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TAX ALERT: NEW TRADE LAW HIKES PENALTIES FOR TAX INFORMATION REPORTING FAILURES, ERRORS AND OMISSION

The debate over the recently enacted Trade Preferences Extension Act of 2015 (TPEA) waged for months. When it was finally signed into law on June 29, there was quite a bit of attention around the so-called fast-track trade authority that the law now provided to 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.

Sec. 806 of the TPEA increases by as much as 150% the penalties for failure to correctly report or otherwise timely file information reporting returns (and related payee statements). The penalties could be triggered by a failure to file common forms such as Internal Revenue Service (IRS) Forms W-2 and 1099, and Forms 1042 and 1042-S.

Failures, Errors and Omissions Subject to Penalties

The new law imposes stiff penalties on taxpayers that fail to file returns or provide payee statements on a timely basis, fail to include all required information, or include incorrect information. These increased penalties will 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 are not subject to penalties. However, some errors and omissions are *never* considered inconsequential. These include errors on information returns relating to a TIN, a payee's surname or any dollar amount. On payee statements, errors and omissions that are never inconsequential include dollar amounts, 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 increases the penalty per return or statement from \$100 to \$250, and doubles the caps on penalties for failing to file correct information returns with the IRS or provide correct payee statements. 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.

Increased penalties will also 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 also doubling 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. In this situation, the annual cap triples from \$500,000 to \$1.5 million, and 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, and there is no annual cap. For certain forms and statements, the penalty will be the greater of \$500 per return or 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. For example, assume a taxpayer with gross receipts of greater than \$5 million fails to file Forms W-2 with the IRS and corresponding payee statements to its employees. The taxpayer would be subject to separate \$3 million annual caps for the information returns and payee statements.

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 applying the cap to only the common parent organization.

How to Reduce Your Risk

There has been an increased focus on information returns audits within the IRS. This development, in turn, may result in additional penalty exposure. 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 does not match, this program can help you reduce your error rates and penalty exposure.

Effective Date

The penalty increases under Sec. 806 of the TPEA will go into effect for most 2015 information returns and statements that are required to be filed in early 2016. The two new Affordable Care Act information return requirements will not be subject to penalties until 2016 (reports due in early 2017) if the reporting entities make a good faith effort to comply.

We can help you ensure all of your returns and statements are in compliance.

For More information

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