

CLIENT ALERT

How Long Do You Have Penalty Exposure for Incorrect 1099s and W-2s?

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Potentially forever.

In October 2013, the IRS released a Chief Counsel Memorandum dated April 2013 (number 111814-13) setting forth its current position on the period of time that a business can be liable for penalties for incorrect Forms 1099 and W-2.

Many businesses file Forms 1099 to report payments of interest, dividends, and compensation to independent contractors (among other things) and Forms W-2 to report compensation to employees. Inevitably, after the filing date each year, businesses realize that at least some of these forms had errors or were not filed.

Generally, the penalty for an incorrect Form 1099 or Form W-2 filed with the IRS is \$100 and the penalty for an incorrect information statement provided to the applicable taxpayer is another \$100. In each case, there is maximum penalty of \$1.5 million per year (for a total maximum penalty of \$3 million). These penalties can be significantly higher, however, in the case of intentional disregard, which can include a pattern of failing to file or filing incorrect information. In such cases, there is no maximum penalty.

The IRS's 2013 guidance provides that the statute of limitations to assess these penalties for an erroneous Form 1099 or Form W-2 filed with the IRS runs three years after filing of the return. Accordingly, where a taxpayer fails to file a Form 1099 or Form W-2, the statute of limitations on the penalty will not begin to run. For this purpose, the filing of a transmittal form (such as a Form 1096 or Form W-3) is not sufficient to begin the statute of limitations.

Unfortunately, the guidance suggests a different rule may apply to the information statement provided to the taxpayer. The IRS acknowledges that the matter has not been decided and takes the position that it is possible that no statute of limitations applies to assessment of penalties applicable to these information statements, even where the payor timely provides a statement to the payee. This position is dubious, given that the information statement provided to the payee is logically tied to the one provided to the IRS. It seems unlikely that a court would hold that different statutes of limitations apply to the different copies.

Despite this suggestion, the IRS's 2013 guidance is more favorable than previous Chief Counsel Memoranda on this issue. For example, in a 2008 Chief Counsel Memorandum (number 138637-08, dated October 17, 2008), the IRS took the position that no statute of limitations applies to penalties on taxpayer information statements.

The IRS position on the statute of limitations underscores the importance of correct information reporting, especially given the need to reserve for potential penalties for known errors on financial statements. Unlike most tax penalty reserves, reserves for information returns that have never been filed may become a permanent part of a taxpayer's reserve. Because the 2013 memorandum notes that there are litigating hazards to the IRS position on the unlimited statute of limitations for information

returns provided to taxpayers, companies subject to an information return audit should expect to go to Appeals (if justified by the potential penalty amounts at issue) on the statute of limitations point.

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