

#29 REDUCE THE FEDERAL TAX DEPOSIT PENALTY IMPOSED ON CERTAIN TAXPAYERS WHO MAKE TIMELY TAX DEPOSITS

Present Law

Internal Revenue Code (IRC) § 6656(a) imposes a penalty, computed as a percentage of a tax underpayment, for the failure to deposit (FTD) taxes in a manner prescribed by regulation, unless such failure is due to reasonable cause and not due to willful neglect.

Treasury Regulation § 31.6302-1(h) requires that federal tax deposits be made electronically via electronic funds transfer. To comply with this requirement, most taxpayers use the Electronic Federal Tax Payment System (EFTPS), a free service offered by the Department of the Treasury. The penalty rate for FTD varies, depending on the length of the taxpayer's delay in making the deposit. IRC § 6656(b)(1) provides that the penalty is two percent for an FTD of not more than five days, five percent for an FTD of more than five days but not more than 15 days, and ten percent for an FTD of more than 15 days. Thus, taxpayers must make deposits on time, in full, and in the correct manner to avoid a penalty for FTD.¹¹⁴

Reasons for Change

The IRS has taken the position that the maximum ten percent penalty rate automatically applies if a deposit is not made in the manner prescribed by the regulation.¹¹⁵ As a result, taxpayers who timely remit full payment to the IRS but who do not do so in the manner prescribed are subject to a higher penalty rate than taxpayers who do not make a timely payment at all. The National Taxpayer Advocate believes it is inappropriate to penalize taxpayers who make timely payments more harshly than taxpayers who do not. Moreover, the Ways and Means Committee has observed that this approach “does not reflect the intent of the Congress.”¹¹⁶

Recommendation

- Amend IRC § 6656 to establish a penalty rate of two percent for FTDs that are fully and timely paid, but not in the manner prescribed by the Secretary of the Treasury.¹¹⁷

¹¹⁴ See *F.E. Schumacher Co. v. United States*, 308 F. Supp.2d 819, 830 (N.D. Ohio 2004) (“penalties assessed pursuant to Section 6656 are appropriate even where taxes are timely paid, albeit by means other than [Electronic Funds Transfer]”).

¹¹⁵ Rev. Rul. 95-68, 1995-2 C.B. 272; IRM 20.1.4.2.2.1, Electronic Funds Transfer (EFT) (Feb. 9, 2018).

¹¹⁶ H.R. REP. NO. 108-61, at 36 (2003).

¹¹⁷ For legislative language generally consistent with this recommendation, see Taxpayer Bill of Rights Enhancement Act of 2017, S. 1793, 115th Cong. § 309 (2017); Taxpayer Protection and IRS Accountability Act, H.R. 1528, 108th Cong. § 108 (2003).