

**Office of Chief Counsel
Internal Revenue Service
memorandum**

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(Procedure & Administration)

subject: Whether the Section 6657 Penalty Applies to Electronic Funds Transfers and Credit Card Payments

ISSUE

Whether the penalty under section 6657 for bad checks applies to payments made by electronic funds transfer or credit card when a taxpayer's account does not have sufficient funds to cover the amount of the payment.

CONCLUSION

The bad check penalty under section 6657 only applies to payments made by check or money order.

FACTS

Taxpayers frequently pay their tax liabilities via other methods besides checks and money orders. For example, taxpayers may authorize an electronic funds withdrawal from the same bank account on which they draw checks and assume it to be an "electronic" check. They also may use a credit card to pay their tax liabilities. Your question is whether the Service can assess the bad check penalty under section 6657 when a taxpayer, who has insufficient funds in his account, makes a payment by electronic funds transfer or credit card instead of by a check or money order.

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LAW AND ANALYSIS

Taxpayers may pay their tax liability by "any commercially acceptable means" that the Service deems appropriate. I.R.C. § 6311(a). Thus, taxpayers may pay their taxes by check, money order, Electronic Federal Tax Payment System (EFTPS), or electronic funds transfers, including those arising from credit cards, debit cards, and charge cards, in the manner and in accordance with the forms, instructions, and procedures prescribed by the Commissioner. Treas. Reg. §§ 301.6311-1, 301.6311-2. Section 6311 of the Internal Revenue Code (Code) and the regulations thereunder address payment methods generally, while section 6302 and the regulations thereunder prescribe rules for forms of payment by electronic funds transfer other than payment by credit card or debit card.

If a taxpayer makes a payment by "any check or money order" and it is not fully paid, the Service may assess a penalty against the taxpayer, unless the taxpayer tendered the check or money order in good faith and with reasonable cause that it would be paid. I.R.C. § 6657. The amount of the penalty is either (1) two percent of the amount of the check or (2) if the amount of the check is less than \$750, \$15 or the amount of the check, whichever is less. Id.

Statutory Analysis

In interpreting a statute, we first look to the language of the statute to determine if it is clear and unambiguous. Robinson v. Shell Oil Co., 519 U.S. 337, 340 (1997); Fed. Home Loan Mortgage Corp. v. Commissioner, 121 T.C. 129, 134 (2003). If the language of a statute is plain, clear, and unambiguous and the statutory scheme is coherent and consistent, the statutory language is to be applied according to its terms. Id.; see also United States v. Ron Pair Enters., Inc., 489 U.S. 235, 241 (1989). The plainness or ambiguity of statutory language is determined by reference to the language itself, the specific context in which that language is used, and the broader context of the statute as a whole. Robinson, 519 U.S. at 341. If the statute is ambiguous or silent, then we look to legislative history to determine congressional intent. Fed. Home Loan Mortgage Corp., 121 T.C. at 134. Words of a statute are given their ordinary meaning unless context shows they are used differently. E.g., Commissioner v. Brown, 380 U.S. 563, 571 (1965); A. Magnano Co. v. Hamilton, 292 U.S. 40, 46-7 (1934).

By its terms, section 6657 applies to "any check or money order." While these terms are not defined in the statute, these words are common terms and should be given their ordinary meaning. Checks, money orders, electronic funds transfers from a bank account, and credit cards are all commercially acceptable means by which to make a payment and, thus, serve the same function; however, they are understood to be distinct payment methods with different definitions.

Black's Law Dictionary defines check as "a draft signed by the maker or drawer, drawn on a bank, payable on demand, and unlimited in negotiability." Black's Law Dictionary (8th ed. 2004). The term e-check is defined as "a paper check that is supplied by a

consumer to a payee (usu. a merchant) who uses the check to make an electronic funds transfer." *Id.* Black's Law Dictionary goes on to note that, when an e-check is used, the payee electronically scans the check's magnetic-ink character-recognition coding to obtain the bank-routing, account, and serial numbers, then enters the amount of the check." *Id.* The term electronic funds transfer (also referred to as funds transfer) is defined as "a payment of money from one person or entity to another; esp., the process by which payment is made through a series of transactions between computerized banking systems, beginning with an originator's payment order and ending when a final payment order is received by the beneficiary's bank." *Id.* The definitions show how these three terms are different payment methods. A "check" is traditionally a paper negotiable instrument. While a payee may use an "e-check" to make an electronic funds transfer, the two terms are not synonymous but refer to different payment methods. Furthermore, an e-check still involves an actual paper check that an individual presents to the payee. Credit card is defined as "an identification card used to obtain items on credit, usu. on a revolving basis." *Id.* Payments made by credit card are clearly different than payments made by check even though both may sometimes involve a series of electronic transfers of money from a bank, such as the credit card company's bank, to a payee. Thus, the dictionary definition of check does not refer to, or include, payments made by electronic funds transfer or credit card.

Where the phrase electronic funds transfer is defined in the Code, it is distinguished from a check. The term electronic funds transfer is defined for purposes of the Code where Congress requires taxpayers to make payments via electronic funds transfer, such as certain federal tax deposits under section 6302(h), certain excise taxes on alcohol under section 5061(e), and certain excise taxes on tobacco under section 5703(b). Electronic funds transfer is defined in sections 6302(h)(3)(B) and 5061(e)(2) as "any transfer of funds, other than a transaction originated by check, draft, or similar paper instrument, which is initiated through an electronic terminal, telephonic instrument, or computer or magnetic tape so as to order, instruct, or authorize a financial institution to debit or credit an account."

In addition, the terms check and money order as used throughout the Code do not automatically include other methods of payment. For example, section 6311 treats the various terms as different payment methods to which different rules apply. Section 6311(a) refers to "commercially acceptable means." Section 6311(b) lists some examples, including "check, money order, or other method of payment, including payment by credit card, debit card, or charge card..." Section 6311(d)(3) also contains special provisions for payments by "credit card" and "debit card." Thus, these terms do not mean the same thing and are not interchangeable.

Further, these various payment methods are defined differently in other Federal statutes. For example, credit card is defined as "any card, plate, coupon book or other credit device existing for the purpose of obtaining money, property, labor, or services on credit." 15 U.S.C. § 1602(k). The term electronic fund transfer means "any transfer of funds, other than a transaction originated by check, draft, or similar paper instrument,

which is initiated through an electronic terminal, telephonic instrument, or computer or magnetic tape so as to order, instruct, or authorize a financial institution to debit or credit an account. Such term includes, but is not limited to, point-of-sale transfers, automated teller machine transactions, direct deposits or withdrawals of funds, and transfers initiated by telephone.” 15 U.S.C. § 1693a(6). Thus, checks are differentiated from electronic funds transfers in other Federal statutes, as well as in the Internal Revenue Code.

Therefore, the wording of the statute appears plain, clear, and unambiguous and should be applied according to its terms. As the statute only lists two specific payment methods to which the penalty applies, the penalty cannot be assessed against taxpayers who use different payment methods.

Legislative History

Even if we assume, *arguendo*, that the language is not clear and look to the legislative history, the legislative history also makes clear that Congress did not intend the penalty to apply when payments are made by other commercially acceptable means. The legislative history to section 6657 only refers to checks and money orders. Moreover, while Congress has amended, and proposed to amend, section 6657 since it was originally enacted, it has not amended the language regarding the method of payments to which the penalty applies. In 1988, Congress amended section 6657 to increase the amount of the penalty. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 5071(a), 102 Stat 3342. In 2004, the Senate proposed another increase to the amount of the penalty. S. Rep. No. 108-257, 108th Cong., 2nd Sess., at 10 (2004). In 2005, the Senate again proposed to increase the amount of the penalty. Tax Relief Act of 2005, S. 2020, 109th Cong. § 535 (2005). The legislative history to these amendments, and proposed amendments, only mentions payments made by checks or money orders. None of the amendments, or proposed amendments, addressed other methods of payment even after Congress amended other provisions to provide for other methods of payments, such as sections 6302 and 6311. Had Congress intended for the penalty under section 6657 to apply to methods of payments besides checks and money orders, presumably it would have so stated. This is especially so as payment by either electronic funds transfer or credit card is often the preferred method of payment, generally, in our modern, technological society.

Furthermore, word usage and legislative history of other sections of the Code show that Congress does not use the terms check or money order to include electronic funds transfers; where Congress intends to refer to other methods of payment it uses other terms. For example, section 6311 was amended by section 1205 of the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788, 995-98, to allow for payment by commercially acceptable means. Before the amendment, section 6311 only allowed taxpayers to pay taxes by “checks or money orders.” As part of the amendment, section 6311(b) specifically included payments made by “credit card” and “debit card.” The legislative history notes the reason for the change is that Congress wanted to expand the payment methods taxpayers could use in order to reduce the burden on

taxpayers and to acknowledge the increasing reliance on electronic funds transfers for payment of obligations. H.R. Conf. Rep. No. 105-220, at 652 (1997). The legislative history also explained that commercially acceptable means include "electronic funds transfers, including those arising from credit cards, debit cards, and charge cards." *Id.* Thus, it appears Congress thought that the terms check and money order did not include electronic funds transfers and that it needed to amend the statute to allow for other methods of payment. It also should be noted that Congress did not make a universal change throughout the Code, such as adding a definition of check to the Code that stated it included other methods of payment, such as electronic funds transfers. Instead, Congress only has made changes to specific statutes, as it deemed necessary.

In addition, some states that have followed section 6657 have interpreted it to not apply to other methods of payment besides checks and money orders. For example, California's bad check penalty incorporates section 6657 in part but specifically states that it is modified to "apply to payments made by credit card remittance or electronic funds transfer in addition to payments made by check or money order." Cal. Rev. & Tax. Code § 19134.

CONCLUSION

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If you have any further questions, please call us at (202) 622-4940.