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When Counsel's Bad Advice Excuses Late Filing of Estate Tax Return: Circuits Still Split

By Howard M. Zaritsky

The Treasury has now determined that practitioners need not caution clients that they cannot rely on their written advice to prevent tax penalties — see the discussion of Circular 230 at page 10 below — but there are some tax penalties that advice of counsel still does not excuse. The Supreme Court held in *United States v. Boyle*, 469 U.S. 241 (1985), that an executor cannot avoid penalties for late filing of an estate tax return merely by relying on the estate's attorney to file the return. The Court in that case did not, however, decide whether late filing penalties are excused when the personal representative relies on advice of counsel regarding the date the return is required to be filed or whether a return is required to be filed. Despite the fundamental nature of this inquiry, the lower courts remain badly split over the extent to which advice of counsel excuses late filing of an estate tax return or late payment of estate taxes. Two recent decisions highlight this split.

Estate of Thouron – It Is Reasonable to Rely on Bad Legal Advice

In *Estate of Thouron v. United States*, ___ F.3d ___ (3d Cir. May 13, 2014) (2014 Westlaw 1887561), *vac'g & rem'g* 2012 Westlaw 5431009, 110 A.F.T.R.2d 2012-6572 (E.D. Pa., 2012), discussed in the June 2014 issue of the REPORTER, the Third Circuit continued to take a broad view of the reasonableness of

relying on advice of counsel. The decedent's estate in that case was required to file its estate tax return by November 6, 2007. The personal representative relied on the advice of an attorney and timely applied for an extension of time to file the estate tax return, but he was not advised to and did not request an extension of the time in which to pay the estate tax.

The personal representative claimed that his attorney advised the estate that the form for an extension of time to pay the tax was not due until the return was filed on extension. On May 5, 2008, the personal representative filed the estate tax return and an application for an extension of time to pay the estate tax. The IRS denied the requested extension as untimely and imposed the late payment penalty. The personal representative paid the tax and penalty and sued for a refund of the penalty.

The U.S. District Court for the Eastern District of Pennsylvania (Judge Slomsky) granted summary judgment for the government. The court pointed out that the regulations and Form 706 itself state that an extension of the time to pay the estate tax must be requested before the due date for filing the return and that separate requests must be made for additional time to file the return and for additional time to pay the tax. The personal representative stated that he had acted on the advice of the estate's tax attorney, but the court held that relying on an agent's advice is not reasonable cause for the late payment of an estate tax return.

The district court discussed *Boyle* and explained that a taxpayer does not have to be a tax expert to know that there are firm filing dates for tax returns and that relying on a tax expert does not excuse the duty to ascertain tax obligations. The court also cited *Baccei v. United States*, 632 F.3d 1140 (9th Cir. 2011), in which the Ninth Circuit held that the reasoning in *Boyle* applied equally to penalties for failure to timely pay the estate tax as to penalties for failure to timely file the estate tax return. See also the similar holding in *E. Wind Industries, Inc. v. United States*, 196 F.3d 499 (3d Cir. 1999).

The Third Circuit (Judge Ambro) vacated and remanded the case, finding that the estate could possibly establish reasonable cause for its late payment in its reliance on the advice of its counsel. The court viewed *Boyle* more leniently than the district court. The Third Circuit stated that *Boyle* had identified three distinct categories of late-filing or late-payment cases:

(a) a taxpayer relies on an agent for the ministerial task of filing or paying;

(b) a taxpayer files a late return relying on the advice of the accountant or attorney; and

(c) an accountant or attorney advises a taxpayer

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on a matter of tax law.

The facts of *Boyle* fit into the first category, and the Supreme Court specifically declined to reach the other two categories.

The Supreme Court in *Boyle* even noted a split of authority as to the second category, stating that:

> [c]ourts have differed over whether a taxpayer demonstrates "reasonable cause" when, in reliance on the advice of his accountant or attorney, the taxpayer files a return after the actual due date but within the time the adviser erroneously told him was available. Compare *Sanderling, Inc. v. Commissioner*, 581 F.2d 174, 178-179 (CA 3 1978) (finding "reasonable cause" in such a situation); *Estate of Rapelje v. Commissioner*, 73 T.C. 82, 90, n.9 (1979) (same); *Estate of DiPalma v. Commissioner*, 71 T.C. 324, 327 (1978) (same), *acq*. 1979-1 Cum. Bull. 1; *Estate of Bradley v. Commissioner*, 33 TCM 70, 72-73 (1974) (same), *aff'd*, 511 F.2d 527 (CA 6 1975), with *Estate of Kerber v. United States*, 717 F.2d 454, 454-455, and n. 1 (CA 8 1983) (per curiam) (no "reasonable cause"), *cert. pending,* No. 83-1038; *Smith v. United States*, 702 F.2d 741, 742 (CA8 1983) (same); *Sarto v. United States*, 563 F.Supp. 476, 478 (ND Cal. 1983) (same). We need not address ourselves to this issue. 469 U.S. at 251, fn 9.

As to the third category, the Supreme Court in *Boyle* stated that, while it was not the case before it, the courts had "frequently held that 'reasonable cause' is established when a taxpayer shows that he reasonably relied on the advice of an accountant or attorney that it was unnecessary to file a return, even when such advice turned out to have been mistaken." 469 U.S. at 250. Essentially, the Supreme Court held that taxpayers may rely on the advice of an expert, but may not, for purposes of completing their statutory duty, rely on an agent to perform the task of filing or paying. In *Thouron,* the taxpayer relied on the advice of a tax expert as to when the return was due. The existence of such reliance would, the court held, constitute reasonable cause, but because it must still be established, the court remanded the case for further fact-finding.

Estate of Liftin — Relying on Legal Advice Is Reasonable Cause Only if It Was Not Too Bad

The Court of Appeals for the Federal Circuit reached a very different conclusion in *Estate of Liftin v. United States*, ___ F.3d ____ (Fed. Cir. June 10, 2014) (2014 Westlaw 2579296), *aff'g* 111 Fed. Cl. 13 (Fed. Cl. 2013), *reconsideration denied* (May 17, 2013). The decedent's will left certain bequests to his widow, who was a Bolivian citizen residing in the United States at the decedent's death. The widow filed claims against the estate based on her interpretation of the couple's premarital agreement.

The executor hired a competent and experienced estates attorney, who advised that an outright bequest to the widow did not qualify for the estate tax marital deduction because the widow was not a U.S. citizen, but that the bequest would be deductible if the widow became a U.S. citizen before the estate tax return was filed and if she resided in the United States at all times after the decedent's death and before becoming a citizen, and that the executor had a fiduciary duty to attempt to obtain a marital deduction. See I.R.C. § 2056(d)(4). The estate obtained a six-month extension of the time to file the return and to pay the estate tax. The executor paid with the application for an extension the tax that it believed would be due if the marital deduction were denied. The estate's attorney also advised that the estate did not have to file a return until the disputed claims under the

premarital agreement were settled.

The widow applied for U.S. citizenship, but she would not receive it within the extended period for filing the return. The estate's attorney explained that the estate tax regulations state that "a late return filed at any time after the due date is considered filed on the date that it is actually filed" for purposes of obtaining the marital deduction for a bequest to a non-U.S. citizen spouse. Treas. Reg. § 20.2056A-1(b). The attorney advised the executor that filing a late return in order to claim the marital deduction would not trigger a penalty, if the return were filed within a reasonable time after the widow became a U.S. citizen.

The widow became a U.S. citizen and six months later, the estate settled her claims under the premarital agreement. Three months after that (23 months after the extended filing date and nine months after the widow became a U.S. citizen), the estate filed its estate tax return, reporting a tax of $678,572.25, citing the estimated tax payment of $877,300, stating that no tax was due and requesting refund of the overpayment of $198,727.75.

The IRS assessed a late-filing penalty of $169,643.06, measured as 25 percent of the reported tax. The executor filed an administrative "Claim for Refund and Request for Abatement" of the penalty. The IRS abated and refunded $33,928.61, leaving a penalty assessment in the amount of $135,714.45 (five percent of the tax liability for each month or fraction of a month that the failure continues, up to 25 percent). The estate paid the penalty and sued for a refund, asserting that the lack of clarity in the marital deduction regulations gave it reasonable cause for filing a late return and that, in any event, it had relied on the advice of its attorney regarding when the return needed to be filed.

The Court of Federal Claims (Judge Miller) held for the government in part and for the estate in part. In granting summary judgment for the government, the Court of Federal Claims divided the two-year delay into two periods — the fourteen months before the widow obtained U.S. citizenship and the nine months from then until the return was filed. The court concluded that the estate's failure to file during the 14 months after the extended deadline but before the widow became a U.S. citizen was due to reasonable cause because the law was unclear regarding when a return must be filed in that period. The court held that the delay for the last nine months after the widow became a U.S. citizen was not due to reasonable cause because there was no reasonable basis for that conclusion.

On appeal, the Federal Circuit affirmed. The majority (Judge Taranto) held that the Supreme Court's opinion in *Boyle* had determined that there was reasonable cause for a taxpayer to rely on counsel's advice that no return need be filed at all, which typically involves whether threshold requirements for filing are met, rather than the date on which the return is due. The court stated, however, that this is different from the question of when legal advice about the due date of a return constitutes reasonable cause, and on that issue, the courts have split.

The Federal Circuit held that legal advice given to an executor on the timing of the estate tax return will not supply reasonable cause if that advice rests on an assumption that is not legally reasonable. The court focused on the basis (or lack thereof) for the legal advice, noting that with respect to the penalties under section 6664, a taxpayer's reliance on the advice of counsel (or other specialized professional) is "reasonable cause," but the "advice must not be based on unreasonable factual or legal assumptions." Treas.

Reg. § 1.6664–4(c)(1)(ii). This regulation, the court stated, excludes advice that depends on unreasonable legal assumptions. This approach looks at the substance of the advice offered, not just the qualifications of the advisor. The court stated that, under the regulation, "[t]he reasonableness of any reliance turns on the quality and objectivity of the advice." Citing *Stobie Creek Invs. LLC v. United States*, 608 F.3d 1366 (Fed. Cir.2010); *Long Term Capital Holdings LP v. United States*, 330 F.Supp.2d 122 (D.Conn.2004), *aff'd*, 150 F. App'x 40 (2d Cir.2005).

The court then applied the same analysis to the reasonable cause exception for the penalty for late payment or late filing under section 6651(a). The court stated that it should be required to ask whether the basis for the advice "clears a threshold of reasonableness." The court also noted that focusing on the objective reasonableness of advice is good policy because, if advice based on unreasonable legal assumptions vitiated penalties, taxpayers would be encouraged to "secure baseless advice as protection against penalties." Therefore, the court stated, the question is not whether counsel's advice was just incorrect, but whether it was objectively unreasonable.

The court noted that the Ninth Circuit had applied this standard to a late filing penalty respecting an estate tax return in *Knappe v. United States*, 713 F.3d 1164 (9th Cir. 2013), discussed in the May 2013 issue of the REPORTER. There, the executor relied on an accountant who advised him that one could request a 12-month extension of the filing deadline, leading the IRS to impose a penalty under section 6651(a)(1). The Ninth Circuit determined that there was no question but that the deadlines were clear and that the law and the instructions to the estate tax return clearly state that one can obtain only a six month extension.

The court admitted that sufficient plausibility depends upon the complexity of the matter, but in this case, there was no support for counsel's advice that, even after the surviving spouse became a naturalized United States citizen, the estate could continue to wait until the other "ancillary matters" were resolved. That advice was based on the theory that a fully accurate return could not be filed until those matters were resolved, but the law clearly provides that one must file as full and complete a return as possible within the required filing period, rather than postpone filing until all uncertainties have been resolved. See Treas. Reg. § 20.6081-1(d); also *Ferguson v. Commissioner*, 568 F.3d 498 (5th Cir. 2009); *In re Craddock*, 149 F.3d 1249 (10th Cir.1998); *Russell v. Commissioner*, 101 T.C.M. (CCH) 1363 (2011 Westlaw 1314673) (2011); *Jacobson v. Commissioner*, 86 T.C.M. (CCH) 204 (2003 Westlaw 21752458) (2003); *Estate of Maltaman v. Commissioner*, 73 T.C.M. (CCH) 2162 (1997 Westlaw 90606) (1997); *Crocker v. Commissioner*, 92 T.C. 899 (1989); *Estate of Vriniotis v. Commissioner*, 79 T.C. 298 (1982); *Duttenhofer v. Commissioner*, 49 T.C. 200 (1967), *aff'd*, 410 F.2d 302 (6th Cir.1969). As there was absolutely no legal basis for the advice given, the executor lacked reasonable cause under section 6651(a)(1) for relying on it, the court held. (Judge Newman dissented, but only on the basis that there should be no penalty to the extent that the estate had made an estimated tax payment sufficient to cover the tax due.)

The circuits are distinctly split on this issue. The Tax Court and the Third and Sixth Circuits take the position that the personal representative of an estate can reasonably rely on opinion of counsel, without having to determine whether or not it is correct. The Federal Circuit, the Eighth Circuit, and the Ninth Circuit all require that the advice of counsel be at least a reasonable interpretation of the law, in order to

provide relief from penalties for the personal representative who relies upon it. From the practitioner's standpoint, it is helpful that the Tax Court appears comfortable with the idea that one may rely on the advice of counsel regarding when the tax return must be filed or the tax paid, without any need to look behind that advice.

The Federal Circuit in *Liftin* appears to have been worried about the risk to the Federal fisc in allowing taxpayers to rely on extremely faulty legal analyses. Certainly, some taxpayers will often meet with multiple advisors until they get the answer they want, rather than the correct answer.

On the other hand, it seems unreasonable to require that a taxpayer evaluate independently the legal and tax advice given by a competent professional. The taxpayer must be required to exercise due diligence in selecting the advisor, but once they have done so, few taxpayers are going to do even the most minimal research to determine whether the advice they received is accurate. An executor who pays an attorney or accountant to prepare a correct estate tax return and to advise the executor when it must be filed should not be expected to do more than review the return for correct factual representations. The executor should not be expected to determine whether the attorney or accountant correctly applied the tax law. It is reasonable to rely on one's professional advisors, and unreasonable not to do so.

The Federal Circuit and the Supreme Court are correct that a taxpayer can be expected to know that, if a tax return is required, there will be a filing date and a payment date for the taxes that accompany the return. A taxpayer should not be able to rely on the advice of counsel who says otherwise. It is, however, unrealistic to expect a layman to know that an advisor is wrong when the latter says that the decedent's estate tax return is due one year after the date of death, or that it is due the following April 15, rather than that it is due nine months after the date of death. It is unreasonable to expect a taxpayer to do even the modest amount of research that would lead the taxpayer to realize that the advice of counsel is incorrect, if the taxpayer has no reasonable basis for suspecting that the advice is incorrect.

This analysis may actually be consistent with the Treasury's definition of reasonable cause under section 6664. Those regulations, as noted in *Liftin*, state that the "advice must not be based on unreasonable factual or legal assumptions." Treas. Reg. § 1.6664–4(c)(1)(ii). The question is, however, in whose eyes does one determine what is "unreasonable"? The better analysis is that the inquiry is into what is unreasonable in the eyes of the taxpayer, who has the responsibility for filing the return, rather than what is unreasonable in the eyes of the advisor.

Until the Supreme Court resolves this dispute, however, practitioners should be careful about advising clients that they can avoid penalties by relying on the advice of their counsel. At least with respect to penalties for late payment and late filing, there are a significant number of courts in which a taxpayer does so at his or her peril. If the advice given is correct, then of course the taxpayer will be safe in relying upon it. If the advice is wrong but it relates to a point of law that is unclear, the taxpayer is likely to be fine and penalties are not likely to be imposed. If the advice is clearly wrong, however, several courts will not permit the taxpayer to avoid the imposition of penalties by relying on it.