



Information Reporting & Withholding

Reasonable Cause



Who is Impacted

Any U.S. withholding agents and payors that submitted U.S. tax or information returns this reporting season may want to consider whether any of their submissions will generate the type of errors that can be waived due to reasonable cause.

In general, penalties exist in order to encourage voluntary compliance by taxpayers and to support the standards of behaviour required by the Internal Revenue Code. For most, this means preparing an accurate return, filing it timely, and remitting any tax due – all of which are elements of compliant behaviour. Penalties generally apply to behaviour that does not meet these obligations.

What Changed

Over the last few decades, we have seen the number of IRS penalty provisions and amounts increase. Recognizing this trend, the IRS aimed to develop a fair, consistent, and comprehensive approach applying equally in similar situations as they administer these penalties.

Generally, there are four categories of relief from penalties, where the IRS will grant relief where applicable and in the following order:

- Correction of IRS error.
- Statutory and regulatory exceptions.
- Administrative errors.
- Reasonable cause.

This article will focus on reasonable cause relief from a failure or error relating to an information reporting requirement.

Reasonable cause is based on all the facts and circumstances in each situation. The penalty for failure relating to an information reporting requirement is waived if the failure is due to reasonable cause and is not due to wilful neglect. In order to establish reasonable cause, the filer must demonstrate that there are *significant mitigating factors* with respect to the failure or that the failure arose from *events beyond the control of the filer*. Further, the filer must show that it acted in a *responsible manner* before and after the failure occurred. In general, this means that the filer took the necessary steps to file correct information returns and events outside of the filer's control occurred. For example, failure to include a recipient taxpayer identification number (TIN) is a failure or error in completing the information return. However, if the recipient failed to give the payor the TIN, the payor cannot include it and must withhold.

Reasonable cause may be considered with respect to a failure to timely file correct information returns, failure to furnish timely a correct payee statement, and failure to comply timely with and to include correct specified information. Reasonable cause relief is not available in cases of fraudulent failure to file or fraud, in general.

Significant mitigating factors include, but are not limited to:

- The filer had never been required to file the particular type of return or furnish the particular type of statement, with respect to which the failure occurred, or

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- The filer is able to establish a history of complying with the information reporting requirement with respect to which the failure occurred. In this case, the IRS will consider:
 - Whether the filer received any prior penalties for the failure, and
 - If the filer received a prior penalty, the extent to which the filer successfully lowered its error rate year over year.

Events generally considered to be *beyond the control of the filer* include, but are not limited to:

- Unavailability of the relevant business records. This unavailability must have been caused by a supervening event, such as a fire, casualty, statutory or regulatory change that directly impacts data processing, or an unavoidable absence (e.g., death or illness) of the person with sole responsibility for filing a return or furnishing a payee statement.
- Undue economic hardship relating to filing on magnetic media. The filer must have lacked the necessary hardware and that it attempted to contract out the magnetic media filing to at least two unrelated parties, but determined that the cost was prohibitive. The filer must have submitted the returns on paper. This reason is not available where the filer sought the same in prior years.
- Certain actions of the IRS. The filer must have reasonably relied on erroneous written information from the IRS. The IRS must have been aware of all facts in providing the guidance in order for it to be considered good faith.
- Certain actions of an agent. The filer must have exercised reasonable business judgement in contracting with an agent to file timely correct returns or furnish timely correct payee statements with respect to which the failure occurred.
- Certain actions of the payee or any other person providing necessary information with respect to the return or payee statement. The failure must have resulted from the failure of a payee or any other person required to provide information to the filer that would be necessary in order for the filer to comply with the information reporting requirements *Look for our article coming in May 2019, which will highlight the requirements for establishing reasonable cause where a filer's failure relates to an incorrect payee TIN, and the failure is attributable to the actions of the payee.*

Acting in a *responsible manner* means that the filer exercised reasonable care. This is the standard of care that a reasonably prudent person would use under the same circumstances in the course of its business when determining its information reporting obligations. The filer must undertake significant steps to avoid or mitigate the failure. Examples include, but are not limited to:

- Requesting extensions of time to file in order to avoid the failure for late returns,
- Attempting to prevent an impediment or a failure, if it was foreseeable,
- Acting to remove an impediment or the cause of a failure once it occurred, and
- Rectifying the failure as promptly as possible once the impediment was removed or the failure was discovered. The IRS considers a correction to be prompt if it is made within 30 days after the date the impediment is removed or the failure is discovered, or the earliest date on which a regular submission of corrections is made. The IRS considers submissions to be regular if they are made at intervals of 30 days or less. This reason is not available with respect to information that the filer cannot alter under specific information reporting rules.

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Requesting a waiver due to reasonable cause.

Penalty notices for 2018 information returns will be sent later in the year. In anticipation of these notices, workpapers and issues identified during filing season are very helpful in thinking through your reasonable cause points. When requesting a waiver of penalty due to reasonable cause, the filer must submit a written statement to the district director or the director of the IRS Service Center where the returns are required to be filed. The statement must:

- State the specific provision under which the waiver is being requested,
- Set forth all the facts alleged as the basis for reasonable cause,
- Contain the signature of the person required to file the return, and
- Contain a declaration that it is made under penalties of perjury.

The penalty due shall be paid upon notice and demand by the IRS and in the same manner as a tax liability is paid.

If the taxpayer provides an explanation that supports its request for penalty relief, then the IRS will waive or abate the applicable penalty or penalties. The reviewer will attach a copy of the information to the original return or other transaction documents.

If the taxpayer is not entitled to relief and does not establish reasonable cause, the IRS will either determine whether additional information could help establish reasonable cause or will document the decision and attach a copy to the original return. The IRS will provide written notification to the taxpayer of the denial and the taxpayers appeal rights. The notice will include:

- Complete explanation of the IRS decision and basis for denial.
- Information on the appeal procedures, including instructions on how to submit a written protest.
- Power of attorney information.

How to Implement

Where filers have identified a failure in the last reporting season for which they may request a waiver of penalty due to reasonable cause, they may want to consider the following questions:

- Filer reason. Be sure to explain your position clearly using dates and explanations that correspond with events on which the penalties are based. Be prepared to provide additional information where the dates and events do not correspond correctly.
- Compliance History. In preceding years (at least three), have you established a pattern of compliant or noncompliant behaviour? Have you received the same penalty previously? Was it abated?
- Length of Time. Was there a considerable amount of time between the event cited as a reason for the noncompliance and subsequent compliance.
- Circumstances Beyond the Control of the filer. Could you have anticipated the event that caused the noncompliance? For example, your organization's primary information reporting person quit on January 15th and the location of key information could not be found.

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- Acting in a responsible manner. Rectify failures as promptly as possible! Consider submitting corrections regularly or every 30 days as provided for in the regulations.
- Unable to obtain records. Why the records were needed to comply? Why the records were unavailable and what steps were taken to secure the records? When and how did the filer become aware that he or she did not have the necessary records? Did the filer explore other means to secure needed information? Did the filer comply promptly once the missing information was received? Did you retain supporting documentation such as copies of letters written and responses received in an effort to get the needed information?

Remember, relying on another person to perform a required act is generally not sufficient for establishing reasonable cause. It is the filer's responsibility to file a timely return and make timely deposits or payments. This responsibility cannot be delegated.

Are you considering reasonable cause relief this year? Let us know what you are thinking in the comment section on [LinkedIn](#) or [email us](#)!

Resources

- Accuracy-Related Penalties. Treas. Reg. 1.6664-4 (IRM 20.1.5)
- Failure to File a Tax Return and/or Failure to Pay Tax Penalties. Treas. Reg. 301.6651-1(c) (IRM 20.1.2)
- Information Return Penalties. Treas. Reg. 301.6724-1 (IRM 20.1.7)

Reasonable cause relief available for the following failures:

- Failure to provide information concerning resident status, IRC 6039E
- Failure to file a return, IRC 6651(a)(1)
- Failure to pay tax when due, IRC 6651(a)(2)
- Failure to pay within 21 days of notice of additional tax due (10 business days if amount is \$100,000 or more) (notices issued after 12/31/1996), IRC 6651(a)(3)
- Failure to file certain information returns, IRC 6652(a)(1)
- Failure to file annual return by exempt organization, IRC 6652(c)(1)
- Failure to file returns under IRC 6034 or IRC 6043(b), IRC 6652(c)(2)
- Notification of change in status of plan, IRC 6652(d)(2)
- Information required in connection with certain plans of deferred compensation, Form 5500, Annual Return/Report of Employee Benefit Plan, IRC 6652(d)(2)
- Failure to give notice to recipients of certain pension, etc. distributions, IRC 6652(h)
- Failure to give written explanation to recipients of certain qualifying rollover distributions, IRC 6652(i)
- Failure to file certification with respect to certain residential rental projects, IRC 6652(j)
- Failure to deposit, IRC 6656(a)
- Accuracy-related penalty on underpayments, IRC 6662
- Accuracy-related penalty on understatements with respect to reportable transactions
- Erroneous claim for refund or credit, IRC 6676

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- Failure to file partnership return, IRC 6698
- Failure to file correct information reporting returns, IRC 6721
- Failure to furnish correct payee statements, IRC 6722
- Failure to comply with other information reporting requirements, IRC 6723

Reasonable cause relief not available for:

- Fraudulent failure to file, IRC 6651(f)
- Fraud, IRC 6663