# Current Federal Tax Developments

Week of March 18, 2019

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## Section: 36B
## MAGI for Purpose of the Premium Tax Credit Includes Social Security Benefits Excluded from Income Under a §86(e) Election

### Citation: Johnson v. Commissioner, 152 TC No. 6, 3/11/1

The Tax Court determined that a taxpayer who elects to exclude a lump sum payment of social security from gross income under IRC §86(e) nevertheless must include that amount in the taxpayer's modified adjusted gross income (MAGI) for computing repayment of the advance premium tax credit under IRC §36B. The case of *Johnson v. Commissioner*, 152 TC No. 6, involved a taxpayer who had received just such a lump sum payment of social security in a year in which he had also received advanced premium tax credits to reduce his health insurance premiums.

IRC §36B provides for advanced payment of premium tax credits that are available to qualified individual purchasing insurance on health insurance exchanges. The advance credit is to be reconciled at the end of the year to the amount of credit the taxpayer qualifies for based on the taxpayer's §36B MAGI. That reconciliation takes place on Form 8962, *Premium Tax Credit*, which is filed with the taxpayer's individual income tax return.

IRC §36B(d)(2)(B) defines MAGI for these purposes as:

> *(B) Modified adjusted gross income*
>
> *The term "modified adjusted gross income" means adjusted gross income increased by—*
>
> > *(i) any amount excluded from gross income under section 911,*
> >
> > *(ii) any amount of interest received or accrued by the taxpayer during the taxable year which is exempt from tax, and*
> >
> > *(iii) an amount equal to the portion of the taxpayer's social security benefits (as defined in section 86(d)) which is not included in gross income under section 86 for the taxable year.*

The provision at §36B(d)(2)(B)(iii) dealing with social security is what the Court sought to interpret in this case.

A special rule exists at IRC §86(e) that deals with social security recipients who receive a lump sum payment of social security in a single year that relates to prior years. Most often this occurs in cases where the agency takes significant time to evaluate the claim for benefits, such as in many disability claims.

That provision provides for the following election:

> *(e) Limitation on amount included where taxpayer receives lump-sum payment*
>
> *(1) Limitation*
>
> *If—*
>
> *(A) any portion of a lump-sum payment of social security benefits received during the taxable year is attributable to prior taxable years, and*
>
> *(B) the taxpayer makes an election under this subsection for the taxable year,*
>
> *then the amount included in gross income under this section for the taxable year by reason of the receipt of such portion shall not exceed the sum of the increases in gross income under this chapter for prior taxable years which would result solely from taking into account such portion in the taxable years to which it is attributable.*

In this case the taxpayer was arguing that the provision in IRC §36B(d)(2)(B)(iii) refers to amounts of social security "for the taxable year." Such amounts, the taxpayer argues, should only refer to amounts of social security attributable to 2014 (the year before the Court) and not benefits attributable to an earlier year that just happen to have been paid in 2014. Or, at the very least, IRC §36B is ambiguous on this point and the result (having him repay the credit based on the delay in receiving his social security benefits) is contrary to Congress' intent in enacting the premium tax credit.

The Tax Court disagreed with that reading. The Court notes that a basic tenet of tax law is that those who report on the cash basis of accounting (as this taxpayer does) report income when received:

> *The year of <u>receipt</u>, as opposed to the year to which the Social Security benefits <u>are attributable</u>, is the significant definitive factor. See secs. 441, 451. It is an established legal principle that a cash method individual generally reports income in the year it is received, even if the benefits are attributable to a prior year. See sec. 451(a); sec. 1.451-1(a), Income Tax Regs. In that regard petitioner agrees that the Social Security benefits attributable to 2013 are "technically taxed" in the year received. Accordingly, the phrase "for the taxable year" is not ambiguous.*

The taxpayer argues this is not significant, arguing:

> *Petitioner argues, however, that "[a]lthough the lump-sum payment [relating to 2013] is technically taxed in the year the lump-sum payment is received, a portion of it is includible in income only because it is attributable to tax owed in a prior taxable year under [s]ection 86." That is, the Social Security benefits received in 2014 but attributable to 2013 are not Social Security benefits received "under section 86 for the [2014] taxable year".*

The Tax Court did not find this argument persuasive:

> *Although section 36B and its accompanying regulations are silent with regard to the effect, if any, on MAGI if a taxpayer makes a section 86(e) election, section 36B and the underlying regulations provide that Social Security benefits received in a taxable year that were "not included in gross income under section 86 for the taxable year" must be added to a taxpayer's MAGI. Sec. 36B(d)(2)(B)(iii); see sec. 1.36B-1(e)(2), Income Tax Regs. Petitioner, however, misinterprets the application of section 36B when a section 86(e) election has been made. A section 86(e) election determines the amount*

> *included in gross income for the year of receipt. Petitioner's section 86(e) election simply determined which amount of the lump-sum payment attributable to 2013 should be included in his gross income for 2014. We find that the phrase "under section 86" is not ambiguous and the cross-reference requires the consideration of section 86 in its entirety, including section 86(e).*

Thus, the Court concludes:

> *For the aforementioned reasons, we hold that the text of the statute is not ambiguous and that petitioner must include in his MAGI all of the Social Security benefits received in 2014, irrespective of the section 86(e) election. As a result, petitioner's adjusted gross income is increased by the amount of Social Security benefits not included in gross income and, as explained below, his MAGI exceeds the established threshold for PTC eligibility by a relatively small amount.*

## Section: 199A
## §199A Signed Safe Harbor Statement Must be Attached as a PDF to an E-Filed Return

### Citation: Eric Yauch, "IRS Open to Additional Guidance on Portions of 199A," Tax Notes Today, 3/11/19

If a taxpayer is electing making the safe harbor election for a real estate enterprise under Notice 2019-07 and electronically filing his/her return, a signed copy of the election must be submitted as a PDF attachment to e-filed return reports *Tax Notes Today*. In an article in the March 11, 2019 edition of *Tax Notes Today*, Eric Yauch reports that IRS Office of Chief Counsel Attorney Robert Alinsky confirmed that requirement while speaking at the Federal Bar Association Conference in Washington.[1]

Notice 2019-07, issued concurrently with the final regulations under IRC §199A, provided a draft revenue procedure that allowed a safe harbor election to treat a real estate enterprise as a trade or business which would qualify for the deduction of a qualified business income amount under IRC §199A. The Notice provided that taxpayers may rely on the proposed revenue procedure until the final revenue procedure is issued by the IRS.

Section 3.06 of the draft revenue procedure provides for the following procedural requirements to apply the safe harbor:

> *A taxpayer or RPE must include a statement attached to the return on which it claims the section 199A deduction or passes through section 199A information that the requirements in Section 3.03 of this revenue procedure have been satisfied. <u>The statement must be signed by the taxpayer, or an authorized representative of an eligible taxpayer or RPE,</u> which states: "Under penalties of perjury, I (we) declare that I (we) have examined the statement, and, to the best of my (our) knowledge and belief, the statement contains all the relevant facts relating to the revenue procedure, and such facts are true, correct, and complete." The individual or individuals who sign must have personal knowledge of the facts and circumstances related to the statement.*

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[1] Eric Yauch, "IRS Open to Additional Guidance on Portions of 199A," *Tax Notes Today*, https://www.taxnotes.com/tax-notes-today/partnerships-and-other-passthrough-entities/irs-open-additional-guidance-portions-199a/2019/03/11/29737 (subscription required), 2019 TNT 47-15

The article reports the IRS has received comments on how to handle this signature requirements on e-filed returns. On online tax professional discussion forums some had wondered the electronic signature on the e-filed return itself would suffice to meet this requirement. Mr. Alinsky clarified this point, noting that the statement itself must be signed and then attached to the return.

As the article states:

> *"The rule is that it has be a separate, signed statement attached to the return," Alinsky said. "So, if you are e-filing, you have to have a separate statement and PDF it and attach it to the return."*[2]

## Section: 6212
## Filing Forms 2848 and 4868 Did Not Serve as Proper Notice of Taxpayers' New Address

### Citation: Gregory v. Commissioner, 152 TC No. 7, 3/13/19

The IRS is under obligation only to mail notices to the taxpayer's last known address in order to start the clock running on the time period to take specific actions. In the case of *Gregory v. Commissioner*, 152 TC No. 7, the Tax Court ruled that neither Form 2848, *Power of Attorney and Declaration of Representative*, nor Form 4868, *Application for Automatic Extension of Time to File U.S. Individual Income Tax Return*, served to change a taxpayer's last known address.

In the case before the Tax Court the taxpayers had moved from Jersey City, NJ to Rutherford, NJ in June of 2015. However, after the move in error they listed their old address on their 2014 income tax return when they filed it in October of 2015. This mistake led to the following events:

> *On October 13, 2016, the Commissioner sent by certified mail a notice of deficiency to the Gregorys at their Jersey City address. At that time the Gregorys had not yet filed their 2015 Federal income tax return. On November 11, 2016, the U.S. Postal Service marked the notice "Return To Sender/Unclaimed/Unable to Forward" and returned it to the Commissioner. The parties do not dispute that the Gregorys did not actually receive the notice of deficiency.*
>
> *The Gregorys became aware of the notice of deficiency on January 17, 2017, and filed their petition that day.*

Since January 17, 2017 is more than 90 days after October 13, 2016, the IRS argued that their petition had not been timely filed with the Tax Court and asked that their petition be dismissed for lack of jurisdiction.

The Gregorys had sent documents to the IRS between the date they filed their 2014 tax return using the wrong address and when the IRS issued the notice of deficiency. Those documents had shown the proper address in Rutherford. The Gregorys contended that these documents should serve as putting the IRS on notice with regard to their new address.

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[2] Ibid.

IRC §6212 which governs the process by which the IRS issues the notice of deficiency to the taxpayer provides:

> *(a) In general*
>
> *If the Secretary determines that there is a deficiency in respect of any tax imposed by subtitles A or B or chapter 41, 42, 43, or 44 he is authorized to send notice of such deficiency to the taxpayer by certified mail or registered mail. Such notice shall include a notice to the taxpayer of the taxpayer's right to contact a local office of the taxpayer advocate and the location and phone number of the appropriate office.*
>
> *(b) Address for notice of deficiency*
>
>> *(1) Income and gift taxes and certain excise taxes*
>>
>> *In the absence of notice to the Secretary under section 6903 of the existence of a fiduciary relationship, notice of a deficiency in respect of a tax imposed by subtitle A, chapter 12, chapter 41, chapter 42, chapter 43, or chapter 44 if mailed to the taxpayer at his last known address, shall be sufficient for purposes of subtitle A, chapter 12, chapter 41, chapter 42, chapter 43, chapter 44, and this chapter even if such taxpayer is deceased, or is under a legal disability, or, in the case of a corporation, has terminated its existence.*

The term "last known address" is defined in Reg. §301.6212-2 which begins:

> ***(a) General rule.*** *Except as provided in paragraph (b)(2) of this section, a taxpayer's last known address is the address that appears on the taxpayer's most recently filed and properly processed Federal tax return, unless the Internal Revenue Service (IRS) is given clear and concise notification of a different address. Further information on what constitutes clear and concise notification of a different address and a properly processed Federal tax return can be found in Rev. Proc. 90-18 (1990-1 C.B. 491) or in procedures subsequently prescribed by the Commissioner.*

As of October 13, 2016 the most recently filed and properly processed tax return of the Gregorys was that 2014 return showing the old address. However, since that time they filed a Form 2848 power of attorney form (filed in November 2015) and an extension request, presumably for their 2015 income tax return, in April of 2016. Both of these forms listed the Gregory's current address in Rutherford.

Revenue Procedure 2010-16 is the most current IRS ruling on what constitutes a tax return and neither of those forms is listed as being a return. In fact, at Section 5.01(4) of the procedures the IRS states:

> *The term "return" does not include applications for extension of time to file a return or powers of attorney. Thus, for example, a new address listed on Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return, or on a Form 2848, Power of Attorney and Declaration of Representative, will not be used by the Service to update the taxpayer's address of record.*

But the regulation cited above provides that even the last return filed and processed contains a no longer valid address, the taxpayer's address can still be updated by giving clear and concise notice to the IRS of the address change.

But the Tax Court points out that the instructions to both forms make clear that they will not serve to the IRS on notice of an address change:

> *Form 2848 and its instructions make clear that the form does not provide the Commissioner with clear and concise notification that the taxpayer's address has changed. The instructions to the 2014 Form 2848 explicitly state: "Address information provided on Form 2848 will not change your last known address with the IRS." The 2014 Form 2848 also explicitly cautions users that it will "not be honored for any purpose other than representation before the IRS." The Commissioner has conveyed to taxpayers that Form 2848 will not change their last known address. In effect, the Gregorys used forms that explicitly state that they are not to be used to update a taxpayer's address but now want the Commissioner to honor those forms to update to their address.*
>
> *Similarly, the instructions to the 2015 Form 4868 warn taxpayers that filing the form will not update their address. The instructions state: "If you changed your mailing address after you filed your last return, you should use Form 8822, Change of Address, to notify the IRS of the change. Showing a new address on Form 4868 will not update your record."*

The opinion also cites an additional provision in Rev. Proc. 2010-16 found at Section 5.04(1)(a) that provides:

> *Clear and concise written notification is a written statement signed by the taxpayer and mailed to an appropriate Service address informing the Service that the taxpayer wishes the address of record changed to a new address. In addition to the new address, this notification must contain the taxpayer's full name and old address as well as the taxpayer's social security number, individual taxpayer identification number, or employer identification number. Filers of a joint return should provide both names, social security numbers, and signatures. Individuals who have changed their last name should provide the last name shown on the most recently filed return and the new last name. In all cases, clear and concise written notification must be specific as to a change of address. Thus, a new address reflected in the letterhead of taxpayer correspondence will not by itself serve to change a taxpayer's address of record.*

The Tax Court had previously held, in the case of *Hunter v. Commissioner*, TC Memo 2004-81, that a Form 2848 had served to provide the IRS with proper notice of an address change. But the Tax Court points out that this case can no longer be relied upon, as the instruction for Form 2848 at the time the Hunters filed that form did not put taxpayers on notice that it would not serve to update their address with the IRS. Based on those instructions, the Hunters could reasonably assume that their last known address would be updated once the IRS received that form.

But in the interim the IRS has changed the instructions to Form 2848, so the Court notes:

> *But that assumption is no longer reasonable. Since 2004 the Commissioner has issued clear guidance informing taxpayers of what actions will and will not change their last known address with the Commissioner. We noted in Hunter that section 301.6212-2, Proced. & Admin. Regs., which had been issued in January 2001 to define the term "last known address", was not yet effective; it is effective for this case. And at the time we decided Hunter, Rev. Proc. 2001-18 had not yet been superseded by Rev. Proc. 2010-16. The earlier revenue procedure did not specifically address Form 2848. And perhaps most notably, the warning on the Form 2848 that it would not be used for any purpose other than representation was not included in the form at issue in Hunter, and the instructions to Form 2848 were silent regarding a taxpayer's last known address. The Forms 2848 at issue here expressly state that they will not be honored for any purpose other than representation before the IRS.*

Thus, neither Form 2848 nor Form 4868 will serve to change the taxpayer's last known address for purposes of issuing a notice of deficiency—a fact that will affect the beginning the running of the 90 day period to file a petition with the Tax Court when the letter, being mailed to the old address, is not received by the taxpayer.

## Section: 6699
## No Harm, No Foul Does Not Create Reasonable Cause for Late Filing of S Corporation Return

### Citation: ATL & Sons Holding Inc. v. Commissioner, 152 TC No. 8, 3/13/19

The taxpayer in the case of *ATL & Sons Holding Inc. v. Commissioner*, 152 TC No. 8, sought to have the Tax Court order the IRS to stop pursuing a failure to file penalty imposed on the taxpayer's S corporation. The taxpayer argued that there had been no harm to the government since the shareholders had timely filed their personal returns and reported the income. While they may not have applied for an extension of time to file the S corporation return, they had filed for such an extension on their personal return and filed within the time period for such filing.

IRC §6699 provides, in part:

> *(a) General rule*
>
> *In addition to the penalty imposed by section 7203 (relating to willful failure to file return, supply information, or pay tax), if any S corporation required to file a return under section 6037 for any taxable year—*
>
> > *(1) fails to file such return at the time prescribed therefor (determined with regard to any extension of time for filing), or*
> >
> > *(2) files a return which fails to show the information required under section 6037,*
>
> *such S corporation shall be liable for a penalty determined under subsection (b) for each month (or fraction thereof) during which such failure continues (but not to exceed 12 months), unless it is shown that such failure is due to reasonable cause.*
>
> *(b) Amount per month*
>
> *For purposes of subsection (a), the amount determined under this subsection for any month is the product of—*
>
> > *(1) $195, multiplied by*
> >
> > *(2) the number of persons who were shareholders in the S corporation during any part of the taxable year.*

The S corporation return in question, while due on March 15, 2013, was not actually filed until September 13, 2013. All of the S corporation stock was held by Mr. and Mrs. Allen. They had filed a Form 4868, *Application for Automatic Extension of Time to File U.S. Individual Income Tax Return*, prior to the due date of their personal return in April 2013 and timely filed their personal return on October 14, 2013. Their return properly reported the information contained on the K-1 issued by the corporation.

The taxpayers argued the penalty should not apply since there was no harm to the Government—all income was reported and tax paid timely. But the Tax Court did not accept that view, noting:

> *…an S corporation is an entity separate from its shareholders. In general, the S corporation does not incur a liability for Federal income tax. Sec. 1363(a). But see infra note 9. Rather, its shareholders are taxed on their respective shares of the S corporation's income. Sec. 1366(a)(1). As we noted above, an S corporation is required to file an annual information return on its own Form 1120S, and on that return it reports its own income, deductions, and other matters. Sec. 6037(a); 26 C.F.R. sec. 1.6037-1(a), Income Tax Regs. To extend the time to file the S corporation return, a separate form — Form 7004 — is required. See 26 C.F.R. sec. 1.6081-3(a)(1), Income Tax Regs.; 2012 Instructions for Form 1120S. ATL did not file Form 7004 nor any other document requesting an extension of the deadline for filing its 2012 Form 1120S.*

But IRC §6699(a) does provide that the penalty will not apply if the failure is due to reasonable cause. The taxpayers argued what some have tried in many situations to use to justify not following the clear requirements of the law—that so long as the Treasury isn't harmed by the loss of revenue, there should be no penalty for noncompliance.

The Tax Court rejects that argument in this case:

> *…ATL argues that the reasonable cause exception should apply because ATL's two shareholders were aware of the business loss for taxable year 2012 and "no one else has been harmed" — i.e., no harm, no penalty. ATL evidently conceives that the sole purpose of the Form 1120S is to give a shareholder the information that he or she needs in order to file a Form 1040 tax return; and since Mr. and Mrs. Allen knew the affairs of ATL, did eventually file their Form 1040 timely (under an extension), and did not fail to report any income, the intended purpose of the S corporation's filing requirement was accomplished and the penalty was moot. ATL cites no authority in support of its claim that the penalty should be waived on the grounds that its two shareholders were aware of the information to be shown on the return. Section 6699 does not include a condition of harm before the penalty is imposed; it simply imposes a penalty when the filing is late (without reasonable cause). A taxpayer may not disregard a filing deadline and be excused from this penalty simply because it reckons that no harm was done.*

The Tax Court also used this case to expand the penalties that it holds are covered by IRC §6751(b)(2)'s exception to requiring supervisory approval before a penalty is assessed by the IRS. As was true in the case of *Walquist v. Commissioner*, 152 TC No. 3, the Tax Court determined this was a case of an "automatically calculated" penalty as described in IRC §6751(b)(2). Such penalties do not require approval by a supervisor before a penalty is imposed, a rule that applies under the general rule of IRC §6751(b)(1).

The Tax Court rejected the taxpayer's contention that, because the penalty does not apply if reasonable cause existed for the failure to timely file, the penalty is not truly automatically calculated. A supervisor should have been involved to determine that such reasonable cause did not exist before the penalty was assessed.

The Tax Court points out that there is a list of specific penalties excepted in IRC §6751(b)(2)(A), along with "other automatically calculated penalties." Most of the specifically listed penalties have a reasonable cause exception, yet the Court notes the law seems to view them as automatically calculated penalties, pointing out the reference to *other* automatically penalties in §6751.

While the penalty under IRC §6699 is not in that list, the Court finds it still can be an "automatically calculated" penalty:

> *Evidently, a penalty can be "automatically calculated" for purposes of section 6751(b)(2)(B) even if non-arithmetical issues might be invoked to challenge the liability so calculated. The section 6699 penalty applies unless reasonable cause "is shown" — i.e., shown by the taxpayer.*

The Court in this case doesn't indicate in this case if the taxpayer had originally challenged the penalty prior to assessment—the case arose as a collection due process (CDP) case, so it seems likely the taxpayer failed to initially challenge the penalty's imposition.

In the *Walquist* case the Court had noted that if the taxpayer had protested the substantial understatement penalty in a timely fashion, then the IRS position was that supervisory approval was needed to assess the penalty. That issue is not addressed in this case, but presumably if the taxpayer had presented what the taxpayer asserted was reasonable cause in response to the notice that supervisory approval of assessing the penalty would likely be deemed to be required under §6751 by the Court.