**Accuracy related penalties (Some facts in the case may be modified here).**

Santa Fe Pacific Gold Company proposed a merger with Homestake Mining Co., in order to avoid a hostile takeover by Newmont USA Limited. During the negotiations with Homestake, Santa Fe entered into a merger termination agreement. This agreement obligated Santa Fe to pay a $65-million dollar merger termination fee if Santa Fe did not complete the merger. Later, Newmont increased the amount of its hostile takeover merger offer. Santa Fe was required under state law to accept the larger hostile merger offer. Santa Fe was required

to pay the $65-million dollar merger termination fee to Homestake.

The corporation’s taxable income was $200,000,000, before deducting this fee.

Your firm conducted research related to the issue of deductibility of this fee.
Your firm prepared the corporate tax return for Santa Fe, for a fee of $50,000.
This $65-million dollar fee was deducted as an expense on its Federal tax return.

The IRS has audited the tax return and seeks to require the company to capitalize this
$65 million fee. For the purpose of this question, you may assume that the IRS also
seeks to impose an accuracy related penalty on both the corporation and the preparer.

(Santa Fe Paciﬁc Gold Company. U.S. Tax Court, 32 TC 240)

1. How much penalty will the IRS seek to impose on the taxpayer?

2. What argument should be used to support the position that the accuracy related penalty should not be imposed on the taxpayer?

3. How much understatement penalty will the IRS seek to impose on you, the tax preparer?

4. What argument should be used to support the position that the understatement penalty should not be imposed on you?

We are not considering the decision of the court.
We are discussing how the IRS might seek to penalize the company and tax preparer when audit is completed.