Tax Watch

BROWNEDWARDS
certified public accountants

July 23, 2015
Issue 9

New Trade Law Hikes Penalties for Tax Information Reporting Failures, Errors and Omissions

The debate over the recently enacted Trade Preferences Extension Act of 2015 (TPEA) waged for months. When it was finally signed into law by President Obama at the end of June, much ado was made about the so-called fast-track trade authority the act gives the President. But little attention was paid to a provision that has nothing to do with trade or globalization and could have a direct and costly impact on taxpayers subject to tax-related information reporting requirements.

Section 806 of the TPEA increases by as much as 150% the potential penalties for taxpayers that err in their information reporting to the IRS or payees (for example, employees and vendors). The penalties could be triggered by failures to file common information reporting returns (and provide payee statements) such as IRS Forms W-2 and 1099, as well as certain forms required by the Affordable Care Act (ACA) — or by errors or omissions on such forms. Sec. 806 is intended to raise revenues to offset the costs related to other aspects of the TPEA.

Failures, errors and omissions subject to penalties

The IRS imposes stiff penalties on taxpayers that fail to file a correct information return or to provide correct payee statements. The penalties apply if you fail to file returns or provide statements on a timely basis, fail to include all required information, or include incorrect information. They also apply if you file on paper when you were required to file electronically, report an incorrect tax identification number (TIN) or fail to report a TIN, or fail to file paper forms that are machine readable.

"Inconsequential" errors or omissions won't expose you to the penalties. Some errors and omissions, however, are *never* considered inconsequential. On information returns, errors and omissions related to a TIN, a payee's surname or any dollar amount aren't ever inconsequential. On payee statements, errors and omissions that are never inconsequential include those related to a dollar amount, a significant item in a payee's address, the use of the correct form and the manner of furnishing the statement.

The increased penalties

Sec. 806 boosts the penalties for failing to file correct information returns with the IRS and provide correct payee statements. The general penalty increases from $100 to $250 per return or statement, and the maximum penalty during a calendar year increases from $1.5 million to $3 million. Smaller taxpayers — defined as those with gross receipts of less than $5 million — will see the annual cap increase from $500,000 to $1 million.

Lower, but also increased, penalties will apply to taxpayers that correct their failures within 30 days after the required filing date. In such a case, the penalty will be $50 (up from $30) for each return, with the annual cap rising from $250,000 to $500,000. For smaller taxpayers, the annual maximum will increase from $75,000 to $175,000.

If a failure is corrected after 30 days but on or before August 1 of the calendar year of the required filing date, the penalty will be $100 (up from $60) for each return or statement. The annual cap will increase from $500,000 to $1.5 million. The annual maximum for smaller taxpayers will rise from $200,000 to $500,000.

If any of the failures are due to "intentional disregard," the penalty generally will increase from $250 to $500 per return or statement, with no annual cap. For certain forms and statements, the penalty will be $500 or, if greater, 10% of the total amount of items required to be reported correctly.

Under existing law, the penalties will be adjusted for inflation every five years.

A "multiplier" effect

Taxpayers that fail to file required information returns and to provide required payee statements could be subject to penalties of up to twice the annual maximum caps — because each of these types of reporting is subject to a separate cap. An employer that, for example, neither files any Forms W-2 with the IRS nor provides the forms to employees will be subject to a $3 million annual cap on the former and a separate $3 million cap on the latter. Even if the employer doesn't have enough employees to approach the caps, it should be aware that the per-employee general penalty will total $500, not $250.

Moreover, the annual caps apply on a per-filer basis, rather than per-company. In other words, each subsidiary that files separate returns from the parent company may be subject to its own cap, as opposed to an aggregate cap applying to the entire organization, parent and subsidiaries.

How to reduce your risk

To reduce the odds of incurring penalties, taxpayers must implement appropriate systems and controls to minimize the risk of errors in information reporting. Among other things, make use of the IRS's Taxpayer Identification Number On-Line Matching program.

The program allows qualified taxpayers to check their Form 1099 information against IRS records before filing information returns. It accepts up to 25 payee TIN/name combinations on-screen — bulk matching is available for up to 100,000 combinations to be matched using a text file submission. By allowing you to request verification from payees when your information and the IRS information don't match, the program can help you reduce your error rates and, in turn, penalties.

Effective date

The penalty increases under Sec. 806 of the TPEA will go into effect for most information returns and statements required to be filed after December 31, 2015 — meaning returns and statements for payments made this year. Certain ACA-related forms are exempt from penalties for 2015 reports as long as the employer makes a good-faith effort to comply with reporting requirements.

We can help you ensure all of your returns and statements are in compliance. Please contact your Brown Edwards professionals if you have questions regarding the increased penalties.