

IRS PENALTIES

The law imposes penalties to ensure that all taxpayers pay their taxes. Some of these penalties are discussed below. If you underpay your tax due to fraud, you may be subject to a civil fraud penalty. In certain cases, you may be subject to criminal prosecution.

Failure-to-file penalty. If you do not file your return by the due date (including extensions), you may have to pay a failure-to-file penalty. The penalty is 5% of the tax not paid by the due date for each month or part of a month that the return is late. This penalty cannot be more than 25% of your tax, but it is reduced by the failure-to-pay penalty (discussed next) for any month both penalties apply. However, if your return is more than 60 days late, the penalty will not be less than \$100 or 100% of the tax balance, whichever is less. You will not have to pay the penalty if you can show reasonable cause for not filing on time.

Failure-to-pay penalty. You may have to pay a penalty of 1/2 of 1% of your unpaid taxes for each month or part of a month after the due date that the tax is not paid. This penalty cannot be more than 25% of your unpaid tax. You will not have to pay the penalty if you can show good reason for not paying the tax on time.

Penalty for frivolous return. You may have to pay a penalty of \$500 if you file a return that does not include enough information to figure the correct tax or that shows an incorrect tax amount due to a frivolous position on your part, or a desire to delay or interfere with the administration of federal income tax laws. This penalty is in addition to any other penalty provided by law.

Accuracy-related penalty. An accuracy-related penalty of 20% applies to any underpayment due to either (a) negligence or disregard of rules or regulations, or (b) a substantial understatement of income tax. This penalty also applies to conditions not discussed here. Even though an underpayment was due to both negligence and substantial underpayment, the total accuracy-related penalty cannot exceed 20% of the underpayment. The penalty is not imposed if there is reasonable cause accompanied by good faith.

Negligence. Negligence includes the lack of any reasonable attempt to comply with provisions of the Internal Revenue Code.

Disregard. Disregard includes the careless, reckless, or intentional disregard of rules or regulations.

Substantial understatement of income tax. For an individual, income tax is substantially understated if the understatement of tax exceeds the greater of (a) 10% of the correct tax, or (b) \$5,000.

Information reporting penalties. Any person who does not file an information return or a complete and correct information return with the IRS by the due date is subject to a penalty for each failure. A penalty applies to information returns as follows:

- Correct information returns filed within 30 days after the due date, \$15 each.
- Correct information returns filed after the 30-day period but by August 1, \$30 each.

- Information returns not filed by August 1, \$50 each.

Maximum limits apply to all these penalties.

Failure to furnish correct payee statements. Any person who does not provide a taxpayer with a complete and correct copy of an information return (payee statement) by the due date is subject to a penalty of \$50 for each statement. If the failure is due to intentional disregard of the requirement, the penalty is the greater of (a) \$100 per statement, or (b) 10% or 5% (depending on the type of statement) of the amount to be shown on the statement.

Identification numbers and other information. Any person who does not comply with other specified reporting requirements, including the use of correct identification numbers (employer identification numbers and social security numbers), is subject to a penalty of \$50 for each failure.

The law provides penalties for failure to file returns or pay taxes as required.

Civil Penalties

If you do not file your return and pay your tax by the due date, you may have to pay a penalty. You may also have to pay a penalty if you substantially understate your tax, file a frivolous return, or fail to supply your social security number. If you provide fraudulent information on your return, you may have to pay a civil fraud penalty.

Filing late. If you do not file your return by the due date (including extensions), you may have to pay a failure-to-file penalty. The penalty is based on the tax not paid by the due date (without regard to extensions). The penalty is usually 5% for each month or part of a month that a return is late, but not more than 25%.

Fraud. If your failure to file is due to fraud, the penalty is 15% for each month or part of a month that your return is late, up to a maximum of 75%.

Return over 60 days late. If you file your return more than 60 days after the due date or extended due date, the minimum penalty is the smaller of \$100 or 100% of the unpaid tax.

Exception. You will not have to pay the penalty if you show that you failed to file on time because of reasonable cause and not because of willful neglect.

Paying tax late. You will have to pay a failure-to-pay penalty of 1/2 of 1% of your unpaid taxes for each month, or part of a month, after the due date that the tax is not paid. This penalty does not apply during the extension period available by filing Form 4868, Application for Automatic Extension of Time To File U.S. Individual Income Tax Return, if you paid at least 90% of your actual tax liability before the original due date of your return through withholding on wages, estimated tax payments, or a payment sent in with Form 4868.

If a notice of intent to levy is issued, the rate will increase to 1% at the start of the first month beginning at least 10 days after the day that the notice is issued. If a notice and demand for immediate payment is issued, the rate will increase to 1% at the start of the first month beginning after the day that the notice and demand is issued.

This penalty cannot be more than 25% of your unpaid tax. You will not have to pay the penalty if you can show that you had a good reason for not paying your tax on time. This failure-to-pay penalty is added to interest charges on late payments.

Combined penalties. If both the failure-to-file penalty and the failure-to-pay penalty (discussed earlier) apply in any month, the 5% (or 15%) failure-to-file penalty is reduced by the failure-to-pay penalty. However, if you file your return more than 60 days after the due date or extended due date, the minimum penalty is the smaller of \$100 or 100% of the unpaid tax.

Accuracy-related penalty. You may have to pay an accuracy-related penalty if (1) you underpay your tax because of either "negligence" or "disregard" of rules or regulations, or (2) you substantially understate your income tax.

The penalty is equal to 20% of the underpayment. The penalty will not be figured on any part of an underpayment on which a fraud penalty (discussed later) is charged.

Negligence or disregard. The term "negligence" includes a failure to make a reasonable attempt to comply with the tax law or to exercise ordinary and reasonable care in preparing a return. Negligence also includes failure to keep adequate books and records. You will not have to pay a negligence penalty if you have a reasonable basis for a position you took.

The term "disregard" includes any careless, reckless, or intentional disregard.

The penalty is based on the part of the underpayment due to negligence or disregard of rules or regulations, not on the entire underpayment on the return.

Adequate disclosure. You can avoid the penalty for disregard of rules or regulations if you adequately disclose on your return a position that has at least a reasonable basis. See Disclosure statement, later.

Substantial understatement of income tax. You understate your tax if the tax shown on your return is less than the correct tax. The understatement is substantial if it is more than the larger of 10% of the correct tax or \$5,000. However, the penalty is reduced to the extent there is:

- Substantial authority, or
- Adequate disclosure and a reasonable basis.

Substantial authority. Whether there is or was substantial authority for the tax treatment of an item depends on the facts and circumstances. Consideration will be given to court opinions, Treasury regulations, revenue rulings, revenue procedures, and notices and announcements issued by the IRS and published in the Internal Revenue Bulletin that involve the same or similar circumstances as yours.

Disclosure statement. The understatement may also be reduced if you have adequately disclosed the relevant facts about your tax treatment of an item. To make this disclosure, use Form 8275, Disclosure Statement. You must also have a reasonable basis for treating the item the way you did.

In cases of substantial understatement only, items that meet the requirements of Revenue Procedure 96-58 (or later update) are considered adequately disclosed on your return without filing Form 8275.

Use Form 8275-R, Regulation Disclosure Statement, to disclose items or positions contrary to regulations.

Reasonable cause. You will not have to pay a penalty if you show a good reason (reasonable cause) for the way you treated an item. You must also show that you acted in good faith.

Frivolous return. You may have to pay a penalty of \$500 if you file a frivolous return. A frivolous return is one that does not include enough information to figure the correct tax or that

contains information clearly showing that the tax you reported is substantially incorrect.

You will have to pay the penalty if you filed this kind of return because of a frivolous position on your part or a desire to delay or interfere with the administration of federal income tax laws. This includes altering or striking out the preprinted language above the space provided for your signature.

This penalty is added to any other penalty provided by law.

The penalty must be paid in full upon notice and demand from IRS even if you protest the penalty.

Fraud. If there is any underpayment of tax on your return due to fraud, a penalty of 75% of the underpayment due to fraud will be added to your tax.

Joint return. The fraud penalty on a joint return does not apply to a spouse unless some part of the underpayment is due to the fraud of that spouse.

Failure to supply social security number. If you do not include your social security number (SSN) or the SSN of another person where required on a return, statement, or other document, you will be subject to a penalty of \$50 for each failure. You will also be subject to the penalty of \$50 if you do not give your SSN to another person when it is required on a return, statement, or other document.

For example, if you have a bank account that earns interest, you must give your SSN to the bank. The number must be shown on the Form 1099-INT or other statement the bank sends you. If you do not give the bank your SSN, you will be subject to the \$50 penalty. (You also may be subject to "backup" withholding of income tax.)

You will not have to pay the penalty if you are able to show that the failure was due to reasonable cause and not willful neglect.

Failure to furnish tax shelter registration number. A person who sells (or otherwise transfers) to you an interest in a tax shelter must give you the tax shelter registration number or be subject to a \$100 penalty. If you claim any deduction, credit, or other tax benefit because of the tax shelter, you must attach Form 8271, Investor Reporting of Tax Shelter Registration Number, to your return to report this number. You will have to pay a penalty of \$250 for each failure to report a tax shelter registration number on your return. The penalty can be excused if you have a reasonable cause for not reporting the number.

Criminal Penalties

You may be subject to criminal prosecution (brought to trial) for actions such as:

- Tax evasion
- Willful failure to file a return, supply information, or pay any tax due
- Fraud and false statements, or
- Preparing and filing a fraudulent return.

