

MEMO# 1237

July 6, 1989

HOUSE WAYS AND MEANS COMMITTEE APPROVES MODIFICATIONS TO INFORMATION REPORTING PENALTY SYSTEM

- 1 - July 6, 1989 TO: CLOSED-END FUND COMMITTEE NO. 23-89 UNIT INVESTMENT TRUST COMMITTEE NO. 32-89 TRANSFER AGENT SHAREHOLDER ADVISORY COMMITTEE NO. 14-89 OPERATIONS MEMBERS NO. 18-89 TAX MEMBERS NO. 21-89 RE: HOUSE WAYS AND MEANS COMMITTEE APPROVES MODIFICATIONS TO INFORMATION REPORTING PENALTY SYSTEM

As you may know, the House Ways and Means Subcommittee on Oversight has been considering modifications to the Internal Revenue Code's civil tax penalty provisions. In this regard, the Institute submitted a statement noting several concerns with the existing due diligence and backup withholding regulations. (See Institute Memorandum to Tax Committee No. 5-89, Operations Committee No. 7-89, Transfer Agent Shareholder Advisory Committee No. 10-89, Closed-End Fund Committee No. 11-89, and Unit Investment Trust Committee No. 19-89, dated April 21, 1989.) In its statement, the Institute indicated that the industry supports reasonable efforts to enhance tax compliance. The Institute believes, however, that because efforts to obtain a reasonable definition of due diligence under the existing regulations have been unsuccessful, legislation creating a different standard for determining payor compliance with information reporting requirements is necessary. Recently, the House Ways and Means Committee approved legislation that would amend the Code's civil tax penalty provisions, including those provisions involving information reporting penalties. Under current law, separate Code sections provide penalties for (1) failures to supply taxpayer identification numbers (TINs), (2) failures to file certain information returns, (3) failures to furnish certain payee statements, and (4) failures to include correct (non-TIN) information on returns or statements. The House Ways and Means Committee amendments would restructure the reporting requirement penalties by providing specific Code sections to penalize (1) failures to file correct (non-TIN) information on IRS returns, (2) failures to furnish correct payee statements to shareholders and (3) failures to comply with other information reporting - 2 - requirements (such as the requirement to supply correct TINs on returns and statements). Attached are copies of the Ways and - 3 - Means Committee press release, the Oversight Subcommittee's press release, the Joint Committee on Taxation's summary explanation, and the civil tax penalty bill as introduced. (A revised version of the bill incorporating the amendments made by the Oversight Subcommittee and the Ways and Means Committee is not currently available.) Several changes to the information reporting penalty provisions included in the bill are significant. First, the bill makes two changes to the TIN reporting provisions. Unlike current law, where the \$50 per failure penalty for filing a return with no

TIN or for including an incorrect TIN on a dividend return or statement is not limited by any ceiling, the bill would cap the penalty for a payor at \$100,000 per calendar year. A second change modifies the conditions that must be satisfied to assert a defense to the \$50 penalty. Under current law, only a payor who has exercised "due diligence" may assert a defense against the imposition of the penalty. Under the bill, no penalty would be imposed with respect to any such failure which is shown to be due to "reasonable cause" and not to "willful neglect." The Subcommittee's Summary Explanation states that "[t]he Subcommittee intends that for this purpose, reasonable cause exists if significant mitigating factors are present, such as the fact that a person has a history of complying with the information reporting requirements." The extent to which the current due diligence requirements might remain applicable to any determination of reasonable cause is unclear, however, at the present time. The current law penalties of \$50 for failing to file information returns with the IRS and for failing to furnish payee statements to shareholders are combined under the bill with the \$5 penalty for failing to include correct (non-TIN) information on returns or statements in two new penalties: (1) a \$50 per failure penalty for failing to file correct information returns to the IRS and (2) a \$50 per failure penalty for failing to furnish correct payee statements to shareholders. Unlike current law, where the \$50 and \$5 penalties are not "capped" in the case of interest or dividend returns or statements, the bill would cap the \$50 penalty for failing to file correct information returns to the IRS at \$250,000 and would cap the \$50 penalty for failing to furnish correct payee statements to shareholders at \$100,000. As under current law, these failure to file and failure to furnish penalties would not be imposed with respect to any failure shown to be due to reasonable case and not to willful neglect. In addition, the penalty for failure to file correct information returns with the IRS would be modified under the bill to encourage persons to file correct information returns even though such returns are filed after the prescribed filing date. If a payor files a correct return after the prescribed filing - 4 - date but on or before the date that is 30 days after the required filing date, the amount of the penalty is \$15 per return, with a - 5 - maximum penalty of \$75,000 per year. If a person files a correct information return after the date that is 30 days after the prescribed filing date but on or before August 1, the amount of the penalty is \$30 per return, with a maximum penalty of \$150,000 per calendar year. If a correct return is not filed on or before August 1 of any year, the amount of the penalty is \$50 per return, with a maximum penalty of \$250,000 per calendar year. This sliding scale penalty system would not apply, however, to either failures to include correct TINs on information returns or statements or failures to provide correct payee statements to shareholders. The bill also provides that when incorrect information returns filed with the IRS are corrected on or before August 1, the original return will be treated as having been filed with the correct information. This relief is limited, however, to the greater of 10 returns or one-half of one percent of the total number of returns that are required to be filed by the person during the calendar year. Once again, this relief does not apply to either failures to include correct TINs on information returns or statements or failures to provide correct payee statements to shareholders. Present law rules for failures that are due to intentional disregard of the filing requirements would be retained under the bill for failures to file correct information returns with the IRS and would be added for failures to furnish correct payee statements to shareholders. As under present law, no special rules would apply under the bill to any intentional disregard of the requirements to supply TINs on returns filed with the IRS or on statements sent to shareholders. We will keep you informed of the progress of this legislation. Keith D. Lawson
Assistant General Counsel Attachments

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