Current Federal Tax Developments

Week of June 10, 2019

Edward K. Zollars, CPA
(Licensed in Arizona)

ACCOUNTING
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CURRENT FEDERAL TAX DEVELOPMENTS
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Section: 1362
Disregarded Entity Holding S Corporation Stock Terminated Election When Entity Obtained a Second Sharholder

Citation: PLR 201922002, 5/31/19

LLCs were created by the state of Wyoming years ago to be an entity that the IRC had no way to classify. That status has continued to today—an LLC is not an entity type for federal income tax purposes, even though it is an entity type for most other purposes under state law. Eventually the IRS decided to deal with the entity type issue by using what we refer to as a "check the box" election.

The check the box regulations, found at IRC §301.7703-3, allow the taxpayer to choose between certain entity types based on the number of equity holders of the LLC. In essence, we pretend, for federal tax purposes, that the LLC is really some other entity.

Generally taxpayers have liked this flexible approach, but from time to time taxpayers are bitten by forgetting that the fact that even though the underlying legal entity doesn't change, the pretend tax entity can end up changing when a new member is either brought into the LLC or acquires an interest in the LLC from an existing member.

That was the problem the taxpayer faced that led to the private ruling request (and costs) in PLR 201922002.[1] The problem arose due to the complications inherent when shares in an S corporation are held by an LLC.

For a corporation to retain an S election, all shares must be held by eligible shareholders. Individuals, estates and certain trusts are among those that are eligible shareholders[2], but partnerships are not in that list.

EXAMPLE

Mary purchases 100 shares of Kelly Manufacturing, Inc., an S corporation. She is a U.S. citizen shareholder and holds the 100 shares personally. The 100 shares represent all of the outstanding shares of Kelly Manufacturing. In this case, all shares of Kelly Manufacturing, Inc. are held by shareholders eligible to hold S corporation shares. Assuming all other requirements are met, Mary's acquisition of all of the shares of Kelly will not, by itself, terminate Kelly's S election.

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If an LLC has only one owner, by default the entity is disregarded, and any assets held by the LLC (including shares of a corporation) are treated as held by that owner. If that owner is an eligible S shareholder, having the shares held by the LLC is not an issue—because the tax law ignores the LLC, the shares are treated as being held by an eligible shareholder.

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[1] https://www.irs.gov/pub/irs-wd/201922002.pdf, retrieved from website on May 31, 2019

[2] IRC §1362(a)(1)(B)

EXAMPLE

Mary hears about this LLC thing and reads about them on the internet. She decides to form a domestic LLC of which she owns all of the interests. She transfers the Kelly Manufacturing shares into this LLC. Kelly does not make an explicit check the box election to have the LLC treated as a corporation.

Since, without an election to be treated as a corporation, this LLC is a disregarded entity, the shares continue to be deemed held by Mary and Kelly Manufacturing continues to be treated as an S corporation for income tax purposes.

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However, if even a very small interest in the LLC is issued to or transferred to another party, the LLC's default status changes to a partnership immediately upon the transfer. Since a partnership is not an eligible S shareholder, an existing S election would be terminated when a second owner holds any interest in the LLC. Only if the LLC holds 100% of the corporation stock, is itself eligible to and does make an S election on formation, and a QSUB election for the corporation owned by the LLC can the S election continue once there is a second interest holder in the LLC.

EXAMPLE

Mary continued her reading on the internet and learned that she could gift up to $15,000 worth of her interest in the LLC each year to her daughter, Denise, with no gift tax return required—and it would remove the interest and appreciation from her estate at her death. Mary decides to not waste any time, and immediately transfers an interest in the LLC valued at $15,000 to Denise. This gives Denise 1% of the LLC member interests. Again, no check the box election is filed at this time.

Under the check the box regulations, the LLC is now treated as a partnership. Under the make-believe world of the check the box rules, Mary is treated as having distributed a proportionate interest in the assets to Denise. Denise then turned around and, with her mother, formed a new partnership with each member contributing their share of the assets to the new partnership.

As was noted earlier, a partnership is not an eligible S shareholder. So Kelly Manufacturing is treated as having its S election terminated at the end of the day before the transfer, with Kelly now being taxed as a C corporation.

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The S corporation in PLR 201922002 faced this problem—what had been a disregarded entity became a partnership when the entity gained a second interest holder. Eventually the problem was noticed and it was decided to approach the IRS to obtain relief.

The good news is that the IRS is authorized to provide such relief for inadvertent terminations per IRC §1362(f). In this case there was no intent to somehow gain a tax advantage that wasn't otherwise available—rather, it appears to have been a matter of simple ignorance of the law leading to shares being held by an ineligible shareholder (the deemed partnership).

The previously disregarded entity (now a deemed partnership) agreed to transfer the shares to the individual who previously owned 100% of the disregarded entity. The IRS agreed to grant the taxpayer relief as if the termination had never taken place.[3]

But now for the bad news—such relief can only be obtained by applying for a private letter ruling since the IRS's consent must be obtained. That will require the payment of a user fee for the ruling (based on the current year's schedule of such fees), the preparation of the formal request and the additional time and expense involved in working with the IRS attorney assigned to the matter to negotiate the terms of any relief, as well as getting the IRS the attorney any information he/she feels is necessary to determine if the requested relief should be granted.

EXAMPLE

Mary now finds an article on the internet describing this issue and realizes that the S election hasn't survived the transfer of an interest in the LLC. Her daughter agrees to return the interest in the LLC to Mary.

Although Mary did not intend to terminate the S election and did not otherwise have a "tainted" reason to attempt to avoid S corporation restrictions, her actions do not serve to retroactively restore the corporation's S election. Unless she applies for the private letter ruling and obtains specific relief from the IRS, the corporation remains a C corporation.

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Some may be thinking that they've never heard of the IRS ever catching something like this—the agent won't look for evidence of any prior transfers and it is so costly to get relief it's fine to just do what Mary did. The argument is that such advice is "real world" advice and suggesting that anything else should be done is doing the client a disservice.

Not quite—while it may be true that the likelihood of the IRS catching this issue is small (but not zero, to be clear), there are other parties who might (and often do) discover the issue. For instance, say Mary is contacted by a public company that is interested in acquiring Kelly Manufacturing to integrate it into their business. All is fine—but they require Mary consent to having the corporation's activities reviewed by a due diligence team.

A due diligence review will likely turn up this issue, either because the LLC still has its interests held by multiple people (which is highly likely—Mary discovering this problem is virtually zero if she continues to avoid paying for professional advice) or because the team specifically inquires of Mary regarding if there had ever been multiple owners of the LLC. Once the issue is uncovered by the due diligence team, the sale will likely go "on hold" until Mary can provide assurance the IRS won't attempt to assert there are unpaid C corporation taxes—and this triggers the need to obtain the PLR. As well, in this case, the buyer will likely insist that their due diligence team must be involved in the PLR request, with all costs of the request (including the due diligence team's billable hours) paid for by the seller.

[3] PLR 201922002.pdf, pp. 2, 4

Section: 1402
Author Could Not Divide Payments From Her Publisher to Exclude Portion from Self-Employment Income

Citation: Slaughter v. Commissioner, TC Memo 2019-65, 6/4/19

An author attempted to argue that income from her publisher should be divided between income from writing, which would be subject to self-employment tax, and income related to other items covered by her contract are not subject to self-employment. However, in the case of *Slaugther v. Commissioner*, TC Memo 2019-65[4] the Tax Court did not agree with her view.

The taxpayer in question is a well-known and successful author. During the years involved in this case, the taxpayer spent from 12 to 15 weeks engaged in writing. In addition, during those years she spent additional time building as a *brand author*. The opinion describes a brand author as "one who provides prestige or reliable profits to a publishing house."[5] She spent significant additional time meeting with publishers, agents, media contacts and others to "protect and further her status as a brand author."[6]

The taxpayer received two types of payments from her publisher each year. One type is a nonrefundable advance, while the second is a royalty based on revenue or profits from the work in question. She was not paid any amount from the royalty payment category until the total computed amount for that category exceeded the nonrefundable advance she had already been paid.[7]

The author's position was that while her writing may be self-employment income, most of what she was paid was for, effectively, being herself—that is, the "brand" of the taxpayer.

The Tax Court described the rights beyond just the ability to publish the manuscript that are found in the contracts:

> *The contracting publishers receive more than just the right to print, publish, distribute, sell, and license the works and manuscripts written, or to be written, by petitioner. They also secure the right to use her name and likeness in advertising, promotion, and publicity for the contracted works. Petitioner is required to provide photos and be available for promotional activities. The contracts include noncompete clauses which vary in scope, from requiring that the specified manuscript be completed before others, to prohibiting petitioner's entry into another contract until her writing obligations are met. Publishers also secure the right to advertise other works in petitioner's books, qualified by the requirement that petitioner consent to the specific advertisements. Several of the contracts allow for, but do not require, a share of advertising proceeds to be paid to petitioner as a condition of her consent. Finally, the contracts include an exclusive option for the respective publisher to negotiate the contract for petitioner's next works.*

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[4] https://ustaxcourt.gov/UstcInOp/OpinionViewer.aspx?ID=11963

[5] *Slaugther v. Commissioner*, TC Memo 2019-65, p. 3

[6] *Ibid*

[7] *Ibid,* pp. 3-4

Petitioner also receives more than just her advances and royalties. For instance, some contracts include a marketing guaranty requiring the publisher to spend a minimum amount on marketing for petitioner's books. Although the publishers fund the marketing plan, petitioner's agent retains the authority over its development. Another example is petitioner's option to purchase the publisher's plates at a reduced cost for any book that goes out of print and that the publisher refuses to reissue or license. In that instance, the rights in the work also revert to petitioner.

The various requirements of the contracts and the additional benefits described above appear to be standard in the publishing industry. It is not standard, however, to assign a particular value to such rights and benefits in the contracts. Petitioner's contracts are no exception; they do not allocate the advances or royalties between writing the works, promoting the works, noncompete clauses, or exclusive options.[8]

The accounting firm that worked with the author to prepare her return came to the conclusion that the taxpayer's income could be bifurcated between income for writing, which would be self-employment income, and income from the non-writing portions of the payment, which would not be subject to self-employment taxes. As the opinion continues:

To prepare her 2010 and 2011 returns, petitioner turned to the same tax preparation firm she has worked with for approximately 20 years. Several people from the firm, including Karen Wesley, a certified public accountant, worked together to prepare petitioner's 2010 and 2011 returns. Ms. Wesley has been licensed since 1989, prepares roughly 300 tax returns per year, and has worked with petitioner for approximately eight years. In order to prepare the returns, petitioner first met with a bookkeeper and then with Ms. Wesley to review questions and ensure that the firm had everything it needed. For each return, the firm worked as a team and addressed any follow-up issues with petitioner on the phone. After finalizing the return, petitioner reviewed it with Steve Harless, the paid preparer who signed the return.

Over the course of working with petitioner and talking with petitioner's agent, it became apparent to Ms. Wesley that petitioner was compensated for more than simply writing. Ms. Wesley came to understand that an author's earned income is generally the amount paid for actually writing but that petitioner's income was higher because she was also paid for her name and likeness. Ms. Wesley concluded that any amount paid to petitioner for the use of her name and likeness was "investment income", i.e., payment for an intangible asset beyond that of her trade or business as an author. Ms. Wesley noted the distinction between investment income and income generated from writing because, in her opinion, only the latter would give rise to self-employment tax. Ms. Wesley therefore concluded that petitioner should pay self-employment tax only on the amount that publishers pay her for writing and not on amounts paid for her name and likeness.

Although the preparers conducted research to determine the income allocable to petitioner's trade or business, they found no definitive authority in the particular instance of a brand author's income.[9]

The accounting firm did run into a problem about how to divide up the income, since the publisher did not separately designate payments for "pure writing" separate from those related

[8] *Ibid.*, pp.4-5

[9] *Ibid.*, pp 7-8

to the author's brand. The Tax Court described how the firm went about dividing up this income and reporting it, noting the accounting firm:

> *… decided to report all of the advances and royalties petitioner received on a Schedule E, Supplemental Income and Loss, subtract the portion relating to the trade or business of writing, and report that amount on a Schedule C, Profit or Loss From Business. The Schedule C amount, therefore, represents the team's calculation of petitioner's trade or business income. The preparers calculated the amount of petitioner's self-employment tax due using only the Schedule C income amount; they did not calculate any self-employment tax due from the balance of the advances and royalties left on Schedule E.*
>
> *The accounting team did not have copies of petitioner's publishing contracts. To calculate the amount reported on petitioner's Schedule C, the preparers used a calendar-based approach. They applied the percentage of the year which petitioner spent writing to the total payments she received for the year. Petitioner did not provide the preparers with a work calendar. Instead, the preparers relied on petitioner's statement that it took her roughly 12 to 15 weeks to produce a manuscript for a publisher. The preparers applied a 12-week period and assumed a five-day workweek because petitioner told them she occasionally took time off from writing. For the 2011 tax year the percentage reported was higher than that for 2010 because petitioner spent more time writing.*
>
> *No other adviser recommended apportioning the income in the foregoing manner, and no appraiser was employed to value petitioner's contracts or opine on the calendar-based approach. The only individuals outside the accounting firm with whom the team discussed their conclusions were petitioner and her agent.*[10]

The IRS did not agree that the income could be divided in this manner. The IRS argued that all her activities fit the definition of self-employment income found in IRC §1402(a) which provides in part:

> ***(a) Net earnings from self-employment*** *The term "net earnings from self-employment" means the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle which are attributable to such trade or business, …*

In the IRS's view all the payments the taxpayer received from the publisher represented trade or business income related to her writing trade or business.

The taxpayer argued that Rev. Rul. 68-499 supported her position. That ruling dealt with two employees who were among five people the employer paid for licenses to manufacturer items for which the five individuals held patents. The other three individuals receiving payments were not employees of the company paying the royalties.

The ruling held that the payments to the two employees represented a royalty payment that was separate and distinct from the wages paid, and that the royalties were not subject to payroll taxes, nor were they to be included in the employees' W-2s. The taxpayer argued that the same result should occur in her case—that this justified her "non-writing" work being treated separately from the brand assets (effectively, just being her) that she was being paid for.[11]

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[10] *Ibid.,* pp. 8-9

[11] *Ibid.,* p. 16

The Tax Court found, though, that the ruling wasn't relevant because self-employment income's definition is tied to *income related to a trade or business*, which is distinct from the definition of wages (which generally looks at payment to an employee for services). As the Court stated:

> *Petitioner's analogy fails because it attempts to adapt out-of-context definitions of employment to the definition of trade or business income under section 1402. We are not able to focus solely on the words "net earnings" to the exclusion of the words "trade or business". The statute provides that "net earnings from self-employment" includes income derived from any trade or business. An allocation within petitioner's contracts is beside the point if all elements are to be allocated to a trade or business.*[12]

The Tax Court found that all the "brand" activities the taxpayer engaged in were clearly related to her trade or business of being an author:

> *We conclude that petitioner's brand is part of her trade or business. We construe "trade or business" broadly, and, examining all of the facts, find that petitioner was engaged in developing her brand with continuity and regularity for the primary purpose of income and profit. See Jones v. Commissioner, T.C. Memo. 1998-354; Dacey v. Commissioner, T.C. Memo. 1992-187; Hittleman v. Commissioner, T.C. Memo. 1990-325. Petitioner set out in a businesslike fashion to obtain stationery, a reputable agent, and a publishing contract. Petitioner worked with a media coach and publishers to develop a successful brand. She has spent time, including during 2010 and 2011, meeting with publishers, agents, media contacts, and others to protect and further her status as a brand author. She attended interviews and promotional events and works to develop and maintain good relationships with booksellers and librarians. Petitioner also uses social media, websites, and a newsletter to maintain her brand with her readership. Further, it is common in the publishing industry for writers to build brands and promote their work. We have held that an author's TV and radio appearances, for example, are evidence that a taxpayer is in the trade or business of writing rather than writing as a hobby. See, e.g., Dacey v. Commissioner, T.C. Memo. 1992-187.*[13]

The issue of what is a trade or business arises quite frequently under the IRC and the Court noted that the same arises when determining what is included in self-employment income. The Court also makes clear that the view of what is included in the trade or business is a broad one for self-employment purposes. But advisers must remember that §1402(a)(1) has a long list of items that are specifically excluded from self-employment income, such as interest, dividends and rentals of real estate, that will exclude items from self-employment income even if the item is otherwise related to the trade or business.

As well, this case reminds us that although self-employment income and FICA wage seem to be a similar concept, there are not the same thing and the fact that something may fall into one category in one situation, say when someone is an employee, does not mean the same treatment will arise when the question arises in the other context.

EXAMPLE

Assume the two employees referenced in Rev. Rul. 68-499 were not employees, but rather each had a sole proprietorship where they performed services for a company manufacturing the product under license and granted that organization the right to manufacture the product that involved the patent they owned.

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[12] *Ibid*, pp. 17-18

[13] *Ibid*., pp. 18-19

In this case, both the payment for the services rendered to the manufacturer and the amount the manufacturer is paying for the use of that patent would likely be considered part of the same trade or business for self-employment tax purposes.

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Section: 3402
Revised Draft Publication for Computing Withholding by Employers Issued to Go Along with Draft 2020 W-4

Citation: Publication 15-T, Federal Income Tax Withholding Methods, 6/7/19

The IRS has unveiled a draft of the employer publication to make use of the 2020 draft Form W-4 to compute payroll check withholdings in Publication 15-T, *Federal Income Tax Withholding Methods*.[14] The publication is being issued to assist employers in getting systems ready for 2020 withholding.

The nine page publication has 2 pages devoted to instructions[15], a full page Employer's Withholding Worksheet[16] outlining calculations for both the wage bracket and percentage method of withholdings, a page of withholding method tables[17], and ends with five pages containing the wage bracket method tables.[18]

The draft publication has only the weekly wage bracket withholding tables and uses the 2019 values. The final version will contain all of the bracket withholding tables and will be updated for the 2020 values.

The employer worksheet for employees that file new W-4s for 2020 has the employer compute an annualized income for the employee based on the current payroll. That annualized income is used to determine the withholding for the employee. The employees are instructed to enter dependent credit information and income/deduction adjustments only on the W-4 for the highest earning job for the tax filing unit (such as the higher earning spouse for a married couple that each has one job, or the higher earning job for a single individual who holds two jobs).

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[14] https://www.irs.gov/pub/irs-dft/p15t--dft.pdf, accessed June 7, 2019

[15] Draft Publication 15-T, *Federal Income Tax Withholding Methods*, June 6, 2019, pp. 1-2

[16] *Ibid*, p. 3

[17] *Ibid*, p. 4

[18] *Ibid*, p. 5-9

The worksheet serves to translate the data provided on the revised Form W-4 into a withholding amount. The draft Form W-4 contains the following information:

Form **W-4**

Department of the Treasury
Internal Revenue Service

Employee's Withholding Allowance Certificate

▶ Complete Form W-4 so that your employer can withhold the correct federal income tax from your pay.
▶ Give Form W-4 to your employer.
▶ Your withholding is subject to review by the IRS.

OMB No. 1545-0074

2020

Step 1: Enter Personal Information

1a First name and middle initial | Last name | **1b Social security number**

Home address (number and street)

City or town, state, and ZIP code

▶ **Does your name match the name on your social security card?** If not, to ensure you get credit for your earnings, contact SSA at 800-772-1213 or go to *www.ssa.gov*.

1c ☐ **Single or Married filing separately** ☐ **Married filing jointly**
☐ **Head of household** (Check only if you're unmarried and pay more than half the costs of keeping up a home for yourself and a qualifying individual.)

Complete Steps 2 through 4 if they apply to you; otherwise, skip to Step 5. See instructions on page 2.

Step 2: Account for Multiple Jobs

Caution: The correct amount of withholding depends on income earned from all jobs in the household. If you:
- Hold more than one job at a time, or
- Are married filing jointly and both you and your spouse work,

account for this below or you may owe additional tax when filing your tax return.
(If you and/or your spouse have income from self-employment, see page 2.)

2 **Multiple jobs.** Do **only one** of the following.
- Use the calculator at *www.irs.gov/W4App* for most accurate withholding; **or**
- Use Worksheet 1 on page 3 and enter the result on line 4c below for roughly accurate withholding; **or**
- If there are only two jobs in your household, you may check here. Do the same on Form W-4 for the other job. With this option, more tax than necessary may be withheld from your wages, but you generally won't have too little tax withheld . . . . ▶ ☐

Complete lines 3 through 4b on Form W-4 for only one job in the household. (Your withholding will be most accurate if you do this on the Form W-4 for the highest paying job.)

Step 3: Claim Dependents

3 **Dependents.** If your income will be $200,000 or less ($400,000 or less if married filing jointly) (see instructions):
- Multiply the number of qualifying children under age 17 by $2,000 ▶ $
- Multiply the number of other dependents by $500 . . . . ▶ $

Add the amounts above and enter the total here . . . . **3** $

Step 4: Other Adjustments (optional)

4a **Other income.** If you want tax withheld for other income you expect this year that will not have withholding, enter the amount of other income here. This may include interest, dividends, and retirement income. You should not include income from any jobs . . **4a** $

b **Deductions.** If you expect to claim deductions other than the standard deduction and want to reduce your withholding, use Worksheet 2 on page 3 and enter the result here **4b** $

c Enter any additional amount you want withheld each **pay period** . . . . **4c** $

d **Exemption.** You can claim exemption from withholding for 2020 if:
- For 2019, you had **no** federal income tax liability; **and**
- For 2020, you expect to have **no** federal income tax liability.

If you meet both of these conditions, certify by writing "Exempt" here . . . . . ▶ **4d**

Step 5: Sign Here

Under penalties of perjury, I declare that this certificate, to the best of my knowledge and belief, is true, correct, and complete.

▶ **Employee's signature** (This form is not valid unless you sign it.) ▶ **Date**

Employers Only

5 Employer's name and address | 6 First date of employment | 7 Employer identification number (EIN)

For Privacy Act and Paperwork Reduction Act Notice, see page 2. Cat. No. 10220Q Form **W-4** (2020)

That data moves onto the worksheet on page 4 of Publication 15-T:

Employer's Withholding Worksheet

Keep for Your Records

Note. This illustrates what the 2020 procedure could look like by using the 2019 tax parameters. There would be just one procedure for both the Form W-4 from before 2020 and new Forms W-4. The formatting will change, and some of the details may need to be modified slightly to conform to the final Form W-4.

Table 1	Monthly	Semimonthly	Biweekly	Weekly	Daily
	12	24	26	52	260

Step 1. Adjust the employee's wage amount

1a Enter the employee's total taxable wages this period . . . . . 1a $ ______

1b Enter the number of pay periods you have per year (see Table 1) . . . . . 1b ______

1c Multiply the amount on line 1a by the number on line 1b . . . . . 1c $ ______

If the employee **HAS** submitted a Form W-4 for 2020 or later, figure the Adjusted Wage Amount as follows:

1d Enter -0- if the employee checked the box on Step 2 of the W-4 to be withheld at a higher rate. Otherwise enter 3 if the employee is married filing jointly, or 2 otherwise . . . . . 1d ______

1e Multiply line 1d by $4,200 . . . . . 1e $ ______

1f Subtract line 1e from line 1c. If zero or less, enter -0- . . . . . 1f $ ______

1g Enter the amount here that is on line 4a of the employee's Form W-4 . . . . . 1g $ ______

1h Add lines 1f and 1g . . . . . 1h $ ______

1i Enter the amount from line 4b of the employee's Form W-4 . . . . . 1i $ ______

1j Subtract line 1i from line 1h. If zero or less, enter -0-. This is the **Adjusted Annual Wage Amount** . . . . . 1j $ ______

1k Divide line 1j by the number of pay periods on line 1b. This is the **Adjusted Wage Amount** . . . . . 1k $ ______

If the employee has **NOT** submitted a Form W-4 for 2020 or later, figure the Adjusted Wage Amount as follows:

1l Enter the number of allowances claimed on the employee's most recent Form W-4 . . . . . 1l ______

1m Multiply line 1l by $4,200 . . . . . 1m $ ______

1n Subtract line 1m from line 1c. If zero or less, enter -0-. This is the **Adjusted Annual Wage Amount** . . . . . 1n $ ______

1o Divide line 1n by the number of pay periods on line 1b. This is the **Adjusted Wage Amount** . . . . . 1o $ ______

Step 2. Figure the Tentative Withholding Amount

based on the employee's Adjusted Wage Amount or Adjusted Annual Wage Amount, filing status (box 1c of 2020 Form W-4 or line 3 on earlier forms), and whether the box in Step 2 of 2020 Form W-4 is checked (to be withheld at a higher rate).

Option 1: Wage Bracket Method

2a Enter the employee's **Adjusted Wage Amount** this pay period from line 1k or 1o above . . . . . 2a $ ______

2b Use the amount on line 2a to look up the tentative amount to withhold in the appropriate Wage Bracket Method table in Section 3 for your pay frequency, given the employee's filing status and whether the employee has checked the box in Step 2 of the Form W-4 to be withheld at a higher rate. This is the **Tentative Withholding Amount** . . . . . 2b $ ______

Option 2: Percentage Method

2c Enter the employee's **Adjusted Annual Wage Amount** from line 1j or 1n above . . . . . 2c $ ______

2d Find the row in the appropriate Percentage Method table in Section 2 in which the amount on line 2c is at least the amount in column A but less than the amount in column B, then enter here the amount from column A of that row . . . . . 2d $ ______

2e Enter the amount from column C of that row . . . . . 2e $ ______

2f Enter the percentage from column D of that row . . . . . 2f ______ %

2g Subtract line 2d from line 2c . . . . . 2g $ ______

2h Multiply the amount on line 2g by the percentage on line 2f . . . . . 2h $ ______

2i Add line 2e and line 2h . . . . . 2i $ ______

2j Divide the amount on line 2i by the number of pay periods on line 1b. This is the **Tentative Withholding Amount** . . . . . 2j $ ______

Step 3. Account for tax credits

3a Enter the Tentative Withholding Amount from line 2b or line 2j above . . . . . 3a $ ______

3b If the employee's Form W-4 is from 2020, enter the amount from Step 3 of that form; otherwise enter -0- . . . . . 3b $ ______

3c Divide the amount on line 3b by the number of pay periods on line 1b . . . . . 3c $ ______

3d Subtract line 3c from line 3a. If zero or less, enter -0- . . . . . 3d $ ______

Step 4. Figure the final amount to withhold

4a Enter the additional amount to withhold from the employee's Form W-4 (line 4c of the 2020 form or line 6 on earlier forms) . . . . . 4a $ ______

4b Add lines 3d and 4a. **This is the amount to withhold from the employee's wages this pay period** . . . . . 4b $ ______

Publication 15-T (2020) Page 3

While there are an infinite number of possible W-4 entries and numbers the employer will receive, looking at some example calculations using the worksheet can help understand how the new W-4 relates to the amounts actually withheld.

EXAMPLE

Mary turns in her W-4. She enters her address and checks the head of household box in Step 1. She signs the form in Step 5 but makes no entry in Steps 2-4. She is paid $1,000 on a weekly payroll.

Mary's employer computes her withholding as follows. First, the employer multiplies Mary's taxable wages for the pay period ($1,000) times the 52 weekly pay periods in the year, entering $52,000 on line 1c.

Since Mary's filing status is head of household, the employer will enter 2 on line 1d. The employer than uses that factor and multiples it by 4,200, entering 8,400 on line 1f. As there is no amount entered on line 4a of Mary's Form W-4, the employer also enters 8,400 on line 1h. Again, since Mary did not fill in Step 4, there is no amount on line 4b. Thus, Mary's adjusted annual wage amount is $52,000 less $8,400, or $43,600.

Mary's employer now reduces that down to a weekly amount by dividing by 26 since the company pays on a weekly pay period, resulting in an adjusted wage amount per pay period of $838.46.

Mary's employer uses the wage bracket method to compute withholding. Using the instructions for Step 2, lines 2a and 2b, the employer looks up her pay period wages in the wage bracket method tables for income tax withholding. The table bracket Mary falls in is the one from $830-$840, and her withholding as head of household is $72.

EXAMPLE

Assume Mary's employer decides to use the percentage method to compute her withholding. In this case the calculation begins with <u>annual</u> adjusted wage amount from line 1j of the worksheet, or $43,600.

The employer uses the standard withholding rate schedule for the head of household filing status. In that case, the initial calculation from table results in the total of $1,385 plus 12% the amount of Mary's annual adjusted wage amount in excess of $23,800, or $19,800:

$$\$1{,}385 + (12\% \times (\$19{,}800) = \$1{,}385 + \$2{,}376 = \$3{,}761$$

To get the withholding per pay period, the annual amount calculated is divided by 52 (the number of weekly pay periods in the year), arriving at $72.33 to be withheld from the week's paycheck.

EXAMPLE

Assume Mary is married and her job has higher wages than that of her spouse. The couple has one dependent child under age 17 and expects their income to be less than $400,000. They do not have other significant income, they expect to claim the standard deduction in lieu of itemizing and do not expect to have any other deductions. Mary and her spouse want to avoid owing tax on their tax return and this represents their primary goal.

Mary and her spouse each check the box in Step 2 on line 2 to force a higher rate of withholding for their two jobs. Only Mary completes Step 3. In that step, she enters $2,000 for their dependent child and carries that number down to line 3. She does not enter any additional income on line 4a or additional deductions on line 4b. She does not request any additional withholding on line 4c, nor does she claim exemption from withholding on line 4d.

Mary's employer uses the wage bracket method. This time the employer again multiples Mary's $1,000 payroll for the week by 52 weekly pay periods in the year, arriving at $52,000.

This time the employer enters 0 on line 1d since Mary has checked the box on line 2 in Step 2. That results in no amount to be subtracted for the personal exemptions on line 1f and, as well, there is no addition for additional income nor subtraction for an additional deduction. Thus, Mary's annual adjusted wage amount is $52,000.

Since the wage bracket amount tables are being used by the employer, the $52,000 annual adjusted wage amount is divided by 52 (number of weekly pay periods in the year), arriving back at a $1,000 weekly adjusted wage amount. The employer goes to the wage bracket amount table and selects the initial withholding amount. Although the standard withholding amount would be $86, since Mary had checked the box on line 2 of Step 2 to have the higher withholdings, the initial withholding amount for her is $90.

However, the employer is not done yet since Mary listed a dependent child under the age of 17 on her W-4. The $2,000 total amount will be divided by 52 (again, the annual number of weekly payroll periods) which amounts to $38.46. The employer would use this weekly credit value on line 3c, and subtract this amount from the initial withholding amount, resulting in the amount of $51.54 ($90.00 – $38.46).

EXAMPLE

Assume Mary had filed a Form W-4 in 2019 claiming one allowance and married status, but does not file a new Form W-4 for 2020. The employer uses the allowances and status from the 2019 Form W-4 to calculate Mary's withholding.

In this case, the employer would begin filling in the worksheet on line 1l, entering "1" for the number of allowances. The employer enters $4,200 on line 1m, which is $4,200 times the number of allowances claimed (1). The adjusted annual wage amount would be the $52,000 annualized earnings reduced by $4,200, or $47,800. That number is divided by the number of pay periods in the year (52), coming to an adjusted wages amount of $919.23.

The employer takes Mary's adjusted wage amount and consults the wage bracket method table to determine the withholding amount. In this case that amount is $75.00.

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The IRS is taking comments in at this time regarding the new W-4 form and employer computation using that form. When the draft W-4 was issued on May 31, 2019 the IRS indicated that the agency expects to release a "near final" Form W-4 in mid-to-late July. Presumably a similar near final version of Publication 15-T would be released around the same time to allow employers to update systems to take into account the new calculations.

Section: 6662
TIGTA Finds Fewer Penalties Imposed in LB&I Exams With Tax Due of Over $10,000 Than in SB/SE Exams

Citation: "Few Accuracy-Related Penalties Are Proposed in Large Business Examinations, and They Are Generally Not Sustained on Appeal," Treasury Inspector General for Tax Administration, 2019-30-036, 5/31/19

The Treasury Inspector General for Tax Administration (TIGTA) issued a report that found the IRS is imposing accuracy-related penalties on businesses covered by the IRS Large Business and International Division (LB&I) less often that it does on businesses examined by the Small Business/Self-Employed Division (SB/SE).[19] The report looked at accuracy related penalties imposed under IRC §§6662 and 6662A.[20]

The report seemed particularly interested in the fact that LB&I examiners assess proportionately fewer accuracy-related penalties than do SB/SE examiners. The report found that for fiscal year 2015-2017, for returns that ended up with additional tax assessments of $10,000 or more, 6% of LB&I cases had an accuracy-related civil penalty assessed, while 25% of SB/SE cases with such taxes assessed also have an accuracy-related civil penalty assessed.[21]

The report does note that are reasons why the two rates may vary that do not relate to issues on how those cases are handled:

> *The disparity may be attributable to the differences in LB&I and SB/SE business taxpayers. For example, the LB&I Division examines businesses with assets of more than $10 million, while the SB/SE Division examines businesses with assets of $10 million or less. Therefore, LB&I business cases are larger and more complex than SB/SE cases. In addition, IRS management stated that LB&I taxpayers are sophisticated business owners or publicly traded companies, with the majority having their own internal tax department, a tax director or controller, etc., and that SB/SE taxpayers may be less likely to employ full-time tax expertise. Another factor, according to IRS management, is that substantial understatement accuracy-related penalties in large business returns may be less likely to apply when tax understatements are less than 10 percent of the corrected tax liability, even though the additional tax exceeds $10,000.*[22]

But TIGTA's report also found that other issues may be involved that could also explain some of this disparity, noting:

> *Another reason for the disparity between LB&I Division and SB/SE Division assessment of accuracy-related penalties may also be attributable, at least in part, to other conditions we identified*

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[19] "Few Accuracy-Related Penalties Are Proposed in Large Business Examinations, and They Are Generally Not Sustained on Appeal," Treasury Inspector General for Tax Administration, 2019-30-036, May 31, 2019 https://www.treasury.gov/tigta/auditreports/2019reports/201930036fr.pdf

[20] *Ibid*, p. 1-2

[21] *Ibid*, p. 7

[22] *Ibid*

> *during this audit. Specifically, LB&I examiners did not always consider or justify the penalty decision, and supervisors were not always involved in the decision to propose, or not propose, the penalty. In addition, the IRS's quality review systems do not address all required actions that examiners must take for proper consideration of civil penalties.*[23]

The report contains a series of recommendations to the IRS in these areas. The first one provides:

> ***Recommendation 1:*** *The Commissioner, LB&I Division, should conduct a study to: 1) understand the reason why examiners' proposed tax assessments and accuracy-related penalties are not being sustained by Appeals and 2) evaluate whether examiners are taking into account all the relevant facts and circumstances before proposing the tax adjustments and accuracy-related penalties.*

This was a recommendation that the IRS only partially agreed with. The agency noted that Appeals and exam serve two different functions, which could impact the rate at which penalties are or are not sustained on appeals. That includes the hazards of litigation.

While the IRS does not say so, given the relatively larger size of the taxpayers involved, the risk of litigation is likely quite a bit more significant to the agency in the average LB&I case. So any consideration of the risk of litigation in such a context would seem to be subject to at least some influence based on the knowledge that the evaluation of such risks would likely be subject to evaluation based on actual results.

The IRS also notes that penalty resolution varies from case to case and issue to issue. Appeals is looking at settling the case as a whole, and which does not necessarily provide insight to examiners regarding why a specific penalty was or was not ultimately sustained in a settlement.[24]

TIGTA issued a comment with regard to the IRS's response:

> *We believe that the IRS should have a single approach to penalty issuance and that large corporations should be subject to the accuracy-related penalty to the same extent as small businesses. The LB&I Division should understand whether there is a reluctance among its revenue agents to impose the accuracy-related penalties on large corporations and, in the instances in which the penalty is proposed, to understand the specific factors Appeals will rely upon to sustain the penalty.*

TIGTA's report noted that they also found that LB&I examiners did not document their consideration of accuracy-related penalties or their justification for decisions related to such penalties and that documentation did not show that supervisors were always involved in penalty development or approval.[25]

Thus, TIGTA made the following recommendations with which the IRS agreed:

> ***Recommendation 2:*** *Ensure that examiners and supervisors are trained to: 1) consider the accuracy-related penalty for all applicable examination cases; 2) follow the proper procedures to document all actions taken during penalty consideration and development, whether proposing or not*

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[23] *Ibid,* p. 8

[24] *Ibid*, p. 8

[25] *Ibid*, p. 9

proposing the penalty; and 3) follow the requirements for supervisory involvement and timely, written approval of all penalty decisions.

> ***Management's Response:*** *The IRS agreed with the recommendation. The IRS stated that the Penalty Practice Network will provide materials for all LB&I employees on procedures to document penalty considerations and development and the requirements for supervisory involvement and timely written approval of penalty decisions. The Penalty Practice Network will also consider revising the penalty lead sheet to address this recommendation.*

> ***Recommendation 3:*** *Revise IRM 4.46 guidelines to: 1) clearly indicate which LB&I examiners are ultimately responsible for penalty development and documentation and 2) provide more specificity on the requirements of supervisory involvement in penalty development when proposing and not proposing penalties.*

> ***Management's Response:*** *The IRS agreed with the recommendation. The IRS stated that IRM 4.46 has recently been updated for some penalty-related matters. IRM 20.1.1, Penalty Handbook, Introduction and Penalty Relief, is in the process of being updated. The Penalty Practice Network will review and provide recommendations, if any, for potential additional updates.*

> ***Recommendation 4:*** *Ensure that quality review systems are adequate and can accurately determine whether examiners are properly considering civil penalties, adequately supporting penalty decisions, consistently involving management, and obtaining required approvals.*

> ***Management's Response:*** *The IRS agreed with the recommendation. The Quality Review and Analysis function will review the IRM, including any updates or revisions, to determine if and how the quality review process should be modified to consider examiner and management responsibilities related to accuracy-related penalties.*[26]

TIGA also found a more general problem with closed examination paper files, finding such files were often missing or incomplete. This leads to the final TIGTA recommendation and response:

> ***Recommendation 5:*** *Using the IRS's Lean Six Sigma team or other process improvement resources, evaluate the procedure for closing, shipping, and storing paper examination case files and take corrective action to improve the process.*

> ***Management's Response:*** *The IRS agreed with the recommendation. The IRS will review case closing and shipping procedures and the procedures to request closed case files from the Federal Records Center to determine whether additional clarity is needed and to ensure that employees are aware of the procedures.*

> *The IRS further stated that it believes employees follow the rules relating to record retention policies. While TIGTA experienced problems in securing closed case files, the IRS believes that was due to many factors, including how the files were requested, the Document Locator Number used, the fact that the entire CIC case could not be provided due to its size, and that not all case information is initially*

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[26] *Ibid*, pp. 14-15

closed to the Federal Records Center. Nonetheless, the IRS agreed that TIGTA's report highlights the need for the IRS to evaluate improvements or adjustments to its current file retrieval process.

Office of Audit Comment: *As discussed on page 15 of this report, IRM procedures require all IC examination workpapers with the closed paper case file to go to the IRS's Centralized Case Processing function for closing actions and then to be sent to the Federal Records Center. TIGTA followed the IRM procedures to order the cases and provided the IRS with all the information used in the ordering process, including the Document Locator Numbers, to assist with locating the files. As of December 2018, we had only received partial closed files for 12 IC cases and received no files for four IC cases. Even if not all workpapers are initially sent to the Federal Records Center, as management states in their response, the fact remains the IRS was not able to provide the remaining workpapers.*[27]

Concerns have been expressed by those representing large businesses in exams that the report implies that LB&I's penalty imposition rate on cases with assessments in excess of $10,000 should be the same SB/SE's, or that SB/SE's penalty imposition rate is the correct rate at which penalties should be imposed.[28]

Certainly, since the substantial understatement penalty is tied to the percentage of tax understated, it's likely that $10,000 is more than the trigger level in far more SB/SE exams than LB&I exams. The fact that the report focused on a single fixed amount of tax rather than a percent of tax ultimately determined to be due on exam certainly seems to introduce an issue with TIGTA's methodology unless they controlled for this in a way not obvious from reading the report.

Specifically, IRC §6662(d)(1) provides the trigger levels for substantial understatement:

(d) Substantial understatement of income tax

(1) Substantial understatement

(A) In generalFor purposes of this section, there is a substantial understatement of income tax for any taxable year if the amount of the understatement for the taxable year exceeds the greater of—

(i) 10 percent of the tax required to be shown on the return for the taxable year, or

(ii) $5,000.

(B) Special rule for corporationsIn the case of a corporation other than an S corporation or a personal holding company (as defined in section 542), there is a

[27] *Ibid*, pp. 17-18

[28] Eric Yauch, "Practitioners Poke Holes in TIGTA Report's Penalty Theories," *Tax Notes Today*, 2019 TNT 109-5, June 6, 2019, https://www.taxnotes.com/tax-notes-today/audits/practitioners-poke-holes-tigta-reports-penalty-theories/2019/06/06/29l17 (subscription required)

substantial understatement of income tax for any taxable year if the amount of the understatement for the taxable year exceeds the lesser of—

> *(i) 10 percent of the tax required to be shown on the return for the taxable year (or, if greater, $10,000), or*
>
> *(ii) $10,000,000.*

(C) Special rule for taxpayers claiming section 199A deduction

In the case of any taxpayer who claims any deduction allowed under section 199A for the taxable year, subparagraph (A) shall be applied by substituting "5 percent" for "10 percent".

EXAMPLE

Small Company, Inc., a C corporation, faces a proposed assessment of $11,000 on its 2017 income tax return. The final corrected tax determined for the year is $50,000, meaning the $11,000 is 22% of the tax required to be shown on the return. Small Company, Inc.'s proposed assessment represents a substantial understatement if sustained on exam, meaning that the §6662 20% accuracy-penalty generally applies unless the taxpayer can carry the burden to show why it should not.

Large Company, Inc., also a C corporation, also faces a proposed assessment of $11,000 on its 2017 income tax return. The assessment arises from disallowance of a specific deduction that is identical in amount and type as that of Small Company, Inc. The final corrected tax determined for the year is $200,000. The $11,000 proposed assessment represents 5.5% of the tax required to be shown on the return. In this case, the assessment is below the level that will be treated as a substantial understatement.

If the IRS wishes to pursue an accuracy related penalty against Large Company, Inc. it would bear the burden of proving that the underpayment was due to negligence or disregard of the rules under IRC §6662(b)(1), as defined in IRC §6662(c). The fact that the IRS has to show that negligence or disregard took place makes it much more difficult for the IRS to successfully impose the penalty.

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Section: 7502
Taxpayer Could Not Prove Timely Mailing of Petition to Tax Court, Case Dismissed

Citation: Williams v. Commissioner, TC Memo 2019-66, 6/5/19

An attorney's testimony that he recalled the date of mailing of a taxpayer's Tax Court petition was not found to be sufficient to prove the document had been mailed in a timely fashion in the case of *Williams v. Commissioner*, TC Memo 2019-66.[29]

IRC §7502(a) provides what is often referred to as the "timely mailing is timely filing" rule:

> *(1) Date of delivery*
>
> *If any return, claim, statement, or other document required to be filed, or any payment required to be made, within a prescribed period or on or before a prescribed date under authority of any provision of the internal revenue laws is, after such period or such date, delivered by United States mail to the agency, officer, or office with which such return, claim, statement, or other document is required to be filed, or to which such payment is required to be made, the date of the United States postmark stamped on the cover in which such return, claim, statement, or other document, or payment, is mailed shall be deemed to be the date of delivery or the date of payment, as the case may be.*

<u>EXAMPLE</u>

On April 15, 2019 Elaine dropped her Form 1040 into a mailbox near her home at 3:00 pm. The mail that had been deposited in that box was picked up at it's scheduled 4:00 pm pick up time by the US Postal Service and taken to the local post office. The envelope containing the tax return was postmarked by the local post office with a date of April 15, 2019. The postmark is clear and legible.

The envelope containing the tax return is delivered to the IRS on April 20, 2019, which is after the due date for Elaine's return. However, under §7502(a) the return is treated as delivered to the IRS on April 15, 2019 based on the postmark applied by the USPS.

The same result would occur if, for whatever reason, the delivery by the USPS was delayed for a period well beyond the normal date an item mailed from Elaine's city would be expected to arrive at the particular IRS location to which it was mailed.

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In this case the Tax Court petition was required to be filed by December 3, 2014. The envelope containing the petition arrived nearly a month after that date at the Tax Court on January 8,

[29] https://www.ustaxcourt.gov/UstcInOp/OpinionViewer.aspx?ID=11971 (references to page numbers refer to this PDF of the document posted by the US Tax Court)

2015. While the envelope had USPS stamps on it and was delivered by the USPS, no postmark or other markings applied by the USPS had been applied to the envelope.[30]

The taxpayer's attorney had prepared and mailed the petition on behalf of the taxpayer. The attorney provided a declaration under penalty of perjury where he states that:

> *… he recalls preparing this petition because his daughter was scheduled to have surgery on December 3, 2014, the petition's due date. He recalls that he "had a full day of appointments and was not able to prepare the petition until the evening before the surgery." (This recollection seems inconsistent with the date next to his signature on the petition, which is November 29, not December 2.) He states that he drafted the petition at home, affixed "postage stamps from his home," and deposited the petition in a mailbox "outside of the United States Post Office at 3350 S. 2940 E., Salt Lake City, UT 84109 late in the evening of December 2, 2014."*[31]

The Court notes that USPS standards provide that a document mailed from Salt Lake City should be delivered to Washington, DC within 8 days of being mailed. The attorney speculated that the document's delivery must have been delayed due to some issue in the US Postal System.[32]

Neither IRC §7502 nor the regulations the IRS has promulgated under that section provide for rules that would apply when a document is delivered by the USPS, but the envelope appears not to have been postmarked by the USPS. The Tax Court notes that case law has developed to deal with this situation which it explains as follows:

> *… When a postmark is missing, our case law instructs us to deem the postmark illegible and permit the introduction of extrinsic evidence to ascertain the mailing date. See Sylvan v. Commissioner, 65 T.C. 548, 553-555 (1975); see also Mason v. Commissioner, 68 T.C. 354, 356 (1977). The burden is on the party who invokes section 7502 to present "convincing evidence" of timely mailing. Mason, 68 T.C. at 356-357; see sec. 301.7502-1(c)(1)(iii)(A), Proced. & Admin. Regs. (providing that, if a USPS postmark "is not legible, the person * * * [invoking section 7502] has the burden of proving the date that the postmark was made").*
>
> *When confronted with illegible or missing postmarks, we have considered various types of extrinsic evidence, including testimony from the person claiming to have mailed the envelope. See Mason, 68 T.C. at 357. We also look to evidence regarding the normal delivery time from the place of origin to our Court in Washington, D.C. See ibid.; Selter v. Commissioner, T.C. Memo. 2000-316, 80 T.C.M. (CCH) 491, 493-494; Robinson v. Commissioner, T.C. Memo. 2000-146, 79 T.C.M. (CCH) 1956, 1957. We may examine the envelope to see whether any markings indicate that the letter had been "misplaced, missent, or inadvertently lost or damaged." Robinson, 79 T.C.M. (CCH) at 1957 (noting the testimony of a post office employee that, in the event of misdelivery or damage, "there should be some marking on * * * [the envelope] 'to let you know exactly what has happened to that letter'").*
>
> *In some cases we have considered evidence regarding holiday conditions at the post office as a possible explanation for a delayed delivery. Such conditions might include holiday closures, unusually large*

[30] *Ibid*, pp. 3-4

[31] *Ibid,* p. 3

[32] *Ibid*

> *volumes of mail, or inefficiencies attributable to temporary staff. Generally speaking, we have found such evidence persuasive in explaining relatively short delays only. Compare Rotenberry v. Commissioner, 847 F.2d 229 (5th Cir. 1988) (finding that holiday conditions could explain a three-day delay in ordinary delivery time for a letter mailed on December 23), with Robinson, 79 T.C.M. (CCH) at 1958 (declining to find an 11-day delay explained by holiday conditions around Memorial Day), and Chang v. Commissioner, T.C. Memo. 1998-298, 76 T.C.M. (CCH) 290, 292 (declining to find a delay of 6 to 10 days explained by holiday conditions for a petition that arrived in mid-November.)*[33]

EXAMPLE

Assume Elaine's document arrived on May 10, 2019, long after the expected delivery date for an item mailed on April 15, 2019, and the envelope in question contained no postmark. However, the document had markings applied by the USPS indicating that the document had originally been delivered to the wrong address. The Tax Court would consider this information, along with Elaine's testimony regarding mailing of the return, to determine if it was reasonable to accept that the document had been timely mailed.

However, since this is a factual determination made by the Court based on the evidence available, Elaine cannot assume that the Court will find the explanation adequate to allow the Court to infer that she had timely mailed the return. But, because she has introduced evidence that may explain the late delivery, she has a chance the Court will find the filing timely.

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In this case the attorney argued that since the envelope has been mailed between Thanksgiving and New Years' Day, a period when the volume of mail being handled by the USPS is at its peak, the delay in delivery could be explained.[34]

The Tax Court did not accept that as a reasonable explanation of the delay in delivery:

> *We find this explanation unpersuasive. As of December 2 the Thanksgiving holiday was over and the Christmas holiday was three weeks away. Given this timeframe, holiday conditions at the post office cannot explain a 28-day delay in delivery. Cf. Rotenberry v. Commissioner, 847 F.2d 229 (finding that holiday conditions could explain a three-day delay for a letter mailed on December 23).*[35]

Thus, in the end the Court found that the taxpayer had not carried his burden to show that his petition with the Court had been timely filed.

Since a taxpayer (or, in this case, the taxpayer's representative) cannot assure that a postmark will be applied by the USPS, nor assure that the item will actually be delivered so that the

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[33] *Ibid,* pp. 5-7

[34] *Ibid*, p. 8

[35] *Ibid*

envelope can be examined for the postmark, are both fully at the mercy of the USPS? Actually, no.

IRC §7502(c) provides that taxpayers can obtain evidence of the filing by using registered mail or, based on regulations issued by the IRS, make use of evidence obtained through the use of certified mail or via electronic filing.

Reg. §301.7502-1(c)(2) provides the following rules for using registered or certified mail to tied down the postmark (and thus filing) date:

> ***(2) Registered or certified mail.*** *If the document or payment is sent by U.S. registered mail, the date of registration of the document or payment is treated as the postmark date. If the document or payment is sent by U.S. certified mail and the sender's receipt is postmarked by the postal employee to whom the document or payment is presented, the date of the U.S. postmark on the receipt is treated as the postmark date of the document or payment. Accordingly, the risk that the document or payment will not be postmarked on the day that it is deposited in the mail may be eliminated by the use of registered or certified mail. (emphasis added)*

EXAMPLE

Elaine takes her return to the Post Office on April 15 before it closes, takes her return to the counter and mails the return using certified mail. She obtains the white stamped receipt from the USPS employee at the counter showing the postmark date of April 15, 2019. She does not pay for the green proof of delivery card.

When the IRS claims her return was not timely filed, Elaine can present a copy of the white stamped receipt to shift the burden to the IRS to show that her return was not timely mailed, which effectively means the burden will be on the agency to prove that her return was not in the envelope covered by the receipt or that the document truly was never delivered to the IRS and somehow lost by the IRS. Suffice it to say that will be an extremely difficult burden for the IRS to carry.

EXAMPLE

Elaine pays for the "green card" that is to be stamped by an IRS employee upon receipt of the document. When she receives that card back, she throws away the white receipt.

Again the IRS claims that the return was not timely filed. Elaine is at risk now of facing late filing penalties, since the regulation only provides protection if she produces the receipt she received when she presented the document for mailing. As is often true in taxes, details matter.

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For electronically filed documents, the date of the electronic postmark obtained from the electronic return transmitter is deemed to be the date of filing per Reg. §301.7501-1(d)(3). The time of the electronic postmark, while based on when the return is received by electronic return transmitter's host system, is based on the *time zone* of the taxpayer (not that of the electronic return transmitter or the electronic return originator).[36]

Under IRC §7502(f), a similar result can be obtained via the use of certain specified services provided by private delivery services. The services that qualify for this treatment can be found currently in Notice 2016-30, with the IRS maintaining an unofficial list of such services on its website.[37]

In both cases, only the use of the specific services listed[38] and compliance with the other requirements will serve to provide prima facia proof of the postmark date. Thus, for instance, obtaining a proof of mailing document from the USPS, or sending the package via FedEx 3 Day will not suffice to come under these rules.

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36 Reg. §301.7502-1(d)(3)(ii)

37 https://www.irs.gov/filing/private-delivery-services-pds

38 Note that even if one of the vendors adds a "faster" delivery option at some point, it won't count for purposes of these rules until the IRS issues a new Notice or similar guidance adding that service to the list. So checking the official IRS list is crucial if you wish to use the private delivery service option.