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ISSUES

1. What is the Assessment Statute Expiration Date (ASED) for penalties under I.R.C. sections 6721, specifically in the context of Forms 1099 and W-2?

2. What is the ASED for penalties under I.R.C. section 6722 with respect to the furnishing of correct payee statements, specifically those associated with Forms 1099 and W-2?

3. Does the filing of a summary or transmittal form, such as a Form 1096 or W-3 start the assessment period of limitation for penalties under sections 6721 and 6722 for the applicable year?

CONCLUSIONS

1. The assessment statute of limitations for penalties under section 6721 is governed by I.R.C. section 6501 and runs three years after the filing of the return. The return, for purposes of starting the three-year statute, would be the individual information returns (Forms 1099 or W-2 for example). If any information return is not filed, I.R.C. section 6501(c)(3) dictates that the assessment statute of limitations will not begin to run.

2. Penalties under section 6722 are based on an independent obligation to furnish payee statements. While this obligation arises out of the same nexus as the
requirement for filing information returns (a reportable payment) it is not based on the filing of any return. This issue has never been decided and falls between analogous decisions.

3. No, the filing of a summary or transmittal form such as a Form 1096 or W-3 is not sufficient to begin the section 6501 assessment period applicable to section 6721 or 6722. Forms 1096 and W-3 are not returns for purposes of calculating the penalty under section 6721 or for purposes of the underlying information reporting statutes. As a result, they cannot be the return required to be filed by the taxpayer for purposes of applying section 6501 to these statutes.

LAW AND ANALYSIS

I.R.C. section 6721 provides penalties for a failure to file correct information returns. Section 6722 provides penalties for a failure to furnish correct payee statements. Generally, these penalties apply if the specified documents are furnished or filed incomplete, with inaccuracies, late, or not at all.

I.R.C. section 6671 provides that penalties and liabilities in “Subchapter B – Assessable Penalties” (Sections 6671 to 6724) including sections 6721 and 6722, shall be paid upon notice and demand by the Secretary, and shall be assessed and collected in the same manner as taxes. Sections 6721 and 6722 do not provide a specific assessment period and therefore should be limited, if at all, by the general assessment period applicable to taxes, as set out in section 6501.

Section 6501 dictates that, unless otherwise provided, taxes must be assessed within three years of the filing of the return, whether or not that return was filed on or after the date prescribed. For the purposes of section 6501, “return” means the return required to be filed by the taxpayer. In the case of a failure to file a return, the tax may be assessed, or proceeding in court commenced without assessment, at any time. I.R.C. § 6501(c)(3).

I. The Assessment Statute Expiration Date with Respect to Penalties under Section 6721

Section 6721 provides that “with respect to an information return, such person shall pay a penalty of $100 for each return with respect to which such failures occur” indicating that the “return” on which the penalty is based is the “information return” which is defined in the regulations. Treas. Reg. § 301.6721(g). The “return” required to be filed by the taxpayer would therefore be each individual information return. The regulations list the applicable information returns by reference to the code sections which require them.
Thus, for purposes of applying section 6501 to section 6721 we must look at the definition of "return" as used in section 6721 and the underlying code sections referenced.

The underlying statutes define "a return" for purposes of the provision fairly consistently (though not identically). For example, section 6050(h) defines "return" for purposes of satisfying that provision as being "in such form as the Secretary may prescribe," and containing the "name and address of the individual," as well as the amount of the interest and points received during the year, and other information the Secretary prescribes. Similarly, I.R.C. 6041(a) provides that the payer must make such "true and accurate return" in such "form and manner" prescribed by the Secretary, including the "gains, profits, and income, and the name and address of the recipient of such payment."

For the term "return" to be read consistently, it must mean each properly filed individual information return. An example of this would be a Form 1099 transmitted in its proper format, including the accompanying Form 1096. Any document which does not satisfy the requirements of a "return" in the underlying statutes and regulations could not constitute a "return" for purposes of section 6501 and would not begin the period for assessment. Therefore, documents such as the Form 1096 which do not include items specifically required by the statute to be on the "return," such as the name and address of the payee, could not constitute the "return required to be filed by the taxpayer," and would not start the period of limitations. A naked summary or transmittal form, such as a Form 1096 or W-3 would simply not contain the requisite elements specifically required for a return with respect to the underlying provisions.

We conclude that penalties under I.R.C. sections 6721 should be assessed within three years of filing of the particular information return which forms the basis of the penalty (such as Forms 1099 or W-2). If the particular information return (such as a Form 1099 or W-2) has not been filed, then section 6501(c)(3) would dictate that there is no limitations period on assessment of the penalty. A transmittal or summary form such as the Form 1096 or W-3 is not, by itself, a return for purposes of starting the assessment statute of limitations.

II. The Assessment Statute Expiration Date with Respect to Penalties under Section 6722

Section 6722 is based on the issuance of payee statements and is not directly based on the filing of a "return." As a result, application of the assessment period is less straightforward. Generally, an action filed by the United States is not subject to a time limitation unless Congress clearly imposes one by enactment, and such limitations are to be strictly construed in favor of the government. Badaracco v. Comm'r, 464 U.S. 386, 398 (1984); Mullikin v. United States, 952 F.2d 920, 926 (6th Cir. 1992).

The IRS has argued that no statute of limitation applies with respect to at least two other kinds of assessable penalties, promoter penalties and trust fund recovery penalties. The IRS was successful in arguing that no statute of limitations applies to the promoter
penalties under sections 6700 and 6701. See generally, Sage v. United States, 908 F.2d 18 (5th Cir. 1990) (6700 penalty); Mullikin, 952 F.2d 920 (6701 penalty). In determining that no period of limitation applies to these penalties, the courts relied on the anti-fraud nature of the penalties, and in some instances on the fact that the penalties were not based on a return. By contrast, the IRS has unsuccessfully argued that no statute of limitations applies to the trust fund recovery penalty under section 6672, and eventually abandoned the position. Lauckner v. United States, 68 F.3d 69 (3rd Cir. 1996), acq. 1996-29 I.R.B. 4.

In the context of section 6721, there is no meaningful basis for arguing for any statutory period other than the three-year period in section 6501. The penalty, by its terms, is based on a “return” filed with the IRS and the three-year period begins to run for each individual information return when it is filed. Section 6722 penalties, on the other hand, are based on the issuance of payee statements, not returns filed with the IRS. While the obligation to issue these payee statements arises from the same nexus as the requirement to file information returns, the requirement to send payee statements is an independent, concurrent obligation.

While these obligations are nearly perfectly correlated, they are not interdependent and compliance or non-compliance with one of the obligations does not impact the other. As a result, section 6722 penalties seem to fall between established precedents. They are not designed specifically for fraud prevention, but they are also not penalties based on a return.

Penalties under section 6722 differ from the case of a trust fund recovery penalty under section 6672. Following the filing of Forms 941 the IRS is on notice of both the obligation to pay, and the failure to pay, which forms the basis of a trust fund recovery investigation. Since the obligation to pay is a transaction involving the IRS, the IRS has all the information necessary to begin an investigation. The filing of information returns such as Forms 1099 and W-2 provide the IRS with only derivative notice of the obligation. The information return makes the IRS aware of the reportable payment which in turn reveals the obligation to furnish payee statements, but it does not indicate whether the obligation has been fulfilled.

The sending of payee statements is a third-party transaction not involving the IRS. Arguably, this is more analogous to the behavior involved in promoter penalties than in trust fund recovery penalties. Promoter penalties are based on an action between the taxpayer (the promoter) and a third party. There is no means for the IRS to observe the interactions between the taxpayer and a third party. One long-standing justification for extended or unlimited periods of limitations is the need for the IRS to have notice and opportunity to investigate.

Penalties regulating behavior between the taxpayer and a third party are not readily observable by the IRS and should not be shoehorned into the tax-return dependant world of section 6501(a) unless the behavior is reported on a return. The basic framework of
section 6501 begins the assessment statute of limitations running when the government receives the "return," which is generally meant to provide the IRS with the necessary facts to determine whether an obligation has been satisfied. In the ordinary section 6501 context, an unlimited statute is available in the case of fraud or failure to file. This is because in the event of fraud, or no return, the IRS generally does not have ready access to the information needed to begin an investigation. Since there is no requirement that a taxpayer disclose whether a payee statement has actually been sent, the framework under section 6501 is not readily applicable.

However, both the obligations to file information returns and the obligations to furnish payee statements arise out of the same nexus, usually a payment, and include substantially identical requirements. This nexus or correlation of events suggests that "the return" for purposes applying section 6501 to section 6722 could plausibly be the underlying information return. Similarly, while an information return does not report the behavior at issue (the timely furnishing of accurate payee statements); it does indirectly inform the IRS of the obligation to furnish payee statements, and the information which should have been included. While these "returns" are more disconnected from the conduct subject to penalty or tax than other "returns" for purposes of 6501(a); they would be the most logical starting point for the three-year period under section 6501, if applicable. This matter has not been decided and it is difficult to predict at this point how a court would rule on this question as a matter of first impression.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

It is arguable that section 6501(a) is inapplicable to section 6722 penalties because like 6700 and 6701, these penalties are not based on a return. If section 6722 is treated like sections 6700 and 6701 there would be no period of limitation on assessment.

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