

## **IRS memo discusses how aiding and abetting penalty may apply to appraisers**

### **Chief Counsel Advice 200512016**

An Office of Chief Counsel Internal Revenue Service memorandum (“memo”) has concluded that an appraiser may be assessed a penalty under Code Sec. 6701 for aiding and abetting a taxpayer's understatement of income tax if he had knowledge that false statements would lead to an understatement. This memo was written to another branch of IRS that sought advice because it is developing guidance to assist IRS agents in determining whether to impose this penalty on appraisers whose appraisals result in taxpayers' understatements of income tax.

Observation: This seems to indicate that IRS is preparing to take an aggressive stance against appraisers who assist taxpayers in understating their tax liability in a manner that violates Code Sec. 6701 , such as by falsely or fraudulently overstating the value of property in an appraisal that the appraiser knows will be used by the taxpayer to attempt to improperly reduce tax liability.

*Background.* A penalty is imposed on any person who:

... aids or assists, procures, or advises with respect to, the preparation or presentation of any portion of a return, affidavit, claim, or other document;

... knows (or has reason to believe) that the return, affidavit, etc. will be used in connection with any material matter arising under the internal revenue laws; and

... knows that if the portion of the return or other document were so used, an understatement of the tax liability of another person would result. ( Code Sec. 6701(a) )

The penalty is \$1,000. However, it's \$10,000 if the return, affidavit, or other document relates to the tax liability of a corporation. A separate penalty applies to each return that the person aided, abetted, etc. in the understatement of tax liability, but not to each tax year affected by the return. ( Code Sec. 6701(b) )

IRS has issued no temporary, proposed, or final regs for Code Sec. 6701 .

*Analysis in IRS memo.* The memo includes the following analysis of each of the elements of Code Sec. 6701 :

... The first element requires assistance in return or document preparation. The memo points out that while most Code Sec. 6701 cases involve penalties imposed on income tax return preparers, Congress intended the penalty to apply in numerous situations, including to appraisers who violate its requirements. Indeed, a reg dealing with recordkeeping requirements for charitable contributions provides that an appraiser's “intentionally false or fraudulent overstatement of the value of the property described in the qualified appraisal or appraisal summary may subject the appraiser to a civil penalty under section 6701 for aiding and abetting an understatement of tax liability.” ( Reg. §§ 1.170A-13(c)(5)(D) )

... The second element requires that a person know, or have reason to believe, that the document will be used in any material matter. While “material” has not been defined for this purpose,

the memo notes it has been defined under the comparable criminal penalty of Code Sec. 7206 as any failure to report income.

... The third element requires that a person ““know”” that, if so used, the document will result in an understatement of the tax liability of another person. The memo notes that the existence of actual knowledge is a question of fact and that no bright line rule defines this requirement. It provides a useful summary of relevant cases in which the actual knowledge requirement was at issue.

To summarize, for an appraiser to be held liable for a Code Sec. 6701 penalty, IRS would have to show by a preponderance of the evidence, that the appraiser helped prepare or present a document that led to an understatement of tax by a taxpayer. IRS would also need to demonstrate that the appraiser had actual knowledge that the taxpayer would rely on the document that would lead to an understatement.

*Administrative procedures for identifying and asserting the penalty.* The memo highlights Internal Revenue Manual guidance for identifying and asserting the Code Sec. 6701 penalty. It points out that, since the government has the burden of proof, the penalty can be assessed only by employees who have the requisite knowledge of the facts giving rise to the penalty. Therefore, the penalty normally will be assessed by revenue agents and office auditors at an IRS office as a result of an examination of a tax return or document or in connection with a tax shelter registration examination. The memo stresses that there is no statute of limitations on a Code Sec. 6701 assessment because the penalty does not depend on the filing of a return.

*Injunctions against appraiser.* The memo observes that, in a proper case, an injunction could be sought against an appraiser under Code Sec. 7408 . To obtain an injunction, the government must show that a person engaged in conduct subject to penalty under Code Sec. 6701 and that injunctive relief is appropriate to prevent the recurrence of such conduct. The memo lists factors courts have considered in determining the likelihood of recurrence.

*Challenges to the penalty.* An appraiser (or other person) who is assessed a penalty under Code Sec. 6701 has several procedural avenues to challenge the penalty:

... First, under Code Sec. 6703 , he could pay 15% of the entire assessed amount of the penalty and get review. Specifically, if, within 30 days after the day on which the notice and demand of any penalty under Code Sec. 6701 is made, the taxpayer pays 15% of the penalty, he gets administrative and judicial review. If a taxpayer initiates a suit under Code Sec. 6703 , IRS is barred from collecting the penalties imposed under Code Sec. 6701 until there has been a final resolution of a suit brought to determine the liability of a taxpayer. ( Code Sec. 6703(c) )

Observation: Assume an appraiser is assessed three \$1,000 penalties under Code Sec. 6701 . He could pay \$450 (15% of \$3,000 total penalty), and file a claim for refund under the Code Sec. 6703 procedures. The advantage of doing this is it prevents IRS from collecting the penalties until there has been a final resolution of the Code Sec. 6703 proceeding.

... Second, he could follow the general refund procedures of Code Sec. 7422 to challenge the

penalty. Because courts have held the penalty is divisible, the appraiser could pay the entire amount of one \$1,000 penalty assessed to file a claim for refund on all of the Code Sec. 6701 penalties imposed.

... Third, the appraiser also could treat the penalty as a divisible tax for purposes of the Code Sec. 6703 procedures. Thus, he could pay 15% of one Code Sec. 6701 penalty in order to challenge all of related Code Sec. 6701 penalties.

*Appeals review of the penalty.* There is no pre-assessment right to Appeals review for the penalty imposed under Code Sec. 6701 . The post-assessment Appeals rights set forth in Reg. §§ 601.106(a)(1)(iv) don't apply to the Code Sec. 6701 penalty.

*Disqualification under Circular 230.* Under Circular 230, which sets forth the duties of practitioners before IRS and the grounds and procedures for disbarment and suspension, the Treasury Secretary, or his delegate, after due notice and opportunity for hearing, may disqualify any appraiser with respect to whom a penalty has been assessed under Code Sec. 6701(a) . A disqualified appraiser is barred from presenting evidence or testimony in any administrative proceeding before the Department of Treasury or IRS, unless and until authorized to do so by the Director of Practice. Any appraisal made by a disqualified appraiser after the effective date of disqualification will not have any probative effect in any administrative proceeding before the Department of the Treasury or IRS.