

Penalties and Defenses

Chapter 3 pp. 83-122

2023 National Income Tax Workbook™



Penalties and Defenses

p. 83

- Individual and Business Penalties
- Individual and Business Penalties Defenses and Relief
- Penalty Abatement Requests and Appeals
- International Penalties and Defenses
- Preparer Penalties and Defenses

Purpose of Penalties

p. 83

2021 Stats:

- \$ 37.3 billion civil penalties
 - \$ 17.1 billion for individual & estates/trust
- \$13.3 billion abated
 - \$ 2.7 billion for individuals & estates/trust
- Penalty Handbook - www.irs.gov/irm/%20part20

Individual & Business Penalties:

Failure-to-file (FTF) & Failure-to-pay (FTP) p. 84

- IRC §6651 – Individuals & C Corporations
- IRC §6698 – Partnerships (P/S)
 - IRC §6031 – include all info on P/S returns
- IRC §6699 – S Corporations
 - IRC §6037 – include all info on S Corp returns

Individual & Business Penalties:

Failure-to-file (FTF) & Failure-to-pay (FTP) p. 85

- 2021 penalties on Individuals, estates & trusts
 - FTF - \$4,568,266
 - FTP - \$8,028,212
- Types of Errors:
 - Late-filing – discrepancy between postmark date
 - Missing payment or credit
 - Start date is incorrect
 - Amount is excessive considering tax liability

Individual & Business Penalties:

Failure-to-file (FTF) penalty rates

p. 85

- IRC §6651(a)(1)
- Generally 5% of unpaid tax per month up to 25% of unpaid liability
- 60 day rule – lesser of minimum amount or 100% of unpaid tax due

FIGURE 3.1
Minimum FTF Penalty

Return Due Date (without Extensions)	Minimum Penalty Amount
On or before 12/31/2008	\$100.00
Between 01/01/2009 and 12/31/2015	\$135.00
Between 01/01/2016 and 12/31/2017	\$205.00
Between 01/01/2018 and 12/31/2019	\$210.00
Between 01/01/2020 and 12/31/2022	\$435.00
After 12/31/2022	\$450.00

Individual & Business Penalties:

Annual minimum penalty

pp. 85 - 86

- Does not apply to Employment, Excise, Gift or Estate Taxes
- Applies to individual income tax returns UNLESS only filing to report:
 - SE Tax
 - Household Employment Tax
 - Taxes on Qualified Retirement Plans
 - 10% tax on early distributions on Retirement Plans

Individual & Business Penalties:

Failure-to-file (FTF) penalty rates

p. 86

If fraudulent and willful:

- Rate is 15% of unpaid tax per month
- Maximum amount is 75% of unpaid liability

Individual & Business Penalties:

Failure-to-file (FTF) penalty rates

p. 86

IRS has burden to prove failure was fraudulent

Considers the following factors:

- TP refuses/unable to explain failure to file
- TP's statement doesn't agree with facts of case
- TP has history of noncompliance & can pay
- TP fails to reveal or conceals assets
- TP uses cash for expenses or does not deposit receipts
- TP is aware of filing requirement

Individual & Business Penalties:

Failure-to-pay (FTP) penalty rates

p. 86

- IRC §6651(a)(2)
 - Begins at 0.5% of unpaid tax per month
 - Increases to 1% per month 10 days after IRS Notice
 - Maximum of 25% of unpaid tax
- If entered into Installment Agreement
 - Penalty is 0.25% of unpaid tax per month
 - IRC §6651(h)

Individual & Business Penalties:

Failure-to-file (FTF) & Failure-to-pay (FTP) p. 86

- If both FTF & FTP apply:
 - FTF is reduced to 4.5% (IRC §6651(c)(1))
 - FTF maximum = 22.5%
 - FTP is NOT reduced – remains .5% with maximum of 25%
 - Maximum for both will be 47.5%

Individual & Business Penalties: Failure to file partnership return

p. 87

- IRC §6698
- \$ 220 per partner, Per month
- Up to 12 months
- Reasonable Cause may provide relief
- Rev. Proc. 84-35 – Small domestic partnership:
 - 10 or fewer partners (attribution rules apply)
 - All partners are individuals
 - Partner's income, deduction, credits allocated
 - Partner's report their share on timely filed returns

Individual & Business Penalties: Failure to file S Corp return

p. 88

- IRC §6699
- \$ 220 per shareholder, Per month
- Up to 12 months
- Does not apply if Reasonable Cause met
 - Rev. Proc. 84-35 does not apply
 - May be eligible for 1st time abatement

Individual & Business Penalties: Individual Estimated Tax

p. 88

- IRC §6654 – failure to pre-pay
- IRC §6654 – failure to make
- Estimates required if:
 - Owe at least \$1,000 in the tax year
 - Withholding and credits less than the smaller of:
 - 90% of current year tax (66% if at least two-thirds from gross farming), OR
 - 100% of prior year tax (110% if AGI > \$75,000/150,000)

Individual & Business Penalties: Individual Estimated Tax

p. 88

- No estimates required if:
 - No prior year tax liability
 - US citizen or resident alien the whole year
 - Prior tax year covered 12-month period

MUST MEET ALL THREE

Individual & Business Penalties: Individual Estimated Tax

p. 89

Estimated Tax Due Dates

FIGURE 3.2
Estimated Tax Payment Due Dates

For the Period	Due Date
January 1–March 31	April 15
April 1–May 31	June 15
June 1–August 31	September 15
September 1–December 31	January 15 of the following year*

* If the taxpayer files Form 1040, U.S. Individual Income Tax Return, by January 31 of the following year and pays the remaining tax owed, then no January 15th estimated payment is required.

Individual & Business Penalties:

Individual Estimated Tax Penalty p. 89

- IRC §6621
- Assessed per quarter
- Multiply daily rate by underpayment amount
- I.R.C. §6654(e) – Provides waiver
 - Equity & Good Conscience
 - NOT the same as Reasonable Cause
 - Is for casualty, disaster, or other unusual circumstance
 - Retired or Disabled

Individual & Business Penalties: Individual Estimated Tax Penalty

pp. 89 - 90

Equity & Good Conscience examples:

- TP's records were destroyed in casualty or natural disaster
- TP become seriously ill or injured
- Overpayment offset rather than overpayment credited toward estimated tax payment
- Community property state – filed original joint return then filed separate amended return

Individual & Business Penalties: Individual Estimated Tax Penalty

p. 90

Not Against Equity & Good Conscience if:

- Foreseeable event
- Taxpayer's action shows no reasonable effort

Reasons for no waiver:

- Reliance on advice of a competent tax advisor
- Retroactive application of statute or regulation
- Erroneous advice from the IRS (unless meets provisions of written advice)
- Lack of funds

Individual & Business Penalties: Individual Estimated Tax Penalty

pp. 90 - 91

Examples of foreseeable event or TP's action

- Scheduled surgery – NOT OK
- Taxpayer's house burns down & funds used for basic living - OK
- Taxpayer's house burns down & they buy luxury items – NOT OK
- Taxpayer's house burns down & they don't make estimated payments after receiving insurance settlement – NOT OK

Individual & Business Penalties: Individual Estimated Tax Penalty

p. 91

Requesting a waiver:

- IRC §6654(e)(3)(A)
 - Submitted in writing
 - Signed by TP or authorized tax practitioner
- Waiver for retired or disabled TP's
 - I.R.C. 6654(e)(3)(B)
 - Retired or disabled; AND
 - Reasonable cause

Individual & Business Penalties: Corporate Estimated Tax

p. 91

- IRC §6655 – Imposes estimated tax penalty
- Must make estimates if tax (income – credits) > \$ 500
- Estimate is lesser of:
 - 100% of current-year tax liability, OR
 - 100% of prior-year tax liability (cannot use if zero liability or did not cover 12 months)

Individual & Business Penalties: Corporate Estimated Tax Penalty

pp. 91 - 92

- Penalty rate for corporation is same as individuals
- To determine amount of required payments:
 - Corporations use Form 1120-W
 - Exempt Organizations use Form 990-W
- Form 2220 - Used to compute, reduce or eliminate penalty. Required to be filed if:
 - Using adjusted seasonal installment method,
 - Using annualize income installment method,
 - Is a large corporation

Individual & Business Penalties: Corporate Estimated Tax Penalty p. 92

Large Corporations:

- Has taxable income \$ 1mil or more during any of the 3 preceding years
- Must pay 100% of current tax year
- May use 100% of prior-year tax liability for first installment ONLY
 - If less than current year liability, must add difference in 2nd installment

Individual & Business Penalties: Corporate Estimated Tax Penalty

p. 92

Example 3.2 - Blacktail Sports, Inc

- \$1.4 M 2022 liability ($1.4 \div 4$ installments = \$350,000)
- \$1.6 M 2023 liability ($1.6 \div 4$ installments = \$400,000)
- Est. Tax should be based on 2023 tax liability
- May use prior year liability for 1st installment ONLY
 - 1st installment = \$350,000
 - 2nd installment = \$450,000
 - 3rd & 4th installment = \$400,000 each

Individual & Business Penalties: Corporate Estimated Tax Penalty p. 92

Abatement/Waiver:

- Must specify: Legislative or Administrative provision (see instructions for F 2220)
- No provision in law for:
 - Reasonable Cause
 - Unusual circumstances
- May get waiver if:
 - IRS misapplied payment/refund and assessment is against equity & good conscience

Individual & Business Penalties: Failure to Deposit (FTD) Penalty

pp. 92 - 93

- IRC §6656 assesses penalty if:
 - Deposit is not timely made,
 - In the correct amount,
 - In the correct manner
- Safe Harbor
 - 100% of tax liability generally required
 - No penalty if shortfall < greater of \$100 or 2% of the amount required, AND
 - Paid/deposited by shortfall makeup date

Individual & Business Penalties: Failure to Deposit (FTD) Penalty

p. 93

IRC §6656(b)(1) – four-tier penalty system

- 1-5 days late = 2%
- 6-15 days late = 5%
- Greater than 15 days = 10%
 - Additional 5% if unpaid > 10 days from date of 1st IRS Notice
- Failure to use EFTPS = 10%
- Waiver of penalty for:
 - Reasonable Cause
 - First-Time Abatement

Individual & Business Penalties: Failure to Deposit (FTD) Penalty

p. 93

Practitioner's note – Unbanked Taxpayers

- Generally unable to use EFTPS
- May seek reasonable cause relief
 - Make all payments on-time
 - Provide signed statement which explains:
 - Attempts to obtain bank account
 - Includes denial letter or other bank correspondence

Individual & Business Penalties: Failure to Deposit (FTD) Penalty

p. 94

First Time Abatement

- Administrative Waiver for inadvertent failure-to-deposit if:
 - Net Worth
 - \$ 2,000,000 individuals
 - \$ 7,000,000 partnerships & corps
 - Only applies to 1st Quarter required to deposit
 - Timely filed employment tax return

Individual & Business Penalties: Failure to Deposit (FTD) Penalty

p. 94

Deposit Schedule Changes

- Full penalty abatement or waiver
 - When changing frequency of deposits
 - Applies to first deposit after change only

Application of Late Deposits

- I.R.C. §6656(e) – allows designation of deposit
- TP has 90-days from date of FTD notice to make designation
- Can use to minimize penalty

Individual & Business Penalties: Return Related Penalties

pp. 94 - 95

Accuracy-Related - IRC §6662(d)

- 20% of underpayment amount
- Reasonable cause relief available if:
 - Acted in Good Faith
 - Reasonable effort to report the proper tax liability
- Other considerations:
 - Taxpayers experience, knowledge & education
 - Taxpayer's reliance on advice of tax advisor
 - Complexity of the tax issue
 - Competence of the tax advisor

Individual & Business Penalties: Return Related Penalties

p. 95

- Reliance on Advice
 - Can serve as basis for reasonable cause/good faith
- Reasonable cause relief available if:
 - TP Supplied all necessary information
 - Advisor discloses:
 - Conflict of interest
 - Lack of expertise
 - Advice based on factual or legal assumptions

Individual & Business Penalties: Return Related Penalties

p. 96

Civil Fraud Penalty - IRC §6663(a)

- Penalty = 75% of underpayment due to fraud
- IRS has burden of proof to show intent
- Joint return – must establish intent for each spouse
- No penalty relief

Individual & Business Penalties: Return Related Penalties

p. 96

Erroneous Claim for Refund or Credit Penalty - IRC §6676

- Penalty = 20% of excessive amount claimed
 - No reasonable basis for claimed tax treatment
- Reasonable cause relief – IRC §6664(c)
 - Must show reasonable cause for amount claimed
 - Must show economic substance

Individual & Business Penalties: Information Return Penalties pp. 96 - 98

Information Return Penalties

- IRC §6721 – failure to file
- IRC §6722 – failure to furnish correct payee statements
- IRC §6723 – failure to comply with other information reporting requirements
- Applies to W-2, W-3, 1099, 1096, 1098 series, etc.
- Figure 3.3 on pages 97 & 98 shows the due dates for the various information returns

Individual & Business Penalties: Information Return Penalties

p. 99

Electronic Filing Waiver

- IRC §6011(e) requires electronic filing for 10 or more same document types
- IRC §6721 - penalties apply if TP does not file electronically
- TP can submit Form 8508, Request for Waiver from Filing Information Returns Electronically
 - Must show it would create an economic hardship
- TP can request 30-day extension of time to file
 - Form 8809, Application for Extension of Time to File Information Returns
 - FIRE system

Individual & Business Penalties: Information Return Penalties

p. 99

Penalty amounts & limitations

	Within 30 days	After 30 days, before Aug 1st	After Aug 1st
Penalty per failure	\$50	\$110	\$290
Annual Maximum penalty	\$588,500	\$1,766,000	\$3,532,500
Max. for Small Business	\$206,000	\$588,500	\$1,177,500

- If failure is due to intentional disregard:
 - \$580 per failure, No maximum
- IRC § 6723 imposes a \$50 penalty for each failure, with a maximum of \$100,000 for any calendar year, to comply with other information reporting requirements.

Individual & Business Penalties: Information Return Penalties pp. 99 - 100

Reasonable cause waiver for information returns

- Show error was due to reasonable cause & not willful neglect
- No first-time abatement is available
- Request waiver - provide written statement showing:
 - Specific provision
 - Facts & circumstances
 - Signature of filer
 - Declaration under penalties of perjury

Individual & Business Penalties: Information Return Penalties

p. 100

Reasonable manner - Treas. Reg. 301.6724-1(d)

- TP exercised same care as a reasonable prudent person would both before & after the failure occurred
- Includes taking steps to avoid failure such as:
 - Request appropriate extensions
 - Attempting to prevent a failure if foreseeable
 - Acting to remove an impediment or the cause of the failure
 - Correcting the failure promptly, generally within 30 days

Individual & Business Penalties: Information Return Penalties

p. 100

- Significant mitigating factors:
 - Prior to failure – return was not required
 - Taxpayer's compliance history
- Events Beyond the Taxpayer's Control
 - Availability of relevant business records
 - Undue economic hardship
 - Reliance on erroneous written information from IRS
 - Actions of an agent

Individual & Business Penalties Defenses and Relief

p. 101

- I.R.M. 20.1.1.3 establishes 4 categories of relief
- Penalty Relief Ordering
 - Correction of IRS error
 - Statutory & regulatory exceptions
 - Administrative waivers
 - Reasonable cause
- Categories do not apply equally to all civil penalties

Individual & Business Penalties

Defenses and Relief

pp. 101 - 102

Statutory & Regulatory Exceptions:

- Rev. Proc. 84-35: Small Partnership failure-to-file relieve
- IRC §6654(e): Waiver for individual estimated tax penalty
- IRC §6404(f) & Treas. Reg. §301.6404-3: Erroneous Advice
 - Practitioner Note: other penalty relief
- IRC §7508A & Treas. Reg. §301.7508A-1:
Federally Declared Disaster
 - Postpone certain deadlines
 - Mandatory 60-day postponement Federally Declared Disaster

Individual & Business Penalties Defenses and Relief

pp. 102 - 104

Administrative Waivers:

- IRS Policy granting relief under specific conditions
 - Policy Statements
 - New Release
 - Formal Communication from IRS
- First-Time Abatement for FTP & FTD
 - To qualify:
 - Filed all required returns
 - Paid or arranged to pay all tax currently due
 - Not have requested within 3 years prior

Individual & Business Penalties Defenses and Relief

p. 104

Reasonable Causes:

- Based on facts & circumstances
- Usually granted if:
 - TP acted in good faith, NOT with willful neglect
- IRS considerations:
 - What happened & when
 - Facts & circumstances that prevented compliance
 - How did TP handle other affairs
 - Attempts made to comply

Individual & Business Penalties Defenses and Relief

p. 105

Ordinary Business Care & Prudence

- IRS will consider:
 - Taxpayer's reason
 - Compliance history
 - Length of time between failure & corrective actions
 - Circumstances beyond TP's control

Individual & Business Penalties Defenses and Relief

pp. 106 - 107

Events outside of TP's control

- Death, Illness, or Absence
- Fire, Casualty or Disaster
- Unable to Obtain Records

Can also consider supporting factors

- Mistake, Reliance, Ignorance, and Forgetfulness

Penalty Abatement Request & Appeals

pp. 108 -110

Request:

- Taxpayer has Burden of Proof
- Request as early as possible
- Explain the following:
 - What facts & circumstances prevented the taxpayer from filing a return, paying a tax or otherwise complying with the law?
 - How did the facts & circumstances result in the taxpayer not complying?
 - How did the taxpayer handle the remainder of his/her affairs during this time?
 - What attempt did the taxpayer make to comply?

Penalty Abatement Request & Appeals

p. 110

Appeals:

- TP must request
- Appeals determinations:
 - Penalty stands as proposed
 - Taxpayer did not commit prohibited action or failure to act – Penalty dropped
 - Settles for less than full amount - Hazards of litigation
- Practitioner Note – Preassessment Appeals

International Penalties & Defenses

p. 111

Foreign Bank Account Reporting (FBAR)

- Required for US Citizens, residents & certain other persons
- Annual Reporting
- Direct or indirect financial interest in or signature authority
- Aggregated value > \$ 10,000 at any time during the calendar year
- Form 114 – FinCEN
 - Due April 15th
 - 6-month automatic extension

International Penalties & Defenses

pp. 111 - 112

Foreign Bank Account Reporting (FBAR)

- Failure to comply may result in penalties:
 - Non-willful = \$ 15,611 (Individuals)
 - Willful = 50% of account value or \$ 156,107 (Individuals)
 - Negligence = \$ 1,350 (Financial Institutions)
 - Pattern of negligence = \$ 105,083 (Financial Institutions)
- Examiners have discretion in determining penalty amount (See Figures 3.6 & 3.7 on pg 112)

International Penalties & Defenses

pp. 113 - 114

Reasonable Cause relief for FBAR

- Only applies to non-willful violations
- IRS will consider the following:
 1. Reason for not meeting filing obligation
 2. TP's compliance history for all tax obligations
 3. Length of time between failure and compliance/correction
 4. Circumstances beyond TP's control exist
 5. Ignorance of the law – Did TP make a reasonable & good-faith effort to comply?

International Penalties & Defenses, cont'd

pp. 113 - 114

Reasonable Cause relief for FBAR

- IRS will consider the following when TP claims they were unaware of the obligation:
 - a) TP's education level, professional background
 - b) Has TP been penalized before for this penalty
 - c) The level of complexity of the issue
 - d) Any recent changes in the law
 - e) Any intentional effort to conceal/report income or assets

International Penalties & Defenses

pp. 114 - 115

Other International Penalties

F8938 – Statement of Specified Foreign Financial Assets	\$10,000, plus \$10k added every 30 days, maximum of \$50,000
F3520 - Annual Return to Report Transactions With Foreign Trusts & Receipt of Certain Foreign Gifts	\$ 10,000 or 35% of gross reportable amt 5% of gift per month up to 25% max
F3520-A - Information Return of Foreign Trust With a U.S. Owner	\$ 10,000 or 5% of gross value of trust assets owned by US person
F5471 – Information Return of US persons with Respect to Certain Foreign Corporations	\$10,000, plus \$10k added every 30 days, maximum of \$50,000
F5472 - Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation engaged in U.S. Trade or Business	\$25,000, plus \$25k added every 30 days
F926 - Return by a U.S. Transferor of Property to a Foreign Corporation	10% of the value transferred \$ 100,000 max
F8865 - Return of U.S. Persons With Respect to Certain Foreign Partnerships	\$ 10,000 + \$ 10k added every 30-days, \$ 50,000 max 10% of contributed property value, \$ 100,000 limit

Preparer Penalties & Defenses

p. 117

Preparer penalties:

IRC §6713 – Disclosure or use of Tax Return Information

- Can only disclose pursuant to code or court order
- Penalty = \$250 per violation, \$10,000 max
- If disclosure causes ID theft, penalty increased to \$1,000 per violation, \$50,000 max

Preparer Penalties & Defenses

p. 118

Preparer penalties cont'd:

IRC §6694(a) – Unreasonable Position

- Knows/should have known position unreasonable
- Acted in good faith when relying on advice of 3rd party
- Not deemed good faith if:
 - Advice is unreasonable on its face
 - Knew/should have known adviser unaware of facts
 - Advice no longer reliable due to changes in law

Preparer Penalties & Defenses

pp. 118 - 119

Preparer penalties:

IRC §6694(b) – Willful or Reckless Understatement

- Intentional disregard for rules & regulations
- IRS bears Burden of Proof
- Penalty = Greater of \$5,000 or 75% of income derived

Preparer Penalties & Defenses

pp. 119 - 121

Preparer penalties:

IRC §6695(a) – Failure to Furnish Copy to Taxpayer

IRC §6695(b) – Failure to Sign Return

IRC §6695(c) – Failure to Furnish Identifying Number

IRC §6695(d) – Failure to Retain Copy or List

IRC §6695(e) – Failure to File Correct Information Returns

- These penalties will not apply if due to reasonable cause and not willful neglect

IRC §6695(f) – Negotiation of Check

- No reasonable cause exception to this penalty

Preparer Penalties & Defenses

pp. 121 - 122

Preparer penalties:

IRC §6695(g) – Due Diligence

- Complete Form 8867, Paid Preparer's Due Diligence Checklist
 - Use information provided by taxpayer
 - Information reasonably known by you
 - Keep all records and documentation
 - Do not ignore the implications of information furnished to, or known by, you
 - Make reasonable inquiries if information furnished appears incorrect, inconsistent, or incomplete
 - Keep contemporaneous documentation

Thanks!

