PITFALL HOTLINE

☐ **Divorce trap.** A couple divorced, with the wife receiving custody of their children. She had little income, so she gave the dependency exemptions for the children to the husband by signing a Form 8332 waiver. A few years later, she got a job and then did claim the exemptions—but so did he. The wife objected that when she signed the waiver, she never intended to give away the exemptions for future years when she might be working. *Tax Court:* The form that the wife signed clearly stated that she waived the exemptions until 2013. The husband keeps the exemptions.

Joann Bramante, TC Memo 2002-228.

☐ **Express delivery filing trap.** Richard Schafer sent a Tax Court petition to the Court using UPS next day service. When the IRS said the petition arrived late, he invoked the "filed when mailed rule," which now applies to IRS-approved express de- [illegible] ... was that on which the filing was given to UPS—so it was late.

Richard M. Schafer, TC Summary Opinion 2002-119.

☐ **If you make a mistake on your tax return,** you may escape underpayment penalties by showing you acted reasonably and "in good faith." This exception is applied case by case, "in light of the experience, knowledge, and education of the taxpayer." *Example:* Charles Reynolds tried to escape a penalty by showing he had reasonably relied on professional tax publications and reputable tax software when preparing his return. *Court:* "The 'experience, knowledge, and education' proviso is fatal" for Reynolds because he is an IRS-employed attorney, CPA, and audit supervisor who has no excuse for not knowing the rules. He owes the penalty.

Charles Reynolds, CA-7, No. 00-2966.

in prior years. It had filed 1099s for the year being examined—and the IRS held that that was sufficient.

Select Rehab Inc., DC MD Pa., No. 3-cv-01-1278; and IRS Legal Memorandum 200211037.

Winner: **IRS can't assume "average profits" for failing business.** An IRS auditor determined that the owner of a supermarket had underreported the store's profits. The auditor did this by applying the Dun & Bradstreet average profit percentage for supermarkets to the store's gross receipts, which produced a number larger than the owner had reported in the business's income.

Tax Court: The store was located in an economically distressed area and had actually gone out of business since then (in a later year). Thus, the average profit percentage for all supermarkets was too high to apply to it. The IRS had no other evidence to support its case, so the store's income was deemed reported correctly.

Yan Dang, TC Memo 2002-117.

[illegible] ... jury acquitted the firm. ... The IRS then asked for a new trial because the jury had ... New trial denied.

... Inc., DC ND Ind., No. 1-99-cv-428.

Winner: **IRS pays price for not giving taxpayer something to appeal.** An employer filed for a refund of taxes it claimed to have paid, but never heard from the IRS even after several follow-up inquiries. So it finally sued for the refund in court, where the IRS quickly conceded. The employer then asked the court to order the IRS to pay its legal bills. The IRS objected that the company hadn't exhausted its remedies by going to an IRS appeals conference before filing a court case, so it is in- [illegible]

Newscope Services Inc., DC SD ... NA-96-1 ... and CA-7, No. 00-3335.

Winner: **Partners escape liability for partnership's tax bill.** The IRS assessed a tax bill against a partnership. Its individual partners argued that since they hadn't been assessed personally, they weren't liable for the tax. The IRS answered that general partners are by law liable for a partnership's debts.

Court: A partnership and its partners are separate taxpayers, as evidenced by their different taxpayer ID numbers. While partners may be liable for a partnership's tax debts, they must be separately assessed for them. And since more than three years had passed, it was too late to assess them—so they escape the tax.

Abel C. Galletti, et ux., et al., CA-9, Nos. 01-55953 and 01-55954.

Winner: **IRS must let company copy records that were stolen from it.** An employee stole tax and financial records from his employer and gave them to the IRS. *Court:* The IRS must allow the company to make copies of all the stolen records that are in its possession.

Rudd Drywall Co., DC ED Ky., No. 01 ... JMH.

Winner: **Settlement paid to government is deductible.** A company pleaded guilty to an antitrust violation and paid a fine. The government said it also intended to bring a civil suit against the company over the same violation. The company then agreed to pay an additional amount to the government in exchange for its not filing the case. Then the company tried to deduct the payment, but an auditor noted that fines and penalties