

Webcast questions and answers

The IRS penalty maze: How did I get here?
Wednesday, May 9, 2012 1:00 p.m. EDT

All questions contained herein were submitted by viewers of the referenced webcast.

Question:

Does the penalty for filing a late information return with the IRS apply to 2011 Forms 1099 filed in 2012?

Answer:

Yes. All late filed information returns are subject to a penalty under section 6721, and penalty rates change periodically by Congressional action. The increased penalty rates shown on the slide apply to filings in 2011 and 2012. For Forms 1099 filed in 2010 (thus, 2009 information returns), the penalty rate was one-half of the rate reflected for inadvertent late filings on slide eight. The rate for intentional late filing for returns due before 2011 was \$100 per return.

Question:

Does the penalty for filing a late information return with the IRS apply on top of the failure to file penalty for Forms 1065 and 1120S?

Answer:

The Form 1065 and Form 1120S filings require the Schedule K-1s to be attached to the filed return. Thus, those forms are not separate filings to which a separate penalty applies. However, if the partnership or S Corporation fails to provide the Schedule K-1s to the partners/shareholders, a penalty for failure to furnish the information return may be imposed. That penalty is \$100 per Schedule K-1, up to a maximum penalty of \$1.5 million for all such failures during a calendar year. If the requirement to provide the information return to the partners/shareholders is intentionally disregarded, the penalty is increased to \$250 per failure or, if greater, to 10 percent of the aggregate amount of items required to be reported, with no maximum penalty.

Question:

Does the IRS stack late payment penalties under section 6651(a)(2) and section 6651(a)(3)?

Answer:

The section 6651(a)(2) penalty is not “stacked” with the 6651(a)(3) penalty. This is because the 6651(a)(2) penalty continues to accrue until the tax is paid or the maximum penalty of 25 percent is reached. However, both penalties can apply at the same time to the same tax year, but to different portions of the liability. For example, an examination adjustment (or math error adjustment) can be subject to the section 6651(a)(3) penalty if the IRS sends a notice about those additions and the tax is not paid within the applicable time frame (21 calendar days or 10 business days). At the same time, the original or amended return liability can be subject to the section 6651(a)(2) penalty based on amounts shown on those returns.

Question:

If an individual does not file an extension and files his Form 1040 late (in May) and owes money with the return, will his penalty be 5 percent for each of the two months?

Answer:

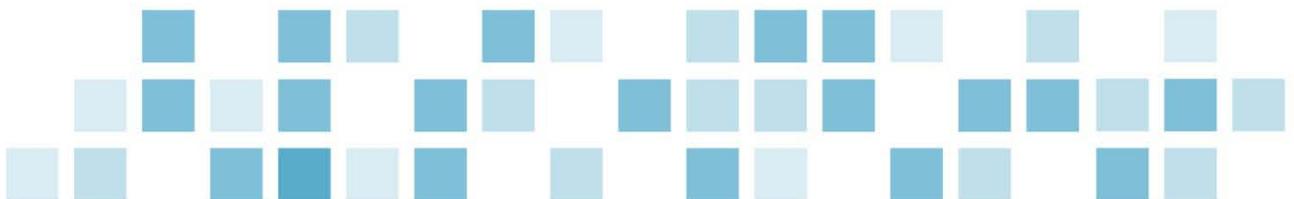
The individual will owe a 5 percent penalty for April and a 5 percent penalty for May (combined penalty for failure to file and failure to pay). If the full liability shown on the return is not paid with the return filing in May, then the failure to pay penalty (0.5 percent) will continue to accrue until the liability is paid (subject to a maximum penalty of 25 percent, of which 1 percent has already accrued through May).

Question:

Is there a risk that a timely request for an automatic extension to file a return will not be considered valid if the tax balance shown on the extension request is not paid with the request?

Answer:

For individuals, if a proper estimate of the liability is made and reflected on the request for automatic extension, there is no risk that the IRS would determine the extension request to be invalid simply because the individual did not pay the tax due. There is not a requirement that individuals pay the amount that they properly estimate with their extension. However, when the return is filed, the failure to pay penalty (0.5 percent per month) will be assessed if there is a balance due with the return. For corporations, both a proper estimate and payment of the estimated tax liability are required for a valid request for automatic extension. Thus, there is a risk that the extension will be determined to be invalid if the corporation does not pay the tax it properly estimated to be due.



Question:

What if a corporation or individual estimates its tax liability to be zero when it prepares its request for an automatic extension, but then shows a tax liability when it files its return? Will the IRS treat the extension of time as void?

Answer:

The IRS could determine that an extension request is invalid (for an individual or a corporation) if the corporation or individual estimates no tax liability and then reflects a liability on the filed return. In this case, the taxpayer would need to show that it made a proper estimate of its liability when its request for an automatic extension was filed. That showing would include all relevant facts relating to its tax liability on the date the request for extension was filed. This showing may also include reasonable cause factors, including that it acted in a reasonable and prudent manner when preparing its request for automatic extension and that it has a strong history of compliance.

Question:

If a person is self-employed and does not make estimated tax payments throughout the year, will the person be subject to a penalty?

Answer:

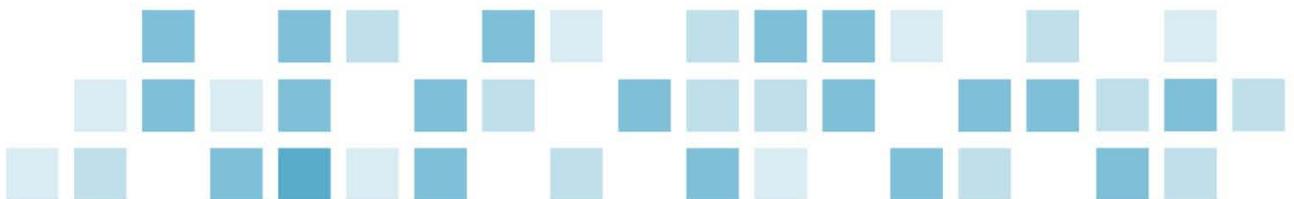
The estimated tax payments required of a self-employed person include both income tax and self-employment tax. A self-employed person will be subject to a penalty for failure to make estimated tax payments if he/she owes \$1,000 or more with the return. However, the amount of the estimated tax penalty is determined by the lateness of each required installment. Special rules may apply to each installment that may reflect a reduced penalty or no penalty at all (depending upon the circumstances) for one or more of the installments.

Question:

Does the “110 percent of prior year” exception to the estimated tax penalty apply to any Form 1040 (married filing jointly, single, married filing separately) with AGI of \$150,000 or more in the prior tax year?

Answer:

Yes. There is no separate AGI limit based on filing status.



Question:

Can individuals filing Form 1040 rely on the “annualization method” to make their estimated tax payments?

Answer:

Yes. They should reflect the annualization method on the Form 2210 and include it with their Form 1040 filing.

Question:

Are individuals filing Form 1040 permitted to pay their first quarter estimate based on 100 percent of their tax liability from the prior year?

Answer:

Yes, they can base their estimated payments on timely payment of 100 percent of their tax liability from the prior year unless their AGI for that prior year was \$150,000 or more. In this latter case, they must make timely estimated payments equal to 110 percent of their prior year liability in order to escape penalty.

Question:

Is the Form 2210 or Form 2220 required to be filed with the return?

Answer:

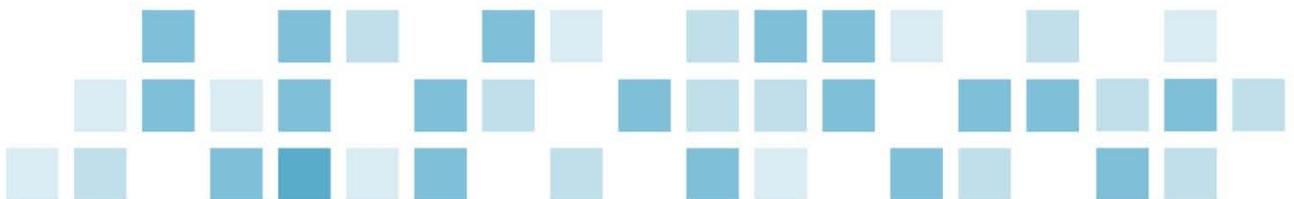
No. The IRS will compute the penalty if the Form 2210 (Form 1040) or Form 2220 (Form 1120) is not included with the return filing.

Question:

If a corporation fails to file a timely request for an extension of time to file its Form 1120 and then when it files the Form 1120 (after the return due date) it includes Forms 5471 with its return, will the Forms 5471 be considered late and potentially subject to a penalty?

Answer:

Forms 5471 filed late (as described above) will generally be subject to a penalty. However, if the information required to be included on the Forms 5471 has been included in computing the taxable income on the Form 1120, the IRS may excuse the penalty for late filed Forms 5471 on a showing of reasonable cause. In 2011, the IRS Offshore Voluntary Disclosure Initiative excepted late filed Forms 5471 from penalties if they were filed pursuant to the procedures outlined in OVDI Q&A 17 and the income tax liability of the filer was not affected by the late filed Forms 5471. A new OVDI program was announced in 2012. However, Q&A 17 (from the 2011 OVDI) has not been announced by the IRS to be applicable to the 2012 OVDI. Thus, it is



unclear whether there is an avenue for a penalty-free filing of Form 5471 filed after its due date outside of a showing of “reasonable cause.”

Question:

Who makes the decision at the IRS for abatement of a penalty? Does the IRS have guidelines?

Answer:

Abatement of a penalty on the basis of reasonable cause or administrative waiver is generally considered by a “reasonable cause” assistant or the “penalty appeals coordinator” at an IRS campus (service center). However, the authority to abate penalties on the basis of reasonable cause or administrative waiver is also delegated to various levels within the IRS, including Examination, Appeals, Collection and Counsel. There are guidelines that the IRS follows when considering abatement of penalties. However, because there are individuals who are considering reasonable cause factors, there can be differences of interpretation of the facts that lead to different penalty results.

Question:

If a return has been filed without a Form 8275 attached, may an amended return be filed solely to attach the Form 8275?

Answer:

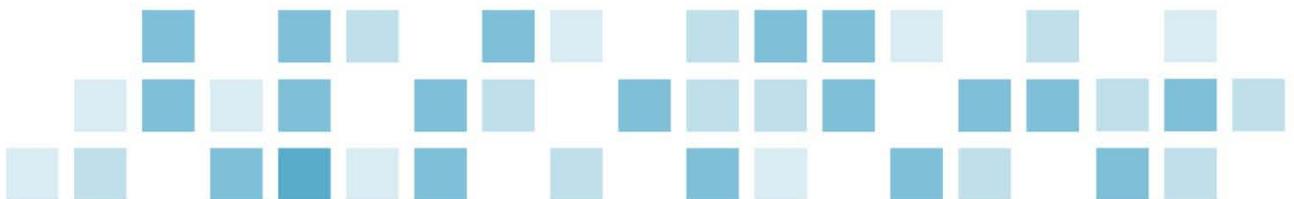
The filing of an amended return solely to attach the Form 8275 will be treated as a Qualified Amended Return if it is filed before the date that the taxpayer (or a pass-through entity) is contacted for examination or, in the case of a return with tax shelter items, before any person is contacted for a section 6700 return examination related to the item, before a John Doe summons is served on a third person, before the IRS contacts a tax shelter organizer/promoter/seller/material adviser about a listed transaction which is reflected on the return, or before the IRS announces a settlement initiative for a listed transaction which is reflected on the return.

Question:

Can the penalty for a late filed partnership return be abated for reasonable cause or administrative waiver?

Answer:

The IRS will not abate a penalty of a late filed partnership return without evaluating the partnership’s reasonable cause factors or compliance history.



Question:

How does the IRS determine “willfulness” for purposes of imposing a higher penalty?

Answer:

The IRS determines willfulness based on facts and circumstances surrounding the particular penalty. Generally, willfulness reflects an intentional, deliberate, voluntary and knowing disregard of requirements. Another way to think of it is as a non-accidental failure to perform a specific requirement.

Contributed by:

Patti Burquest, Washington National Tax, patti.burquest@mcgladrey.com

David Click, Tax Services, david.click@mcgladrey.com

800.274.3978
www.mcgladrey.com

Disclaimer

The information contained herein is general in nature and based on authorities that are subject to change. McGladrey LLP guarantees neither the accuracy nor completeness of any information and is not responsible for any errors or omissions, or for results obtained by others as a result of reliance upon such information. McGladrey LLP assumes no obligation to inform the reader of any changes in tax laws or other factors that could affect information contained herein. This publication does not, and is not intended to, provide legal, tax or accounting advice, and readers should consult their tax advisors concerning the application of tax laws to their particular situations.

Circular 230 Disclosure

This analysis is not tax advice and is not intended or written to be used, and cannot be used, for purposes of avoiding tax penalties that may be imposed on any taxpayer.

McGladrey LLP is the U.S. member of the RSM International (“RSMI”) network of independent accounting, tax and consulting firms. The member firms of RSMI collaborate to provide services to global clients, but are separate and distinct legal entities which cannot obligate each other. Each member firm is responsible only for its own acts and omissions, and not those of any other party.

McGladrey, the McGladrey signature, The McGladrey Classic logo, The power of being understood, Power comes from being understood and Experience the power of being understood are trademarks of McGladrey LLP.

© 2012 McGladrey LLP. All Rights Reserved

