said the court, he lacked good faith.

What about the advice from Grasso, Schmidt's regular counsel? That too was no good. Grasso didn't base his advice on all necessary and accurate information, as required. Grasso only saw a redacted opinion with no facts or information specific to Schmidt and SAS. His advice wasn't based on ***any***—let alone ***all***—pertinent facts.

The court found that Schmidt, a sophisticate who ran his own business, did not rely in good faith on Grasso's judgment. Schmidt engaged in the deal solely to create tax losses, said the court. What about his claim he did the deal to make money? It was contradicted by the evidence.

For more, see:

Points to Keep in Mind When Choosing a Tax Professional

Sell Then Rescind? IRS Respects Some Do-Overs

No Appraisal No $18.5M Deduction, Says Tax Court

IRS Warns Taxpayers Not To Be 'Too Concise' on Returns

British Lawyer Nabbed at JFK For Helping Americans Hide Swiss Accounts

IRS Wants You To Report Abusive Tax Promotions Or Preparers

"DAD" Tax Shelter Is A Deadbeat

Don't Look For (Tax) Shelter Under Wells Fargo Wagon

How Bad Is Your Tax Shelter?

Why Tax Opinions Are Valuable

Relying On Tax Advisers May Not Prevent Penalties

Robert W. Wood practices law with Wood LLP, in San Francisco. The author of more than 30 books, including Taxation of Damage Awards & Settlement Payments (4th Ed. 2009 with 2012 Supplement, Tax Institute), he can be reached at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.