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**MEMORANDUM**

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**RE:**     **UNREPORTED INCOME (IRS):** FRAUDULENT FAILURE TO  
          FILE TAX RETURNS

**DATE:**  NOVEMBER 19, 2007

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In order to avoid the 75% penalty for fraudulent failure to file tax returns the tax payer must establish:

- 1) The delinquent filing is due to reasonable cause.
- 2) The delinquent filing is not due to willful neglect.

If both elements are established the failure to file penalty does not apply.

**Penalty: Failure to file tax return**

To establish that the penalty does not apply, the taxpayer must furnish the IRS a written statement setting out the grounds of the claim. The statement must contain a declaration that it is signed under penalty of perjury. Treas. Reg. Section 301.6651-1(c)(1). The written statement must be filed with the IRS office where the late return is filed.

If the IRS determines that the delinquency was due to reasonable cause and not due to willful neglect, the penalty is not assessed.

If a taxpayer exercised ordinary business care and prudence and was nevertheless unable to file a return, the delay is due to reasonable cause. Treas. Reg. Section 301.6651-1(c)(1).

The Internal Revenue Manual (**IRM 20.1.2.1.2.4**) lists the following circumstances under which reasonable cause may exist:

- (1) the delinquency was due to the death or serious illness of the taxpayer or a member of the taxpayer's immediate family (for a corporation, estate, trust, etc., the delinquency was due to the death of the individual responsible for filing or a death in the immediate family of such individual);

- (2) the taxpayer is unable to obtain records;
- (3) reliance on erroneous advice from the IRS;
- (4) reliance on a tax adviser; and
- (5) failure to file resulting from a fire, casualty, natural disaster, or other disturbance.

**Penalty: Failure to pay tax shown on return**

Treas Reg Section 6652(a)(2) penalizes the failure to pay the amount shown as tax on the taxpayer's return unless the delinquency in payment is due to reasonable cause and not due to willful neglect.

The penalty period starts with the date prescribed for payment (generally the due date of the related return, but determined with regard to extensions) and ends with payment of the tax. The penalty is one-half percent for each month (or part of a month) up to a maximum of 25 percent. However, the one-half percent rate is increased to 1 percent if the taxpayer fails to pay after the IRS notifies the taxpayer.

The appropriate penalty rate is applied to the amount of tax shown on the return, which is the net amount of tax due. The net amount due is the total amount shown as tax reduced by the sum of (1) any part of the tax that is paid on or before the beginning of the month and (2) the amount of any credit against the tax that may be claimed on the return. If the amount of tax required to be shown on the return is less than the amount shown on the return, the lesser amount is used for computing the penalty. Treas. Reg. Section 6651(c)(2).

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