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Reliance Upon a Tax Professional Will Not Save the Day if Your Tax Filing is Late

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In ***Peter Knappe v. U.S.***, 713 F3d 1164 (9th Cir., April 4, 2013), the United States Court of Appeals for the Ninth Circuit was presented with the question whether reliance upon a tax professional may excuse the late filing of a tax return.

Peter Knappe was the personal representative of the Estate of Ingborg Pattee. He was also trustee of her testamentary trust.

Mrs. Pattee died in 2005, leaving a large estate. Mr. Knappe was her long-time friend. Although he had business experience, Mr. Knappe had no experience serving as a personal representative or preparing estate tax returns. So, he engaged the services of Mr. Francis Burns, CPA. Burns had been his company's outside accountant for several years. Mr. Knapp was always satisfied with his work.

Burns told Knappe that a Form 706 for the estate of would need to be filed by August 30, 2006. Knappe had trouble obtaining the needed appraisals on or before the filing deadline. Burns advised Knappe that he could obtain an extension of one (1) year for both the filing and the payment of the taxes due.

Burns filed a Form 4786, seeking both an extension for filing and for payment of the taxes due. The extension sought was one year.

As we know, the filing extension, unless the personal representative is out of the country, is only six (6) months. The payment extension, however, in the discretion of the Service, may be up to one year. Burns, however, believed both extensions were automatically one (1) year. **OOPS!**

Given this belief, upon receipt of the extension acknowledgment from the Service, Burns did not examine it carefully. He thought he received the requested one (1) year extension for both filing and payment of taxes. The extension, however, actually provided a new filing date of February 28, 2007, and a new payment date of August 30, 2007.

Burns filed the 706 on May 18, 2007, and enclosed a check in payment of the tax shown due. A few weeks later, Burns received a notice from the IRS that the estate owed a late payment penalty of about $200,000. The penalty assessed is 5% per month, up to a maximum of 25%.

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In response to the notice, Burns actually pulled the Code and Regulations off his bookshelf. Once he dusted off the cobwebs, and reviewed the Code, he realized he made an error. Nevertheless, the taxpayer asked the Service to abate the penalty under Section 6651 for reasonable cause. The taxpayer argued his reliance on CPA Burns constituted reasonable cause for the late filing. The IRS denied the request. So, Knappe paid the penalty and filed a claim for a refund with the Service. Upon denial of the claim for refund, he sued in District Court.

Unfortunately, the District Court ruled summarily in favor of the Service. Knappe then appealed to the Ninth Circuit. The court concluded: "To constitute reasonable cause, a taxpayer must prove he or she exercised ordinary business care and prudence, and was nevertheless unable to file the return" on time.

Of course, Knappe argued his reliance on the advice of Mr. Burns constituted ordinary business care and prudence. It was clear that Mr. Burns did not know that a Form 706 filing extension is limited to six (6) months. So the question was: Did Knappe's reliance on Burns's bad advice constitute "reasonable cause"?

The court broke reliance into two categories:

1. reliance on substantive advice; and
2. reliance on non-substantive advice.

For substantive advice, reliance upon a tax professional may constitute reasonable cause. For non-substantive advice, however, the court concluded that reliance upon a tax professional will not save the day. The court ultimately concluded the Form 706 due date is not a substantive tax issue. The law is clear- there is no debate!

Accordingly, reliance upon a tax professional will not save the day in the context of a tax filing deadline. The $200,000 late filing penalty was upheld. **OUCH!**

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