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COMPENSATION AND BENEFITS



SUBJECT

PENALTIES ON INFORMATION RETURNS INCREASED BY THE TRADE PREFERENCES EXTENSION ACT OF 2015 (THE “ACT”)

Effective for information returns filed after December 31, 2015

BACKGROUND

Internal Revenue Code section 6721 provides for penalties for failing to file information returns with the IRS. IRC section 6722 provides for penalties for failing to furnish a copy to a payee. These penalties apply to Forms W-2, 1098, 1099, 3921, 3922, 8937, 1042-S, etc., and beginning in 2015, will also apply to Forms 1094 and 1095, for reporting of health plan coverage.

The current penalty is \$200 per violation, or \$100 for each IRS and payee copy that is not filed or furnished to the recipient, with a maximum penalty charge of \$1.5 million per calendar year for failure to file and another \$1.5 million for failure to furnish. The penalties also apply to timely filings with incorrect information.

SUMMARY OF CHANGES

Effective for information returns filed after December 31, 2015, the Act increases the penalty from \$200 to \$500 per violation, or \$250 for each IRS and payee copy not filed or furnished to the recipient, respectively. The penalty exposure will typically be \$500 per form because the same error usually occurs on both the IRS and payee copies. The maximum penalties per calendar year are doubled from the current maximum of \$3 million to \$6 million (\$3 million for IRS copies and \$3 million for participant copies). The penalty for intentionally failing to file, increases from \$500 to \$1,000 per violation, or \$500 for each IRS and payee copy not filed or furnished to the recipient.

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SUMMARY OF CHANGES

The applicable information return penalties can be significantly reduced by acting quickly to correct errors and/or delinquent filings. However, the Act also significantly increases the amount of these reduced penalties. For failures that are corrected within 30 days after the filing due date, the \$250 penalty is reduced to \$50 per return (currently \$30) and the maximum penalty of \$3 million is reduced to \$500,000 per calendar year (currently \$250,000). For failures corrected after 30 days but before Aug. 1, the \$250 penalty is reduced to \$100 per return (currently \$60) and the maximum penalty of \$3 million is reduced to \$1.5 million per calendar year (currently \$500,000).

Filers with gross receipts under \$5 million are subject to the same per return penalty as outlined above but continue to get a break on the maximum annual penalty. Still the new law doubles the current maximum from \$500,000 to \$1 million per calendar year with reductions to \$175,000 (currently \$75,000) if corrected within 30 days, and \$500,000 (currently \$200,000) if corrected after 30 days but before Aug. 1.

It is the enforcement position of the IRS National Office that the statute of limitations for penalties under sections 6721 and 6722 runs for three years from the filing of individual information return(s) (e.g., Forms W-2, 1099, etc.). (See, for example, IRS CCM number 111814-13 (4/4/2013)). Accordingly, the statute of limitations will not begin to run in connection with delinquent filings. In addition, a 2008 Chief Counsel Memorandum advised there was not a statute of limitations on information returns furnished to taxpayers. (CCM number 138637-08 (10/17/2008)). These unsettling positions at the IRS underscore the importance of accurate and timely information reporting, not only from the penalty assessment viewpoint, but also with regard to a potential need to reserve for known errors on financial statements. Unlike most tax penalty reserves, reserves for civil penalties related to delinquent information returns may become a permanent part of a taxpayer's reserve.

While the IRS has discretion to waive/abate these penalties upon a showing of reasonable cause for the errors, it is better to avoid these potentially excessive penalties by ensuring compliance. Payers should begin now to review their practices and procedures related to tax information reporting, including the classification of workers as employees or independent contractors. In particular, employers should have a plan in place for how to fulfill their Form 1095 filing requirements under the Affordable Care Act, because these penalties apply to the 2015 information returns that are due in 2016.

Please contact us if you require further guidance or assistance in complying with any of your tax information reporting obligations, including compliance with the new requirements under the Affordable Care Act.

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