

**Legislative Recommendation #33****Reduce the Federal Tax Deposit Penalty Imposed on Taxpayers Who Make Timely Tax Deposits****PRESENT LAW**

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 the failure is due to reasonable cause and not due to willful neglect. The penalty rate for FTD varies, depending on the length of the taxpayer's delay in making the deposit. IRC § 6656(b)(1)(A) 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.<sup>1</sup> Thus, taxpayers must make deposits on time, in full, and in the correct manner to avoid a penalty for FTD.<sup>2</sup>

IRC § 6302(h) directs the Secretary to prescribe "such regulations as may be necessary for the development and implementation of an electronic fund transfer system which is required to be used for the collection of depository taxes." Treas. Reg. § 31.6302-1(h) implements this directive by requiring that federal tax deposits be made electronically via electronic funds transfer. To comply with this requirement, many taxpayers use the Electronic Federal Tax Payment System (EFTPS), a free service offered by the Department of the Treasury.

**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.<sup>3</sup> As a result, taxpayers who timely remit full payment to the IRS but who do not do so in the manner prescribed may be 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 House Ways and Means Committee has observed that this approach "does not reflect the intent of the Congress."<sup>4</sup>

**RECOMMENDATION**

- Amend IRC § 6656 to establish a penalty rate of two percent for FTDs that are fully and timely paid in a manner other than that prescribed by the Secretary of the Treasury.<sup>5</sup>

<sup>1</sup> IRC § 6656(b)(1)(B) imposes a penalty of 15 percent in certain circumstances.

<sup>2</sup> 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]").

<sup>3</sup> Rev. Rul. 95-68, 1995-2 C.B. 272; Internal Revenue Manual 20.1.4.2.2.1, Electronic Funds Transfer (EFT) (Feb. 9, 2018).

<sup>4</sup> H.R. REP. NO. 108-61, at 36 (2003).

<sup>5</sup> 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).