



# TaxNewsFlash

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## U.S. Tax Court: Written supervisory approval required before contact with taxpayers, accuracy-related penalty

The U.S. Tax Court today held that the IRS revenue agent had failed to obtain written supervisory approval before the first formal communication of an initial determination to assess penalties, and therefore did not meet the burden of production for penalties under section 7491.

The case is: *Clay v. Commissioner*, 152 T.C. No. 13 (April 24, 2019). Read the Tax Court's [opinion](#) [PDF 165 KB]

### Summary

In these consolidated cases, the taxpayers were members of the Miccosukee tribe (a federally recognized Native American tribe). During the years at issue, the tribe operated a casino in Florida on tribal land that was owned communally by all members. The tribe made regular distributions from casino revenue to each member. The taxpayers received these distributions and did not report them as income.

The IRS determined that the distributions were taxable to the taxpayers and, therefore, that the taxpayers had unreported taxable income for the amounts of the distributions. The IRS also determined that the taxpayers were liable for accuracy-related penalties under section 6662(a). The 30-day letter was the first formal communication to the taxpayer of the initial determination to assess penalties.

A question presented in this case was whether IRS supervisory approval for imposition of penalties can come after the revenue agent sent the taxpayers the proposed adjustments that include penalties.

The taxpayers asserted that the initial determination of a penalty would be “the first time an IRS official introduced the penalty into the conversation” and further claimed that the Revenue Agent’s Report (RAR) contained the first suggestion of penalties, making the RAR—and not the notice of deficiency—the initial determination.

According to a summary provided by the Tax Court:

- The distributions to the taxpayers from the casino revenue were unreported taxable income to the taxpayers.
- For purposes of section 6751(b), the Revenue Agent Report (RAR) and the 30-day letter, to which the RAR was attached, constituted an initial determination by the IRS to assess penalties.
- The IRS had to show that written supervisory approval for the penalty assessments was obtained before the first formal communication to the taxpayer of the initial determination to assess penalties. However, the IRS did not obtain written supervisory approval before this first formal communication of its initial determination to assess penalties and did not meet its burden of production for penalties under section 7491(c).

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