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Quoted in Daily Tax Report on IRS Proposal for Listed Transaction Penalties

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Available at: https://works.bepress.com/robert-probasco/45/
BNA Snapshot

REG-103033-11

Development: IRS proposed rules define how agency will calculate penalties for failure to report listed transactions.

Takeaway: Guidance under amended statute has been in the works for five years.

By Laura Davison

Aug. 27 — Proposed rules that define the penalties taxpayers who fail to disclose reported transactions must pay lessen the burden on small businesses and individuals who unknowingly engage in what the government considers to be tax-avoidance schemes.

Taxpayers who don't report these listed transactions will pay the penalty, equal to three-quarters of the benefit derived from the deal, which includes unpaid excise taxes tied to the transaction, the Internal Revenue Service said in proposed regulations (REG-103033-11, RIN 1545-BK62) released Aug. 27 under tax code Section 6707A. Business taxpayers face a minimum $10,000 penalty, with a maximum of $200,000. Individuals will pay at least $5,000 and could pay up to $100,000.

The penalties used to be set at fixed amounts, which were so high they could “wipe out” small or medium businesses, Dean Zerbe, national managing director at Alliantgroup, told Bloomberg BNA. “The Service got the penalties into a Goldilocks level, where they affect behavior, but don’t put a real grind on taxpayers,” he said.

Penalty Parameters

The rules define the decrease in tax, of which 75 percent is the penalty paid, as “the difference between the amount of tax reported on the return as filed and the amount of tax that would be reported on a hypothetical return where the taxpayer did not participate in the reportable transaction.”

The penalty would be determined by taking into account the aggregate decrease in tax shown on all the returns for which disclosure wasn't provided, the proposed rules said. The figure isn't impacted if the IRS and the taxpayer end up settling for a different amount.

“It's a doable provision on how to calculate the 75 percent,” said Shawn O'Brien, a partner at Mayer Brown LLP in Houston. “The IRS agent who is examining will probably ask the tax practitioner working with the client for a calculation and compare it against their own and compromise on what the penalty will be.”

The inclusion of excise taxes, such as penalties from excessive Roth individual retirement account contributions, could go beyond what's in the statute, said Robert Probasco, of the Probasco Law Firm in Dallas.

“It's not clear that Congress authorized the IRS to do what it has done here,” Probasco said.

Timing Is Key

The proposed regulations don't distinguish between reportable transactions that hadn't been identified by the IRS at the time an original return is filed, and those that are subsequently listed by the agency while the statute of limitations is still open,
Probasco said.

“The disclosure obligation covers years that are still open, even though they were before the transaction was listed,” Probasco said. “Arguably, a harsh penalty like Section 6707A is more appropriate when the taxpayer engages in the transaction after it is listed than before it is listed.”

Some taxpayers may also realize, after filing their tax returns, that they included a reported transaction without disclosing it, Probasco said, and less-sophisticated taxpayers might think they can solve the problem by simply filing an amended return where they give up the tax benefits claimed for that transaction.

“The tax system should encourage such attempts to come back into compliance,” he said in an e-mail. “The proposed regulations apparently would not reduce the harsh 75 percent penalty even though the taxpayer voluntarily gave up those tax benefits.”

The minimum penalty will also be imposed on returns where tax isn't required to be shown, such as passthrough returns, but that fail to report listed transactions.

A provision in the Small Business Jobs Act of 2010 switched the penalty calculation to a percentage amount in an attempt to make the penalty proportionate to the tax benefit derived by the transaction, which includes Son-of-BOSS (bond and options sales strategy) tax shelters and S corporations shifting income to tax-exempt organizations. The IRS hadn't previously provided guidance about the penalty amounts for failure to file a form a Form 8886, Reportable Transaction Disclosure Statement, after the law was amended by the Jobs Act.

Error Assumption

The IRS also interpreted that the maximum penalty shouldn't be levied on instances where the transaction isn't reported to the Securities and Exchange Commission, because the Service believes it to be a drafting error by Congress.

Subjecting that reporting failure to the highest penalty “would be contrary to the purpose of the 2010 amendments to Section 6707A,” the proposed rules said. “It seems likely the intent was to reference the amount of the penalty generally under subsection (b),” which defines the penalty amounts.

The proposed rules are scheduled for publication in the Aug. 28 Federal Register. Comments and requests for a public hearing are due by Nov. 27.

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For More Information

Text of REG-103033-11 is in TaxCore.