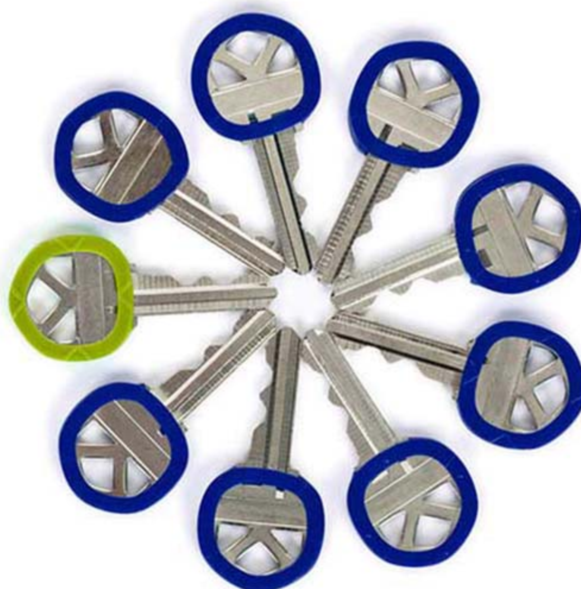

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Proposed and Temporary Regulations for Electing Into the BBA Partnership Audit Regime Issued

The Bipartisan Budget Act of 2015 ("BBA"), as amended by the Protecting Americans from Tax Hikes Act of 2015, created a new partnership audit regime (the "BBA Rules") to replace the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") partnership audit rules (the "TEFRA Rules")and the electing large partnership rules. The BBA Rules apply to tax years beginning after December 31, 2017.

Under section 1101(g)(4) of the BBA, partnerships can elect to have the BBA Rules apply to income tax returns for tax years beginning after November 2, 2015, and before January 1, 2018 ("eligible tax years"). Temporary and proposed regulations were issued on August 5, 2016, that provide the time, form, and manner for electing to adopt the provisions under the new partnership audit regime for eligible tax years.

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Temp. Treas. Reg. § 301.9100-22T(a) provides the general rule that a partnership may elect, subject to some exceptions, to apply the BBA Rules to any return of the partnership filed for an eligible tax year (an "Election"). A partnership that makes an Election to apply the BBA Rules to an eligible tax year may not then elect out of the BBA Rules under the small partnership exception[1] contained in Internal Revenue Code ("IRC") § 6221(b).[2] Additionally, an Election under Temp. Treas. Reg. § 301.9100-22T, once made, may only be revoked with the consent of the IRS. Finally, an Election is not valid if it frustrates the purposes of the BBA, which include the collection of any imputed underpayment that may be due by the partnership.

An Election may be made in only two circumstances: (1) in response to an IRS notice of selection for examination[3] or (2) in order to file an Administrative Adjustment Request ("AAR") under IRC § 6227. Temp. Treas. Reg. § 301.9100-22T(b) explains that an Election in response to an IRS notice of selection for examination must be made within 30 days of the date of notification to a partnership that a return of the partnership for an eligible tax year has been selected for examination. The partnership makes this Election by providing a written statement containing, among other things, language indicating that the partnership is electing application of the BBA Rules for the eligible tax year identified in the notice of selection for examination. Additionally, a partnership electing the early application of the BBA rules must designate a partnership representative ("PR") as defined in IRC § 6223.[4] Finally, the partnership must represent that it is not insolvent and does not reasonably anticipate becoming insolvent; is not currently and does not reasonably anticipate becoming subject to a bankruptcy petition; and has sufficient assets and reasonably anticipates having sufficient assets to pay a potential imputed underpayment that may be determined during the examination.

Temp. Treas. Reg. § 301.9100-22T(c) provides that a partnership that has not been issued a notice of selection for examination may make an Election with respect to a partnership return for an eligible tax year for the purpose of filing an AAR under IRC § 6227.[5] This Election may not be made before January 1, 2018, and an AAR filed on behalf of a partnership before this date is deemed to be an AAR filed under the TEFRA Rules or an amended return of partnership income, as applicable. This Election must be made in the manner to be prescribed by the IRS in accordance with applicable regulations, forms and instructions, and other guidance issued by the IRS.

In order to avoid proceedings under both the TEFRA Rules and the BBA Rules for the same tax year, an Election may not be made if the partnership has taken affirmative steps to apply the TEFRA Rules to the partnership return for that tax year, such as when the tax matters partner has filed an AAR under the TEFRA Rules. Similarly, an Election may not be made if a partnership that it not subject to the TEFRA Rules has filed an amended partnership return for a tax year.

Tax Court Examines Taxpayers' Discovery Responses Generated Using Predictive Coding

Dynamo Holdings Limited Partnership, through its tax matters partner, Dynamo GP, Inc., and Beekman Vista, Inc. (the "Petitioners") filed separate petitions with the Tax Court, which were then consolidated into one case. In 2013, the IRS filed a motion to compel the production of electronically stored information relating to adjustments and transfers between the Petitioners. The Petitioners filed an objection to the motion, and argued that if they had to produce the information, they should be permitted to use predictive coding, a computer-based discovery tool, to respond. The Tax Court compelled the Petitioners to produce certain electronic documents, but allowed them to use predictive coding in

[1] The small partnership exception applies to partnerships with 100 or fewer partners who are individuals, C corporations, foreign entities that would be treated as C corporations if they were domestic, S corporations, or an estate of a deceased partner. In counting the number of partners, all shareholders of an S corporation, in addition to the S corporation itself, are counted.
[2] All references to the IRC reflect the sections as amended by the BBA.
[3] The notice of selection for examination is a notice that precedes the notice of an administrative proceeding as required by IRC § 6231(a).
[4] The preamble to the regulations states that the Treasury Department and the IRS expect to issue additional guidance regarding the designation of the PR, including who is eligible to be a PR.
[5] The preamble to the regulations states that the Treasury Department and IRS intend to issue guidance regarding AARs under IRC § 6227.

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order to do so.[6] The Tax Court explained that predictive coding is an expedited and efficient form of computer-assisted review that allows parties in litigation to avoid the time and costs associated with the traditional, manual review of large volumes of documents.

In order to proceed with responding to the discovery requests, the IRS provided the Petitioners with 76 terms to be used in searching the universe of electronic documents. The Petitioners initially searched over 400,000 documents and provided the IRS with a table of results that showed, for each term, the number of individual term hits (the number of times each term appeared in any of the documents), the number of documents with term hits (the number of documents that contained each search term), and the number of individual documents only containing a single term. Next, the Petitioners randomly selected seed sets of 1,000 documents each, which the IRS reviewed in order to identify which documents were relevant to the discovery requests, and which were not. The documents were coded according to their responsiveness, or lack thereof, and this coding was used to create the predictive coding model that would identify which of the remaining documents were responsive. The model was then used against another seed set to test how well it worked.

The model did not originally perform well, so additional documents were coded for responsiveness. The IRS wanted to train the predictive coding model to have a recall rate of 95 percent. A recall rate is the percentage of all relevant documents in the search universe that are retrieved by that search method. The higher the recall, the fewer false negatives (relevant but unretrieved documents) there are. A search method's precision, on the other hand, is the percentage of documents retrieved by the method that are relevant. The higher a method's precision, the fewer false positives (irrelevant but retrieved documents) there are. Often there is a trade-off between recall and precision – a broad search that misses few relevant documents will usually capture a lot of irrelevant documents, while a narrower search that minimizes irrelevant documents will be more likely to miss some relevant documents.

The Petitioners responded to the IRS's discovery requests by using the predictive coding model as established by the parties. The IRS, believing the response to be incomplete, served the Petitioners with a new discovery request asking for all documents containing any of the search terms that had been used in the Boolean search during the predictive coding process to identify how many documents in the electronic records had each term. The Petitioners objected to the new discovery request as duplicative of the previous requests, and the IRS filed another motion to compel. Although the recall rate used in the predictive coding model was 95 percent, the IRS argued that the absence of some documents found in the original Boolean search from the produced documents demonstrated that the algorithm was flawed.

The Tax Court stated that the IRS's position in its motion was predicated on two myths.[7] The first is the myth of human review, which embodies the notion that manual review by humans of large amounts of information is as accurate and complete as possible, maybe even perfect. The Tax Court noted that the truth is that human review is far from perfect, and studies have shown that if two people review the same set of documents to identify what is responsive, they will disagree with each other on more than half of the responsive claims. The second myth is the myth of a perfect response. The Tax Court stated that the IRS was seeking a perfect response to its discovery request, but the Tax Court Rules do not require a perfect response. Rather, the Rules require that the responding party make a reasonable inquiry before responding. The Tax Court pointed out that the fact that a responding party uses predictive coding to respond to a request for production does not change the standard for measuring the completeness of the response, and it is inappropriate to hold electronic discovery to a higher standard than manual review. Therefore, the Tax Court held that the Petitioners satisfied the Tax Court Rules when they responded to the IRS's discovery requests using predictive coding, and the IRS's motion to compel was denied.

Federal Circuit Examines When Separate Entities Are Considered to Be the Same Taxpayer for Interest-Netting Purposes

Wells Fargo & Company ("Wells Fargo") had undergone a number of mergers over several decades, and some of the companies involved in these mergers had various tax overpayments and underpayments over time. Wells Fargo

[6] *Dynamo Holdings Limited P'ship v. Comm'r*, 143 T.C. 183 (2014).
[7] Dynamo Holdings Limited P'ship v. Comm'r, Docket Nos. 2685-11, 8393-12, Opinion (July 13, 2016).

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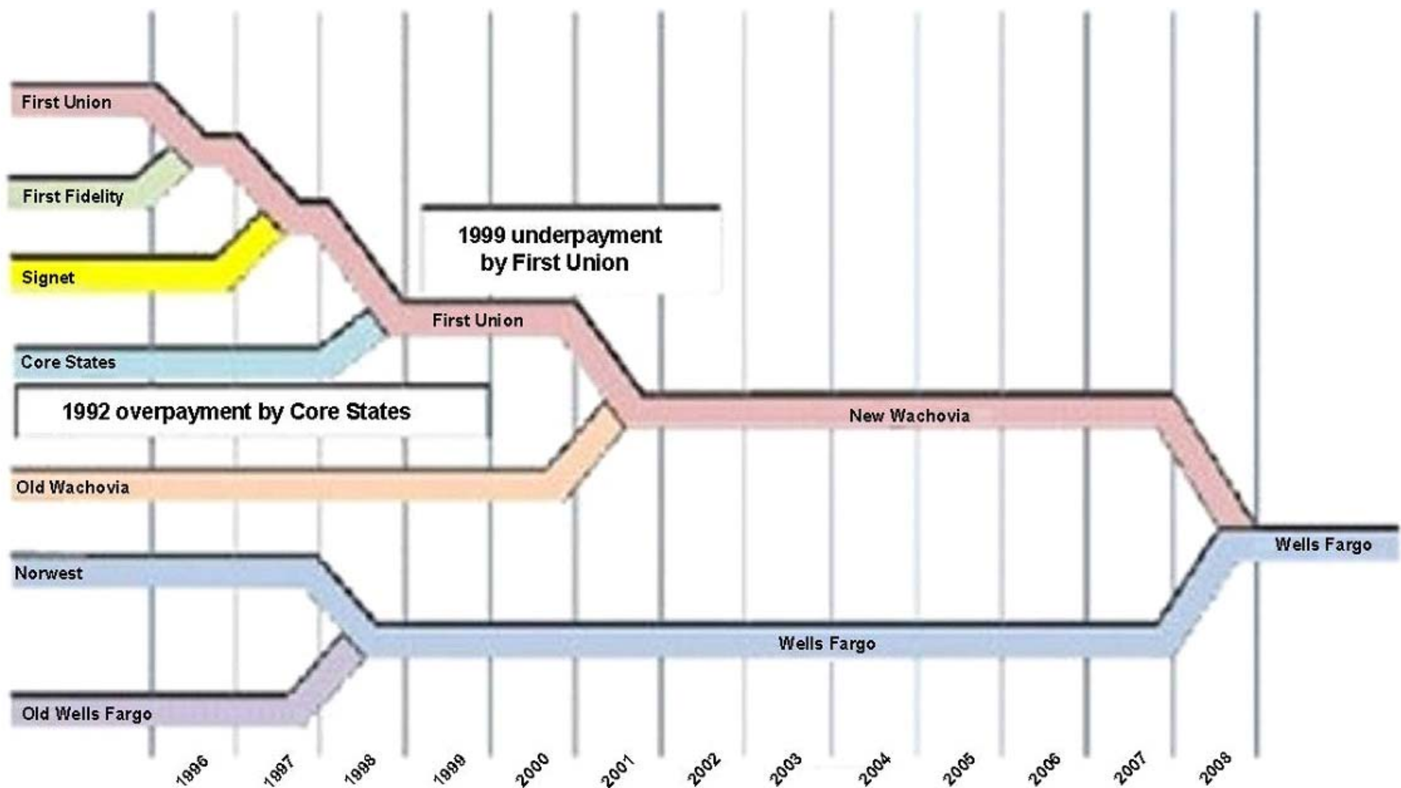
sought to net these overpayments and underpayments under Internal Revenue Code ("IRC") § 6621(d), which provides:

> To the extent that, for any period, interest is payable…on equivalent underpayments and overpayments by the *same taxpayer*…, the net rate of interest under this section on such amounts shall be zero for such period.[8] (emphasis added)

Wells Fargo filed administrative claims with the IRS seeking, among other things, refunds based on interest netting. The IRS denied the claims, and Wells Fargo filed a refund suit in the Court of Federal Claims. The Court of Federal Claims granted summary judgment in favor of Wells Fargo on certain claims on the grounds that Wells Fargo satisfied IRC § 6621(d)'s "same taxpayer" requirement.[9] The United States filed an interlocutory appeal on the issue to the Federal Circuit.

Among the issues considered on appeal was a situation in which an acquired entity had a pre-merger overpayment and the surviving entity had a post-merger underpayment,[10] as depicted below.[11]



Wells Fargo contended that whenever two companies merge, any payments they made, whether before or after the merger, were made by the "same taxpayer" for purposes of IRC § 6621(d) because the surviving corporation acquires and assumes the legal identity of the acquired corporation, so a merger effectively makes two corporations into one,

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[8] Absent an interest-netting provision like IRC § 6621(d), a taxpayer might make have equivalent overpayments and underpayments yet owe interest because corporate taxpayers pay underpayment interest at a rate higher than the overpayment interest rate that is paid to corporations.
[9] *Wells Fargo & Co. v. United States*, 117 Fed. Cl. 30 (2014).
[10] Another issued considered on appeal was a situation in which one entity had a pre-merger overpayment and the other entity had a pre-merger underpayment. The court found that Wells Fargo could not net interest in this situation because the overpayment and underpayment both occurred before the merger and were made by two separate taxpayers and therefore could not meet the "same taxpayer" requirement under IRC § 6621(d).
[11] *Wells Fargo & Co. v United States*, No. 1:11-cv-00808-NBF, 2015 US App. LEXIS 11855 (Fed. Cir. June 29, 2016).

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or the same. The United States argued that the "same taxpayer" determination be made either by reference to the Taxpayer Identification Number ("TIN") of the entity with the underpayment and the entity with the overpayment, or by looking to see if the two entities have "an identity of relevant essentials." The TIN argument was based on a Court of Federal Claims case that had looked at IRC § 6621(d) with respect to a group of affiliated corporations.[12] In that case, the court held that "there seems no better plain meaning of the term 'same taxpayer' then 'same taxpayer identification number.'").[13] The United States also contended that either test should be applied at the time of the overpayment and underpayment, as required by another Court of Federal Claims case.[14]

With respect to a situation in which an acquired entity had a pre-merger overpayment and the surviving entity had a post-merger underpayment, then, Wells Fargo contended that the two entities are the same taxpayer because they were merged, whereas the United States argued that they were not the same taxpayer because the surviving corporation has a different TIN than the acquired corporation and because the two entities did not have the same relevant essentials at the times of the overpayment and underpayment because they were incorporated under different names, filed different tax returns, and had principle offices in different states, to name a few. The court agreed with the United States that the relevant points for determining whether two entities were the same taxpayer were the times of the overpayment and underpayment, but did not agree with the tests set forth by either party.

At the outset, the court noted that both parties agreed that the term "same taxpayer" does not require the taxpayers to be completely identical, but acknowledged that the dispute was over the extent of corporate change that was allowed. The court then looked at the legislative history of IRC § 6621, and found that it reveals that the statute was intended to be remedial in nature, and should therefore be read broadly. Next, the court looked to the legal environment in which IRC § 6621(d) was enacted, specifically the merger law that existed at the time. The court noted that case law consistently describes an acquired corporation as being drowned in or absorbed by the surviving entity, and the Supreme Court had held that a merger was a continuation of the identity of the acquired corporation in the surviving corporation. Additionally, the court noted that federal tax law recognizes statutory mergers under IRC § 368(a)(1)(A) as a form of corporate reorganization where the pre-merger entities' assets and liabilities become the assets and liabilities of the post-merger surviving corporation. Finally, the court noted that the IRS had taken contrary positions regarding merged corporations in the past. First, the IRS had previously held surviving corporations liable for the underpayments but also entitled to the overpayments of their predecessors. Second, the IRS had previously offset overpayments and underpayments under IRC § 6402, which, the court noted, the IRS had treated as providing narrower authority than IRC § 6621(d). As a result, the court held that the surviving corporation in the above situation was the "same" taxpayer as the pre-merger acquired corporation for purposes of interest netting under IRC § 6621(d).

The Tax Court, Applying the Federal Rules of Civil Procedure, Concluded that Taxpayer's Petition is Timely because it was Filed on the First Day that the Court was Accessible after a Weather-Related Closure

In *Guralnik v Comm'r*,[15] the Tax Court analyzed the application of equitable tolling, Internal Revenue Code ("IRC") §§ 7502 and 7503, and the Federal Rules of Civil Procedure. In this case, Felix Guralnik ("Taxpayer") was seeking to petition the Tax Court to appeal a notice of determination relating to a federal tax lien ("Notice"), dated January 16, 2015; however, due to a snowstorm in the District of Columbia ("District"), the petition was not timely delivered.

The Taxpayer received the Notice dated January 16, 2015. Under IRC § 6330(d)(1), a taxpayer must file a petition with the Tax Court in a collection due process ("CDP") case within 30 days of the notice date. On Friday, February 13, 2015, Taxpayer mailed his Tax Court petition using Federal Express ("FedEx") First Overnight delivery service. The petition was expected to be delivered on Tuesday, February 17, 2015, as Monday, February 16, 2015 was a legal holiday; however, due to a snowstorm, the District, and federal government offices in the District, including the Tax

[12] *Magma Power Co. v. United States*, 101 Fed. Cl. 562, 569 (2011).
[13] *Id.*
[14] *Energy East Corp. v. United States*, 645 F.3d 1358 (2011).
[15] 146 T.C. No. 15 (June 2, 2016).

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Court, were officially closed on Tuesday, February 17, 2015. Accordingly, the petition was not delivered by FedEx until Wednesday, February 18, 2015, the first day that the Tax Court was accessible after the snowstorm closure.

Procedural History

The IRS filed a motion to dismiss asserting that Taxpayer had not timely filed his petition and thus, the Tax Court lacked jurisdiction. In November 2015, the motion was assigned to Special Trial Judge Armen, who recommended that it be denied as the snowstorm, which closed the Tax Court, constituted a legal holiday in the District for purposes of IRC § 7503, such that the filing of the petition on Wednesday, February 18, 2015 (the thirty-third day) was timely.[16]

The IRS filed a response concurring with Judge Armen's findings of facts, but objected to conclusions of law. The Taxpayer filed a response agreeing with Judge Armen's recommendation and advancing additional legal theories to support its position that the petition was timely filed. The Harvard Federal Tax Clinic filed a memorandum amicus curiae ("Memo") in support of Taxpayer and both parties responded to the Memo.

Ultimately, the Taxpayer and the Memo put forth the following four theories in support of the timely filing of the petition: (1) equitable tolling; (2) IRC § 7502; (3) IRC § 7503; and (4) inaccessibility of the court's office.

Equitable Tolling

First, the Tax Court discussed the Taxpayer's assertion that equitable tolling would allow the court to have jurisdiction in this instance. Equitable tolling is an equitable doctrine, which, in certain instances, has been utilized by courts to extend the filing period.

The Tax Court noted that there was significant precedent holding that equitable tolling did not apply to the filing of a petition for a CDP case. Even disregarding the precedent, the Tax Court noted that equitable tolling is applicable to instances where the filing requirement can be separated from the jurisdictional requirement. In this situation, the filing period and grant of jurisdiction are inextricably linked and thus the Tax Court held that equitable tolling cannot apply. The court pointed towards the language of Section 6330(d)(1), which states:

> The person may, within 30 days of a determination under this section, petition the Tax Court for review of such determination (and the Tax Court shall have jurisdiction with respect to such matter).

Due to the intertwined nature of the filing period and the grant of jurisdiction, the Tax Court rejected the Taxpayer's argument that equitable tolling could apply to extend the 30-day filing period prescribed by IRC § 6330(d)(1) as the 30-day filing period is jurisdictional.

IRC § 7502

Next, the Tax Court addressed the argument that the petition should be deemed timely filed pursuant to IRC § 7502.[17] IRC § 7502(a) provides, subject to certain requirements, that a return, claim, statement or other document required to be filed within a prescribed period of time or on or before a prescribed date set forth by the Internal Revenue Code will be deemed timely if delivered to the IRS or office with which the document is required to be filed after the due date, but the postmark shows that the document was mailed either on or before the due date.

Under IRC § 7502(f) and the regulations thereunder, a taxpayer may utilize a designated private delivery service; however, only certain delivery services as specified by the Secretary qualify as a "designated delivery service," such that IRC § 7502 applies. During the Taxpayer's filing period for the petition, the applicable list was provided in IRS Notice 2004-83, which did not include the delivery service utilized by the Taxpayer. [18]

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[16] *Guralnik v. Comm'r*, Tax Court Order, Docket No. 4358-15 L. (August 24, 2015). Please see the November 2015 edition of *IRS Insights* for a summary of the Tax Court's Order.
[17] This provision is commonly referred to as the "mailbox rule."
[18] On May 6, 2015, the IRS issued Notice 2015-38, updating the list of designated private delivery services for purposes of IRC § 7502, and including FedEx First Overnight as a designated delivery service.

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The Taxpayer argued that he utilized a superior service, i.e. guaranteed delivery prior to other approved services;[19] therefore, it should be deemed to meet the statutory standards even though not specifically listed in Notice 2004-83. The Tax Court noted that although the designated services were ultimately updated in Notice 2015-38 to include FedEx First Overnight Service, this notice was not retroactive and FedEx First Overnight was not a designated delivery service on the date that the petition was mailed. Accordingly, the Tax Court held that IRC § 7502 did not apply to the Taxpayer's petition.

IRC § 7503

The Tax Court next focused on whether IRC § 7503 applied, such that the petition would be timely filed on Wednesday, February 18. IRC § 7503 prescribes that if the last day for performing any act falls on a Saturday, Sunday, or legal holiday, the performance is considered timely if it is performed on the next business day. Generally, a legal holiday is defined as a holiday in the District of Columbia. Treas. Reg. § 301.7503-1(b).

In this instance, the petition was technically due on Sunday February, 15, which was 30 days after the date of the notice. As the due date fell on a Sunday and the next day was a legal holiday, the petition would be deemed timely filed if received on Tuesday, February 17 under IRC § 7503. However, on Tuesday, February 17, the District had a snowstorm, which closed all federal and District offices, including the Tax Court. Accordingly, the petition could not be delivered on Tuesday, February 17.

The Taxpayer argued that IRC § 7503 should apply to Tuesday, February 17 as the snowstorm in essence rendered the day a legal holiday. The Taxpayer pointed to the declaration of the Mayor of District designating February 17 as a snow emergency day and closure of all public offices as support. The IRS countered that practical considerations counseled against concluding that a snow emergency in the District is equivalent to a legal holiday; specifically, the IRS noted that treating a snow day in the District as a legal holiday would extend the time for performing any act required to be performed anywhere in the country. This in turn would create significant difficulties for both taxpayers and IRS officials to ascertain when snow emergencies began or ended for holidays under the Internal Revenue Code.

While the Tax Court stated that the language of IRC § 7503 does not restrict holidays to only those specifically designated in the District code, it noted the distinction between a snow emergency day and legal holiday, as authorization appears in a different sections of the District municipal code. The Tax Court further noted that if the Mayor had declared that there was a legal holiday in the District, then it would be "arguably clear" that the Tax Court had jurisdiction. Ultimately, the Tax Court stated that the "parties have advanced reasonable arguments on both sides of this question," and determined that it was not required to resolve the IRC § 7503 question because it had jurisdiction on other grounds.

Inaccessibility of the Clerk's Office

The Tax Court observed that its court rules did not specifically address how the 30-day period to file a CDP petition is computed when the Tax Court Clerk's Office is inaccessible due to inclement weather or government closure. Tax Court Rule 25(a) deals with the computation of time; however, does not address the inaccessibility of the court.

Rule 6(a)(3)(A) of the Federal Rules of Civil Procedure ("Civil Rule 6(a)(3)(A)") sets forth the principles for computing time when a District Court clerk's office in inaccessible, providing that that, if the office is inaccessible on the last day of filing, then the time for filing is extended to the first accessible day that is not a Saturday, Sunday or legal holiday. The Taxpayer implored the Tax Court to adopt the computational principles set forth in Civil Rule 6(a)(3)(A), under the authority granted by Rule 1(b) of the Federal Rules of Civil Procedure ("Rule 1(b)"), which allows a federal court to fill procedural gaps by prescribing procedures in matters before it. The Tax Court noted that it has utilized Rule 1(b) in a variety of instances to fill in gaps in the procedural rules where it was silent or unclear. Further, the court stated:

> We see no logical reason why litigants in our Court, unlike litigants in virtually every other Federal court, should be penalized for being unable to file a document that we, by closing our Court, have made impossible for them to file on that day.

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[19] IRS Notice 2004-83 included the following services as designated delivery services: FedEx Priority Overnight, FedEx Standard Overnight and FedEx 2 Day.

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The IRS countered that IRC §§ 7502 and 7503 specify the method of computing time, thus the Tax Court was not allowed to utilize Civil Rule 6(a)(3)(A). The Tax Court disagreed and noted that IRC § 7503 only speaks to the last day and does not discuss any extraordinary circumstances, while IRC § 7503 only addresses the postmark date. Accordingly, the Tax Court concluded that it could apply the principles of Civil Rule 6(a)(3)(A) as IRC §§ 7502 and 7503 did not specify the method to compute time when the Tax Court's Clerk's Office was inaccessible.

The Tax Court held that the time for filing a petition could be extended to the first accessible day after a closure for inclement weather. Therefore, as the petition was filed on February 18, 2015, the first accessible day after the Tax Court was closed due to a winter storm, the Tax Court held that the Taxpayer's petition was timely filed and the court had jurisdiction to hear the case.

IRS Issues Legal Memorandum Discussing Applicability of Penalties under IRC § 6721 Where Withholding Agent Files Form 1042-S Reporting Incorrect Taxpayer Identification Number

In response to an IRS Large Business & International (LB&I) division attorney's request for assistance, the IRS issued a legal memorandum20 ("Memo") addressing whether penalties should be imposed for an invalid Taxpayer Identification Number ("TIN") reported on a Form 1042-S, *Foreign Person's US Source Income Subject to Withholding*, and, if penalties were appropriate, the proper section of the Internal Revenue Code ("IRC") under which the penalties should be assessed.

In this instance, a withholding agent ("Agent") received a Form W-8BEN, *Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding and Reporting (Individuals)*, from a foreign payee ("Payee"), which included the Payee's purported TIN. The Agent utilized the Form W-8BEN information in filing its Form 1042-S to report the withholding for payments to the Payee. Upon examination, the IRS discovered that the incorrect TIN was reported on the Form 1042-S, pursuant to the information provided by the W-8BEN. The LB&I division attorney sought advice about assessing penalties against the Agent for the erroneous TIN reflected on the Form 1042-S.

Background

Pursuant to IRC §§ 1441 – 1443 and the regulations thereunder, generally a withholding agent is required to withhold 30 percent of US-source payments of fixed, determinable, annual, and periodical income ("FDAP income") to foreign payees, subject to certain exceptions. A foreign payee may request a reduced rate of withholding in specific circumstances, such as when there is an applicable income tax treaty, by providing a withholding certificate to the withholding agent detailing its status.21 The withholding agent is responsible for withholding the appropriate amount on US-source FDAP income payments to foreign payees and reporting the tax on a Form 1042, *Annual Withholding Tax Return for US Source Income of Foreign Persons*.[22] Additionally, the withholding agent is responsible for filing Forms 1042-S, detailing payments to specific payees, and issuing a copy of the Form 1042-S to each respective payee.[23]

Discussion

In this instance, the Agent received a Form W-8BEN from the Payee requesting a reduced rate of withholding due to an income tax treaty, which included the incorrect TIN. The Agent utilized this TIN for the Payee on the Form 1042-S filed with the IRS. Pursuant to IRC § 6721, a taxpayer is subject to a penalty for failure to file an information return, provide any information required to be shown on the return, or include correct information.24 Forms 1042-S are considered information returns for this purpose under the definition set forth in IRC § 6724(d)(1).

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[20] ILM 201615012 (February 23, 2016).
[21] Treas. Reg. § 1.1441-1(b)(4).
[22] Temp. Treas. Reg. § 1.1446-1T(b).
[23] Temp. Treas. Reg. § 1.1446-1T(c).
[24] The penalty may be reduced if certain failures are corrected within specified timeframes. See IRC § 6721(b).

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According to the Memo, whether to assess penalties under IRC § 6721 for an invalid TIN on a withholding agent's Form 1042-S is a facts and circumstances inquiry. The Memo states that, generally, penalties should only be applicable where the withholding agent knew or should have known of the error, citing to Temp. Treas. Reg. § 1.1441-6T(b), which provides that, absent actual knowledge or a reason to know that claims are incorrect, a withholding agent may rely on claims made on a withholding certificate or on documentary evidence.[25] Accordingly, the Memo concludes that the Agent in this instance met the standard of compliant behavior as there was no evidence that the Agent knew (or should have known) about the incorrect TIN.

The Memo also provides that even if a penalty had been asserted under IRC § 6721 against the Agent, it could be waived if the Agent could demonstrate the failure was due to reasonable cause and not willful neglect. Pursuant to IRC § 6724(a), "[n]o penalty shall be imposed under this part with respect to any failure if it is shown that such failure is due to reasonable cause and not to willful neglect." The Memo notes that reasonable cause is a facts-and-circumstances analysis, and some factors to be considered are whether the withholding agent acted in a responsible manner, whether mitigating factors exist, or whether the failure resulted from circumstances beyond the withholding agent's control.[26] Further, the Memo notes that Treas. Reg. § 301.6724-1(g)(2) provides a safe harbor establishing reasonable cause and due diligence if a payee certifies that the provided TIN was the correct number.

The Memo concluded that in this situation, where the Agent relied on a TIN provided by the Payee, under the standard of Temp. Treas. Reg. § 1.1441-6T(b), the Agent acted in a responsible manner. Accordingly, the Agent is generally entitled to reasonable cause relief and waiver of information return penalties unless it had knowledge or should have known of the error.

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36 USC 220506

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[25] *See also* Temp. Treas. Reg. § 1.1441-7T(b).
[26] Treas. Reg. § 301.6724-1(a)(2).

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