

**UNITED STATES TAX COURT
WASHINGTON, DC 20217**

PETER B. ZSCHAU & MELANIE Y. ZSCHAU,))
)
Petitioners,))
)
v.)) Docket No. 9285-17S
)
COMMISSIONER OF INTERNAL REVENUE,))
)
Respondent.))

ORDER

Pursuant to Rule 152(b), Tax Court Rules of Practice and Procedure, it is

ORDERED that the Clerk of the Court shall transmit herewith to petitioners and to respondent a copy of the pages of the transcript of the trial in the above case before Chief Special Trial Judge Lewis R. Carluzzo at Boston, Massachusetts, containing his oral findings of fact and opinion rendered at the trial session at which the case was heard.

In accordance with the oral findings of fact and opinion, a decision will be entered under Rule 155.

**(Signed) Lewis R. Carluzzo
Special Trial Judge**

Dated: Washington, D.C.
April 4, 2018

1 Bench Opinion by Special Trial Judge Lewis R. Carluzzo
2 March 21, 2018
3 Peter B. Zschau & Melanie Y. Zschau v. Commissioner of
4 Internal Revenue
5 Docket No. 9285-17S

6 The Court has decided to render oral findings of
7 fact and opinion in this case and the following represents
8 the Court's oral findings of fact and opinion (bench
9 opinion). Unless otherwise noted, section references made
10 in this bench opinion are to the Internal Revenue Code of
11 1986, as amended, in effect for the relevant period, and
12 Rule references are to the Tax Court Rules of Practice and
13 Procedure. This bench opinion is made pursuant to the
14 authority granted by section 7459(b) and Rule 152.

15 This proceeding for the redetermination of a
16 deficiency is a small tax case subject to the provisions
17 of section 7463 and Rules 170 through 174. Except as
18 provided in Rule 152(c), this bench opinion shall not be
19 cited as authority, and pursuant to section 7463(b) the
20 decision entered in this case shall not be treated as
21 precedent for any other case.

22 Peter B. Zschau (petitioner) appeared on his own
23 behalf, as did Melanie Y. Zschau. R. Jeffrey Knight and
24 Francesca Chou appeared on behalf of respondent.

25 In a notice of deficiency dated February 6, 2017



1 (notice), a copy of which is attached to the petition, but
2 not otherwise in the record, respondent determined a
3 deficiency in petitioners' 2014 Federal income tax and
4 imposed a section 6662(a) penalty. According to the
5 notice, the penalty is applicable because the underpayment
6 of tax required to have been shown on petitioners' 2014
7 Federal income tax return (return) is a substantial
8 understatement of income tax within the meaning of section
9 6662(d).

10 Petitioners now concede the deficiency.
11 Although they concede the deficiency -- they've paid most
12 if not all of it before trial -- they dispute the
13 imposition of the penalty. According to petitioners, they
14 did not know of the item of income that resulted in the
15 deficiency at the time the return was filed. The issue
16 for decision is whether petitioners had reasonable cause
17 and acted in good faith with respect to the underpayment
18 of tax required to have been shown on their return.

19 Before summarizing the relevant facts as we
20 would normally do at this point in a bench opinion, we
21 think it more appropriate to briefly outline the
22 applicable law that will inform our decision, and begin by
23 noting that section 6662(a) imposes an accuracy-related
24 penalty on "any portion of an underpayment of tax required
25 to be shown on a return". Sec. 6662(a). Respondent bears



1 the burden of production with respect to the imposition of
2 the penalty, see sec. 7491(c), and that burden includes
3 establishing that the imposition of the penalty was
4 appropriately approved by the immediate supervisor, or
5 higher level official, of the person who made the initial
6 determination to impose the penalty. See sec. 6751(b).
7 The section 6662(a) penalty does not apply to the portion
8 of the underpayment of tax shown to be due to reasonable
9 cause and good faith on the part of the taxpayer. See
10 sec. 6664(c).

11 In this case, the deficiency, the underpayment
12 of tax, and the understatement of income tax are all
13 computed in the same manner. See secs. 6211(a), 6664(a),
14 6662(d)(2)(A). Taking into account the amount of tax
15 shown on the return and the amount of the deficiency
16 determined in the notice, it is clear that the
17 underpayment of tax is a substantial understatement of
18 income tax because the underpayment exceeds 10% of the tax
19 required to be shown on the return. See sec.
20 6662(d)(1)(A). That being so, and because respondent has
21 introduced sufficient evidence to establish that the
22 imposition of the penalty was approved in writing as
23 required under section 6751(b), respondent has met his
24 burden of production with respect to the imposition of the
25 penalty, and we turn our attention to petitioners' claim

1 that they had reasonable cause and acted in good faith in
2 connection with the underpayment/deficiency. The burden
3 of proof in this regard rests with petitioners. See Rule
4 142(a); Higbee v. Commissioner, 116 T.C. 438, 446-447
5 (2001).

6 Whether a taxpayer acted with "reasonable cause
7 and in good faith is determined on a case-by-case basis,
8 taking into account all pertinent facts and
9 circumstances", sec. 1.6664-4(b)(1) Income Tax Regs.,
10 including "the taxpayer's mental and physical condition,
11 as well as sophistication with respect to the tax laws, at
12 the time the return was filed." Kees v. Commissioner,
13 T.C. Memo. 1999-41; see also Hughes v. Commissioner, T.C.
14 Memo. 2015-89.

15 With these fundamental principles in mind, we
16 turn our attention to the "facts and circumstances" relied
17 upon by petitioners to support their claim that they had a
18 reasonable cause and acted in good faith with respect to
19 the underpayment of tax required to be shown on their
20 return. Those facts and circumstances are summarized
21 below.

22 We'll start by noting the that the return was
23 prepared by the same paid Federal income tax return
24 preparer that prepared petitioners' joint Federal income
25 tax returns for many years prior to 2014, which goes a



1 long way in support of their argument against the
2 imposition of a section 6662(a) penalty. We further note
3 that at all times relevant, petitioners maintained
4 numerous non-retirement and retirement investment accounts
5 with various financial institutions, and petitioners'
6 return reports various items of income attributable to
7 those accounts. Here, our focus is on a non-retirement
8 investment account that petitioners maintained with Janus
9 Services, LLC (Janus). Because of capital gains and other
10 income earned by the Janus account during 2014 not
11 distributed to petitioners, but reinvested in the account,
12 the account enjoyed an increase in value by more than 15%.
13 The increases are shown on the annual Overall Portfolio
14 Summary that Janus provided to petitioners before the
15 return was filed. The capital gains and other income that
16 resulted in the increase in the value of the account
17 apparently were reported on a paper Form 1099 that Janus
18 issued and mailed to petitioners for 2014, but due to a
19 delay in delivery, that document was not received by
20 petitioners until long after the return was filed.
21 According to petitioner, that is the reason the income
22 earned from the Janus account was not reported on their
23 original return but shown on an apparently unprocessed
24 amended return submitted to respondent after the notice
25 was issued. It would be appropriate to note at this



1 point, that we completely accept his explanation.
2 Petitioner was the only witness who testified at trial,
3 and we found him to be entirely credible. Without
4 specifically repeating the factual background as outlined
5 in petitioner's testimony, we accept petitioners' version
6 of the events at the time the return was filed. Our
7 favorable assessment of petitioner's credibility, and our
8 acceptance of petitioners' version of events, however,
9 does not distance them entirely from the imposition of the
10 penalty here in dispute. Neither does the fact that
11 petitioners now acknowledge the error made on the return
12 and have paid the deficiency some time ago. On the other
13 hand, respondent's suggestion that petitioners' claim of
14 good faith should be rejected because petitioners paid the
15 deficiency only after the Internal Revenue Service
16 contacted them about it does little to persuade us that
17 the penalty should be imposed. Considering all of the
18 "facts and circumstances" we find this to be a very close
19 case and are disappointed that the parties were unable to
20 resolve it between themselves by splitting the penalty.
21 Because we must resolve the dispute between the parties,
22 and because we cannot on our own, split the imposition of
23 the penalty, on balance and for the following reasons, we
24 find that the scale tips ever so slightly in respondent's
25 favor.



1 We understand that the omitted income giving
2 rise to the deficiency was not distributed to petitioners
3 during 2014. Nevertheless, the year-end summary that
4 Janus provided to petitioners shows a substantial amount
5 of capital gain income and other income earned during
6 2014. Petitioner explained that over his long
7 relationship with his return preparer, the practice
8 between them was only to provide the return preparer with
9 Forms 1099 with respect to the various investment accounts
10 maintained by petitioners over the years. That being so,
11 petitioners did not provide the return preparer with the
12 year-end summary, and because the Form 1099 evidencing the
13 income had not yet been delivered to petitioners, the
14 return preparer did not have that information at the time
15 the return was filed. But petitioners did have that
16 information.

17 The year-end summary was received by petitioners
18 before the return was filed, and even though the document
19 was placed in a folder designated for income tax
20 materials, the document was not provided to petitioners'
21 return preparer. At trial petitioner correctly pointed
22 out that the year-end summary does not characterize the
23 income as taxable, but the year-end summary clearly shows
24 the extent of the capital gains and other income realized
25 by the investment account during 2014. Neither petitioner



1 claims to be unsophisticated in matters of Federal income
2 taxation, and although the record does not disclose the
3 educational background of either, we cannot ignore
4 petitioner's business background as the long-time owner of
5 an independent insurance brokerage agency. Petitioner's
6 professional experiences must have required him to review
7 and understand various types of financial information, and
8 we have difficulty understanding why, in the absence of a
9 Form 1099 and given the information contained on the year-
10 end summary, he would not have given the document to his
11 return preparer even if the document did not clearly
12 characterize the income as taxable. Upon learning of the
13 substantial amount of capital gains and other income as
14 shown on Janus' year-end summary petitioners should have
15 provided that form to their return preparer. Their
16 failure to do so, even if consistent with their routine
17 arrangements with the return preparer for other years,
18 constrains us to reject their claim that there was
19 reasonable cause and they acted in good faith with respect
20 to the underpayment of tax required to be shown on their
21 return. That being so, respondent's imposition of the
22 penalty is sustained.

23 To reflect the foregoing, and because the record
24 shows that a portion, if not all of the deficiency has
25 already been paid by petitioners, the Decision to be



1 entered in this case will be entered under Rule 155 to
2 ensure that the assessments, if any, of those payments are
3 properly accounted for in the amount of the deficiency to
4 be shown on the Decision.

5 This concludes the Court's bench opinion in this
6 case.

7 (Whereupon, at 2:48 p.m., the above-entitled
8 matter was concluded.)

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