

CIVIL PENALTY GUIDE

**Prepared by:
American Institute of Certified Public Accountants
Tax Section
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INTRODUCTION

The complexity of the tax law is a very large burden on America's taxpayers, tax professionals, and tax administrators. A significant piece of the law's complexity involves the difficulties that these three critical stakeholders face in understanding and interpreting the nation's civil tax penalty system.

One specific area whose complexity creates difficulties for these three critical stakeholders to interpret and apply is the As way of background, the 1954 Internal Revenue Code had 14 penalties, today the Internal Revenue Code contains approximately 130 penalties.

This Civil Penalty Guide strives to make sense of the current civil tax penalty structure as administered by the Internal Revenue Service. While tax professionals can readily cite the major reasons why civil penalties have been enacted into law (such as to alter taxpayer behavior, reduce overaggressive tax positions, and encourage tax compliance), tax practitioners are sometimes confused by the technical details of an individual penalty.

The Guide focuses on the more common civil penalties that a traditional CPA might encounter in his or her tax practice. In this context, the Guide does not attempt to address the array of fraud and criminal penalties contained in the Internal Revenue Code. The Guide provides a brief, general overview of the penalties discussed; it does not attempt to address the unique facts and circumstances that a particular taxpayer's situation might involve. For this reason, the Penalty Guide should not in any way be considered a substitute for a tax professional's independent research of the tax law as it may relate to the particular facts and circumstances of a specific taxpayer.

The AICPA Tax Section acknowledges the outstanding contributions of the IRS Practice and Procedures Committee to the drafting of the Civil Penalty Guide; with special acknowledgement to three committee members who guided the development of the Guide from its beginning stages to completion. Specifically, we wish to thank John Keenan, Washington, DC; Jay Starkman, Atlanta, GA; and Robert Caplan, Foster City, CA. In addition, we thank John Miller, Elkhorn, NE, for his editorial contributions to development of the Guide.

Penalty: IRC § 6651(a)(1) - Failure to File Tax Return

Historical Background on Penalty:

The failure to file (“FTF”) tax return penalty, substantially in its present form, predates the Internal Revenue Code of 1939, with the rate of 5 percent per month, up to 25 percent, subject to abatement for reasonable cause. When recodified in 1954, the Senate added subsection (b) to clarify that the penalty applied only to the net amount due, after applying withholding and estimated tax credits. The 1969 Tax Reform Act added penalties for failure to pay tax (“FTP”) under IRC §§ 6651(a)(2) and (a)(3).

Details of Penalty:

IRC § 6651(a)(1) of the Internal Revenue Code (“Code”) penalizes a taxpayer for the failure to file a timely tax return (including extensions) at the rate of an additional 5 percent of the tax due for each month (or fraction thereof) that there is a failure to file a return, not to exceed 25 percent. However, there is no penalty if there is an overpayment of the tax required to be paid.

The Code coordinates between FTF and FTP penalties. When the FTF penalty under IRC § 6651(a)(1) and the FTP penalty for failure to pay tax shown on the return under IRC § 6651(a)(2) both apply for the same months, the FTF penalty under IRC § 6651(a)(1) is reduced by the amount of the FTP penalty under IRC § 6651(a)(2).

Reasonable Cause Exception:

The FTF penalty does not apply if the failure to file a tax return is due to reasonable cause and not willful neglect. Whether both “reasonable cause” and lack of “willful neglect” exists is a question of fact, and the burden of establishing these facts is on the taxpayer. Relief from the failure to file penalty will only apply to the portion of the penalty for the period the taxpayer meets relief criteria.

Reasonable Cause and Good Faith:

The Internal Revenue Manual states that a “taxpayer may establish reasonable cause by providing facts and circumstances showing the taxpayer exercised ordinary business care and prudence (taking that degree of care that a reasonably prudent person would exercise), but nevertheless was unable to comply with the law.

In determining if the taxpayer exercised ordinary business care and prudence, the Internal Revenue Manual directs IRS personnel to review available information including the following:

- The Taxpayer’s explanation for the non-compliance and whether the dates and explanation of events causing the noncompliance correspond to the events upon which the penalty is based.

- The Taxpayer's compliance history for payment patterns and the taxpayer's overall compliance history. The same penalty, previously assessed or abated, may indicate that the taxpayer is not exercising ordinary business care.
- The length of time between the event cited as a reason for the noncompliance and subsequent compliance.
- Whether or not the taxpayer could have anticipated the event that caused the noncompliance.

The Internal Revenue Manual provides guidance regarding establishing reasonable cause in various circumstances, including:

- Death or serious illness of the taxpayer or a member of his immediate family.
- Fire, casualty, natural disaster, or other disturbance.
- Inability to obtain necessary records.
- Lack of funds.
- Ignorance of the law.
- Mistakes or oversight.
- Reliance on competent tax advisor.
- Erroneous oral or written advice from the Internal Revenue Service.

Cases:

In *U.S. v. Boyle*, 469 U.S. 241 (1985), the Supreme Court drew as bright a line as possible in determining when reliance on a tax advisor constitutes reasonable cause for avoiding a failure to file penalty under IRC § 6651. The Court ruled that a taxpayer cannot avoid the penalty by relying on his advisor to file the return. Reliance on a tax advisor with respect to a question of substantive law, on the other hand, may constitute reasonable cause when such advice turns out to be mistaken.

In *Brewery Inc. v. United States*, 33 F.3d 589 (6th Cir. 1994), the Sixth Circuit held that financial difficulty can never be reasonable cause to excuse nonpayment.

In *Fran Corp. v. United States*, 164 F.3d 814 (2d Cir. 1999), the Second Circuit held that financial difficulty may be reasonable cause for the failure to pay and deposit employment taxes, although the corporation in this action failed to establish reasonable cause for its failure to comply

In *East Wind Indus., Inc. v. United States*, 196 F.3d 499 (3d Cir. 1999), the taxpayer manufactured military clothing and goods for sale to the United States Department of Defense. After ten years of performance under its government contracts, certain employees at the Defense Agencies began soliciting illegal bribes from the taxpayer. When the taxpayer declined to pay the bribes, the taxpayer was not awarded new contracts and was not paid amounts due and owing for successfully completed work. The vice president of the taxpayer-corporation sought professional advice concerning the financial and legal issues arising out of the bribery demands and cash flow problems. In turn, the vice president of the taxpayer-corporation sought several personal loans,

including a mortgage on his personal residence, to pay essential personnel, to pay creditors threatening to terminate their services, and to pay a portion of the payroll taxes.

The court found that the taxpayer's decision to pay its creditors "whose services were essential to maintaining and reworking the inventory" rather than to pay its trust fund taxes did not amount to willful neglect. Further, the court found that the taxpayer exercised ordinary business care and prudence as evidenced by: (1) the absence of lavish or extravagant living expenses, and (2) the preservation of \$750,000 worth of inventory at the time of the taxpayer's bankruptcy filing. The court also found that the taxpayer would have suffered undue financial hardship if the employment taxes had been paid when due. Accordingly, the court held that the taxpayer was entitled to an abatement of the penalties assessed by the IRS.

Citation to Internal Revenue Manual (Including URL):

IRM §20.1.1.3: <http://www.irs.gov/irm/part20/ch01s01.html#d0e623>

IRM §20.1.2.1.1: <http://www.irs.gov/irm/part20/ch01s03.html>

Related Penalties:

IRC § 6651(a)(2) – Failure to file tax return

IRC § 6651(a)(3) – Failure to pay tax required to be shown on tax return

IRC § 6651(f) – Fraudulent failure to file tax return

IRC § 6652 – Failure to file certain information returns

IRC § 6654 – Failure by individual to pay estimated income tax

IRC § 6654 – Failure by corporation to pay estimated income tax

IRC § 6656 – Failure to make deposit of tax

IRC § 6672 – Failure to collect and pay over tax, or attempt to evade or defeat tax

Penalty: IRC § 6651(a)(2) - Failure to Pay Tax as shown on return

Historical Background on Penalty:

The delinquency penalties contained in IRC § 6651(a)(2) for failure to pay the amount shown on a filed return and IRC § 6651(a)(3) for failure to pay the amount shown on a notice and demand for payment of an assessed tax within ten days after the date of the notice were both enacted in 1969 to prevent taxpayers from delaying payment of taxes at a time when interest charged on delinquencies was less than the prevailing interest rate.

Prior to 1969, in the case of a failure to pay an income tax when due, simple interest at an annual rate of 6 percent was required to be paid on the unpaid amount. Since the cost of borrowing money at the time was substantially in excess of the 6 percent interest provided for by the Code, taxpayers, by filing a return on the due date and not paying the tax shown as owing on the return, could effectively borrow the amount of the tax at a favorable 6 percent rate for the period the tax remained unpaid. This borrowing could also result from failure to pay deficiencies or to make deposit of taxes. In 1969, to increase the cost of this “borrowing” of tax dollars, Congress added IRC §§ 6651(a)(2) and 6651(a)(3) and amended IRC § 6656, which deals with deposits of taxes.

Details of Penalty:

IRC § 6651(a)(2) penalizes a taxpayer who fails to timely pay the amount shown as tax on any return required by subchapter 61A (relating to income, self-employment, estate, and gift tax returns) or subchapter 51A, 52A or 53A (relating to alcohol, tobacco and firearms, respectively). The penalty does not apply, however, if the failure is due to reasonable cause and not willful neglect. In addition, the penalty does not apply to any failure to pay estimated tax or to certain taxes that the taxpayer properly elects to pay in installments.

The late payment penalty rate is 0.5% of the late payment for each month (or part of a month) that the payment is late, up to a maximum of 25%. In applying the failure to pay penalty, each fraction of a month is counted as an entire month. For this purpose, a month is measured from the date in a calendar month to the date numerically corresponding to it in the succeeding calendar month.

The penalty period is the number of months from the payment’s due date (determined with regard to extensions of time to pay) through the date on which the IRS received payment. The due date of a tax payment is generally the date on which the return is required to be filed. If the last day prescribed for payment falls on a Saturday, Sunday, or holiday, the payment can be made on the next business day.

Extensions of time to file a return do not extend the due date for payment. As a result, they generally do not affect the period for computing the penalty. Reg. § 301.6651-1(c)(3) treats an automatic extension of time to file an individual income tax return on Form 4868 as an extension of time to pay the tax if at least 90% of the tax shown on the

return was paid by the due date (without regard to the extension) and the balance is paid with the return. If the balance due is more than 10% of the total tax or is not paid with the return, the penalty applies to the total balance due from the original due date. Similarly, an automatic extension to file a corporate income tax return on Form 7004 extends the payment date if the tentative tax shown on the extension request is at least 90% of the tax shown on the corporation's return and the balance is paid with the return.

IRC § 6651(d) provides for an increase in the penalty to 1 percent under certain conditions.

Reasonable Cause Exception:

There is an exception to the IRC § 6651(a)(2) failure to pay penalty if the failure to pay is due to reasonable cause and not willful neglect. To claim the exception, the taxpayer must set out the facts on which he relies in a written statement that contains a declaration that it is made under penalties of perjury.

A failure to pay is considered to be for reasonable cause to the extent the taxpayer shows that he exercised ordinary business care and prudence in providing for payment of his tax liability and was nevertheless either unable to pay the tax or would suffer an "undue hardship" if he paid the tax on its due date. In determining whether a taxpayer exercised ordinary business care and prudence, all of the facts and circumstances of the taxpayer's financial situation are considered, including the amount and nature of his expenditures in light of his assets, the funds he could reasonably expect to receive, and his investment practices. The type of tax itself also is taken into account. In addition, the rules are stricter with respect to "trust fund" taxes — i.e., taxes that the taxpayer is required to collect or withhold from others. "Undue hardship" requires more than an inconvenience to the taxpayer. Rather, it requires that the taxpayer will suffer a substantial financial loss if he is forced to make the tax payment on the due date. Having to sell property at its current market price does not ordinarily constitute undue hardship.

As an example, the regulations states:

A taxpayer who incurs lavish or extravagant living expenses in an amount such that the remainder of his assets and anticipated income will be insufficient to pay his tax, has not exercised ordinary business care and prudence in providing for the payment of his tax liability. Further, a taxpayer who invests funds in speculative or illiquid assets has not exercised ordinary business care and prudence in providing for the payment of his tax liability unless, at the time of the investment, the remainder of the taxpayer's assets and estimated income will be sufficient to pay his tax or it can be reasonably foreseen that the speculative or illiquid investment made by the taxpayer can be utilized (by sale or as security for a loan) to realize sufficient funds to satisfy the tax liability. A taxpayer will be considered to have exercised ordinary business care and prudence if he made reasonable efforts to conserve sufficient assets in marketable form to satisfy his tax liability and nevertheless was unable to pay all or a portion of the tax when it became due.

Cases:

Q.E.D., Inc. v. U.S., 55 Fed. Cl. 140 (2003). In determining whether a taxpayer exercised ordinary business care and prudence, all of the facts and circumstances of the taxpayer's financial situation are considered, including the amount and nature of his expenditures in light of his assets, the funds he could reasonably expect to receive, and his investment practices.

Fran Corp. v. U.S., 164 F.3d 814 (2d Cir. 1999). Financial difficulties not reasonable cause for failures to pay and deposit employment taxes where electrical contractor made payments to president, to employees, and to creditors not directly related to projects it was trying to complete.

Hartsell Est. v. U.S., T.C. Memo 2004-211. Having to sell property at its current market price does not ordinarily constitute undue hardship.

Related Penalties:

IRC § 6651(a)(1) Failure to file tax return

IRC § 6651(a)(3) Failure to pay tax after notice and demand for tax not shown on return

IRC § 6651(d) Increase in the penalty for failure to pay in certain cases

Citation to Internal Revenue Manual (Including URL):

IRM §20.1.1.3: <http://www.irs.gov/irm/part20/ch01s01.html#d0e623>

IRM § 20.1.2.1.1: <http://www.irs.gov/irm/part20/ch01s03.html>

Penalty: IRC § 6651(a)(3) - Failure to Pay Tax (Not Shown on Return)

Historical Background on Penalty:

This penalty was added by the Tax Reform Act of 1969 because interest on late payment was then six percent and Congress felt that by adding a penalty, it would encourage quicker payment of assessments.

Details of Penalty:

IRC § 6651(a)(3) imposes a penalty for failure to pay within 21 calendar days from the date of a Notice and Demand for payment (10 business days if amount due equals or exceeds \$100,000), any amount of tax required to be shown on a return (as specified in IRC § 6651(a)(1)) which is not so shown.

For example, the penalty will be assessed for failure to pay a tax as a result of an IRS income tax examination.

The penalty is .5% (.005) of the amount of tax stated in such Notice and Demand per month or part thereof; not to exceed 25% in the aggregate.

IRC § 6651(d) provides for an increase in the penalty to 1 percent under certain conditions.

Reasonable Cause Exceptions:

Refer to analysis provided for IRC § 6651(a)(2).

Citation to Internal Revenue Manual (Including URL):

IRM §20.1.2.5: <http://www.irs.gov/irm/part20/ch01s03.html#d0e9515>

Penalty: IRC § 6651(h) – Limitation on Penalty on Failure to Pay Tax (Shown or Not Shown) During Period of Installment Agreement

Historical Background on Penalty:

This penalty was added by the IRS Restructuring and Reform Act of 1998 (P.L. 105-206). It is designed to halve the penalties normally imposed for failure to pay.

Details of Penalty:

On a return timely filed (with extensions) for which an Installment Agreement to pay the tax due is in effect, the Addition to Tax is computed at 0.25% per month or fraction thereof to a maximum of 25%. It modifies the penalties of IRC §§ 6651(b) and 6651(c) by reducing the monthly accrual from 0.5% per month to 0.25% per month.

Reasonable Cause Exceptions:

See exceptions under IRC §§ 6651(a)(1) and 6651(a)(2).

Cases:

See examples under IRC §§ 6651(a)(1) and 6651(a)(2).

Related Penalties:

IRC §§ 6651(a)(1) and 6651(a)(2).

Citation to Internal Revenue Manual (Including URL):

IRM §20.1.2.8. <http://www.irs.gov/irm/part20/ch01s03.html#d0e9946>

Penalty: IRC § 6654 - Failure by Individual to Pay Estimated Income Tax

Historical Background on Penalty:

Taxpayers who fail to have sufficient withholding from their income or fail to make adequate estimated tax payments are subject to the penalty under IRC § 6654. The underpayment rate is established under IRC § 6621 and is applied to the amount of the underpayment for the period of the underpayment. The penalty for failure to pay current tax in installments predates the Code of 1939 and was adapted to estimated taxes and withholding when those later became requirements.

Details of Penalty:

The penalty applies to individuals who have not evenly paid tax estimates and/or who have insufficient withholding amounts equal to the lesser of:

- a) 90% of the tax shown on the current year's return, or
- b) 100% of the tax shown on the return for the preceding year (110% if an individual has adjusted gross income for the prior year exceeding \$150,000).

Generally, estimated payments are required to be made in 4 equal amounts during the tax year. Each installment payment is to be in an amount to 25% of the total amount of tax owed for the year. The payments are due on April 15, June 15, September 15 and the following January 15.

The period of any underpayment runs from the due date of the installment to the earlier of: the 15th day of the 4th month following the close of the taxable year, or the date on which the portion is paid.

A taxpayer who has uneven income throughout the year may use an annualized income installment method that may result in a smaller installment being required for one payment with a subsequent increase in a latter payment.

Individuals who owe less than \$1,000 with their return are not subject to the penalty.

Individuals who had no tax liability for the preceding taxable year are not subject to the penalty.

Any withholding of the taxpayer is considered a payment of estimated tax and is applied evenly throughout the year unless the taxpayer establishes dates for all of the amounts, in which case the amounts may be considered estimated taxes paid on the dates on which the amounts were actually withheld.

There are special rules for farmers and fishermen. Such individuals are required to make 1 installment for the taxable year due by January 15 of the following taxable year.

Additionally, the installment is required to be 66 2/3% instead of 90% for the current year.

Nonresident aliens must make 3 required installments: June 15, September 15, and January 15 of the following year.

The amount of the penalty is the same as the interest rate for underpayments of tax and is announced quarterly by IRS in accordance with IRC § 6621.

Reasonable Cause Exceptions:

No penalty is imposed if the Secretary determines that the underpayment was caused by casualty, disaster or other unusual circumstances and the imposition of the tax would not be equitable and would be against good conscience. No penalty is imposed with respect to an underpayment if the Secretary determines that the taxpayer retired after age 62 or became disabled during the year and the underpayment was due to reasonable cause.

Reliance upon the advice of a tax advisor is not reasonable cause for abatement of this penalty.

The Tax Court does not have jurisdiction to redetermine a penalty under IRC § 6654 if a tax return has been filed. A proposed penalty this section is not subject to the deficiency procedures.

Calculating the Penalty:

Calculations for the penalty and the use of the annualization method are made by completing IRS Form 2210 and attaching it to 1040. Or, the taxpayer may allow IRS to assess the penalty by not filing Form 2210. In the latter case, interest and late payment penalty do not begin to accrue until 21 days after IRS has made its underpayment penalty assessment.

Citation to Internal Revenue Manual (Including URL):

IRM §20.1.3, Estimated Tax Penalties: <http://www.irs.gov/irm/part20/ch01s04.html>

IRM §20.1.3, Estimated Tax Penalties: (continued):

<http://www.irs.gov/irm/part20/ch01s05.html>

Penalty: IRC § 6655 - Failure by Corporation To Pay Estimated Tax

Historical Background of the Penalty:

The penalty for failure by a corporation to pay estimated income tax was first imposed in 1959. There have been approximately twenty changes to this section, most of which have been to modify the safe harbor provisions for calculating installments to avoid penalties. Specific provisions for large corporations were added in 1988.

Details of Penalty:

The penalty is calculated using the rate established under IRC § 6621. It is applied to the amount of underpayment on a quarterly basis. The underpayment for a quarter is the excess of the required payment over the installment paid or credited by the due date.

Under current law, the required installment payment is either:

- a) 25% of the tax shown on the current year return, or in the case of corporations with less than \$1,000,000 of taxable income in any of the three preceding tax years, the required payment is the lesser of 25% of the tax on the current year return or 25% of the tax for the preceding tax years.
- b) An amount calculated using an annualized income or adjusted seasonal installment amount (Form 2220 pages 3 and 4).

The penalty is calculated for the period from the due date of each installment until the date paid or the due date of the tax return, whichever is earlier.

The due date of each of the four installments is the fifteenth day of the fourth, sixth, ninth and twelfth months of the tax year.

The due date of the tax return is the fifteenth day of the third month following the end of the tax year.

No penalty is assessed if the tax for the year is less than \$500.

Special rules apply to tax years of less than twelve months.

Applicability of the Penalty:

The penalty is assessed at the time the return is processed by the IRS processing center.

Reasonable Cause Exceptions:

There is no “Reasonable Cause” relief available. Waiver of the penalty for Service error, misapplied payments or refund of a taxpayer payment and return within ten days may be available.

Internal Revenue Manual Citation:

20.1.3.5 Corporate Estimated Tax Penalty

Penalty: IRC § 6656 - Failure to Deposit Taxes

Brief Description of Penalty:

Failure to make a required timely tax deposit in a government depository can result in a penalty unless due to reasonable cause and not willful neglect. (IRC § 6656(a)).

The penalty is a percentage of the “underpayment,” i.e., the amount of tax required to be deposited minus any amount that was timely deposited. (IRC § 6656(b)(2); Treas. Reg. § 1.6656-1(a). Small shortfalls in deposits are considered timely made if a remedial deposit is made within the time set by Treas. Reg. § 31.6302-1(f)

The applicable percentage depends on when the failure is corrected:

- a) If it is corrected by the 5th day after the due date, the penalty is 2% of the underpayment. IRC §. 6656 (b)(1)(A)(i)
- b) For failures corrected from the 6th day through the 15th day after the due date, the penalty is 5%. IRC § 6656(b)(1)(A)(ii).
- c) The penalty goes up to 10% if the failure is corrected more than 15 days after the due date (IRC § Sec. 6656(b)(1)(A)(iii)) but on or before the 10th day after the date of the first delinquency notice (under IRC § 6303). IRC § 6656(b)(1)(B)(i).
- d) Finally, a depositor is subject to a 15% penalty if the failure isn’t corrected on or before the earlier of the 10th day after the date of the first delinquency notice, or the day on which notice and demand for immediate payment is given under a jeopardy assessment. IRC § 6656(b)(1)(B).

Reasonable Cause Exceptions:

The Service will consider abatement of the penalty when the taxpayer files a written statement with the IRS office where the return is required, made under penalties of perjury, setting forth the facts which make out a case of reasonable cause. If the Service determines that reasonable cause has been shown, the penalty won’t be imposed. Reg. §1.6656-1(b).

The Service may waive the penalty on a person’s inadvertent failure to deposit any employment tax(i.e., a tax imposed by subtitle C of the Code), IRC § 6656(c), if:

- a) The person meets the net worth, etc., requirements in effect for awards of costs and attorney’s fees under IRC § 7430(c)(4)(A)(ii) (IRC §.6656(c)(1));
- b) The failure to deposit the employment tax occurs during the first quarter the person was required to deposit any employment tax (IRC §.6656(c)(2)(A); and,

c) The return for that tax was filed on or before its due date (IRC § 6656(c)(3)).

The Service generally will waive the penalty in the situations listed at (a) through (c) above and will determine whether a failure to deposit is inadvertent based on all the facts and circumstances. Reg. § 301.6656-1(a).

Crediting tax deposits:

For purposes of determining whether the failure to deposit penalty applies, the taxpayer's deposit will be applied to the most recent period or periods within the specified tax period to which the deposit relates. Unless, the taxpayer making that deposit designates a different period or periods to which that deposit is to be applied. IRC § 6656(e)(1). This designation can only be made during the 90 day period beginning on the date of a notice that a penalty under IRC § 6656(a) has been imposed for a specified tax period. IRC § 6656(e)(2).

For penalty purposes, a depositor wishing to designate the period to which a deposit is to be applied, may either call the number indicated on the penalty notice or write to the Accounts Management Unit as shown on the penalty notice. The Service will adjust the penalty amount to reflect this schedule of deposits. The Service will then notify the taxpayer of any adjustment in writing. Rev. Proc. 2001-58, Sec. 4.02, 2001-2 CD 579.

Rev. Rule 75-19

For those who have been affected by Presidentially-declared disasters, such as Hurricanes Katrina, Wilma, and Rita (2005) or for other Presidentially-declared disasters, the Service will provide relief from these penalties.

Cases:

Parcc Health Care v. U.S., (2002, DC CT) 90 AFTR 2nd 2002-5267; 2002-2USTC Para. 50558, 238F Supp 2nd 435. Conflict among the courts whether financial difficulties can be reasonable.

Glenwal-Schmidt v. U.S., (1978, DC Dist Col) 42 AFTR 2nd 78-5817, 78-2 USTC Par. 9610

Employer who did not consider the tax consequences of a decision to treat sales people as independent contractors, rather than employees. The reasonable cause exception did not apply.

FMC Corp. v. U.S., (1994, DC IL) 74AFTR 2nd 94-5626, 94-2 USTC Par. 504.16

Another case dealing with independent contractors vs. employees. The reasonable cause issue did not apply.

Lowen Corp v. U.S., (1992, DCKS) 69 AFTR 2d 92-894, 785 F Supp 913, 92-2

USTC, Par 50360, affd on this issue sub nom Eastern Investment Corp, (1995cCA10)75
AFTR 2d 95-1445,49F3d 651,95-1 USTC Par. 50188295-1

Braniff Inc In re, (1992, Bkcty Ct FL) 71A AFTR 2d 93-5126,92-1 USTC Par 70016
Bossert, Rudy In re, (1996 Bkcty Ct WA) 78 AFTR 2d 96-7054,201 BR 553, 96-2 USTC

Penalty: IRC § 6662 – Accuracy-related penalty

Historical Background on Penalty:

Prior to 1989, separate sections within the Code imposed penalties on understatements of tax due to negligence, substantial understatements of tax liability, valuation overstatements for income tax purposes, overstatements of pension liabilities, and valuation understatements for purposes of estate or gift taxes. These individual penalties could be applied cumulatively, so that a single transaction could be subject to multiple penalties.

To improve the coordination of these penalties and to prevent the stacking of these penalties, Congress repealed these separate penalty provisions and combined them into a single accuracy-related penalty under s IRC § 6662(a).

Details of Penalty:

IRC § 6662(a) imposes a 20-percent penalty on the portion of an underpayment of tax attributable to:

- Negligence or intentional disregard of rules or regulations;
- A substantial understatement of income tax;
- A substantial valuation overstatement;
- A substantial overstatement of pension liabilities; or
- A substantial estate or gift tax valuation understatement

The penalty applies only to that portion of the underpayment attributable to the particular type of misconduct. The maximum accuracy-related penalty on any portion of an underpayment is 20%.

This penalty guide will discuss the negligence penalty and the substantial understatement penalty (for non-tax shelter situations).

1. Negligence or Disregard of Rules or Regulations

Under IRC § 6662(b)(1), the 20% accuracy-related penalty applies to any portion of an underpayment attributable to negligence or disregard of rules or regulations. For purposes of IRC § 6662(b)(1), the term “negligence” includes any failure to make a reasonable attempt to comply with the Code. Under the section 6662 regulations, negligence includes any failure by a taxpayer to: (1) make a reasonable attempt to comply with the tax laws; (2) exercise reasonable care in return preparation; (3) keep proper books and records; or (4) properly substitute items. A return position that has a “reasonable basis” is not attributable to negligence.

The term “disregard” for purposes of IRC § 6662(b)(1) includes any careless, reckless, or intentional disregard of the Code, temporary or final regulations, revenue rulings or notices, and in some cases, revenue procedures. A “careless” disregard exists when a

taxpayer does not exercise reasonable diligence to determine the correctness of a return provision that is contrary to a rule or regulation. A “reckless” disregard exists when the taxpayer makes little or no effort to determine whether a rule or regulation exists, under circumstances which demonstrate a substantial deviation from the standard of conduct that a reasonable person would observe. An “intentional” disregard exists when a taxpayer knows of the rule or regulation that is disregarded.

A taxpayer taking a position contrary to a revenue ruling or notice will not be considered to have disregarded the ruling or notice if the contrary position has a realistic possibility of being sustained on the merits. A return position is considered to have a realistic possibility of success on the merits if a reasonable and well-informed analysis by a knowledgeable tax adviser would conclude that the position has at least a one in three likelihood of being sustain on its merits if challenged by the IRS.

A taxpayer taking a position contrary to a revenue ruling or notice can also avoid the IRC § 6662(b)(1) accuracy-related penalty by disclosing the return position to the IRS. No penalty under IRC § 6662(b)(1) will be imposed on any portion of an underpayment that is contrary to a rule or regulation if the relevant facts affecting the item’s tax treatment are “adequately disclosed” and, in the case of a position contrary to a regulation, the position represent a good faith challenge to the validity of the regulation. The disclosure exception does not apply, however, where the disclosed position does not have a “reasonable basis” or where the taxpayer fails to keep adequate books and records or to substantiate items properly. Disclosure of an item is generally required to be made on a Form 8275 or Form 8275-R.

2. Substantial Understatement Penalty

If any portions of an underpayment of income tax required to be shown on a tax return is attributable to a substantial understatement, there is a potential for the imposition of the 20-percent accuracy-related penalty. An understatement of tax for purposes of IRC § 6662(b)(2) is substantial if it exceeds the lesser of: (1) 10-percent of the tax required to be shown on the return and is at least \$10,000 for corporation; or (2) \$10 million. An understatement of tax is defined as the difference between the amount of tax the taxpayer was required to report on the tax return for the year and the amount of tax actually reported by the taxpayer on the tax return.

IRC § 6662(d)(2)(B) provides two ways by which a taxpayer can avoid the substantial understatement penalty. One way is if there was substantial authority for the taxpayer’s treatment of the item. The other is if the taxpayer’s relevant facts affecting the item’s treatment are adequately disclosed, usually on Form 8275, and there is a reasonable basis for the tax treatment of the item.

Reasonable Cause and Good Faith:

IRC § 6664 provides that no penalty shall be imposed under IRC § 6662 with respect to any portion of an underpayment of tax upon a showing by the taxpayer that there was

reasonable cause and the taxpayer acted in good faith. A determination as to whether reasonable cause exists and the taxpayer acted in good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances. Generally, the most important factor in determining if the taxpayer acted with reasonable cause and good faith is the extent of taxpayer's efforts to assess the proper tax liability.

Cases:

In *Wadsworth v. Commissioner*, T.C.M. 2008-171, the Court determined the taxpayer did not meet the reasonable cause exception under IRC § 6664(c)(1) because he did not act in good faith by rejecting the advice of his longtime tax preparer. The Court concluded that he failed to act in good faith because he relied on the advice of professionals who did not have sufficient expertise to justify such reliance. Accordingly, the Court upheld the Service's assertion of the substantial understatement penalties under IRC § 6662(d).

In *Bigler v. Commissioner*, T.C. Memo 2008-133, the Tax Court held that an accrual basis taxpayer was required to include in income the full amount shown on its customer's invoices and no deductions were allowed for returns that customers would make in the future. Although the Court found that the taxpayers substantially understated their income taxes, the Court denied any accuracy-related penalties because the taxpayers demonstrated that they had reasonable cause for their position and acted in good faith.

In *Roco, Emmanuel, L*, 121 TC 160 (2003), the taxpayer withdrew his request for a letter ruling upon learning it would be adverse. The taxpayer did not report a large award. The penalty was upheld.

In *Irwin, Pennel Phlander*, (1996) TC Memo 1996-490 the taxpayer deducted all his personal expenses as deductible business expenses because he felt that his life's experiences were incorporated into his literary work. The Tax Court ruled that his claim wasn't made with reasonable cause or in good faith and the penalty was upheld.

In *Keller, Theodore W.* (1996) TC Memo 1996-300 the penalty didn't apply where a college professor claimed travel expenses for education that weren't deductible. The court rules that the taxpayer acted in good faith in claiming the disputed expenses

In *Melnic, Salman* (2006), TC Memo 2006-25 the penalty did not apply in regards to a sham exchange of privately held stock for private annuities. The taxpayers showed that they relied on an attorney who assured the taxpayers that there was reasonable basis for the transaction.

The accuracy-related penalty may apply to one of more items on a taxpayer's return and not to others. Sanders, Philip A. (2002) TC Memo 2002-143.

Related Penalties:

IRC § 6662A – Accuracy-Related Penalty on Understatements With Respect to Reportable Transaction

Penalty: IRC § 6663 - Civil Fraud Penalty

Historical Background on Penalty:

Omnibus Budget Reconciliation Act of 1989 reorganized the various penalties in order to avoid the stacking of penalties. The penalty was effective for returns due (without regard to extensions) after 1989. Many of the cases decided under pre-1989 law have continuing validity.

Details of Penalty:

This penalty is 75-percent of any underpayment attributable to fraud. The penalty is measured by the additional tax owed and no civil fraud penalty can be imposed unless there is an underpayment of tax (usually involving a deficiency). The IRC § 6663 penalty applies only to filed returns. IRC § 6651(f) applies to fraudulent failure to file.

Civil tax fraud generally is considered intentional wrongdoing by a taxpayer with the specific purpose of evading a tax. Mere negligence is not in itself sufficient to establish fraud. Voluntary disclosure does not mitigate the penalty. The filing of an amended return does not bar assessment of the penalty.

There must be an underpayment of tax. Where the correct amount of tax does not exceed the amount shown on a timely filed return, there is no underpayment. There can be no fraud penalty, even if the taxpayer filed a false return.

IRS must prove that some part of the underpayment resulted from the taxpayer's intentional wrongdoing, deceit, and intent to evade tax. Underreporting and inadequate records do not constitute fraud. The IRS Penalty Handbook provides fraud generally involves one or more of the following elements: deception, misrepresentation of material facts, false or altered documents, evasion, or conspiracy.

Stacking of penalties is not allowed. The IRC § 6662 accuracy penalty does not apply to any portion of the underpayment on which the fraud penalty is imposed. Also, if the IRC § 6672 penalty for failure to collect and pay over tax or attempt to evade or defeat tax is imposed, the fraud penalty is inapplicable.

Reasonable Cause Exceptions:

IRS has the burden of proving the fraud. If the IRS establishes that any portion of an underpayment is attributable to fraud, the entire underpayment is treated as attributable to fraud, even though part of the additional tax was paid before the determination of the underpayment. The burden then shifts to the taxpayer to establish which, if any, items are not attributable to fraud and these items are exempt from the 75-percent penalty.

No fraud penalty is imposed on an underpayment if there was reasonable cause for the underpayment and the taxpayer acted in good faith with respect to the underpayment.

If the taxpayer relies on a third party to keep his books and records or to prepare and file his tax return, such reliance may indicate the absence of fraudulent intent, even if an understatement of income occurs.

A taxpayer's intelligence and sophistication, especially his knowledge of tax law, is an important factor in determining whether he has committed fraud.

It is not fraudulent to exclude items from taxable income if there is reasonable doubt as to the correct tax treatment. Where there is reasonable basis for claiming an item as a deduction, fraud is not proven merely because the deduction is disallowed.

Cases:

O. C. Akland, CA-9, 85-2USTC ¶ 9593

A showing that the taxpayer acted with fraudulent intent to evade tax is a prerequisite to imposition of the fraud penalty. IRS must prove by clear and convincing evidence that a taxpayer engaged in intentional wrongdoing with the specific intent to avoid a tax that he or she knew to owe.

R. W. Bradford, CA-9, 86-2USTC ¶ 9602; *J. Edelson*, CA-9, 87-2USTC ¶ 9602

Fraud may be proven by circumstantial evidence and reasonable inferences drawn there from. Such circumstantial evidence or indicia of fraud include: (1) understatement of income; (2) inadequate records; (3) failure to file tax returns; (4) implausible or inconsistent explanations of behavior; (5) concealing assets; and (6) failure to cooperate with tax authorities.

C. P. Recklitis, Dec.45,154

The taxpayer's entire course of conduct is examined to establish the requisite intent.

F. M. Wiseley, 50-2USTC9504

A doctor who had substantially understated his income for tax years 1942-1945 was not subject to fraud penalties because there was no evidence that he was motivated by fraudulent intent to evade taxes.

Palmer v. Commissioner, TC Memo 1987-204

Newman v. Commissioner, TC Memo 1982-61

Scallen v. Commissioner, 877F2nd1364 (8th Cir. 1989)

McCarthy v. Commissioner, TC Memo 1957-194

Solomon v. Commissioner, TC Memo 1982-602, affirmed per curiam 732F2nd1459 (6th Cir. 1984)

Maycock v. Commissioner, 32TC966(1959)

Rohde v. Commissioner, 273 F. Supp. 190 (ED Wis. 1967)

Rice v. Commissioner, 14TC503 (1950)

Nordstrom v. US, 360F2nd734 (8th Cir. 1966), cert. denied 385US826 (1966)

Related Penalties:

IRC § 6651(f) govern fraudulent failure to file. This delinquency penalty is 75 percent.

Citation to Internal Revenue Manual (Including URL):

IRM Sections 20.1.5.3, IRM 20.1.5.12.1(2):

<http://www.irs.ustreas.gov/irm/part20/ch01s09.html#d0e19194>

Penalty: IRC § 6676 - Erroneous Claim for Refund or Credit

Historical Background on Penalty:

Small Business and Work Opportunity Tax Act of 2007 Small Business and Work Opportunity Tax Act of 2007 (the Act) created new penalty risks for both the taxpayer and the preparer with respect to claims for refund, including amended returns claiming a refund.

As background, a taxpayer can be subject to a penalty if the taxpayer's tax return fails to satisfy the standards of care set forth in IRC § 6662 and there was an underpayment of the taxpayer's tax liability. Prior to the enactment of IRC § 6676, a taxpayer taking a position on a refund claim that failed to satisfy the standards of care set forth in IRC § 6662 would not be subject to a penalty because the definition of an "underpayment" would not be met.

In general, under the new rule, taxpayers can be subject to a 20% penalty on refund claims if the IRS denies a refund claim and there is no reasonable basis for the claim. Taxpayers should understand how the standards have changed and the impact of requesting a refund under the new law. Taxpayers who were previously advised to take positions on an amended return, rather than their original return, may need to rethink whether to take these positions at all.

Details of Penalty:

IRC § 6676 provides a penalty for erroneous refund claims with respect to income taxes. Under this provision, a penalty equal to 20 percent of the refund that is "excessive" may be imposed if the refund claim is denied and there was no reasonable basis for the portion of the claim that is "excessive" (i.e., the position was merely arguable; less than 15-20 percent likelihood of success). The portion of a refund claim that exceeds the allowable amount of the refund is considered excessive. The IRC § 6676 penalty does not apply if the IRC § 6662 penalty applies. The IRC § 6676 penalty does not have a reasonable cause exception and is effective for any claim filed or submitted after May 25, 2007.

Reasonable Cause Exceptions:

IRC § 6676 does not have a reasonable cause exception.

Applicable Cases for Reasonable Cause:

Not applicable.

Related Penalties:

As described above, this penalty would generally apply in cases where the IRC § 6662 penalty may have applied but for the fact that there is no underpayment. Pursuant to IRC § 6676(c), the penalty will not apply to any portion of the excessive amount which is subject to the IRC § 6662 penalty.

Citation to Internal Revenue Manual (Including URL): None.

Penalty: IRC § 6698 - Failure to File Partnership Return

Brief Description of Penalty:

The civil penalty under IRC § 6698 (failure to file a partnership return) applies when a partnership fails to file a timely and complete partnership information return (Form 1065). In determining timeliness of the return, the due date is determined with regard to extensions of time for filing. The penalty can be assessed on a timely filed return if the return fails to show the information required under IRC § 6031.

The penalty is assessed for each month (including a fractional month) for which the return is late or incomplete, up to a maximum of twelve months. The amount of the penalty is \$85 times the number of partners in the partnership during the year. The penalty amount was increased from \$50 to \$85 and the coverage period extended from five to twelve months by the *Mortgage Debt Relief Act of 2007* effective for returns filed after December 20, 2007.

The *Virginia Tech Victim's Relief Act* (VTVR) increased the dollar amount under IRC § 6698(b)(1) by \$1. However, this increase is limited to returns filed for years beginning in 2008. Thus, for tax years beginning in 2008, the per-partner penalty for filing a late or incomplete partnership return will be \$86 per partner for a maximum of twelve months. The provisions of VTVR are effective for and limited to returns with a taxable year beginning in 2008.

Reasonable Cause Exception:

The IRC § 6698 does not apply if the failure to file was due to reasonable cause and not willful neglect. Whether both “reasonable cause” and lack of “willful neglect” exists is a question of fact, and the burden of establishing these facts is on the taxpayer.

However, Revenue Procedure 84-35 provides a safe harbor for certain small partnerships. Under Rev. Proc. 84-35, a domestic partnership composed of 10 or few partners, each of whom is a natural person (other than a nonresident alien) and each of whom have fully reported their share of the income, deductions and credits of the partnership on their timely filed income tax returns is considered to have met the reasonable cause test and is not subject to the penalty under IRC § 6698.

If a partnership of 10 or fewer partners fails to qualify for relief under Rev. Proc. 84-35, the partnership may still show reasonable cause for failing to file a timely and complete return.

Cases:

Acme Music Co., Inc. v. IRS, 78 AFTR 2d 96-5447 (196 B.R. 925, 96-2 USTC P 50391), 6/07/1996.

Court determined that activity did not constitute a partnership, nullifying IRS imposition of IRC §6698 penalty but provides comments on demonstration of reasonable cause

Christian Laymen In Partnership, LTD. v. U.S., Cite as 71A AFTR 2d 93-3357, 12/29/1989.

Court held that IRC § 6698 penalty is not divisible by month for purposes of the full payment rule.

U.S. v. Amici, 77 AFTR 2d 96-1457 (197 BR 696), 3/07/1996.

Penalty assessed under IRC § 6698 held not dischargeable in bankruptcy proceeding

Simons v. U.S., 63 AFTR 2d 89-906, 02/23/1989.

Taxpayer failed to prove reasonable cause.

Penalty: IRC § 6699 - Failure to File S Corporation Return

Brief Description of Penalty:

The civil penalty under IRC § 6699 (failure to file a S Corporation return) applies when a S Corporation fails to file a timely and complete S Corporation information return (Form 1120S). In determining timeliness of the return, the due date is determined with regard to an extension of time for filing. The penalty can be assessed on a timely filed return if the the return fails to show the information required under IRC § 6037.

The penalty is assessed for each month (including a fractional month) for which the return is late or incomplete, up to a maximum of twelve months. The amount of the penalty is \$85 times the number of shareholders in the corporation during the year. Prior to the enactment of the *Mortgage Debt Relief Act of 2007* there was no penalty for the the late filing of Form 1120S. The provisions of IRC § 6699 became effective for returns filed after December 20, 2007.

Reasonable Cause Exception:

The IRC § 6699 does not apply if the failure to file was due to reasonable cause and not willful neglect. Whether both “reasonable cause” and lack of “willful neglect” exists is a question of fact, and the burden of establishing these facts is on the taxpayer.

Cases:

This penalty only became effective for returns required to be filed after December 20, 2007. Accordingly, as of the printing of this handbook there had been no litigation related to a penalty assessment under IRC § 6699.

Penalty: IRC § 6702 – Frivolous Tax Submissions

Historical Background on Penalty:

IRC § 6702 of the Code was enacted by the Tax Equity and Fiscal Responsibility Act of 1982, P.L. 97-248, 96 Stat. 324. According to the Senate Report, S. Rep. No. 97494, Vol. 1, 97th Cong., 2d. Sess. 277 (1982), the penalty was intended to attack a variety of tax protest activities including: (1) irregular forms 1040 not in processible form because of altered or incorrect descriptions of line items or other provisions; (2) references to spurious constitutional arguments instead of required completion of a tax form; (3) forms on which there is incomplete information to calculate tax liability; (4) presentation of information which is clearly inconsistent, such as the listing of only a few dependents by a person who claims 99 exemptions; (5) “gold standard” or “war tax” deductions; and (6) deliberate use of incorrect tax tables.

Details of Penalty:

IRC § 6702 was amended by The Tax Relief and Health Care Act of 2006, P.L. 109-432, §407(a), and applies to submissions made and issues raised after April 2, 2007.

Under amended IRC § 6702, a \$5,000 civil penalty may be imposed on any person who submits a “specified frivolous submission.” A submission is a “specified frivolous submission” if it is a “specified submission” (defined in IRC § 6702(b)(2)(B) as a request for a hearing under IRC §§ 6320 or 6330 or an application under IRC §§ 6159, 7122 or 7811) and any portion of the submission (i) is based on a position identified by the Secretary as frivolous or (ii) reflects a desire to delay or impede administration of the Federal tax laws.

IRC § 6702 was further amended to add a new subsection (c) requiring the Secretary to prescribe, and periodically revise, a list of positions identified as frivolous. Notice 2008-14 contains the prescribed list.

The frivolous submission penalty is in addition to any other penalties that may apply.

This penalty is often associated with tax protester arguments (e.g., only income paid in gold or silver coin is taxable income). This penalty has also been applied for lesser offenses.

The penalty may be imposed for failure to sign a return and for altering or deleting the jurat/signature box declaration [Rev. Rul. 2005-18]. Adding anything to one’s signature such as “under protest/duress” should not be attempted. (One court has ruled this to be an exercise of a first amendment right [*McCormick v Peterson*, 94-1 USTC ¶50,026, 73 AFTR2d 94-597 (EDNY, 1993)], but another has not [*Letscher v U.S.*, 2002-2 USTC ¶50,723, 86 AFTR2d 2000-6206 (SDNY, 2000)].)

Court appeal of a frivolous return penalty must be made in District Court, as Tax Court lacks jurisdiction over IRC § 6702 [Sec. 6703; *Van Es*, 115 TC 324 (2000)].

Reasonable Cause and Good Faith:

Once IRS notifies a person that a submission is considered frivolous, he has 30 days to withdraw the submission to avoid the IRC § 6702 penalty. This penalty does not apply to a mathematical or clerical error or filing a return showing the correct tax which the taxpayer refuses to pay. However, once a frivolous return has been filed, except for IRC § 6702(b)(3) withdrawal relief and IRC § 6702(d) penalty reduction by IRS, the taxpayer must pay the tax before seeking court review.

IRS maintains a periodically revised publication "The Truth About Frivolous Tax Arguments" at www.irs.gov/pub/irs-utl/friv_tax.pdf which lists common frivolous positions for not filing a proper tax return. IRS also published a list of 40 frivolous arguments (Notice 2008-30).

Related penalties: Additional penalties which may be imposed in addition to frivolous return penalties include:

IRC § 6662 accuracy-related penalties of 20 percent,
IRC § 6663 penalty for civil fraud of 75 percent,
IRC § 6651 additions for failure to file a return, pay the tax owed, or fraudulent failure to file a return,
IRC § 6673 penalty of up to \$25,000, if the taxpayer makes frivolous argument in the United States Tax Court.

Frivolous positions may also lead to criminal prosecution under (1) IRC § 7201 for attempting to evade or defeat tax, which includes a fine of up to \$100,000 and imprisonment for up to 5 years, (2) IRC § 7203 for willful failure to file a return, which includes a \$25,000 fine (\$100,00 for corporations) and imprisonment for up to a year, and (3) IRC § 7206 for making false statements on a return, statement, or other document, which includes a \$100,000 fine (\$500,000 for corporations) and imprisonment for up to 3 years. In addition, there are potential preparer and promoter penalties under IRC §§ 6694, 7407 and 7408.

Penalty: IRC § 6721 - Failure to file correct information returns.

Historical Background on Penalty:

The genesis to require information returns is based on IRC § 6041 of the Internal Revenue Code. Tax compliance is greatly enhanced by the use of a tax information return to report wage, non-wage and transactions that impact a tax return filing. While most are familiar with the common information returns, Form 1099 and W-2, the magnitude of the varied information returns with their own unique requirements is far reaching. For example, the penalty under IRC § 6721(a) could be asserted on a charity with respect to Form 8282, Donee Information Return. A Guide to Information Returns can be found at <http://www.irs.gov/efile/article/0,,id=98114,00.html> .

The IRC § 6721 penalty for failure to file or file information returns with errors/omissions is to insure the IRS' ability to cross match financial transactions with filed tax returns and sustain focus on the "tax gap."

Details of Penalty:

IRC § 6721(a)(1) provides that in the case of a failure to file a required information return by any person, then such person shall pay a penalty of \$50 for each return with respect to which such a failure occurs, but the total amount imposed on such person for all such failures during any calendar year shall not exceed \$250,000. There is a small business (annual gross receipts less than \$5 million) limitation under IRC § 6721(d).

The penalties under IRC § 6721 apply to:

- Failing to file timely;
- Failing to include all required information;
- Including incorrect information;
- Reporting an inaccurate TIN;
- Failing to report a TIN;
- Filing on paper when the payer meets the criteria to file on magnetic media; and
- Failing to file machine readable paper forms

IRC § 6721(c) provides an exception for a de minimis number of failures to include all required information (incorrect or omitted) that are corrected on or before August 1 of the calendar year in which the information return is due but not failure to file.

Reasonable Cause Exception:

The penalty for failing to file a correct information return is waived if the failure is due to reasonable cause and not willful neglect. More specifically, IRC § 6724 provides:

No 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 regulations provide that a penalty will be waived for reasonable cause if the filer can establish that either: (a) there are significant mitigating factors with respect to the failure; or (b) the failure arose from events beyond the filer's control.

A more complete illustrated discussion can be found at IRM 20.1.3 Relief from Penalties and IRM 20.1.7.9 Waivers, Definitions and Special Rules IRC § 6724.

Related Penalties:

IRC § 6722 - Failure to furnish correct payee statements

IRC § 6723 - Failure to comply with other information reporting requirements

IRC § 6724 - Waiver; definitions and special rules

Citation to Internal Revenue Manual (Including URL):

Part 20, Penalty and Interest.

Chapter 1, Penalty Handbook, 20.1

Section 1, Introduction and Penalty Relief - <http://www.irs.gov/irm/part20/ch01s01.html>

Part 20, Penalty and Interest.

Chapter 1, Penalty Handbook, 20.7

Section 7, Information Return Penalties - <http://www.irs.gov/irm/part20/ch01s14.html>

Penalty: IRC § 6722 – Failure to Furnish Correct Payee Statement

Details of Penalty:

Over 25 types of statements are required to be furnished under various sections of the Code. The bulk of these statements constitute the various Forms 1099 that are filed for such reasons as interest income, dividend income, miscellaneous income and proceeds from real estate transactions.

The amount of the penalty is \$50 per statement for which there is a failure to file, up to a maximum of \$100,000 for any calendar year. If the failure to file is intentional, then the penalty is the greater of a) \$100 per statement or b) 5% or 10% (depending on which IRC section required the filing) of the amount required to be reported, for which there is an intentional failure. The \$100,000 maximum does not apply to intentional failure to file situations. IRC § 6722(c)(2).

Reasonable Cause Exceptions:

IRC § 6724 provides that the IRC § 6722 penalty can be avoided if the person responsible for furnishing the payee statement can show that the failure was due to reasonable cause and not to willful neglect. IRC § 6724(a). The penalty is not to be imposed where the error or omission is inconsequential.

See the discussion of the reasonable cause exception under IRC § 6721.

Related Penalties:

IRC § 6721 - Failure to file correct information returns.

IRC § 6723 - Failure to comply with other information reporting requirements

IRC § 6724 - Waiver; definitions and special rules

Citation to Internal Revenue Manual (Including URL):

<http://www.irs.gov/irm/part20/ch01s13.html#d0e29059>