



TAX TIP

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Late Filing & Payment Penalties

April 17th (March 15th Corporations) was the deadline to file income tax returns or October 15th if an extension of time to file income tax return was timely filed (September 15th Corporations). The Internal Revenue Service assess late filing penalties and interest for late filing of returns and or late payments of income tax.

Individuals & Corporations - Failure to Pay

The failure to pay penalty is .5% for each month (or part of a month) the payment is late. For example if you were six months late the penalty would be 3%. The maximum penalty for failure to file is 25%. This is based on .5% times maximum penalty period of 50 months. If a taxpayer has 90% of tax paid by the original due date of a return they will not be charged a penalty but will be charged interest on the remaining balance.

Failure to File

A failure to file penalty is based on tax owed. Therefore, if a taxpayer has no tax due no penalty will be imposed on a late filing of a tax return. If a taxpayer has a tax due the penalty is 5% per month (or partial month) up to a maximum of 25%. The minimum penalty for filing more than 60 days late is the smaller of \$100 or 100% of the tax required to be paid on the return.

Failure to File & Failure Pay

If a taxpayer has a late return as well as a late payment, the failure to file penalty is 4.5% per month so that the combined penalty remains at 5% per month for the first five months. After the first five months the failure to pay penalty continues at .5% per month for 45 additional months. Thus, the combined penalties can reach a total of 47.5% if a taxpayer is 50 or more months late in filing and paying income tax due.

Interest on Underpayments of Tax

In addition to failure to pay penalties the Internal Revenue Code also charges interest. The underpayment interest rate is the federal short-term rate, rounded to the nearest full percent, plus three percentage points. The rate is adjusted quarterly. The current rate for the calendar quarter beginning April 1, 2007 is 8% for individuals and most corporations. Large corporate underpayments are taxed at the federal short-term rate plus five percentage points which (is 10%) for the current quarter.

S Corporations

If an S corporation does not provide a K-1 to a shareholder when due or gives incorrect information or missing information, they

will be charged a \$50 penalty for each K-1 for which a failure occurs. If information is intentionally disregarded the penalty will increase to \$100 per K-1.

Partnerships

Partnership income is passed through and taxed on the partner's personal income tax return. Since a partnership does not get assessed tax directly, the penalty is not based on tax due. Instead it is based on the number of partners in a partnership and how late the partnership is filing the return. The penalty is \$50 for each month or part of a month (maximum five months) the failure continues, multiplied by the total number of partners in the partnership during any part of the tax year for which the return is filed. For partnerships with many partners this penalty can be quite steep. For example if a partnership was two months late in filing and had 50 partners the penalty would be \$5,000 (two months x \$50 = \$100 x 50 or \$5,000.)

Relief may be available for partnerships with fewer than 10 partners where the income was timely reported by all the partners.

Inability to Pay Income Tax When Due

A taxpayer can file 9465 to request the IRS to enter into an installment agreement. An installment agreement does not, however, stop interest from being charged at the current rate on the unpaid balance. The late payment penalty will be .25% instead of .5% per month. The IRS charges a fee of \$105 for entering into an installment agreement.

A corporate taxpayer expecting an NOL carry back can file form 1138 which is an extension of time for payment of tax. It needs to be filed after the beginning of the tax year the NOL is expected but before the due date for paying the previous year's income tax.

For more information on this subject or for various state tax treatments, please contact your Virchow Krause tax advisor. Pursuant to the rules of professional conduct set forth in Circular 230, as promulgated by the United States Department of the Treasury, nothing contained in this communication was intended or written to be used by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer by the Internal Revenue Service, and it cannot be used by any taxpayer for such purpose. No one, without our express prior written permission, may use or refer to any tax advice in this communication in promoting, marketing, or recommending a partnership or other entity, investment plan or arrangement to any other party.

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