IRS Insights | A closer look

IRS indefinitely authorizes electronic signatures for select forms and documents

In October 2023, the Internal Revenue Service (IRS) announced[1] it was updating its policy for signatures to indefinitely accept electronic or digital signatures ("e-signatures") on certain forms and documents.

The use of e-signatures

Before the COVID-19 pandemic, the IRS generally required a handwritten or "wet" signature on most of its forms and documents. However, as the pandemic progressed and it became increasingly more difficult for taxpayers and tax professionals to affix their handwritten signatures to IRS forms and documents, the IRS implemented a temporary solution.

Deviating from its general policy, the IRS issued guidance authorizing taxpayers and representatives to use electronic or digital signatures on forms that previously required wet signatures. This authorization also extended to certain documents in examinations, Appeals, and collection.[2] This temporary relief was set to expire on October 31, 2023.

However, the *Internal Revenue Manual*[3] (IRM) was recently updated, extending this relief and allowing the use of e-signatures indefinitely. The IRM additionally provides that IRS personnel are permitted to accept e-signatures on certain documents when dealing with taxpayers during examinations, Appeals, and collection. The relevant forms are identified in the IRS's *Internal Revenue Manual* at Exhibit 10.10.1-2, and the specific circumstances in which the IRS accepts e-signatures are discussed in IRM section 10.10.1.6.1.

In this edition

IRM instructions on use of e-signatures

The IRM provisions referenced above are now the IRS's instructions on how taxpayers can use e-signatures. The IRM provides that, although the IRS does not require a specific technology or form of signature, the signature must show an intent by the signatory to sign the electronic record. The IRS has specifically permitted the following types of electronic signatures, but others may still qualify:

- A typed name that is typed within or at the end of an electronic record, such as typed into a signature block
- A scanned or digitized image of a handwritten signature that is attached to an electronic record
- A shared secret, such as a code, password, or PIN
- A unique biometric-based identifier, such as a fingerprint, voiceprint, or retinal scan
- A handwritten signature input onto an electronic signature pad
- A handwritten signature, mark, or command input on a display screen by means of a stylus device
- A selected checkbox on an electronic device such as a computer or tablet
- A signature created by a third-party software

A listing of allowable signature options can be found in IRM Exhibit 10.10.1-2 on IRS.gov. The IRM also provides that the use of e-signatures only applies to the forms and documents listed by the IRS, which currently are as follows:

- Form 11-C, *Occupational Tax and Registration Return for Wagering;*
- Form 637, *Application for Registration (For Certain Excise Tax Activities);*
- Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return;*
- Form 706-A, *United States Additional Estate Tax Return;*
- Form 706-GS(D), *Generation-Skipping Transfer Tax Return for Distributions;*
- Form 706-GS(D-1), *Notification of Distribution from a Generation-Skipping Trust;*
- Form 706-GS(T), *Generation-Skipping Transfer Tax Return for Terminations;*
- Form 706-QDT, *U.S. Estate Tax Return for Qualified Domestic Trusts;*
- Form 706 Schedule R-1, *Generation-Skipping Transfer Tax;*
- Form 706-NA, *United States Estate (and Generation-Skipping Transfer) Tax Return Estate of Nonresident Not a Citizen of the United States;*
- Form 709, *United States Gift (and Generation-Skipping Transfer) Tax Return;*
- Form 730, *Monthly Tax Return for Wagers;*
- Form 1066, *U.S. Real Estate Mortgage Investment Conduit (REMIC) Income Tax Return;*
- Form 1042, *Annual Withholding Tax Return for U.S. Source Income of Foreign Persons;*
- Form 1120-C, *U.S. Income Tax Return for Cooperative Associations;*
- Form 1120-FSC, *U.S. Income Tax Return of a Foreign Sales Corporation;*
- Form 1120-H, *U.S. Income Tax Return for Homeowners Associations;*
- Form 1120-IC DISC, *Interest Charge Domestic International Sales Corporation Return;*
- Form 1120-L, *U.S. Life Insurance Company Income Tax Return;*
- Form 1120-ND, *Return for Nuclear Decommissioning Funds and Certain Related Persons;*
- Form 1120-PC, *U.S. Property and Casualty Insurance Company Income Tax Return;*
- Form 1120-REIT, *U.S. Income Tax Return for Real Estate Investment Trusts;*
- Form 1120-RIC, *U.S. Income Tax Return for Regulated Investment Companies;*
- Form 1120-SF, *U.S. Income Tax Return for Settlement Funds (Under Section 468B);*
- Form 1127, *Application for Extension of Time for Payment of Tax Due to Undue Hardship;*
- Form 1128, *Application to Adopt, Change, or Retain a Tax Year;*
- Form 2678, *Employer/Payer Appointment of Agent;*
- Form 3115, *Application for Change in Accounting Method;*
- Form 3520, *Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts;*
- Form 3520-A, *Annual Information Return of Foreign Trust with a U.S. Owner;*
- Form 4421, *Declaration—Executor's Commissions and Attorney's Fees;*
- Form 4768, *Application for Extension of Time to File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes;*
- Form 8038, *Information Return for Tax-Exempt Private Activity Bond Issues;*
- Form 8038-G, *Information Return for Tax-Exempt Governmental Bonds;*
- Form 8038-GC; *Information Return for Small Tax-Exempt Governmental Bond Issues, Leases, and Installment Sales;*
- Form 8283, *Noncash Charitable Contributions;*
- Form 8453 series, Form 8878 series, and Form 8879 series regarding IRS e-file Signature Authorization Forms;
- Form 8802, *Application for United States Residency Certification;*
- Form 8832, *Entity Classification Election;*
- Form 8971, *Information Regarding Beneficiaries Acquiring Property from a Decedent;*
- Form 8973, *Certified Professional Employer Organization/Customer Reporting Agreement; and*
- Elections made pursuant to Code Sec. 83(b)

Taxpayers cannot rely on advisors to file returns, even if e-filed

A US Court of Appeals recently ruled taxpayers cannot defeat a failure to file penalty because they authorized their return preparer to electronically file their tax return.[4] Almost 40 years ago, the Supreme Court's ruling that taxpayers cannot delegate the responsibility to file their returns to tax return preparers.[5] Many taxpayers and practitioners debated whether the Supreme Court's bright-line rule applied to e-filed returns. The United States Court of Appeals for the Eleventh Circuit ruled the bright-line rule applies to e-filed returns.

Background

If a taxpayer files its tax return late, it is subject to section 6651's failure to timely file penalties. However, if the taxpayer can show it had reasonable cause for

its failure to file, then the failure to file penalties do not apply.[6] The Supreme Court said in *Boyle* that a taxpayer cannot establish reasonable cause by solely showing it relied on an advisor to file the tax return (even if the taxpayer told the preparer to file the return and the preparer said it did file the return).[7] The Supreme Court reasoned that the Internal Revenue Code imposes "an unambiguous, precisely 'defined duty'" on taxpayers to timely file the return. The Supreme Court contrasted the "ministerial task" of filing returns and paying taxes with other situations where a taxpayer could rely on an advisor: reliance under which a taxpayer files or pays after the actual due date, but within the time erroneously advised by a tax professional or reliance on a tax professional's advice about a matter of law.

In *Lee v. United States*, Wayne Lee's CPA failed to file several years of tax returns. Each year, Lee reviewed the return prepared by the CPA and signed Form 8879, *IRS* e-file *Signature Authorization*, authorizing the CPA to e-file the return on Lee's behalf. The IRS assessed failure to file penalties. Lee argued that he reasonably relied on his advisor. The IRS denied his reasonable cause request based on *Boyle*. The district court sided with the IRS. Lee appealed to the Eleventh Circuit.

Decision

On appeal, Lee argued that *Boyle* did not apply because he signed Form 8879, and after he signed Form 8879 the filing was "beyond his control." The court said Form 8879 is merely an authorization form and signing it does not transmit the return to the IRS. Accordingly, Lee still had a duty to ensure his return was submitted. Additionally, the court concluded that filing the tax return was not beyond Lee's control; the court said filing a return was beyond the control of a taxpayer who experiences a disability or illness that affects their ability to exercise ordinary care and prudence.[8]

Next Lee argued that once he signed the Form 8879, the CPA was legally obligated to file the tax return because IRS publications require preparers to file the tax return within three days of the taxpayer's signing of the Form 8879. The court rejected this argument. The court said an IRS publication could not trump *Boyle* and, moreover, the IRS publication explicitly states that a return is not e-filed until the IRS acknowledges acceptance. The court noted that Lee never asked his CPA for confirmation that the returns were filed.

Conclusion

Courts and the IRS continue to narrowly apply the reasonable cause exception for failure to file penalties and reject taxpayers' reliance on advisors' performance of the "ministerial tasks" of filing returns and paying taxes. Taxpayers should confirm that their tax returns are timely filed each year.

IRS updates annual revenue procedures regarding adequate disclosure

The IRS recently updated its revenue procedure that provides guidance on when taxpayers have adequately disclosed an item or position for purposes of reducing a substantial understatement subject to the section 6662 accuracy-related penalty.

Background

If a taxpayer substantially understates its income tax, the section 6662 accuracy-related penalty applies.[9] The penalty is generally 20% of the portion of the underpayment of tax required to be shown on the return.[10]

There is a substantial understatement of tax if the understatement is more than 10% of the tax required to be shown on the return or $5,000, whichever is greater.[11] For corporations (other than S corporations or personal holding companies), there is a substantial understatement if the understatement is more than the lesser of (1) 10% of the tax required to be shown on the return (or, if greater, $10,000) or (2) $10 million.[12] The understatement equals the amount of tax required to be shown on the return less the amount of tax shown on the return.[13] In the case of items not attributable to tax shelters,[14] the amount of the understatement is reduced to the extent that there was (1) substantial authority for the position or (2) reasonable basis for the position and the taxpayer adequately disclosed the position on its return.[15]

Rev. Proc. 2023-40

Each year the IRS publishes a revenue procedure providing guidelines for determining whether disclosure is adequate for purposes of the substantial understatement penalty.[16] Rev. Proc. 2023-40 applies to tax returns that begin in 2023 and end in 2024 and short-year returns that begin in 2024 if the return is to be filed before the 2024 forms are available.[17]

For the items listed in the revenue procedure, disclosure is adequate if the forms and attachments attached to the return are completed in a clear manner and in accordance with their instructions.[18] In addition, the money amounts on the form must be verifiable.[19] That is, the taxpayer can show the origin of the amount used and establish it had good faith for using that amount even if the IRS ultimately rejects the amount.[20] Disclosure of the amount is not adequate if the amount relates to a transaction between related parties (entries that may present a legal issue or controversy because of a related-party transaction must be disclosed on Form 8275, *Disclosure Statement*, or Form 8275-R, *Regulation Disclosure Statement*).[21] Additionally, the amount must be clearly described in the return.[22]

If the amount does not have a preprinted description (e.g., unnamed line under an "other expenses" category), the taxpayer must clearly identify the item.[23]

Taxpayers should consult Rev. Proc. 2023-40 for a comprehensive list of the covered items (i.e., the items for which disclosure on the tax return is considered adequate). The categories of items include itemized deduction,[24] certain trade or business expenses,[25] differences in book and tax reporting,[26] foreign tax items,[27] and other (i.e., moving expenses, employee benefit expenses, fuels credit, investment credit).[28]

Tax Court rejects IRS arguments regarding whipsaw, duty of consistency, and doctrine of election

The Tax Court recently ruled that a taxpayer could disavow its original characterization of certain transfers as debt and reclassify them as equity. In *Estate of Fry v. Comm'r*,[29] the court rejected the IRS's arguments that such a change would cause whipsaw or was prohibited under the duty of consistency or doctrine of election.

Among other issues, the Tax Court in *Estate of Fry* had to decide whether certain transactions between two S corporations were debt or equity. The court concluded that the transfers were, in fact, equity.

The IRS argued that even if the transfers were, in fact, equity, the taxpayers chose to treat them as debt on the relevant federal tax returns. Accordingly, the IRS argued the taxpayer could not change the classification because (1) it would cause harm to the IRS to allow the taxpayer to change its position, (2) the duty of consistency required the taxpayer to continue to treat the transactions as debt, and (3) the doctrine of election prohibited the taxpayer changing how it treated the transaction on its original return.

First, the Tax Court held there was no whipsaw. The court stated that whipsaw generally arises when both parties to a taxable event avoid taxation by taking inconsistent tax reporting positions for the same transaction. The court said there was no inconsistent reporting, so there was no whipsaw. "The question before us is not as much whether [petitioners] took inconsistent tax reporting positions. Rather, the more precise question is whether [the transfer at issue] are properly reclassified as equity, creating sufficient basis in [S corporation] for the losses the [petitioners] claimed for 2013."

Second, the Tax Court said the duty of consistency did not apply. There are three requirements for duty of consistency to apply: (1) there has to be a representation by the taxpayer, (2) the IRS has to rely on that representation, and (3) the IRS would be harmed if the taxpayer was allowed to change its representation after the period of limitations has run. Here, the Tax Court said the first two elements were met because the taxpayers represented that the transactions were debt, and the IRS relied on those representations. However, the court said the third element was not met because there was no harm to the IRS; the IRS did not prove there were distributions in excess of basis.

Third, the Tax Court summarily rejected the IRS's argument that the doctrine of election applied. The doctrine of election precludes a taxpayer who makes a conscious election from later revoking or amending that election without the consent of the IRS. The court said doctrine election does not apply to the choice between debt and equity. "Petitioners do not have a 'free choice' or election to deem the [transfers at issue] either debt or equity. Rather, and as detailed above, the characterization of the [transfers at issue] is based on various factors that indicate the true economic substance of a transaction." Moreover, the Tax Court noted that cases where doctrine is applied are "few and far between," and most recent cases addressing the doctrine decline to apply it.

IRS Notice 2024-19 provides penalty relief for failure to furnish Part IV of Form 8308 to transferors and transferees in section 751(a) exchanges by January 31, 2024

On January 11, 2024, the IRS published Notice 2024-19 (the "Notice"), which provides relief from penalties under section 6722 for failure of a partnership with unrealized receivables or inventory items described in section 751(a) ("section 751 property") to furnish Part IV of Form 8308, *Report of a Sale or Exchange of Certain Partnership Interests*, to the transferor and transferee in a section 751(a) exchange that occurred in calendar year 2023 by January 31, 2024.

Generally, section 6050K and Treas. Reg. § 1.6050K-1 require a partnership with section 751 property to provide information to each transferor and transferee that are parties to a sale or exchange of an interest in the partnership (or portion thereof) in which any money or other property received by a transferor from a transferee in exchange for all or part of the transferor's interest in the partnership is attributable to section 751 property ("section 751(a) exchange"). Treas. Reg. § 1.6050K-1(a)(2) provides that partnerships are required to report each section 751(a) exchange on Form 8308 and attach Form 8308 to Form 1065, *U.S. Return of Partnership Income*, for the taxable year of the partnership that includes the last day of the calendar year in which the section 751(a) exchange took place. Form 8308 is due at the time for filing the partnership return, including extensions.

Each partnership that is required to file a Form 8308 also must furnish a copy of Form 8308 to the transferor and transferee by the later of (a) January 31 of the year following the calendar year in which the section 751(a) exchange occurred or (b) 30 days after the partnership has received notice of the exchange as specified under section 6050K and Treas. Reg. § 1.6050K-1.

Section 6722 imposes a penalty for failure to furnish correct payee statements, including statements under section 6050K, on or before the required date, and for any failure to include all of the information required to be shown on the statement or the inclusion of incorrect information.

In October 2023, the IRS released a revised version of Form 8308. New Part IV of the 2023 Form 8308 requires a partnership to report, among other items, the transferor partner's share of section 751 gain and loss, collectibles gain under section 1(h)(5), and unrecaptured section 1250 gain under section 1(h)(6), as well as the partnership's total hypothetical gain or loss for those items used solely to determine the transferor partner's share.

In response to concerns that partnerships might not have all the information required by Part IV of the 2023 Form 8308 by January 31, 2024, the Notice provides relief from penalties under section 6722 to partnerships that fail to furnish Form 8308 with a completed Part IV by January 31, 2024, if they meet certain requirements. To qualify for relief, a partnership must:

1. Timely and correctly furnish to the transferor and transferee a copy of Parts I, II, and III of Form 8308, or a statement that includes the same information, by the later of (a) January 31, 2024, or (b) 30 days after the partnership is notified of the section 751(a) exchange; and
2. Furnish to the transferor and transferee a copy of the completed Form 8308, including Part IV, or a statement that includes the same information and any additional information required under Treas. Reg. § 1.6050K-1(c), by the later of (a) the due date of the partnership's Form 1065 (including extensions) or (b) 30 days after the partnership is notified of the section 751(a) exchange.

If either of the two requirements are not met, no penalty relief is available under the Notice. The Notice does not provide relief with respect to filing Form 8308 as an attachment to a partnership's Form 1065.

IRS announced waiver of failure to pay penalties for certain returns for 2020 and 2021 tax years

In Notice 2024-7, released December 19, 2023, the IRS announced that it would waive certain failure to pay penalties owed for the 2020 or 2021 tax years. The penalty relief was expected to benefit approximately 4.7 million tax filers, including individuals, businesses, trusts, estates, and tax-exempt organizations, that were not sent automated collection reminders during the COVID-19 pandemic. The IRS estimated that it would provide about $1 billion in penalty relief under this notice.

Pursuant to Notice 2024-7, the IRS will not impose additions to tax under sections 6651(a)(2) or 6651(a)(3) for failure to pay during the relief period (i.e., the period that begins on the date the IRS issued an initial balance due notice or February 5, 2022, whichever is later, and ends on March 31, 2024). The relief does not apply to (1) any addition to tax, penalty, or interest not specifically listed in Notice 2024-7 (including failure to file penalty under section 6651(a)(1); (2) penalties assessed with respect to any tax years other than 2020 or 2021, or to forms not specifically listed; (3) returns to which fraud penalties apply; (4) offer in compromise cases; or (5) cases settled by closing agreements or in judicial proceedings. The relief also does not apply to any amount of interest that accrues because of any tax underpayment.

Taxpayers eligible for relief under Notice 2024-7 include those (1) with assessed income tax for tax year 2020 or 2021, as of December 7, 2023, that is less than $100,000, excluding any applicable additions to tax, penalties, or interest; (2) to whom an initial balance due notice (including, but not limited to Notice CP14 or Notice CP161) was issued on or before December 7, 2023, for taxable year 2020 or 2021; and (3) who were otherwise liable during the relief period for accruals of additions to tax for the failure to pay under sections 6651(a)(2) and 6651(a)(3) with respect to an eligible return for tax year 2020 or 2021. The complete list of "eligible returns" is detailed in the notice but covers a large number of individual and corporate income tax returns as well as returns for trusts and certain tax-exempt organizations.

Eligible taxpayers do not need to take any action, as the penalty relief is automatic. Eligible taxpayers who have already paid their balance in full will also benefit from the relief. The IRS will also automatically process the penalty relief for these taxpayers and then refund or credit the payment toward another outstanding liability.

The penalty relief was released in conjunction with the IRS's announced plan to resume sending automated collection reminder notices and letters that were previously paused due to the pandemic and backlog of returns and correspondence the IRS was working through.

Endnotes

1. IRS-2023-199, October 30, 2023, "IRS extends popular flexibilities set to expire; electronic signatures and encrypted email enhance the taxpayer experience."

2. See IRS Memoranda Control Number NHQ-01-0421-0001, NHQ-10-0421-0002, NHQ-01-1121-0004, and NHQ-10-1121-0005.

3. IRM section 10.10.1.

4. *Lee v. United States*, 84 F.4th 1271 (11th Cir. 2023).

5. *Boyle v. United States*, 469 U.S. 241 (1985).

6. IRC § 6651(a)(1).

7. *Boyle v. United States*, 469 U.S. 241 (1985).

8. *Boyle v. United States*, 469 U.S. 241 (1985).

9. IRC section 6662(b)(2).

10. IRC section 6662(a).

11. IRC section 6662(d)(1)(A).

12. IRC section 6662(d)(1)(B).

13. IRC section 6662(d)(2)(A).

14. IRC section 6662(d)(2)(C).

15. IRC section 6662(d)(2)(B).

16. The revenue procedure also discusses disclosure for purposes of the section 6694 tax return preparer penalty.

17. Rev. Proc. 2023-40, sec. 4.01(1).

18.Rev. Proc. 2023-40, sec. 4.01(2).

19. Rev. Proc. 2023-40, sec. 4.01(2).

20. Rev. Proc. 2023-40, sec. 4.01(2).

21. Rev. Proc. 2023-40, sec. 4.01(3).

22. Rev. Proc. 2023-40, sec. 4.01(4).

23. Rev. Proc. 2023-40, sec. 4.01(4).

24. Rev. Proc. 2023-40, sec. 4.02(2).

25. Rev. Proc. 2023-40, sec. 4.02(2).

26. Rev. Proc. 2023-40, sec. 4.02(3).

27. Rev. Proc. 2023-40, sec. 4.02(4).

28. Rev. Proc. 2023-40, sec. 4.02(5).

29. T.C. Memo. 2024-8.

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