PacificCPE

COURSE
34457A

Penalties, State Taxes, and Taxpayer Rights

Rounding out the bigger picture of IRS enforcement, this course covers penalty and interest rules, strategies for coordinating IRS and state tax installment agreements, and the full scope of the Taxpayer Bill of Rights. It closes with answers to the 25 most frequently asked questions in IRS enforcement and collection matters. Ideal as a capstone to the broader IRS enforcement curriculum, this course equips practitioners with the reference knowledge they need to confidently advise clients across a wide range of compliance situations.

CREDIT HOURS 2 | FIELD OF STUDY TAXES | EXAM QUESTIONS 10

Start Course ↓ | Final Exam Copy ↓

LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Identify under what circumstances the IRS can abate penalties and interest.
- Recall the characteristics of a state audit of income tax.
- Recognize the changes implemented due to the passage of TBOR III.
- Recall how long the IRS has to assess civil penalties for not filing a tax return.

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Chapter 1: PENALTIES AND INTEREST

Chapter Objective

After completing this chapter, you should be able to:

- Identify under what circumstances the IRS can abate penalties and interest.

IRS-imposed penalties and interest charges are discussed throughout the course. These fines can be very expensive. A $7,000 tax bill can turn into $15,000 with interest and penalties. Tax penalties, from the IRS's perspective, are explained in Notice 433, Interest and Penalty Information. (A copy is available on the IRS's website at www.irs.gov.)

Some questions we frequently get:

Is it possible to get the IRS to drop a penalty?

What can I do about the interest on my audit bill?

How many different ways can the IRS penalize me?

Can I negotiate a penalty down?

Does the IRS ever have to pay me interest?

PENALTIES ADDED TO TAX BILLS

When the IRS hits you with an additional tax bill (from an audit, for example), it usually adds penalties and interest. Penalties are added automatically by IRS computers or by IRS personnel at their discretion. Interest charges are required by law (and are discussed below).

Penalties are authorized whenever you file or pay your taxes late, have been found to owe additional taxes, or have failed to file all required tax forms.

Although penalties were originally meant to punish errant taxpayers—that's why they are called penalties—they are now considered a regular and dependable source of revenue in our national budget. Reflecting this, in the past decade, the total dollar amount of penalties imposed on taxpayers increased by 1,000%. In a recent year, over 39 million penalties were assessed for over $73 billion. In short, penalties have become a tax—on a tax.

IRS penalties fall into five basic categories—accuracy, fraud, failure to pay taxes, late filings, and a combined late-filing and -paying penalty.

Tip

Take heart—you might be able to beat the IRS at the penalty game. The IRS can remove a penalty if you can show that your failure to comply with the tax law was due to "reasonable cause" or if you qualify for first-time penalty abatement.

Accuracy Penalties

The IRS can add a 20% accuracy-related penalty to your tax bill if IRS auditors find your tax return understated your tax liability. This is a commonly imposed penalty by the IRS "due to negligence or intentional disregard of the tax law." This means you didn't pay heed to the tax law or you were just plain careless when filing your tax return.

Fraud Penalties

If the IRS concludes that you fraudulently omitted or underreported income, it can add a heavy fraud penalty. This penalty is up to 75% of the amount you underreported. For example, if you fraudulently underreported $10,000, the maximum fraud penalty is $7,500.

Or, if the IRS finds that you fraudulently failed to file a return, it can penalize you—15% for every month you didn't file for up to five months—a total of 75% based on the taxes owed. This fraudulent late-filing penalty is rarely, if ever, imposed. Instead, the IRS usually just hits you with a late-filing penalty of 5% per month for a maximum of five months, a total of 25%.

Failure to Withhold, Deposit, or Pay Taxes for Employees

This is a stiff penalty on employers who do not withhold or pay over their employees' Social Security, Medicare, and income taxes. This happens when employers aren't timely filing IRS Form 941 and making the deposits. The penalty varies by how late the payments are made.

Failure to File Information Returns

This penalty is on business owners who don't file reports with the IRS, most often Form 1099 showing payments to service providers like independent contractors. The penalty varies depending on the type of form and the number of nonfiled forms.

Failure to Pay Penalties

The IRS can add to your bill a penalty of ¼% to 1% per month of the amount you failed to pay on time. The penalty starts off at ½% per month. If you enter into an installment agreement to pay the taxes, the IRS drops the penalty to ¼% per month. If you don't pay and the IRS later issues a Notice of Intent to Levy (see Chapter 1 of course 34455B), it can raise the penalty to 1% per month on the balance due.

This penalty starts on the day after the original due date, April 16 for individual tax returns. It is imposed on the unpaid balance and added to your bill on the 16th day of each month thereafter. This penalty is imposed monthly and is not prorated daily.

Late-Filing Penalties—Late Filing and Late Paying

Did you file your individual tax return late and didn't request an extension? The IRS can impose a penalty of 5% per month on any tax balance due, up to 25% of the bill. You max out on this penalty if, on September 16—five months and one day after April 15—you still haven't filed your individual tax return. If you file late but don't owe any taxes, you must pay a $485 penalty for 2024 ($450 for 2023). For some information-type forms (such as 1099s) filed late, the IRS can impose a penalty in varying amounts according to specific tax code provisions.

To help struggling taxpayers affected by the COVID-19 pandemic, the IRS waived late filing penalties for most individuals and businesses who filed their 2019 or 2020 tax returns late. To qualify, tax returns for these years had to be filed by September 30, 2022. Such penalty relief is automatic; taxpayers don't have to apply for it. The 1.6 million taxpayers who already paid a late penalty for these years will receive refunds from the IRS. (IR 2022-155.)

IRS Penalties		
Reason for Penalty	**Penalty Amount**	**IRC Section**
Failure to file a tax return	• 5% of the unpaid balance per month; maximum of 25% • If more than 60 days late, the lesser of $485 or 100% of the tax due • No penalty if due a refund • A failure to file penalty is reduced by the failure to pay penalty if both apply	6651(a)(1) 6651(c)(1)
Failure to pay tax due	0.5% of the unpaid balance per month; maximum of 25%	6651(a)(2)
Fraudulent failure to file a tax return	15% of the unpaid balance per month; maximum of 75%	6651(f)
Failure to deposit employment taxes	• 2% of underpayment if the amount is properly deposited not more than five days after the due date • 5% of underpayment if the amount is properly deposited more than 5 days but not more than 15 days after the due date • 10% of underpayment if the amount is properly deposited more than 15 days after the due date	6656(b)(1)(A)

Reason for Penalty	Penalty Amount	IRC Section
Failure to file information returns	Penalty assessed per information return: • $50 if correctly filed within 30 days after the required filing date; maximum $500,000 per year ($175,000 for small businesses with gross receipts of $5,000,000 or less) • $100 if correctly filed more than 30 days after the due date but before August 1; maximum $1,500,000 per year ($500,000 for small businesses with gross receipts of $5,000,000 or less) • $290 if correctly filed after August 1 or not filed at all; maximum $3,532,500 ($1,177,500 for small businesses with gross receipts of $5,000,000 or less) • Minimum $500 if failure to file or furnish due to intentional disregard of the requirements	6721, 6722
Accuracy related penalty	20% of underpayment due to: • Negligence, including the failure to make a reasonable attempt to comply or intentional disregard • Substantial understatement of tax, more than the greater of 10% (5% if claiming IRC Section 199A deduction) of the actual amount or $5,000	6662
Fraud	75% of understatement due to fraud	6663
Tax evasion	Willful attempt to evade tax is a felony with a maximum fine of $100,000 ($500,000 for a corporation) and/or up to five years in prison	7201
Failure to collect or pay over tax	Willful failure to collect, account for, and pay over tax is a felony with a maximum fine of $10,000 and/or five years in prison	7202

Combined Penalties

Did you both file late and pay late? The IRS can impose a combined penalty of 5% per month (0.5% per month less than the separate penalties for each). The combined penalty is based on the unpaid tax balance for each month your return is late. When you reach 25%—five months—for filing late, the penalty for late filing stops. The failure-to-pay portion of the combined penalty continues at 0.5% per month until it