

Client Alert

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IRS is Assessing Penalties for Missing or Incorrect Tax Information on Returns

It appears the Internal Revenue Service ("IRS") is now taking aim at banks for what look like foot faults on information returns. Specifically, the IRS has been assessing penalties on banks for missing or incorrect tax identification numbers ("TINs") on information returns, such as the Form 1098, Mortgage Interest Statement; Form 1099-INT, Interest Income; Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.

The IRS is assessing penalties when either the information form is missing a TIN, or more commonly, the IRS believes the TIN provided on the information return is incorrect. Usually, the use of an incorrect TIN by a bank is inadvertent. Sometimes the bank just makes a mistake and lists the wrong number on the information return, or the customer accidentally provided the incorrect TIN to the bank. However, some of the incorrect TINs are less obvious. The following are some common examples of incorrect TINs:

- A customer opens an account at the bank as "Jane Doe." A year later, the customer gets married and is now legally "Jane Doe Smith" (and this is now the name associated with her TIN). The customer did not notify the bank of the name change. When the bank issues the next Form 1098, it lists "Jane Doe," as it has done in the past. However, when the IRS receives the Form 1098, it sees the TIN is assigned to Jane Doe Smith, not Jane Doe. This same problem occurs when a customer divorces and legally changes her name back to her maiden name but does not alert the bank to the name change.
- A customer opens an account at the bank as "John Doe" because that is the name the customer uses. However, the customer's legal name is "Roger John Doe" and that is the name associated with the customer's TIN. When the bank issues the Form 1099-INT, it lists John Doe. However, when the IRS receives the Form 1099-INT, it sees the TIN is assigned to Roger John Doe, not John Doe.

The IRS can assess a maximum penalty charge of \$100 per information return document with a missing or incorrect TIN, up to a maximum of \$1,500,000 per year. The maximum penalty is \$500,000 per year for a small business, which is defined as a business that had gross receipts of \$5,000,000 or less for the three most recent tax years (or time in business, if shorter) ending before the calendar year the information returns were due.

The process the IRS follows for assessing penalties is that it first sends a document called an "Explanation of Penalty." The IRS provides a list of the information returns that were filed with missing or incorrect TINs and allows the bank to check the list against its records to determine if the bank has an acceptable reason why the penalty should not be charged. The bank generally has 45 days from the date of the "Explanation of Penalty" to respond to the IRS. If the bank does not respond, the IRS will send a bill called a "Notice of Penalty Charge" for the amount of the proposed penalty. Interest will be charged from the date of the "Notice of Penalty Charge" to the date payment is received by the IRS in full.

Crafting a careful, thorough response to the IRS is important in reducing or eliminating the amount of the proposed penalty. It is important to consult legal counsel in this process.

These notices are taking community banks by surprise. Banks should review their current practices for validating legal names with TINs. Moreover, banks should include sampling such information as part of the internal audit process. Although the mistakes are generally inadvertent, the IRS need not show intent. Thus, banks will need to consider their processes to avoid the cost of penalty assessed and the hours required to correct mistakes and respond to the IRS.

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