Legislative Recommendation #31

Extend the Reasonable Cause Defense for the Failure-to-File Penalty to Taxpayers Who Rely on Return Preparers to E-File Their Returns

SUMMARY

- *Problem:* A taxpayer who fails to file a tax return by the deadline is subject to a late-filing penalty unless the taxpayer can demonstrate "reasonable cause" for the failure. In 1985, the Supreme Court held that reliance on a tax return preparer to file a return did not alone constitute reasonable cause for a late-filing penalty because the taxpayer had a responsibility to ensure the deadline was met. While that conclusion may be appropriate in the context of paper-filed returns where a taxpayer can mail the return themself, it is not appropriate in the context of e-filed returns, where the preparer typically submits the return and the taxpayer cannot easily verify whether a return has been filed and accepted.

- *Solution:* Allow taxpayers who rely on tax return preparers to e-file their returns to receive reasonable cause relief from the failure-to-file penalty.

PRESENT LAW

IRC § 6651(a)(1) imposes an addition to tax when a taxpayer fails to file a return by the due date unless the taxpayer can show the failure was due to reasonable cause and not due to willful neglect (the "failure-to-file penalty").[1] Reasonable cause exists when a taxpayer has exercised ordinary business care and prudence but was unable to file the return within the prescribed time.[2]

In *United States v. Boyle*, the Supreme Court held that a taxpayer's reliance on an agent to file a return did not constitute reasonable cause for late filing.[3] In *Boyle*, the tax return at issue was filed on paper. In 2023, the U.S. Court of Appeals for the Eleventh Circuit held that the *Boyle* decision also applies to e-filed returns.[4] This was the first time a federal appeals court had decided the issue. Several U.S. district courts have similarly held that *Boyle* applies to e-filing.[5]

In the IRS Restructuring and Reform Act of 1998, Congress adopted a policy that "paperless filing should be the preferred method and most convenient means of filing Federal tax and information returns" and gave the Secretary broad authority to incentivize taxpayers to file returns electronically.[6] IRC § 6011(e)(3) authorizes the Secretary to require tax return preparers to file returns electronically unless they reasonably expect to file ten or fewer individual income tax returns during a calendar year. Treasury Regulation § 301.6011-7 implements this requirement.

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1 The penalty amount is five percent of the tax due for each month or partial month the return is late, up to a maximum of 25 percent. The penalty increases to 15 percent per month up to a maximum of 75 percent if the failure to file is fraudulent. IRC § 6651(f).

2 Treas. Reg. § 301.6651-1(c)(1). *See also* Internal Revenue Manual (IRM) 20.1.1.3.2, Reasonable Cause (Nov. 21, 2017), https://www.irs.gov/irm/part20/irm_20-001-001r.

3 *Boyle*, 469 U.S. 241 (1985).

4 *Lee v. United States*, 84 F.4th 1271 (11th Cir. 2023).

5 *See, e.g.*, *Haynes v. United States*, 119 A.F.T.R.2d (RIA) 2202 (W.D. Tex. 2017), *vacated and remanded*, 760 F. App'x 324 (5th Cir. 2019); *Intress v. United States*, 404 F. Supp. 3d 1174 (M.D. Tenn. 2019); *Oosterwijk v. United States*, 129 A.F.T.R.2d (RIA) 512 (D. Md. Jan. 27, 2022).

6 Pub. L. No. 105-206, § 2001, 112 Stat. 685, 723 (1998); IRC § 6011(f).

REASONS FOR CHANGE

At the time *Boyle* was decided, all tax returns were filed on paper. Taxpayers generally could fulfill the basic responsibility of mailing returns to the IRS themselves, even when they engaged tax professionals to prepare them. In ruling that the taxpayer in *Boyle* was not entitled to reasonable cause abatement as a matter of law, the Supreme Court stated that "[i]t requires no special training or effort to ascertain a deadline and make sure that it is met."[7]

In effect, the *Boyle* decision concluded that the duty to file a return is non-delegable. While that rule might make sense in a paper-filing context, it is not reasonable to apply it in the e-filing context. Today, most taxpayers effectively delegate the electronic filing of their returns to preparers or use software providers. Particularly when a taxpayer uses a preparer, the taxpayer is generally several steps removed from the filing process. When a preparer e-files a tax return, he or she must transmit it through an electronic return originator (typically, a software company) to the IRS. Thus, there are four parties sequentially involved in this chain: (i) the taxpayer; (ii) the preparer; (iii) the software company; and (iv) the IRS. If the IRS rejects an e-filed tax return, it generally sends a notification back through the software company to the preparer, but it will not notify the taxpayer directly.[8] In these circumstances, a taxpayer cannot easily ensure his or her return has been properly submitted by the preparer and accepted by the IRS. In addition, the IRS rejects e-filed returns before processing them for a variety of reasons, and unlike with paper filing, a return that is e-filed with the IRS but rejected before processing is not treated as timely filed.

While Treasury regulations generally require tax return preparers to e-file client returns, the regulations exempt preparers from the e-filing requirement if a taxpayer provides the preparer with "a hand-signed and dated statement" that says the taxpayer chooses to file a paper return.[9] Because taxpayers can mail paper returns themselves, this "opt-out" may reduce a taxpayer's risk of incurring a failure-to-file penalty. In light of the congressional directive to incentivize e-filing, it makes little sense to increase the penalty risk for taxpayers who e-file.[10]

The Eleventh Circuit's decision, *Lee v. United States*, highlights the unfairness of applying the *Boyle* rule in the context of e-filing. In many ways, the taxpayer in *Lee* was a model taxpayer. A surgeon with significant earnings, he hired a certified public accountant (CPA) to prepare and file his complicated returns for 2014-2016. During each of those years, he ensured the returns were timely prepared and verified, and he sent a signed Form 8879, *IRS e-file Signature Authorization*, to the CPA before the filing deadline. Additionally, he made significant overpayments of tax each year to avoid an underpayment penalty, choosing to apply the overpayments to the following year's liability. However, his CPA never filed the returns, apparently because they were too complex for the filing software, and he did not tell the taxpayer. The CPA also did not provide the IRS with the taxpayer's correct mailing address, so the taxpayer did not receive any notices. The taxpayer was completely unaware that his returns had not been filed until the IRS visited his office in 2018. Because the CPA had not filed the returns, the IRS did not apply the 2014 overpayment to subsequent years, leaving the taxpayer with tax liabilities for 2015 and 2016 and approximately $70,000 in penalties.[11]

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7 *Boyle*, 469 U.S. at 252.

8 IRM 3.42.5.7.2(1), Form 1040 Online Filing (Nov. 22, 2023), https://www.irs.gov/irm/part3/irm_03-042-005r.

9 Treas. Reg. § 301.6011-7(a)(4)(ii).

10 For context, over half of all individual income tax returns filed during 2024 were prepared by professionals and e-filed (more than 84 million returns). *See* IRS, 2024 Filing Season Statistics (week ending Oct. 18, 2024), https://www.irs.gov/newsroom/filing-season-statistics-for-week-ending-oct-18-2024.

11 The penalties were for failure to file a return under IRC § 6651(a)(1) and failure to pay tax under IRC § 6651(a)(2). The Eleventh Circuit noted that it and other courts have held that *Boyle* also applies to the failure-to-pay penalty. *Lee v. United States*, 84 F.4th 1271, 1275 (11th Cir. 2023).

After filing a refund claim with the IRS, which was denied, the taxpayer brought suit in U.S. district court, arguing there was reasonable cause for the failure to file due to his reliance on the CPA. The district court held that the *Boyle* rule applied to e-filed returns[12] and the Eleventh Circuit agreed. The taxpayer made several arguments as to why the penalties should be abated, including that once he had sent the Form 8879 to the CPA the burden was on the CPA to file the returns and the failure to do so was beyond the taxpayer's control. However, the Eleventh Circuit rejected the taxpayer's arguments, concluding there was no basis to treat e-filed returns differently from paper-filed returns under the Supreme Court's *Boyle* decision.

One judge wrote a concurring opinion "to highlight the risks facing taxpayers" due to *Boyle*'s application in the e-filing context, noting the fact that the taxpayer owed taxes and penalties to the IRS despite his otherwise prudent actions "is reflective of the current e-filing system and the precarious situation in which it places taxpayers who rely on" preparers.[13] The judge added: "[U]nder Boyle's bright line rule, it is not clear whether Lee would be excused from penalties *even if his accountant [had] affirmatively misrepresented to him that his returns were filed on time*."[14]

Prior to the Eleventh Circuit's decision in *Lee*, several U.S. district courts had similarly held that *Boyle* applied in the e-filing context.[15] As in *Lee*, the facts of these cases illustrate the unfairness of *Boyle*'s application. In *Haynes v. United States*, a married couple employed a CPA to prepare and file their joint tax return.[16] The preparer timely e-filed the return, but the IRS did not accept it for processing because a taxpayer identification number was listed on the wrong line. The preparer did not receive a rejection notice from the IRS. The preparer notified the taxpayers that their return had been timely filed. Ten months later, the IRS notified the taxpayers that their return had not been received and asserted the failure-to-file penalty. The taxpayers requested penalty abatement for reasonable cause, asserting they had sought to file their return timely, their preparer had transmitted the return timely, and both the preparer and the taxpayers believed the return had been received. The taxpayers filed suit in district court, arguing that *Boyle* should not apply in the context of electronic filing because the complexities of e-filing vastly exceed the comparatively simple and verifiable task of mailing a return. The district court concluded that the holding in *Boyle* applies to e-filed returns to the same extent as paper-filed returns and ruled in the government's favor as a matter of law.[17]

The issue in these cases is not whether the failure-to-file penalty is applicable in the first instance. Based on the wording of the statute, there is no doubt the penalty is applicable if the return is filed late. Rather, the issue is whether taxpayers are entitled to request abatement of the penalty on reasonable cause grounds. Because the *Boyle* decision used relatively sweeping language, lower courts have seemingly felt bound to apply its holding in the context of e-filed returns, notwithstanding the significant differences between paper filing and electronic filing.

While the bright-line rule embodied in *Boyle* is convenient for the IRS to administer, the nearly automatic assessment of the failure-to-file penalty for e-filed returns deemed late (often where the return was submitted timely by the taxpayer or preparer but rejected by the IRS before processing) is grossly unfair and undermines

12 *Lee v. United States*, 129 A.F.T.R.2d (RIA) 667 (M.D. Fla. Feb. 8, 2022).

13 *Lee v. United States*, 84 F.4th 1271, 1281 (11th Cir. 2023) (Lagoa, J., concurring).

14 *Id*. at 1282 (emphasis added).

15 *See*, *e.g.*, *Haynes v. United States*, 119 A.F.T.R.2d (RIA) 2202 (W.D. Tex. 2017), *vacated and remanded*, 760 F. App'x 324 (5th Cir. 2019); *Intress v. United States*, 404 F. Supp. 3d 1174 (M.D. Tenn. 2019); *Oosterwijk v. United States*, 129 A.F.T.R.2d (RIA) 512 (D. Md. Jan. 27, 2022).

16 119 A.F.T.R.2d (RIA) 2202 (W.D. Tex. 2017).

17 On appeal, the U.S. Court of Appeals for the Fifth Circuit vacated and remanded the district court's decision on different grounds and did not take a position on the *Boyle* issue. *Haynes v. United States*, 760 F. App'x 324 (5th Cir. 2019). *See also* Keith Fogg, *Reliance on Preparer Does Not Excuse Late E-Filing of Return*, Procedurally Taxing (Sept. 4, 2019), https://www.taxnotes.com/procedurally-taxing/reliance-preparer-does-not-excuse-late-e-filing-return/2019/09/04/7h5vr.

the congressional policy that e-filing be encouraged. The American College of Tax Counsel shares this view and submitted a compelling *amicus curiae* brief in the appeal of the *Haynes* decision.[18]

RECOMMENDATION

- Amend IRC § 6651 to specify that reasonable cause relief may be available to taxpayers that use return preparers to submit their returns electronically and direct the Secretary to issue regulations specifying what constitutes ordinary business care and prudence for e-filed returns.

18 *See* Brief of American College of Tax Counsel (Nov. 27, 2017), https://www.actconline.org/wp-content/uploads/2018/02/ACTC_Amicus_Brief_Haynes.pdf.