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

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| MICHAEL A. BOWSE & CYNTHIA V. VAES A.K.A. CINDY V. VAES, | ) | |
| Petitioner(s), | ) | |
| v. | ) | Docket No. 7549-17. |
| COMMISSIONER OF INTERNAL REVENUE, | ) | |
| Respondent | ) | |

**O R D E R**

This case was submitted for decision without trial under Rule 122, Tax Court Rules of Practice and Procedure, on March 12, 2018. The parties have stipulated that the only remaining issue in this case is whether petitioners are liable for an accuracy-related penalty, under the provisions of I.R.C. § 6662(a), on the basis of a substantial understatement of income tax for their 2014 tax year. On May 11, 2018, the parties filed simultaneous briefs addressing petitioners' liability for this penalty.

On December 20, 2017, the Court issued its Opinion in Graev v. Commissioner, 149 T.C. No. 23 (Graev III). In Graev III the Court held that respondent's compliance with the supervisory-approval requirement of I.R.C. § 6751(b)(1) is part of his burden of production under I.R.C. § 7491(c) and that proof of such compliance is properly at issue in a deficiency case. In his opening brief, respondent acknowledges that I.R.C. § 6751(b)(1) generally requires written supervisory approval before an accuracy-related penalty is determined against a taxpayer. However, respondent contends that supervisory approval was not required here because the penalty was "automatically calculated through electronic means." I.R.C. § 6751(b)(2).

In his opening brief, respondent states that the notice of deficiency in this case was issued as part of the IRS' Automated Underreporter (AUR) program. The notice of deficiency listed a 20% substantial understatement penalty which, according to respondent, "was imposed free of any independent determination by a

Service employee as to whether the penalty should be imposed." After reviewing the parties' opening briefs, the Court would find it helpful to receive supplemental briefing addressing the application of I.R.C. § 6751(b)(2) on the facts of this case.

The notice of deficiency, issued on January 3, 2017, determined for 2014 a deficiency of $82,723 and a substantial understatement penalty of $16,545. After receiving that notice petitioners filed a Form 1040X, Amended U.S. Individual Income Tax Return, for 2014. The IRS Appeals Office (Appeals) accepted that amended return for filing and, on that basis, reduced the deficiency and penalty amounts. On February 27, 2017, the IRS issued petitioners a CP2000 Notice that reduced the deficiency to $69,617 and reduced the penalty to $13,923.

The Internal Revenue Manual (IRM) includes several provisions addressing the circumstances in which a penalty will be regarded as "automatically calculated via electronic means." These provisions include the following:

IRM pt. 20.1.1.2.3(5) (Aug. 5, 2014) provides that:

> Penalty automatically calculated through electronic means encompasses something more than merely an electronic device to perform arithmetic functions to determine the amount of a penalty. Instead, the assessment of a penalty qualifies as one calculated through electronic means if the penalty is assessed free of any independent determination by an IRS employee as to whether the penalty should be imposed against a taxpayer.

The IRM further explains:

> (a.) When IRC 6662 accuracy-related penalties for negligence and substantial understatement are assessed under the Automated Underreporter (AUR) program without an employee independently determining the appropriateness of the penalty, then the penalty is one that is automatically calculated through electronic means and may be assessed without written supervisory approval.
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> (b.) However, if a taxpayer responds either to the initial letter proposing a penalty or to the notice of deficiency that the program automatically issues, an IRS employee will have to consider the taxpayer's response. Therefore, the IRS employee will have to make an independent determination as to whether the response provides a

> basis upon which the taxpayer may avoid the penalty. The employee's independent determination of whether the penalty is appropriate means the penalty is not automatically calculated through electronic means. Accordingly, IRC 6751(b)(1) requires managerial written approval of an employee's determination to assert the penalty.

IRM pt. 20.1.5.1.6(9) (Jan. 24, 2012); see also IRM pt. 4.19.3.2.1.4(2) and (3) (Sept. 1, 2012).

In light of these IRM provisions and the facts of this case, the Court would find it helpful to receive additional briefing from the parties addressing the following questions (and any related issues that may be relevant in providing complete answers):

(1) By filing a Form 1040X for 2014 after receiving the notice of deficiency, did petitioners "respond * * * to the notice of deficiency that the [AUR] program automatically issue[d]," within the meaning of the IRM provision quoted above?

(2) If so, after considering petitioners' response, did an IRS employee "make an independent determination as to whether the response provides a basis upon which the taxpayer may avoid the penalty," within the meaning of the IRM provision quoted above?

(3) By accepting petitioners' amended return and reducing the deficiency and penalty amounts, did the IRS made a new "initial determination" of the assessment of the penalty?

(4) If so, was that new initial determination of the penalty "automatically calculated through electronic means"?

(5) If not, what IRS officer made the "initial determination" of the reduced penalty, and who was the immediate supervisor of that individual?

To assist the Court in addressing these questions, it is hereby

ORDERED that respondent shall file, on or before June 15, 2018, a response to this order addressing the questions outlined above (and any other matters that respondent believes relevant in providing comprehensive answers to these questions). It is further

ORDERED that petitioners may, if they wish, file a reply to respondent's response on or before July 16, 2018.

**(Signed) Albert G. Lauber**
**Judge**

Dated: Washington, D.C.
May 21, 2018