# THE UNPLEASANT SURPRISE OF THE ACCURACY-RELATED PENALTY

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If a retirement account transaction becomes a taxable distribution, you probably know you will owe taxes and possibly the 10% early distribution penalty (if under age 59 ½) on the distribution. But what you may not know is there might be an unexpected surprise. On top of the additional taxes and 10% penalty, you might also be liable for what's called the "accuracy-related penalty." Here's what you need to know about this unpleasant revelation.

The penalty normally kicks in if you substantially underpay your federal income taxes. An underpayment is "substantial" if it is more than the greater of $5,000, or 10% of the tax that was required to be shown on your tax return. (You could also owe the accuracy-related penalty if, in preparing your tax return, you acted negligently or disregarded IRS rules or regulations.) The accuracy-related penalty is normally 20% of the underpayment.

The IRS will waive the penalty if you can show there was "reasonable cause" for the underpayment and that you acted in good faith. The IRS considers reasonable cause on a case-by-case basis, taking into account all pertinent facts and circumstances. However, the IRS says the most important reasonable cause factor is how much of an effort you made to determine your tax liability.

A recent Tax Court case, Lionel E. LaRochelle et al, v. Commissioner; T.C. Summ. Op. 2022-12, illustrates the accuracy-related penalty and the reasonable cause exception. In 2017, Mr. LaRochelle withdrew $238,000 from his IRA, but he and his wife did not show the distribution on their tax return. Since the couple had moved in 2016, Mr. LaRochelle claimed he never received a Form 1099-R from the IRA custodian.

The IRS picked up on his failure to report the $238,000 and assessed additional taxes and the accuracy-related penalty. The LaRochelles paid the taxes but asked the IRS to waive the penalty. After the IRS refused, the case went to the Tax Court.

The couple argued there was reasonable cause for their underpayment because they didn't receive the 1099-R. But the Tax Court said that failing to receive a tax form reporting a distribution isn't a good excuse if the taxpayer knew about the distribution anyway. That was the case here. Next, the LaRochelles claimed that they had relied on their tax preparer to produce an accurate tax return, but the court didn't buy that one either. The court reasoned that, since the couple hadn't informed the tax preparer about the IRA withdrawal, they could not have expected him to file an accurate return. The $9,075 penalty stood.

The threat of the accuracy-related penalty makes it even more important to know about, and accurately report, all taxable retirement account transactions.