



IN CASE YOU MISSED IT – August 2024

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Almost every day, federal and state courts issue opinions that affect taxpayers. The IRS and state taxing authorities also publish guidance on myriad topics.

Each month, this column will review a selection of recent court cases or guidance that tax professionals should know about when advising their clients and preparing tax returns.

For more extensive detail on any of these items, please feel free to reach out to the author.

[Manente v. Commissioner](#): CPAs should know better

The issues in this case were so simple that the judge gave her decision orally at the end of trial. Rather than having a formal, long opinion, the transcript pages from the final morning of trial were attached to the decision document. Why then is it worthy of being included in this column? The taxpayer was a certified public accountant who prepared his own tax return at issue. The positions that he took on his tax return were clearly wrong. Nevertheless, he still managed to prevail in court on some of the issues.

The asserted deficiency in this case was for \$23,416 in income tax for tax year 2018. The IRS also asserted an accuracy-related penalty under [Code section 6662\(a\)](#) on the deficiency.

Taxpayer is a certified public accountant. During 2018, he was the head of the audit department for Rising Pharmaceuticals, Inc. (Rising), and his wife worked as a programmer for Cvent, Inc. (Cvent). While their jointly filed 2018 Form 1040 reported capital losses and losses from rental real estate, it did not reflect any income attributable to wages and/or salaries despite the fact that they were both full-time employees of their respective companies. The return showed that Taxpayer and his wife were owed a refund of \$29,553.

Instead of attaching Forms W-2 issued by their respective employers to the Form 1040, Taxpayer created and attached “representations of [F]orms W-2.” These substitute wage and tax statements showed zero wages paid to either taxpayer, but reflected withheld amounts for federal income tax, Social Security tax, and Medicare tax. All of these withheld taxes were included as part of Taxpayer’s refund claim.

The IRS, relying on third-party information forms that were actually filed by Rising and Cvent, determined that Taxpayer had been paid wages of \$116,862 and his wife had received wages of \$72,718. The IRS also determined based on third-party information reporting by the State of New York that the taxpayers had received a state income tax refund in 2018 in the amount of \$4,151.

During the trial, Taxpayer acknowledged that he and his wife had received the amounts that Rising and Cvent reported as wages, and agreed that he received the state tax refund from the State of New York. (The IRS also claimed that Taxpayer received a \$3,067 tax refund from New Jersey, but when faced by Taxpayer's challenge in court, could not provide sufficient proof to show that Taxpayer actually received it; thus, this was the first "win" for Taxpayer.)

Taxpayer then had the burden to prove to the court that the amounts paid by Rising, Cvent, and the State of New York should not be treated as taxable income.

Taxpayer, who the reader should remember is a certified public accountant, argued that he should not be subject to tax on the amounts received from Rising and Cvent as they were not "gains from labor." He argued that gains from labor were only taxable if the amounts received in return for the provision of labor services were invested and then sold, effectively converting them into "gains." He argued that wages, in and of themselves, are not taxable until they are converted into such gains. None of the authorities that he cited to the Court stood for the position that he was arguing. [Code section 61\(a\)](#) provides that "gross income means all income from whatever source derived," specifically including "[c]ompensation for services." Payments for labor are taxable at the time that they are paid to the person who performed the labor.

Taxpayer also made the bizarre argument that the only "employees" who could be subject to tax on their wages were persons "similar to an officer, employee or elected official of the United States"; therefore, this excluded persons such as himself, privately employed individuals, from being taxed on wages.

The Court refused to even discuss the other arguments that he raised, as "to do so might suggest that these arguments have colorable merit."

Taxpayer did not present any evidence that he should not be subject to tax on the New York State refund.

All was not lost for Taxpayer, though. He also disputed the imposition of an accuracy-related penalty for an underpayment of tax attributable to a substantial understatement of income tax under Code section 6662(a). There was no question that the understatement of \$193,700 of gross income exceeded \$5,000 or 10% of the tax required to be shown on the return. However, the Service failed to show compliance with the supervisory approval requirement of [Code section 6751\(b\)\(1\)](#). This section requires that "[n]o penalty under this title shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the immediate

supervisor of the individual making such determination." There has been a tremendous amount of litigation on this issue over the last eight years, since the Tax Court decided [Graev v. Commissioner](#). The Court here found that the IRS did not submit sufficient evidence to establish the chain of command, so it could not prove that the person who signed the penalty approval form was actually the supervisor of the examining agent. Thus the court declined to sustain the penalty determination.

Even though this CPA should have known better than to prepare his returns the way he did and to make the arguments that he did in court, he did succeed in getting the penalties thrown out. The court warned him though that it found his behavior appalling, stating "We end by noting that Mr. Manente's return positions are unbecoming to his position as a CPA. We warn Mr. Manente that under [section 6673\(a\)](#), this Court has authority to impose a penalty of up to \$25,000 for making frivolous or groundless arguments in proceedings before us. Because this appears to be the first case that Mr. Manente has brought to trial in our Court, we will not impose a penalty at this time. We may not be so lenient if he repeats his performance in the future."

Takeaway: CPAs should be held to a higher standard when it comes to preparation of their own returns. This taxpayer was lucky that the court did not impose the additional penalties under Code section 6673 for the baseless arguments that he raised in support of the exclusion of wages from taxable income.

[Saslaw:](#) Not always a responsible person

The issue in this case was whether the Petitioner could be held to be personally liable as a person required to collect and pay sales and use taxes under [New York Tax Law §§ 1131 \(1\) and 1133 \(a\)](#).

Petitioner worked for an ice cream shop, the "Company." The Company timely filed its sales and use tax reports during the periods at issue, but either made only partial payments or no payments at all of the amounts shown as due on the returns.

The Division of Taxation determined that Petitioner was a responsible person based on the many documents that had been submitted indicating his status as such. These included: i) Form IT-204, New York State Partnership Return, on which the return preparer listed Petitioner's name under "[s]ignature of the general partner; " ii) an online services business account creation form Petitioner submitted for the Company; iii) Forms DTF-17, application to register for a sales tax certificate of authority, and DTF-17-ATT, schedule of business locations for a consolidated filer, both of which listed Petitioner as the responsible person and identified him as the manager of the Company whose primary duties included, among others, a) check signing authority, b) authority over business decisions, and c) deciding which financial obligations are paid; iv) Form DTF-95, Business Tax Account Update, signed by Petitioner as "former" Director of Finance; and v) numerous electronically submitted sales tax returns, including: Forms ST-100, New York State and Local Quarterly Sales and Use Tax Returns, Forms ST-809, New York State and Local Sales and Use Tax Return for Part-Quarterly (Monthly) Filers,

and Forms ST-810, New York State and Local Quarterly Sales and Use Tax Return for Part-Quarterly (Monthly) Filers.

Tax Law § 1133 (a) provides, in part, that “every person required to collect any tax imposed by this article shall be personally liable for the tax imposed, collected or required to be collected under this article.” Tax Law § 1131 (1) in turn defines a person required to collect tax imposed by this article to include, among others: “any officer, director or employee of a corporation or of a dissolved corporation, any employee of a partnership, any employee or manager of a limited liability company, or any employee of an individual proprietorship who as such officer, director, employee or manager is under a duty to act for such corporation, partnership, limited liability company or individual proprietorship in complying with any requirement of, or has so acted; and any member of a partnership or limited liability company.”

The regulations promulgated by New York State expand this definition with respect to corporate officers and employees, by stating: “Whether an officer or employee of a corporation is a person required to collect, truthfully account for, or pay over the sales or use tax is to be determined in every case on the particular facts involved. Generally, a person who is authorized to sign a corporation's tax returns or who is responsible for maintaining the corporate books, or who is responsible for the corporation's management, is under a duty to act.” [20 NYCRR 526.11 \[b\] \[2\]](#).

This seems like it should have been an easy win for the Division in the face of all of the documentary evidence naming Petitioner as a responsible person. However, Petitioner testified that the Company was in serious financial distress. By January 1, 2019, its parent company stopped approving all payments and told Petitioner he could no longer authorize automatic payments or cut any checks. All payment functions were placed under the control of the managing member. Petitioner testified that he only continued to sign the tax applications and forms so that the Company could continue in business. He was directed to say he was managing the Company so that there would be no delays if the member was unavailable to sign documents. Although he was still listed as an authorized signatory on the checking account, he testified that such authority was “impractical” and “of no authority because [he] was unable to use it.” His testimony, while seeming self-serving, was corroborated by the Company's Senior Accounting Manager and the Company's staff accountant. The staff accountant explained that checks were piling up on his desk waiting for the authorization of the managing member as no one could pay any bills without his approval, and that approval never came. Eventually the parent company filed for bankruptcy and a Chief Restructuring Officer was appointed. He too testified that there was no way that Petitioner could have issued any checks during the periods at issue.

In determining whether a person should be viewed as a responsible person, the Tax Appeals Tribunal looks beyond the paperwork that was submitted to review the substance of the person's authority. “The question to be resolved in any particular case is whether the individual had *or could have had* sufficient authority and control over the

affairs of the corporation to be considered a responsible officer or employee.”
(Emphasis added) *Matter of Constantino*.

Petitioner here might have had the necessary authority on paper to file the sales and use tax returns and make the necessary tax payments, but he was prevented from doing so by his superiors. The Tax Appeals Tribunal recognizes an exception to the general rule when the responsible person “lacked the necessary authority or he had the necessary authority, but he was thwarted by others in carrying out his corporate duties through no fault of his own.” (*Matter of Goodfriend*, Tax Appeals Tribunal, January 15, 1998 TAT 813674)

While the documents the Division relied on to determine Petitioner’s responsible person status would seem to indicate that Petitioner was in fact a responsible person, the judge determined that Petitioner’s “corroborated and unrefuted testimony” established that he lacked the necessary authority during the periods at issue to ensure that sales tax was remitted on behalf of the Company.

Takeaway: While Petitioner may have started out as a responsible person, once check writing ability was taken away from him, his status changed. Testimony, corroborated by third parties, was enough to overcome a mountain of paper evidence to the contrary.

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