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Christmas Comes Early: IRS Announces Penalty Relief for Many 2019 and 2020 Returns

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INTRODUCTION

On August 24, 2022, the IRS released Notice 2022-36.² The Notice provides relief from the failure-to-file penalties imposed by §6051 and many Internal Revenue Code provisions governing filing international information returns. However, the relief is only available for 2019 and 2020 income tax and information returns filed on or before September 30, 2022. The Notice also provides relief for 2019 W-2s, 1098s, 1099s, and similar returns filed before August 1, 2020, as well as 2020 W-2s, 1098s, 1099s, and similar returns filed before August 1, 2021. Otherwise, the penalties identified in the Notice are automatically abated, refunded, or credited as appropriate. Taxpayers do not need to specifically request relief under the Notice.

TO WHAT RETURNS DOES FAILURE TO FILE PENALTY RELIEF APPLY?

- The penalty relief provided by the Notice applies to many commonly filed U.S. income tax returns for individuals, trusts and estates, corporations,

private foundations, and real estate mortgage and investment conduits.³

- For individuals: Form 1040, *U.S. Individual Income Tax Return*; Form 1040-C, *U.S. Departing Alien Income Tax Return*; Form 1040-NR, *U.S. Nonresident Alien Income Tax Return*; Form 1040-NR-EZ, *U.S. Income Tax Return for Certain Nonresident Aliens with No Dependents*; Form 1040 (PR), *Federal Self-Employment Contribution Statement for Residents of Puerto Rico*; Form 1040-SR, *U.S. Tax Return for Seniors*; and Form 1040-SS, *U.S. Self-Employment Tax Return (Including the Additional Child Tax Credit for Bona Fide Residents of Puerto Rico)*.
- For trusts and estates: Form 1041, *U.S. Income Tax Return for Estates and Trusts*; Form 1041-N, *U.S. Income Tax Return for Electing Alaska Native Settlement Trusts*; Form 1041-QFT, *U.S. Income Tax Return for Qualified Funeral Trusts*.
- For corporations: Form 1120, *U.S. Corporation Income Tax Return*; Form 1120-C, *U.S. Income Tax Return for Cooperative Associations*; Form 1120-F, *U.S. Income Tax Return of a Foreign Corporation*; Form 1120-FSC, *U.S. Income Tax Return of a Foreign Sales Corporation*; Form 1120-H, *U.S. Income Tax Return for Homeowners Associations*; Form 1120-L, *U.S. Life Insurance Company Income Tax Return*; Form 1120-ND, *Return for Nuclear Decommissioning Funds and Certain Related Persons*; Form 1120-PC, *U.S. Property and Casualty Insurance Company Income Tax Return*; Form 1120-POL, *U.S. Income Tax Return for Certain Political Organizations*; Form 1120-REIT, *U.S. Income Tax Return for*

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² 2022-36 I.R.B. 1.

³ The failure-to-file penalty under §6651(a)(1) is based upon the amount of tax determined to be due on a late-filed return calculated at a rate of 5% of the tax liability for each month the return is late, up to a maximum penalty of 25%.

Real Estate Investment Trusts; Form 1120-RIC, *U.S. Income Tax Return for Regulated Investment Companies*; Form 1120-SF, *U.S. Income Tax Return for Settlement Funds*(Under Section 468B).

- For private foundations: Form 990-PF, *Return of Private Foundation Under Section 4947(a)(1) Trust Treated as a Private Foundation*; Form 990-T, *Exempt Organization Business Income Tax Return (and Proxy Tax Under Section 6033(e))*.
- For REMICs: Form 1066, *U.S. Real Estate Mortgage and Investment Conduit (REMIC) Income Tax Return*.

The Notice provides relief from penalties imposed by §6038, §6038A, §6038C, §6039F, and §6677 for failures to timely file the following international information returns.⁴

- For U.S. persons owning or controlling foreign corporations: Form 5471, *Information Return of U.S. Persons with Respect to Certain Foreign Corporations*.
- For foreign persons owning U.S. corporations and foreign corporations engaged in a U.S. trade or business: Form 5472, *Information Return of a 25% Foreign Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business*.
- For individuals receiving gifts from foreign persons and U.S. persons settling foreign trusts: Form 3520, *Annual Return to Report Transactions with Foreign Trust and Receipt of Certain Foreign Gifts*; Form 3520-A, *Annual Information Return of Foreign Trust with a U.S. Owner (Under Section 6048(b))*.

⁴ Section 6038(b) imposes a \$10,000 penalty for each annual accounting period with respect to which a taxpayer fails to file Form 5471 and imposes an additional \$10,000 penalty for each 30-day period (or any portion thereof) during which the failure to file continues for more than 90 days after notice of such failure is mailed to the taxpayer responsible for filing the Form 5471 up to a maximum of \$50,000. Section 6038A(d) imposes a penalty of \$25,000 for each taxable year with respect to which Form 5472 has not been timely filed, increasing the penalty by \$25,000 for each 30-day period (or any portion thereof) during which the failure to file continues for more than 90 days after notice to the taxpayer required to file the form. Section 6038C(c) applies the failure-to-file penalty provisions imposed by §6038(A) to any foreign corporation engaged in a U.S. trade or business which fails to timely file a Form 5472. Section 6039F(c) imposes a penalty of 5% of the amount of any foreign gift required to be reported on Form 3520 for each month (or portion thereof) the failure to file continues up to a maximum of 25% of the amount of the gift. Section 6677(a) imposes a penalty equal to the greater of \$10,000 or 35% of the amount required to be reported on Form 3520 for transfers to or assets of foreign trusts and increases the penalty to \$10,000 for each 30-day period (or portion thereof) during which the failure to file continues for more than 90 days after notice.

- For partnerships: Penalties under §6698(a)(1) for failure to timely file or report required information on Form 1065, *U.S. Return of Partnership Income*.⁵

- For S corporations: Penalties imposed by §6699 for any S corporation which fails to timely file or report required information on Form 1120-S, *U.S. Income Tax Return for an S Corporation*.⁶

In order to qualify for abatement of the penalties described above, individuals, estates and trusts, REMICs, private foundations, partnerships, S corporations, and other persons required to file the income tax or information returns identified above must submit the unfiled returns on or before September 30, 2022, in order to qualify for abatement, refund, or credit.

In addition, penalties imposed by §6721(a)(2)(A) for failures to timely file any information return required by §6724(d)(1) will be abated, refunded, or credited for 2019 returns filed on or before August 1, 2020, and 2020 information returns filed on or before August 1, 2021.⁷

Penalty relief provided by the Notice is limited only to the failure-to-file penalty and does not extend to penalties imposed by §6651(a)(2) or §6651(a)(3) for failures to timely pay the taxes determined to be due on the late filed returns.⁸ The relief provided by the Notice extends only to those taxpayers and returns expressly identified in the Notice (all of which are referenced above). Further, even with respect to those taxpayers and returns, penalty relief is denied if the taxpayer is subject to the penalty imposed by §6651(f) for a fraudulent failure to file or if the taxpayer is sub-

⁵ Section 6698(a) and §6698(b) impose a penalty equal to \$195 times the number of partners in the partnership during any part of its taxable year for each month the partnership's Form 1065 remains outstanding or fails to report the information required under §6031 not to exceed a maximum of 12 months.

⁶ Section 6699(a) and §6699(b) impose a penalty equal to \$195 times the number of shareholders of the S corporation during any part of the taxable year for each month the corporation's Form 1120-S remains outstanding after its due date or fails to show the information required by such return, up to a maximum of 12 months.

⁷ Section 6721(a) imposes a penalty of \$250 for each Form W-2, 1098 series, 1099 series, and other Forms required by §6724(d)(1) up to a maximum of \$3,000,000 for all such failures during a calendar year.

⁸ Section 6651(a)(2) imposes a penalty of .05% of the amount of tax determined to be due for each month or additional month the tax remains unpaid subject to a maximum of 25% of the tax liability. Section 6651(a)(3) imposes an additional penalty of .05% of the amount of tax determined to be due for each month (or portion thereof) during which the failure continues for more than 21 days (10 days in the case of tax liabilities equal or exceeding \$100,000) after notice to the taxpayer up to a maximum of 25% of the tax due.

ject to the fraud penalty imposed by §6663.⁹ The penalty relief provided by the Notice is inapplicable to penalties comprised in an accepted offer in compromise allowed under §7122. The penalty relief does not apply to any penalties settled in a closing agreement under §7121 or finally determined in a judicial proceeding.

Notable exclusions from the relief provided by the Notice include Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return*; Form 709, *United States Gift (and Generation-Skipping Transfer) Tax Return*; Form 990, *Return of Organization Exempt from Income Tax*; Form 990-EZ, *Short Form Return Organization Exempt from Income Tax*; Form 8858, *Information Return of U.S. Persons with Respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs)*; Form 8865, *Return of U.S. Persons with Respect to Certain Foreign Partnerships*; Form 8938, *Statement of Specified Foreign Financial Assets*; and FBARs (*FinCEN Report 114*).

UNCERTAINTIES

Curiously, the Notice's penalty relief for Form 5471 is expressly confined to its submission when attached to a delinquent Form 1120 or Form 1065. Omitted are Forms 5471 attached to an individual's Form 1040, an S corporation's Form 1120-S, or any other returns to which a Form 5471 could be attached. It is unclear whether this omission is intentional or merely an oversight. Also unclear is the effect which the relief provided by the Notice will have on taxpayers claiming "First Time Abate" relief.¹⁰

As described by the IRS website, in order for a taxpayer to qualify for First Time Abate, the taxpayer

must be currently compliant and have filed the same type of return for which penalty relief is requested for the three years prior to the year in which the penalty under consideration was received. In addition, compliance requires that the taxpayer did not "receive any penalties during the prior three years, or any penalty was removed for an acceptable reason other than First Time Abate."¹¹

OBSERVATIONS

The Notice explains the IRS's dispensation to certain delinquent taxpayers is the result of two circumstances. First, the "unprecedented effect on the IRS's personnel and operations" arising from the Covid-19 pandemic including distributing 476.1 million economic impact payments while "sustaining its regular operations in a pandemic environment where employees were sometimes unable to be physically present to process tax returns and correspondence." Second, as an administrative convenience allowing the IRS to focus its limited resources to process tax returns and taxpayer correspondence backlogged as a result of the pandemic so as "to return to normal operations for the 2023 filing season." It is unfortunate that the IRS's experience with the burdens endured by its personnel was not reflected in allowing taxpayers and their return preparers additional time to prepare and file those returns identified in the Notice. Instead of imposing a filing deadline of September 30, 2022 for 2019 and 2020 returns, a November 30 or December 31, 2022 deadline would have been more reasonable. It is foreseeable that many return preparers are already busy meeting the September 15 and October 15 deadlines for 2021 returns.

⁹ Section 6651(f) increases the failure-to-file penalty from 5% to 15% a month and increases the maximum penalty from 25% to 75% of the tax due. Section 6663(a) imposes a penalty equal to 75% of any underpayment attributable to fraud.

¹⁰ The August 24, 2022 National Taxpayer Advocate Blog

stated the relief provided by the Notice will not preclude taxpayers from receiving First Time Abate relief for the next three years.

¹¹ See Penalty Relief due to First Time Abate or Other Administrative Waiver (Aug. 24, 2022).