

STATE OF MICHIGAN



JOHN ENGLER, Governor

DEPARTMENT OF TREASURY

TREASURY BUILDING, LANSING, MICHIGAN 48922

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REVENUE ADMINISTRATIVE BULLETIN 1999-12**Approved:** December 13, 1999**Estate Tax Penalty and Waiver Provisions**

RAB-99-12. This bulletin explains who is responsible for filing and paying the Michigan Estate Tax return, what penalties apply to the tax and how the reasonable cause waiver standard is applied. Examples of reasonable cause for penalty waiver are also provided.

ISSUES

- I. Who is responsible for filing a Michigan Estate Tax return and paying the tax?
- II. What penalty provisions apply to the Michigan Estate Tax?
- III. Do late payment penalties apply to Michigan Estate Tax paid on extended federal due dates pursuant to Internal Revenue Code § 6163 and 6166?
- IV. Under what conditions are penalties waived?
- V. What is the procedure for requesting a penalty waiver?
- VI. What constitutes reasonable cause for waiving a penalty?

CONCLUSIONS

- I. The "personal representative" of the estate who is required by federal law to file a federal estate tax return is also personally liable for filing and paying a Michigan Estate Tax return. The personal representative's liability extends to tax, interest and penalties. [MCL 205.235; MSA 7.591(5) and 205.237; MSA 7.591(7)]
- II. The same penalties that are assessed under sections 23 and 24 of the Revenue Act [MCL 205.23; MSA 7.657 (23) and MCL 205.24; MSA 7.657 (24)] also apply to the Michigan Estate Tax. Sections 23 and 24 of the Revenue Act provide for discretionary and non-discretionary penalties. Non-discretionary penalties under section 24 include the failure to file an estate tax return, failure to pay the estate tax, failure to file an information return. Failure to file and failure to pay penalties are assessed at \$10.00 or 5% of the tax deficiency per month, whichever is greater. The penalties cannot exceed 50%. Discretionary penalties in section 23 are assessed as a percentage of the tax deficiency and include the 10% negligence, the 25% intentional disregard penalty and the 100% fraud penalty.

- III. If a federal extension to pay the tax under IRC § 6163 or 6166 is not approved at the time the Michigan Estate Tax becomes due and payable, the obligation to file the return and pay the tax remains on the original due date. Therefore, in situations where an estate has applied for a federal extension under either IRC § 6163 or 6166, the Department will assess the failure to pay penalty if the tax is not paid by the original due date. However, evidence that the Internal Revenue Service has granted the taxpayer an extension of time to pay the tax under IRC § 6163 or 6166 will be accepted as reasonable cause for waiver of the failure to pay penalty. Interest will be assessed on all payments received after the original due date.
- IV. The failure to file/pay penalties are waived if it is shown to the satisfaction of the department that the failure was due to reasonable cause and not to willful neglect. Likewise, the negligence penalty is waived if the taxpayer demonstrates that the deficiency or excess claim for credit was due to reasonable cause. An intentional disregard or civil fraud penalty may be waived at the discretion of the Commissioner of Revenue if the taxpayer establishes facts that negate a finding of intent to disregard a tax law or evade a tax.
- V. A request for waiver of penalty must be submitted, in writing, to the Commissioner of Revenue, and mailed to: **Estate Tax Section, Michigan Department of Treasury, Lansing, MI 48922**, explaining in detail the facts and circumstances that constitute the basis for waiver.
- VI. Reasonable cause exists if, despite the exercise of ordinary business care and prudence, the taxpayer was still unable to file an estate tax return or pay the estate tax by the prescribed date. The facts and circumstances of each case will be considered in determining penalty waivers. Taxpayers bear the burden of establishing reasonable cause for a waiver of any penalty.

LAW AND ANALYSIS

For deaths occurring after September 30, 1993, the Michigan Estate Tax is imposed on the transfer of the estate of a Michigan resident or the transfer of a nonresident's real or tangible personal property located in this state. MCL 205.232; MSA 7.591(3). Unlike the former Inheritance Tax Act, Michigan's Estate Tax is administered under the Revenue Act and is subject to the penalty provisions contained sections 23 and 24 of the Revenue Act.

The "personal representative" of the estate who is required by federal law to file a federal estate tax return is also personally liable for filing and paying a Michigan Estate Tax return. The personal representative's liability extends to tax, interest and penalties. MCL 205.237; MSA 7.591(7). The Estate Tax Act defines a "personal representative" to include personal representatives appointed by the probate court, persons who are in actual or constructive possession of estate property, if the representative is not acting, or persons who are required to file a return or pay the tax. MCL 205.256(1); MSA 7.591(26). Generally, a " personal

representative" will be the executor of an estate, administrator, trustee, successor, legal representative, any person charged with managing the affairs of a decedent.

The Michigan Estate Tax return is due at the same time the federal estate tax return is due, generally nine months after the date of the decedent's death. Untimely filed returns or failure to pay any part of the tax by the due date are subject to the non-discretionary failure to file/pay penalties.

In some circumstances, the Internal Revenue Service (IRS) may extend the time for payment of a portion of the federal estate tax under IRC § 6161. When an extension to file the return is approved, the tax must still be remitted by the original due date of the return or the payment is subject to the failure to file/pay penalty. When the IRS has approved an extension for a portion of the federal estate tax under IRC 6161, the Michigan Estate Tax Act also extends the time for payment of that portion of the tax.

Since approval of the federal request for extension of time to pay is not automatic and does not extend the time for filing the return, there will be situations when the approved extension of time to pay is not received until after the due date of the Michigan Estate Tax return. In these situations, the Department will assess the failure to pay penalty if the entire tax is not paid by the due date. In these situations, the estate should return a copy of the assessment with a copy of the approved federal extension of time to pay and the failure to pay penalty will be waived. Estates should use the *Michigan Estate Tax Estimate Voucher* (form 2527) to make a payment before the tax return is filed.

ESTATE TAX PENALTIES

Sections 23 and 24 of the Revenue Act recognize two types of penalties: non-discretionary penalties, which are assessed by virtue of a failure to file or pay, and discretionary penalties, which are assessed based on the Department's review of facts. Both the discretionary and non-discretionary penalties are described in detail in RAB 1995-4.

Non-discretionary Late Penalties

The non-discretionary penalties include late penalties for the failure to file the Michigan Estate Tax Return and to pay the tax. Both are found in section 24 of the Revenue Act.

Failure to file tax return	- \$10.00 or 5% per month (maximum 50%)
Failure to pay a tax	- \$10.00 or 5% per month (maximum 50%)
Failure to file information return	- \$10.00 per day (maximum \$400.00)

Except for the information returns, these penalties are calculated as a percentage of the tax due after subtracting credits and prepayments. The maximum penalty of 50% is a combined maximum for failure to file and/or pay. The penalties for failure to file and/or pay are applied at the stated rate per month or fraction of a month.

Failure to File

This penalty of \$10.00 or 5% of the tax due per month (maximum 50%) is applied to a tax return required by law that is filed after the prescribed due date for that return or an authorized extended due date. If adjustments are made as a result of a review of the tax return or from an audit of the taxpayer's records and increase the tax due, the additional tax due may be subject to the discretionary penalties.

Failure to Pay

When a taxpayer has filed a return but fails to pay the tax due, the penalty of \$10.00 or 5% of the tax due per month (maximum 50%) is added. This penalty is also applied to assessed taxes until the aggregate of 50% of the tax due has been applied.

A copy of an approved federal form 4768, *Application for Extension of Time To File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes* must be attached to the Michigan Estate Tax return when it is filed to avoid application of the failure to file/pay penalty.

Discretionary Penalties

MCL 205.23 prescribes the discretionary penalties of negligence, intentional disregard, and fraud in descending order of the severity of the penalty. If a tax deficiency is due to negligence, a penalty equal to \$10 or 10% of the deficiency, whichever is greater, plus interest is added to the deficiency. If the deficiency is due to intentional disregard of the law, the penalty is raised to the greater of \$25 or 25% of the deficiency plus interest, and, if the tax deficiency is due to fraud, the penalty is increased to 100% of the deficiency plus interest.

First	- Fraud	100%
Second	- Intentional Disregard	25%
Third	- Negligence	10%

The Department may apply a discretionary penalty to a Michigan Estate Tax deficiency or excessive claim for credit if it is determined that the taxpayer exhibited negligence, intentional disregard of the tax law or rules, or fraud.

As used in section 23, "deficiency" is the amount to which the discretionary penalties are applied. Deficiency is a tax liability determined by the department and may result from an underpayment of tax or an excessive claim for refund. Generally, adjustments reducing the amount of a refund are not subject to these penalties because there is no deficiency.

If any part of the Michigan Estate Tax deficiency is subject to one of the discretionary penalty provisions, the penalty is applied to the entire deficiency. When more than one of these penalties is applicable to a deficiency, the higher percentage penalty applies. However, if a taxpayer is successful in disputing an intentional disregard penalty, the department may not impose the negligence penalty on the same tax.

PENALTY WAIVER

Both sections 23 and 24 permit a waiver of certain penalties for reasonable cause. Section 23 requires the Commissioner to waive the negligence penalty if the taxpayer shows reasonable cause. Similarly, section 24 requires the waiver of the failure to file or pay penalty if the taxpayer shows that the failure was due to reasonable cause and not due to willful neglect. These penalty waiver provisions are addressed in greater detail in administrative rules. R 205.1012 gives examples of the imposition and waiver of the negligence penalty. R 205.1013 does the same for the non-discretionary penalty. In addition, Revenue Administrative Bulletin (RAB) 1995-4 explains in detail the application and waiver of penalty provisions as they apply to all taxes administered under the Revenue Act.

The following examples illustrate the types of circumstances that establish reasonable cause for waiving an estate tax penalty. The examples are not exhaustive and are intended as illustrations.

Examples of Reasonable Cause for Non-discretionary Penalty Waiver

The following examples, if clearly established and if other contributing circumstances do not exist, constitute reasonable cause for failure to file or pay. They are not intended to be the only instances in which reasonable cause may be established.

- (1) The delay in filing or payment is caused by the prolonged, unavoidable absence of the personal representative due to circumstances beyond that person's control which preclude that person from making alternate arrangements for filing estate tax returns or paying the tax.
- (2) The delay in filing or payment is caused by destruction, by fire or other casualty, of the decedent's records if the records are directly necessary to the ability to comply with filing requirements and prevented timely compliance with the law.
- (3) The delay arose from the personal representative's inability to obtain necessary records or information due to reasons beyond the personal representative's control. The personal representative shall explain why the records are needed to comply, why the records are unavailable, what other avenues were pursued to secure the information, and why the information can not be estimated.
- (4) The personal representative provided all necessary records and information but received erroneous **written** information from a department employee in response to the personal representative's personal inquiry. The erroneous written information directly related to and prevented the personal representative from complying with state tax obligations.
- (5) The filing of a return or payment of tax is delayed by the United States Post Office and the taxpayer demonstrated that the tax return was postmarked by the due date set for filing the return. The taxpayer demonstrated that the completed return or payment

was timely mailed, that is, the United States postmark stamped on the envelope was dated on or before the due date set for filing the return, including extensions; or

- (6) A financial institution error that was the sole cause of the failure to pay.

Examples of Factors Considered for Reasonable Cause

The following factors by themselves do not constitute reasonable cause for waiver of the failure to file or pay penalties. However, these factors may be considered with other facts and circumstances and may constitute reasonable cause. Because each case is different, these factors are for illustration only and are not exhaustive:

- (1) The personal representative furnished all necessary information and records to a tax advisor, but the advisor incorrectly advised the personal representative. The personal representative acted reasonably in not securing further advice. Upon discovery of the error, the personal representative took immediate remedial steps including payment of the tax and interest due.
- (2) Additional tax became due because assets were found after the estate tax return had been filed and tax paid. Within 60 days of the asset's discovery, the personal representative took remedial steps that included payment of the additional tax and interest.
- (3) The personal representative took reasonable steps to determine the estate's gross value and determined that a return would not be due. No return was filed. However, after the filing due date had passed, a return and/or tax became due because of a change in the valuation of one or more of the estate's assets. Within 60 days of the change, the personal representative took remedial steps including filing a return and payment of the tax.
- (4) Personal representative remitted the total tax believed due and requested an extension to file the return but did not request an extension to pay. Upon preparation of the return, the personal representative determined that additional tax was due. The personal representative demonstrated to the Department that the failure to pay the additional tax was not due to negligence. The estimation error was minor. 90% of the total tax liability had been paid as an estimated payment.
- (5) An extension to file was approved, however, tax or additional tax became due because of a contested will or other litigation involving the estate.
- (6) No one was in actual or constructive possession of the decedent's assets and a personal representative was not appointed until after the due date for filing and paying the tax.
- (7) Tax could not be paid timely due to the death or serious illness of the personal representative or the person responsible for the payment of the tax.

- (8) The estate lacks sufficient cash or other liquid assets –i.e. certificate of deposits, bonds— to fully pay the estate tax and other estate assets cannot be converted into cash without undue hardship –i.e. substantial financial loss of value due to a sacrifice price. *See* Treas Reg § 20.6161-1.

Examples of Negligence Penalty Waiver

The standard for determining negligence is whether, under the circumstances, the taxpayer failed to exercise ordinary care and prudence in preparing and filing a return and paying the applicable tax in accordance with the statute. The following examples show cause for waiving a negligence penalty:

- (1) The personal representative made simple transpositions or mathematical errors.
- (2) Additional tax became due because of a final determination by the internal revenue service and an amended return was filed and the additional tax and interest was paid within 60 days of the audit adjustment. The example would not result in waiver of the negligence penalty if the Internal Revenue Service had assessed a negligence or fraud penalty.
- (3) Facts that required waiver of the failure to file/pay penalty may establish reasonable cause in the case of discretionary penalties.

Examples of What Does Not Constitute Reasonable Cause

The following examples describe situations or factors that do not constitute reasonable cause or are irrelevant to the determination of reasonable cause:

- (1) The Michigan Estate Tax Act requires an amended return to be filed within 60 days of the date of the federal determination. The personal representative failed to file an amended return within the 60 days.
- (2) The past compliance history of the taxpayer or the personal representative.
- (3) The estate tax return is a single filing event and therefore the fact that it was the first return required to be filed for the decedent is not relevant when determining reasonable cause definitions.

Definitions

Department The Revenue Bureau of the Department of Treasury.

Negligence Lack of due care in failing to do what a reasonable and ordinarily prudent person would have done under the circumstances.

Intentional Disregard	Knowingly and willfully disregarding the laws, rules and instructions published and/or administered by the department without the intent to commit fraud or evade payment of tax.
Fraud	Knowingly and willfully acting in a manner to commit fraud, such as: failing or refusing to file a return, or filing a false return with the intent to evade payment of tax or part of a tax; claiming a false refund or a false credit; or aiding, abetting or assisting another in an attempt to evade payment of a tax or part of a tax, claim a false refund or claim a false credit
Information Return	Any tax return required by the department that does not, by law, require the payment of a tax liability. However, this definition specifically excludes an information return wherein, as a result of reconciliation, a tax is determined due. In such cases, the tax return is treated like a non-information return.
Discretionary	A collective term that addresses the negligence, intentional disregard and fraud penalties as judgmental in application and distinctly separate from the obvious errors of failure to file and failure to pay. The application of these penalties requires the reviewer to evaluate facts, circumstances, degrees of action or omission and apply penalties accordingly.