Viewpoint

Omnipresent *Seinfeld* Episodes Contain Ample Clues About Tax Policy

BY ROBERT W. WOOD AND STUART M. VOGT

With the advent of digital video disc collections and the never-ending life of situation comedies in syndication, *Seinfeld*, it seems, will never pass from our scene.

Perhaps that is good. The self-professed ''show about nothing'' covered lots of somethings, provoking endless conversations around the water cooler and kitchen table about otherwise neglected topics.

Take taxes. Although *Seinfeld* was high comedy, it educated viewers on a host of tax topics. If you play sitcom detective and sift through the episodes, you'll find that *Seinfeld* contains quite a bit of tax law.

'The Truth'

Let us start with ''The Truth,''[1] an episode drawing its title from the character of George telling his girlfriend she is pretentious than from truths about the IRS. Yet, in not so subtle ways, this episode explores one of the most misunderstood tax questions: what can the IRS really do to taxpayers? Many people may agree with Jerry's axiom: ''The IRS. They're like the mafia. They can take anything they want.''[2]

In this episode, Jerry is questioned by the IRS about a $50 charitable contribution he made to help rescue the people of Krakatau. He made the contribution in 1985 or 1986. The Krakataun charity turns out to be fictitious, and the IRS attempts to adjust Jerry's tax return.

First, let's dispel one ''truth.'' The IRS normally does not require taxpayers to substantiate charitable donations if the amount is less than $250.[3] For Jerry's contribution of $50, he would be required to show only that he donated the money—a check or bank account statement would probably suffice. The episode makes a fuss of Jerry's lost receipt. Yet, the loss of his Krakataun receipt would not put Jerry in an adverse position with the IRS. He could merely call his bank and it send over a statement or a copy of the check.

There's a more fundamental point, though. Jerry's audit was for 1985 or 1986, yet the show first aired in the fall of 1991. Assuming that Jerry filed his 1986 tax return in 1987 (even if he filed on extension), this audit goes beyond the three year statute of limitations (and yes, it's *statute* of limitations[4]). [5] For the IRS to go beyond the three year statute, the IRS must show the taxpayer committed fraud or omitted more than 25 percent of his or her gross income.[6] Here, Jerry did not omit any income, but merely took a questionable charitable deduction. Thus, this audit should not have even occurred.

In one episode, Jerry is questioned by the IRS about a $50 charitable contribution he made to help rescue the people of Krakatau.

However, during the audit process, there are ample opportunities to resolve the issue. In all likelihood, Jerry would have resolved a questionable $50 deduction long before a notice of deficiency was issued. A notice of deficiency allows the taxpayer 90 days to file in Tax Court, and the case will then be transferred to IRS Appeals, where most cases are resolved without court battles.

With characteristic hyperbole, Jerry suggests that the IRS can show up unexpectedly and ''take anything they want.'' Actually, there are plenty of procedural safeguards to prevent this, as long as the taxpayer keeps the administrative process going.

Write-Offs

Write-offs are misunderstood, and the term is widely misused. Prime fodder for *Seinfeld.* In ''The Package,''[7] Kramer convinces Jerry to let him borrow Jerry's broken stereo. Kramer mails the stereo back to Jerry, and unbeknownst to Jerry, insures the package for $400. When the packaged arrives, Kramer suggests Jerry can claim the contents were damaged during shipping and

[1] Episode 19, aired Sept. 25, 1991.
[2] *Id.*
[3] See Internal Revenue Code Section 170(f)(8)(A).

Robert W. Wood practices law with Wood & Porter in San Francisco (http://www.woodporter.com). He is the author of **Taxation of Damage Awards and Settlement Payments** *(3d Ed. 2005 with 2006 supplement), published by Tax Institute and available at http://www.damageawards.org. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.*

Stuart Vogt is the manager of corporate taxes at a public company in Marin County, Calif.

[4] See ''The Cafe,'' episode 24, aired November 6, 1991. In this episode Jerry and Kramer disagree over whether the term is ''statue'' or ''statute'' of limitations.
[5] See I.R.C. Section 6501.
[6] See I.R.C. Section 6501(e).
[7] Episode 139, aired Oct. 17, 1996.

receive $400. Their conversation exemplifies what many Americans think about write-offs:

Kramer: ''It's just a write-off for them.''

Jerry: ''How is it a write-off?''

Kramer: ''They just write it off.''

Jerry: ''Write it off what?''

Kramer: ''Jerry, all these big companies, they write-off everything.''

Jerry: ''You don't even know what a 'write-off' is.''

Kramer: ''Do you?''

Jerry: ''No. I don't.''

Kramer: ''But they do, and *they* are the ones writing it off.''

This exchange plainly shows that neither Jerry nor Kramer comprehend write-offs. As always, their confusion mirrors our national confusion. A write-off is a deduction, a cost of doing business that can reduce taxable income.[8] Here, the United States Postal Service would have to fork over $400 to Jerry for his damaged stereo. The USPS (if the agency filed a tax return!) would then deduct this cost on its return.

We have all heard people exclaim, ''Oh, I'll just write it off,'' as if to say ''this expense does not count.'' While write-offs are subsidized by the government, the expense still has to be incurred. Despite ''writing something off,'' the cost is real dollars spent out of pocket. If you write off $100 and are in a 35 percent tax bracket, your *real* cost is $65.

With characteristic hyperbole, Jerry suggests that the IRS can show up unexpectedly and ''take anything they want.''

The real problem with write-offs is not the concept, of course, but rather *which* costs can be deducted. The devil, as they say, is in the details.

We've all heard about small business owners running their family expenses through the family company. *Seinfeld* addresses this too.

In ''The Chicken Roaster,''[9] Elaine, acting as president of the J. Peterman catalog company, makes outrageous purchases at a high-end store on the ''Peterman account.'' George accompanies Elaine on one such outing, coercing her into purchasing an $8,000 sable hat for him on the Peterman account. Later in the episode, Peterman's accountant calls Elaine to discuss her recent ''business'' purchases.

Aghast at being questioned by Peterman's accountant, Elaine's first response is, ''Isn't the President allowed to do whatever they want?'' In the real world, and even on *Seinfeld*, the answer is plainly ''no.''

Like Elaine, many taxpayers think the president of a company can do whatever she wants. Yet, Elaine and other not-so-fictional chief executive officers like Dennis Kozlowski and Ken Lay learned they cannot. Business expenses must relate to the business or be for the production of income.[10] Elaine purchases thousands of dollars worth of items not related to her role as president, and not related to the production of income for the J. Peterman catalog.

Remember Dennis Kozlowski's $10,000 shower curtain? Or the ice sculpture of Michelangelo's David that peed vodka? When determining whether expenses can be deducted, bear in mind that the expenses must be for the production of income or be related to running the business. One of Elaine's purchases was a water pick (made for brushing teeth), which she claimed she used to water the plants in her office. The IRS would frown upon this, as did Peterman's accountant.

Stock Options

Even *Seinfeld* was not impervious to the stock option craze hitting corporate America in the 1990s. In ''The Money,''[11] Elaine discusses how the stock options she receives as president of J. Peterman ''work.'' She suggests to Jerry that the intricacies of stock options is interesting, but as Jerry acidly responds, ''Yeah, when it's your money, it's fascinating.''

So, to make it fascinating, perhaps try to pretend it's *your* money. There are two types of options. As J. Peterman's newest, president Elaine could receive either incentive stock options (ISOs) or nonqualified options. A grant of ISOs is not a taxable event. If Elaine wants capital gain treatment when she sells her stock, she must wait two years from the date of the grant *and* one year after she exercises the options.[12] Otherwise, when she sells her stock, it will be considered part of her regular compensation.

If Elaine receives non-qualified stock options instead of ISOs, she will be taxed upon grant, if the stock has a readily ascertainable fair market value.[13] If the stock is traded on an established market, the market price upon grant dictates that fair market value. Here, let's assume J. Peterman stock is traded on an established market. When Elaine receives her non-qualified options, she must recognize as ordinary income the fair market value of the options. Elaine will not be taxed again when she exercises the options and buys the stock, but will be taxed upon sale of the shares—assuming there's a gain. The holding period for determining whether the gain (or loss) is long-term starts the day *after* the option was exercised.

During the episode, Peterman returns to take his post as president, revoking Elaine's options.[14] Elaine later gets upset that the J. Peterman stock rose 12 points on Peterman's return, which would have secured her a nice little profit. But, it also teaches another lesson. If Elaine had received non-qualified options and the stock price declined, Elaine could take a deduction for her loss, but would still be hit with the financial burden of a losing investment. Stock options don't always equal profits.

Prizes, Awards & Gifts

Prizes and awards may seem universally positive, but they can also be burdensome. In some cases, the Inter-

[8] See I.R.C. Sections 162 and 212.

[9] Episode 142, aired November 14, 1996.

[10] See I.R.C. Sections 162 and 212.

[11] Episode 146, aired Jan. 16, 1997.

[12] See Treasury Regulations Section 1.422-1(a)(1)(i)(B).

[13] See Treasury Regulations Section 1.83-1(a) and 1.83-7(a).

[14] It is quite possible Peterman cannot legally revoke her options, but that is the subject of another article. Peterman seems to do a lot of things one cannot do in the business world.

  DTR ISSN 0092-6884

nal Revenue Code treats prizes and awards as ordinary income taxable to the recipient. Ouch. In ''The Summer of George,''[15] when Kramer ''won'' his Tony, he may have incurred taxable income equal to the value of the award.

The Accidental Tony

In this episode, Kramer gets hired to be a seat filler at the Tony Awards ceremony in New York. Kramer finds an empty seat, which happens to be in the middle of a group of people who win a Tony for their show *Scarsdale Surprise*. After the announcement, Kramer is rushed up on stage with the group and is accidentally awarded a Tony. Conceivably, Kramer must report the value of his Tony despite the fact he was not part of the production team that actually won the award. In 1986, Congress added the requirement that to exclude from income the value of awards for certain types of achievements, such as artistic or literary works, the recipient must transfer the award to a governmental unit or a charity.[16]

Here, as we find out, Kramer wants to keep his Tony, so it is arguably taxable despite what his ''feelings are on this.''[17] Anyhow, the value of the Tony is presumably nominal, so if there is any tax hit, it's small. However, later in the episode, the producers tell Kramer he can keep the award if he fires *Scarsdale Surprise's* lead actress, Raquel Welch, who is expendable because she does not move her arms while she tap dances, evidently quite a *faux pas* in tap dancing.

When Kramer introduces himself to Welch's character as ''one of the producers,'' he has apparently accepted the producer's offer. Kramer clearly has income, since he received the Tony as compensation for firing Raquel Welch.

Gift Taxes

In another episode,[18] while still employed by the New York Yankees, George is asked by his boss to sign a birthday card for George Steinbrenner, the Yankees' owner. After signing it, he is supposed to give it to another Yankees' employee, and then eventually to Mr. Steinbrenner. After some typical *Seinfeldian* finagling, the birthday card winds up being framed and presented to Mr. Steinbrenner prematurely.

Assuming you are not a Red Sox fan, this birthday card might carry some street value and possibly incur gift taxes. Although I realize this card should not fetch more than $12,000 (the threshold required to file a gift tax return), once the Yankees all sign the card, the card gains value. Upon giving it to Mr. Steinbrenner, perhaps each Yankee should arguably have to report a share of the gift?

If a gift is valued at $12,000 or more, the donor (the person giving the gift) must report the gift to the IRS.[19] The donee is not subject to tax (but the IRS can seize the gift to collect the tax if the donor is unavailable). A donor can give $12,000[20] per year to *each* person they desire without being required to file a gift tax return.

But, intent can be scrutinized. Here, this ''gift'' might be viewed as motivated not by detached and disinterested generosity, but rather by lucre. It might be a way for the players to induce Steinbrenner to make more favorable contracts. If so, Steinbrenner would have to include the value of the birthday card in his income, regardless of its value.

Independent Contractors

''Whoa! Give it to the girl. I'm an independent contractor. *Tax purposes!*'' This line emanates from an episode in which Jerry is involved in a mix-up with a maid service.[21] The disreputable maid's boss avoids paying payroll taxes by purporting to make his maids ''independent contractors.'' The implicit question is: when may you permissibly classify workers as ''independent contractors,'' and what are the stakes?

A disreputable maid's boss avoids paying payroll taxes by purporting to make his maids "independent contractors." The implicit question is: when may you permissibly classify workers as "independent contractors," and what are the stakes?

This is not merely a tax issue. Indeed, at stake are other costs associated with employees, such as employee benefits, insurance, 401(k) costs, and so on. Classifying workers is not discretionary based on the employer or employee's wishes, or even on agreement. The IRS publishes guidelines to aid employers in determining when a worker is an independent contractor or employee. Employers can face major tax liabilities, interest, and penalties to the IRS and state taxing authorities, plus serious liabilities to their own workers for misclassification.

Various tests have emerged to determine when a worker is an employee. Each test emphasizes different factors, but the common focus is the ''right to control'' standard.[22] An easy way to remember this test comes from the episode ''The Race,'' in which Jerry dates Lois, who works for one of Jerry's high school track adversaries, Duncan.

Lois tells Jerry that unless Jerry races Duncan, Duncan will fire her. When Jerry questions her on this, she simply says, ''he [Duncan] controls the means of production.'' Lois implies that Duncan controls her wages, and thus her livelihood. The more you control your worker, the more likely they are to be classified as an employee.

[15] Episode 156, aired May 15, 1997.
[16] See I.R.C. Section 74(b)(3), which was added by Section 122(a)(1)(C) and (D) of Pub. L. No. 99-514, 10-22-86.
[17] In ''The Truth,'' Kramer hints that he disagrees with having to pay taxes in general.
[18] Episode 114 ''The Wink,'' aired Oct. 12, 1995.
[19] See I.R.C. Section 2503.
[20] I.R.C. Section 2503(b).
[21] Episode 176 ''The Maid,'' aired April 30, 1998.
[22] See Robert W. Wood, *Legal Guide to Independent Contractor Status*, (Aspen, 3rd ed. 2005), Section 1.06.

Property and Casualty Losses

Property or casualty loss deductions can be tricky, but *Seinfeld* has a gloss on this topic, too. In "The Summer of George," after Kramer fires Raquel Welch, she destroys Kramer's Tony. It is debatable whether the Tony is a business or personal asset. Casualty and theft losses on personal assets (i.e., those not held in a trade or business) in excess of a $100 floor can be claimed as an itemized deduction, to the extent they exceed 10 percent of the taxpayer's adjusted gross income.[23] When Raquel Welch destroys Kramer's Tony, he can claim the loss as a personal property loss. He may not be able to recover the value of the Tony because the Tony's value probably does not exceed 10 percent of his adjusted gross income.

So often in the tax world, filing is key, and that's all about the mailbox rule.

However, if Kramer's only income is the Tony itself (after all, he does not work!), Kramer may be able to take advantage of the loss. If Kramer can characterize the Tony as property held in a trade or business, there is no limitation on the property loss deduction.[24] After all, he did not "win" the Tony. Instead, it was paid to him as compensation for firing Raquel Welch.

Perhaps Kramer could claim the statuette was a business asset owned by Kramerica Industries, which he founded in the episode "Male Unbonding."[25] This supposed company continued throughout most of the duration of *Seinfeld's* nine-year run, most notably in "The Voice,"[26] which aired after the destruction of Kramer's Tony.

Likewise, in "The Frogger,"[27] Peterman purchases a prized piece of cake for $29,000, which Elaine consumes—much to Peterman's horror. Perhaps Peterman could consider the piece of cake a business acquisition, and deduct the loss.

The Mailbox Rule

Concluding our run of *Seinfeld's* take on tax, we visit the hallowed mailbox rule. In "The Sniffing Accountant,"[28] Jerry and Newman suspect that their accountant is "on" something. They fear his judgment could be affected, but are afraid to confront him. Therefore, they decide to fire him through the mail. This episode actually relates to bankruptcy more than tax. Indeed, had Jerry and Newman mailed their letter in time, they would have received the money the accountant was holding *before* he filed Chapter 7. Still, the same mailing rules apply for tax purposes.

Any return, claim or statement that must be filed with the IRS or the Tax Court is regarded as having been timely filed if it is postmarked on or before the due date.[29] This same rule applies to any payment. So, you get to float on the money. The timely-mailed-is-timely-filed rule has been extended to cover returns that are electronically filed, and to those using private carrier services, such as Federal Express.[30]

If the mailing in this episode involved a tax return, Jerry's exclamation to Newman would still ring true. So often in the tax world, filing is key, and that's all about the mailbox rule. As Jerry exclaims to Newman, success or failure often turns on whether "a certain imbecile had been able to get to a mailbox and mail a letter!"

Conclusion

Seinfeld's take on tax may not be comprehensive, but it does illustrate the extent to which tax considerations permeate popular culture. Even when a show is about "nothing," it can illustrate the degree to which even seemingly pedestrian parts of our tax system are both pervasive and misunderstood. Yada, yada, yada.

[23] See I.R.C. Section 165(h).
[24] See I.R.C. Section 1033.
[25] Episode 4, aired June 14, 1990.
[26] Episode 158, aired Oct. 2, 1997.
[27] Episode 174, aired April 23, 1998.
[28] Episode 68, aired Oct. 7, 1993.
[29] See I.R.C. Section 7502(a).
[30] See Treasury Regulations Section 301.7502-1 and I.R.C. Section 7502(f).

   ISSN 0092-6884