

Congress Enacts Dramatic Increase in Information Reporting Penalties While Filers Still Barred From TIN Matching Program

By Michael M. Lloyd and
S. Michael Chittenden

Michael M. Lloyd is a member of, and S. Michael Chittenden is a senior associate in, Miller & Chevalier in Washington. Lloyd served on the IRS Information Reporting Program Advisory Committee from 2011 through 2013. The views expressed herein are the authors' own.

Lloyd and Chittenden discuss the little-noticed but dramatic increase in information reporting penalties found in the Trade Preferences Extension Act of 2015 signed into law June 29. They explain why this is not as painless as it seems because of recent laws that have increased the complexity of information reporting and the IRS's continued refusal to expand the taxpayer identification number matching program.

In the endless search for revenue on Capitol Hill, few sources seem as painless to taxpayers as an increase in information reporting penalties. The theory goes that increasing these penalties harms only noncompliant businesses and encourages greater compliance. As Congress looks to close the tax gap, information reporting and associated penalties for information reporting errors have taken a lead role. In the past five years, Congress has increased information reporting penalties, added new information reporting requirements, and indexed information reporting penalties for inflation. Now, Congress has increased penalties yet again, while at the same time denying a decade-old plea to expand the taxpayer identification number matching program, which has been shown to dramatically decrease error rates on specific information returns.

Increased Per-Failure Penalties

The latest culprit is a little-noticed provision buried deep within the Trade Preferences Extension Act of 2015, P.L. 114-27, a law enacted to extend

trade preferences with specific foreign countries.¹ Signed on June 29 by President Obama, the law includes an under-the-radar but dramatic increase to the most common information reporting penalties — penalties often imposed for mistakes that businesses cannot prevent on numerous types of information returns. Section 806 of the law increases the penalty from \$100 per failure to \$250 per failure under each of sections 6721(a) and 6722(a), which impose the penalty for each incorrect information return filed with the IRS and each copy sent to the payee or recipient, respectively. This means that a single error on a 2015 information return (filed in 2016) could result in a \$500 penalty unless the taxpayer is granted an abatement on reasonable cause or other grounds.

As mentioned above, this is not the first time that Congress has gone to the information reporting well. In 2010 Congress doubled the then-existing penalties from \$50 to \$100 for information returns filed or furnished after December 31, 2010. As a result of these two increases, the per-failure penalty rate is now five times what it was only five years ago. The penalties will continue to increase, as Congress only last year indexed the penalties for inflation.² The first inflation adjustments under those provisions have not yet occurred.

Increased Aggregate Penalty Limits for Large Taxpayers

Congress also dramatically increased the aggregate maximum penalties that can be imposed under sections 6721³ and 6722.⁴ In 2010 the aggregate penalty maximum per filer under the two statutes was \$500,000 — \$250,000 under each of sections 6721⁵ and 6722.⁶ For information returns required to be filed after December 31, 2015, the aggregate maximum penalty per filer will be \$6 million — \$3 million

¹For background, see Andrew Velarde, "New Law Quietly Doubled Reporting Penalties, and Nobody Noticed," *Tax Notes*, July 13, 2015, p. 132.

²Sections 6721(f) and 6722(f).

³Section 6721(a).

⁴Section 6722(a).

⁵Section 6721(a) (2010).

⁶Section 6722(a) (2010).

| Information Reporting Penalties (Before) and After P.L. 114-27 | | | | |
|--|---|--|---|-------------------------------|
| | Standard Penalty Under Each of Sections 6721(a) and 6722(a) | Discounted Penalty for Correction Within 30 Days | Discounted Penalty for Correction Before August 1 | Intentional Disregard Penalty |
| Per failure | \$250 ^a (\$100) | \$50 ^b (\$30) | \$100 ^c (\$50) | \$500 ^d (\$250) |
| Annual maximum | \$3 million ^e (\$1.5 million) | \$500,000 ^f (\$250,000) | \$1,500,000 ^g \$500,000 | None ^h |
| Annual maximum for filers with gross receipts of \$5 million or less | \$1 million ⁱ (\$500,000) | \$175,000 ^j (\$75,000) | \$500,000 ^k (\$200,000) | None ^l |

^aPub. L. 114-27 sections 806(a)(1) and (e)(1)(A).
^bPub. L. 114-27 sections 806(b)(1)(A) and (e)(2)(A)(i).
^cPub. L. 114-27 sections 806(b)(2)(A) and (e)(2)(B)(i).
^dPub. L. 114-27 sections 806(d)(1)(A) and (e)(4)(A). In the case of certain returns, the penalty for intentional disregard is the greater of 10% of the amount required to be reported on the return and the amount shown.
^ePub. L. 114-27 sections 806(a)(2) and (e)(1)(B).
^fPub. L. 114-27 sections 806(b)(1)(C) and (e)(2)(A)(iii).
^gPub. L. 114-27 sections 806(b)(2)(C) and (e)(2)(B)(iii).
^hI.R.C. sections 6721(e)(3) and 6722(e)(3).
ⁱPub. L. 114-27 sections 806(c)(1)(A) and (e)(3)(A).
^jPub. L. 114-27 sections 806(c)(2)(A) and (e)(3)(B).
^kPub. L. 114-27 sections 806(c)(3)(A) and (e)(3)(C).
^lI.R.C. sections 6721(e)(1) and 6722(e)(1).

under each of sections 6721⁷ and 6722⁸ — 12 times the maximum penalty imposed only five years ago.

Increased Penalties, New Information Reporting Requirements, and Lack of Access to Information Verification

The additional penalties come in the wake of the Affordable Care Act, which enormously increased the volume of information returns that must be filed. The ACA imposed multiple information reporting requirements on employers and health insurers, such as Code DD reporting of the value of employer-provided health insurance on Form W-2,⁹ Form 1095-A reporting by health exchanges, Form 1095-B reporting by insurers and other providers of minimum essential coverage,¹⁰ and Form 1095-C reporting of offers of minimum essential health coverage by applicable large employer members.¹¹ These new requirements will result in the filing of tens of millions of new information returns every year, each of which exposes the filer to a potential combined per-failure penalty of \$500. These ACA information reporting requirements arrived not long after another set of complex new reporting requirements under the Foreign Account Tax Com-

pliance Act.¹² Further, all these new and revised information reporting requirements were lumped on top of an already broad range of returns subject to potential penalties under sections 6721 and 6722.

Unfortunately, given the volume of information returns that must be filed, even the largest and most diligent of information return filers cannot avoid all information reporting penalties. Although the IRS Information Reporting Advisory Committee has for years pushed for a de minimis error reporting exception,¹³ no congressional or legislative action has been taken, so even a 1-cent error could conceivably result in a \$500 penalty. Filers can reduce common errors by using the IRS TIN matching program for certain information returns, but the IRS has restricted access to this valuable tool to only those transactions subject to backup withholding, a subset of all information returns that must be filed.¹⁴ Despite 12 years of urging from IRPAC and prodding by the Taxpayer Advocate Service, large

⁷P.L. 114-27 section 806(a)(2).

⁸P.L. 114-27 section 806(e)(1)(B).

⁹Section 6051(a)(14).

¹⁰Section 6055.

¹¹Section 6056.

¹²FATCA significantly changed reporting on Form 1042-S and added new reporting requirements for some filers under Form 8966, "FATCA Report."

¹³See, e.g., 2014 IRPAC Public Report: Burden Reduction Subgroup, section A.

¹⁴See On-Line Taxpayer Identification Number (TIN) Matching Program, Pub. 2108A, section 1(1).

Information Returns Subject to Penalties under Sections 6721 and 6722

- Form 1095-A, *Health Insurance Marketplace Statement*;
- Form 1095-B, *Health Coverage*;
- Form 1095-C, *Employer-Provided Health Insurance Offer and Coverage*;
- Form 1097-BTC, *Bond Tax Credit*;
- Form 1098, *Mortgage Interest Statement*;
- Form 1098-C, *Contributions of Motor Vehicles, Boats, and Airplanes*;
- Form 1098-E, *Student Loan Interest Statement*;
- Form 1098-G, *Certain Government Payments*;
- Form 1098-T, *Tuition Statement* ;
- Form 1099-A, *Acquisition or Abandonment of Secured Property*;
- Form 1099-B, *Proceeds From Broker and Barter Exchange Transactions*;
- Form 1099-C, *Cancellation of Debt*;
- Form 1099-K, *Merchant Card and Third Party Network Payments*;
- Form 1099-Q, *Payments from Qualified Education Programs*;
- Form 1099-R, *Distribution From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*;
- Form 1099-S, *Proceeds From Real Estate Transactions*;
- Form 1099-INT, *Interest Income*;
- Form 1099-DIV, *Dividends and Distributions*;
- Form 1099-OID, *Original Issue Discount*;
- Form 1099-LTC, *Long-Term Care and Accelerated Death Benefits*;
- Form 1099-SA, *Distributions From an Archer MSA or Medicare + Choice MSA*,
- Form 1099-PATR, *Taxable Distributions Received From Cooperatives*;
- Form 5498, *IRA Contribution Information*;
- Form 5498-SA, *Coverdell ESA Contribution Information*;
- Form 5498-MSA, *Archer MSA or Medicare+Choice MSA Information*;
- Form 1042-S, *Foreign Persons U.S. Source Income Subject to Withholding*;
- Form 3921, *Exercise of Incentive Stock Option Under Section 422(b)*;
- Form 3922, *Transfer of Stock Acquired through an Employees Stock Purchase Plan Under Section 423(c)*;
- Form 8027, *Employer's Annual Information Return of Tip Income and Allocated Tips*;
- Form 8282, *Donee Information Return*;
- Form 8300, *Report of Cash Payments Over \$10,000 Received in a Trade or Business*;
- Form 8308, *Report of a Sale or Exchange of Certain Partnership Interests*;
- Form 8594, *Asset Acquisition Statement*;
- Form 8935, *Airline Payments Report*;
- Form 8966, *FATCA Report*;
- Form W-2, *Wage and Tax Statement*;
- Form W-2G, *Certain Gambling Winnings*;
- Schedule K-1, Form 1065, *Partner's Shares of Income, Deductions, Credits, etc.*,
- Schedule K-1, Form 1120S, *Shareholder's Share of Income, Deductions, Credits, etc.*, and
- Schedule K-1, Form 1041, *Beneficiary's Share of Income, Deductions, Credits, etc.*

filers, and the authors of this commentary, the IRS has steadfastly and without a legitimate reason refused to expand the program.¹⁵ This generally permits filers of only forms 1099-MISC, 1099-B, 1099-K, and specific other returns to use the program, even though it has been shown to dramatically decrease error rates and would very likely provide similar benefits for all information returns. The IRS has pointed to Congress, asserting that Congress must provide the statutory authority for an expanded program — a request that has for more

than a decade fallen on deaf ears, despite the multiple increases in penalties.¹⁶

Conclusion

As potential information reporting penalties increase, employers and other enterprises filing information returns would be wise to focus additional resources on compliance. Too often, information reporting is left to personnel who lack the expertise and knowledge needed to make correct reporting determinations, an increasingly risky practice now, as the IRS is developing audit teams specifically trained to focus on withholding. Another idea may be to call Congress and ask why businesses should face stiffer penalties when they are denied access to a tool that would help them avoid these errors in the first place.

¹⁵See Michael M. Lloyd and S. Michael Chittenden, "Expand TIN Matching Program to Prevent Another ACA Debacle," *Tax Notes*, Jan. 27, 2014, p. 424.

¹⁶See, e.g., Treasury, "General Explanation of the Administration's Fiscal Year 2016 Revenue Proposals," at 216 (Feb. 2, 2015).