

Client Alert

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Incorrect Tax Information Returns: IRS Penalties

Businesses, financial institutions, and governmental entities (State and local) are required to file tax information returns with the U.S. Social Security Administration (“SSA”) or Internal Revenue Service (“IRS”). Common information returns include W-2 and 1099 forms for employees and contractors, 1098s for mortgage interest, and various 1099s for dividends, interest, and miscellaneous income. Some organizations file hundreds of thousands or millions of these forms on a regular basis.

The IRS imposes penalties for information returns that are incorrect. In some cases, the IRS identifies the issue and imposes penalties. For example, the IRS often asserts penalties in the case of a mismatch with respect to a Taxpayer Identification Numbers (“TIN”) reported on an information return and the name/TIN information that the IRS has on its system.

In other circumstances, the Taxpayer files information returns but later determines that those original returns contained incorrect information or were untimely filed. The IRS imposes penalties when the Taxpayer files corrected information returns. Penalties may apply to both the information returns filed with the SSA or IRS and with respect to the returns furnished to the payees, borrowers, or other recipients.

These penalties are often substantial. In recent years, Congress has almost tripled the penalties applicable to incorrect information returns. Congress also has raised the maximum annual Charts published by the IRS are included at the end of this advisory which provides the applicable penalty rates and caps.

As an illustration, assume that a large financial institution filed 12,000 forms for tax year 2016 with incorrect information. The error was not identified until late 2017. The penalty exposure, in general, could be as much as \$3.12 million (12,000 returns x \$260 per return penalty). In some cases, the penalty could be even higher depending on the number of years involved, the penalty cap amount, and whether the error is deemed to be an “intentional disregard.”

Although the penalties are substantial, the IRS may waive penalties if the Taxpayer establishes reasonable cause for the incorrect information return or untimely filing. Hunton & Williams’ tax practice has considerable experience responding to IRS information return penalties. Hunton & Williams has secured waivers of penalties by establishing reasonable cause with the IRS.

The IRS provides an informal program to disclose incorrect information reporting pursuant to a voluntary correction agreement. In many cases, a voluntary correction agreement may be negotiated to avoid unnecessary burden on the Taxpayer and the affected employees, contractors, borrowers, payees, or other information return recipients. Hunton & Williams has substantial experience in negotiating voluntary correction agreements with the IRS.

PENALTY RATES

The penalty rates and maximums for not filing correct information returns and/or not furnishing correct payee statements, including inflationary adjustments if applicable, are reflected in the following table (*-as adjusted for inflation):

Large Businesses with Gross Receipts of More Than \$5 Million and Government Entities (*Average annual gross receipts for the most recent 3 taxable years) IRC 6721 & IRC 6722

Time returns filed/furnished	Due 01-01-2011 thru 12-31-2015	Due 01-01-16 thru 12-31-2016 (inflation adjusted)	Due 01-01-17 thru 12-31-2017 (inflation adjusted)	Due 01-01-18 thru 12-31-2018 (inflation adjusted)
Not more than 30 days late (by March 30 if the due date is February 28)	\$30 per return/ \$250,000 maximum	\$50 per return/ \$529,500 maximum	\$50 per return/ \$532,000 maximum	\$50 per return/ \$536,000 maximum
31 days late – August 1	\$60 per return/ \$500,000 maximum	\$100 per return/ \$1,589,000 maximum	\$100 per return/ \$1,596,500 maximum	\$100 per return/ \$1,609,000 maximum
After August 1 or Not At All	\$100 per return/ \$1,500,000 maximum	\$260 per return/ \$3,178,500* maximum	\$260 per return/ \$3,193,000 maximum	\$260 per return/ \$3,218,500 maximum
Intentional Disregard	\$250 per return/ No limitation	\$520 per return/ No limitation	\$530 per return/ No limitation	\$530 per return/ No limitation

Note: increased penalty amounts may apply for certain failures in the case of intentional disregard. See IRC 6721(e)(2) and IRC 6722(e)(2). **Note:** Adjusted for inflation prior to the Tax Cuts and Jobs Act.

Small Businesses with Gross Receipts \$5 Million or Less

(*Average annual gross receipts for the most recent 3 taxable years) IRC 6721 & IRC 6722

Time returns filed/furnished	Due 01-01-2011 thru 12-31-2015	Due 01-01-16 thru 12-31-2016 (inflation adjusted)	Due 01-01-17 thru 12-31-2017 (inflation adjusted)	Due 01-01-18 thru 12-31-2018 (inflation adjusted)
Not more than 30 days late (by March 30 if the due date is February 28)	\$30 per return? \$75,000 maximum	\$50 per return/ \$185,000 maximum	\$50 per return/ \$186,000 maximum	\$50 per return/ \$187,500 maximum
31 days late – August 1	\$60 per return/ \$200,000 maximum	\$100 per return/ \$529,500 maximum	\$100 per return/ \$532,000 maximum	\$100 per return/ \$536,000 maximum
After August 1 or Not At All	\$100 per return/ \$500,000 maximum	\$260* per return/ \$1,059,500 maximum	\$260 per return/ \$1,064,000 maximum	\$260 per return/ \$1,072,500 maximum
Intentional Disregard	\$250 per return/ No limitation	\$520 per return/ No limitation	\$530 per return/ No limitation	\$530 per return/ No limitation

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