

Around the Country: Recent Cases in Tax Penalty Abatement

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Introduction – What Is Tax Penalty Abatement?

Audits can be an incredibly frustrating ordeal. From initial contact with tax authorities to digging up old financial records to possibly increasing tax liability, there are few things to celebrate throughout the process. However, one aspect of an audit that is particularly frustrating is the tax penalties imposed. These penalties are often required by statute and can carry hefty price tags, sometimes getting as high as 25% of the reassessed tax liability.

While remedies for these penalties exist (also called “abatement”), a recent trend has revealed that many reviewing bodies have been reluctant to grant such relief. Furthermore, the rate at which penalties have been sought and imposed has simultaneously increased. These notions are particularly true at the state and local levels, where the standards and burdens for taxpayers seeking relief vary from state to state. Accordingly, the [State and Local Tax group at Kilpatrick](#) has prepared the following article, which documents the most recent and preeminent cases on this subject. These cases reveal some common themes and hurdles taxpayers have faced nationwide.

Each case discussed will begin with a brief recollection of the facts, followed by a discussion of the legal analysis the court or reviewing body used to reach its conclusion. These case illustrations are designed to show the variations in analysis among a selection of jurisdictions. For a more general overview of the application of penalties, please review our previous article on this topic [here](#)[JTF1], and for a more complete list of penalty abatement strategies, please view another of our articles on the topic [here](#).

Abatement Denied – Penalty Must Be Paid:

This first set of cases will show instances of increased revenue department aggression in audit and penalty proceedings, as well as taxpayer activity that did not result in penalty abatement. Unfortunately, these taxpayers are stuck either paying the penalties assessed by such state tax authorities or, if possible, appealing the case further.

Vectren Infrastructure v. Michigan Department of Treasury

We begin with the Vectren case out of Michigan. This case is a perfect showcase for the increased aggression of state tax authorities in pursuing alleged tax deficiencies and their unwillingness to drop imposed penalties related to such deficiencies.

In 2011, Vectren purchased MLI, a Minnesota corporation that had performed a three-month contract in Michigan immediately before the sale. MLI shareholders sold their stock to Vectren in a Section 338(h)(10) sale. Accordingly, Vectren was required to report its gain on the sale in a short-period return. On this return, the company asserted an alternative apportionment method.

The Department of Treasury (the Department) audited this return and raised the apportionment factor from 15% to 70% and the amount owed from \$405,000 to \$2.3 million. For reference, MLI's Michigan apportionment factor averaged 7% in the past ten years. Vectren challenged this assessment, arguing that using the standard apportionment formula would distort their business activities within the state. The Department denied this request, triggering Vectren's appeal to the trial court. The trial court granted Vectren's alternative apportionment, initiating the Department's appeal to the appellate court, which affirmed the trial court's ruling. The Department appealed again to the Michigan Supreme Court.

The Michigan Supreme Court ruled that Vectren was not entitled to alternative apportionment. Unfortunately, this catastrophic loss for Vectren meant that its \$2.3 million assessment was reinstated alongside the penalties incurred. Despite their victories in the lower courts, the case now returns to a Michigan trial court where the issue of penalty abatement is being decided. Thus far, the Department has refused to waive the penalties and actively seeks their payment in addition to the assessment.

Traditionally, after multiple defeats at the trial and appellate levels, a state would back away from a case entirely or waive penalties as a part of a settlement. However, the Department did not back down. Not only did they appeal this case to the Michigan Supreme Court and win, but they are still expending resources litigating this case over the attached penalties. This case emphasizes just how important it is for companies and individuals to contact experienced tax professionals early in the audit process to avoid lengthy and expensive litigations with state agencies that have adopted increasingly aggressive audit and penalty imposition habits.

Herbalife v. New Mexico Taxation and Revenue Department

The Herbalife case out of the New Mexico Administrative Hearings Office (the Office) demonstrates another instance of an imposed tax penalty and abatement being denied. The tax at issue here is a gross receipts tax for the years 2009 through 2016.[1] Herbalife failed to collect this tax and was thus subject to a reassessment by the New Mexico Taxation and Revenue Department (the "Department").[2] A penalty was imposed for a total of \$130,068.40 for the years at issue.[3] Herbalife issued a written protest of the imposed penalty, which the Office then heard.[4]

The Office began its analysis by reiterating that the taxpayer bore the burden of proof in all penalty assessment and interest cases.[5] The taxpayer must present countervailing evidence that disputes the factual correctness of the imposed penalty.[6] Unlike some other reviewing bodies, the Office explicitly mentions that the assessment of a penalty for late or unpaid taxes is mandatory under New Mexico law and that imposition is not discretionary.[7]

The Office then stated that a taxpayer's ignorance or lack of knowledge of their tax liability is considered

negligence for penalty assessment purposes and will cut against a taxpayer's request for abatement on "good faith and on reasonable grounds." [8] Functionally, this standard operates like the "reasonable cause" standard seen at many other state levels, such as Illinois. [9] However, New Mexico has gone further and explicitly made negligence destroy any claim of good faith and reasonable cause. [10] According to the Office, negligence includes: "inadvertence, indifference, thoughtlessness, carelessness, erroneous belief or inattention." [11] Interestingly, a taxpayer's reliance on an agent, such as an accountant, tax preparer, or lawyer, to perform actions such as filing a return is not an excuse that will eliminate the taxpayer's negligence, at least on its own. [12]

The major takeaway from this case is that ignorance is not bliss. You must be vigilant and always act with proper business care and prudence when dealing with your company's tax obligations. Adding taxpayer negligence to the reasonable cause exception makes overcoming this hurdle during review even more challenging. Here, Herbalife failed to produce evidence demonstrating that their failure to pay their tax liability was based on a mistake of law made in good faith and on reasonable grounds, and therefore, penalty abatement was denied. [13]

Matter of Red Vision Systems Inc.

This case from the California Office of Tax Appeals (the "Office") again demonstrates the importance of understanding penalty abatement and the idea of "reasonable cause." The penalty stems from the taxpayer's failure to pay California income tax for the short tax year following the sale of their company. [14] The taxpayer paid the tax in full some months later, but the California Franchise Tax Board still imposed a \$9,725.56 penalty for tax year 2016. [15] The taxpayer paid the penalty but filed a claim for a refund of the penalty, which was ultimately denied. [16]

The Office again noted the exception of reasonable cause and how willful neglect of a taxpayer's obligations can eliminate reasonable cause. [17] The Office continued that when the Franchise Tax Board imposes a penalty, the reviewing body presumes the penalty was imposed correctly and shifts the burden of proof to the taxpayer to demonstrate that reasonable cause exists. [18] Like many other states, a taxpayer demonstrates reasonable cause by showing that their failure to pay the tax in full and on time occurred despite their exercise of ordinary business care and prudence. [19] However, unlike other states, there is no mention of "good faith." [20] Instead, the taxpayer must show that an ordinarily intelligent and prudent businessperson would have acted the same or similar under the circumstances. [21] Finally, the Office notes that the taxpayer's lack of documentation or the difficulty associated with calculating a tax liability or its deadline does not, in and of itself, constitute reasonable cause. [22]

In a 2-1 split decision, the Office held that the taxpayer did not qualify for the reasonable cause exception. [23] The majority held that the taxpayer had presented no evidence that they were "unable" to make their payment within the prescribed time and had not provided a sufficient reason for the delay in mailing a check containing the total amount of their liability. [24] The taxpayer had correctly computed its liability three weeks before the due date but failed to postmark the letter containing the check until after such deadline had passed. [25]

The dissenting opinion of the Office held that the taxpayer's delay between calculating liability and

payment of such liability was reasonable and consistent with ordinary business care and prudence.[26] The specific transaction undertaken by the sale of the company (a section 338 transaction) is notorious for being complex and time-consuming to execute.[27] In the dissenting opinion, the judge was persuaded by the taxpayer's reasoning and cited precedent that such a period was reasonable cause for the delinquent payment, thus believing the penalty should have been abated.[28]

Paying tax liabilities on time is just as important as paying them in full, even if doing so is difficult. Here, the taxpayer correctly calculated their tax liability prior to the due date but delayed mailing the check for the total amount. This action incurred a penalty of nearly \$10,000 and many hours of stress in appeals and hearings with the Office. Avoiding this process altogether through prompt, in-full payments is a far superior use of time and energy.

Abatement Granted – Penalty Waived:

The only recent case where a taxpayer has had their tax penalty abated is discussed in more detail below. The simple fact that this is the only major case we have identified in the past year is a testament to just how rare abatements have become and emphasizes the importance of remaining in compliance with state and local tax laws to avoid penalty imposition in the first place.

Unique Paving Materials v. Cuyahoga County Board of Revision

This case out of the Ohio Board of Tax Appeals (the “Board”) is between a taxpayer who owns three parcels of real property within Cuyahoga County, Ohio.[29] In the second half of tax year 2022, the taxpayer received a “late payment penalty” for each of the three properties.[30] The taxpayer appealed the lower board's decision to deny penalty abatement because of the taxpayer's lack of reasonable cause.[31]

The taxpayer provided the Board with documented evidence that they had paid their correctly computed property taxes on time via the county's online payment portal.[32] However, when the taxpayer reconciled their statement, they realized the money had not been taken out of their account.[33] The taxpayer then called the county treasurer's office and was informed that the office had been facing technical issues with the platform.[34] They instructed the taxpayer to use the portal again and fill out the necessary forms seeking to remove all interest and penalties.[35]

The taxpayer had a history of tax compliance with the country and state, going back at least three years. [36] Despite this, the Treasurer and Fiscal Officer both suggested that the requests for abatement of penalties and interest be denied because the taxpayer was delinquent on their property taxes.[37] The taxpayer appealed the decision to the Board.[38]

Fortunately for the taxpayer, the receipt issued upon their initial online transaction contained language stating that their payment was accepted and paid on the submitted date, before the deadline.[39] The Board found this language particularly persuasive on the Treasurer's receipt provided to the taxpayer.[40] Additionally, the Board noted that the Treasurer had provided no evidence that the taxpayer was ever delinquent on their property taxes to the county office.[41] Accordingly, the Board reversed the lower board's decision and granted the taxpayer's penalty abatement.[42]

Penalty abatement is possible, but doing so has become increasingly complex and requires an

extraordinary set of facts. In this case, the taxpayer did nothing wrong and was still met with a penalty. Due to the local government's ineptitude, the Board was provided the abatement the taxpayer deserved. However, this case does not serve as any precedent in Ohio, as it was considered through the Board's small claims docket. As such, it is merely illustrative that abatement is possible but requires careful and diligent planning long before an audit, assessment, or penalty is imposed.

Conclusion:

Thank you for reading this series of articles on tax penalty abatement. Please do not hesitate to contact the [State and Local Tax group at Kilpatrick](#) if you have any further questions or inquiries about tax penalties, penalty abatements, or other questions related to state and local tax law.

[1] *Herbalife v. Taxation and Revenue Department*, AHO No. 23.07-027A, D&O No. 24-01, 1 (State of New Mexico Administrative Hearings Office Jan. 24, 2024).

[2] *Id* at 2.

[3] *Id* at 1.

[4] *Id*.

[5] *Id* at 3.

[6] *Id*.

[7] *Id*.

[8] *Id*.

[9] See *Id* at 3-4.

[10] *Id* at 4.

[11] *Id*.

[12] *Id*.

[13] *Id* at 8.

[14] *In the Matter of the Appeal of Red Vision Systems, Inc.*, OTA Case No. 18124068, 2 (State of California Office of Tax Appeals, Mar. 23, 2023).

[15] *Id* at 1.

[16] *Id* at 9.

[17] *Id* at 3.

[18] *Id*.

[19] *Id*.

[20] *Id*.

[21] *Id*.

[22] *Id*.

[23] *Id* at 5.

[24] *Id* at 7.

[25] *Id*.

[26] *Id* at 9.

[27] *Id*.

[28] *Id*.

[29] *Unique Paving Materials v. Cuyahoga County Board of Revision*, Case No. 2023-1445, 1-2, (Ohio Board of Tax Appeals, 2023).

[30] *Id*.

[31] *Id* at 1.

[32] *Id* at 3.

[33] *Id* at 2.

[34] *Id*.

[35] *Id*.

[36] *Id*.

[37] *Id*.

[38] *Id*.

[39] *Id* at 3.

[40] *Id*.

[41] *Id*.

[42] *Id*.

[JTF1] [Application and Abatement of Penalties in Illinois](#)

Related People



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