

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

CC:PA:01
POSTS-119407-11

UILC: 6657.00-00

date: September 01, 2011

to: Diane Bonciolini
Tax Analyst
(Wage & Investment, Electronic Payments and Federal Tax Deposits Branch)

from: Charles A. Hall
Senior Technician Reviewer
(Procedure & Administration)

subject: Application of the Section 6657 Penalty to a Dishonored Instrument Submitting Levied Funds

This memorandum responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE

Whether the Internal Revenue Service should impose a penalty under section 6657 against a taxpayer or a third party if the Service receives an instrument, whether through paper or electronic means, that is not fully paid by the third party under the Automated Levy Programs (ALPs).

CONCLUSION

No. The penalty under section 6657 should not be asserted against a taxpayer or a third party when the Service receives a dishonored instrument, whether through paper or electronic means, under the ALPs. In this scenario, the taxpayer has not tendered an instrument in payment of his or her tax obligation.¹ Additionally, the third party who surrenders the funds to the Service in response to a levy does not tender the funds in payment of a tax liability.

¹ In addition, in other scenarios, it is inappropriate for the Service to assert a section 6657 penalty against a taxpayer or a third party when it receives a dishonored instrument from the third party in response to a levy. For example, if the Service levies on a taxpayer's wages and a third party, in an attempt to comply with the Service's levy, tenders an instrument that is dishonored, a section 6657 penalty should not be asserted against the taxpayer or the third party.

FACTS

The Service has agreements with several federal agencies and states to administer the ALPs. Under the ALPs, federal tax debts are matched with state authorities and federal agencies disbursing funds to taxpayers. These Programs allow the Service to collect delinquent taxes by capturing federal and state payments owing to taxpayers. These ALPs include: 1) the Federal Payment Levy Program (FPLP); 2) the State Income Tax Levy Program (SITLP); 3) the Social Security Administration Levy Program (SSA Levy Program); and 4) the Alaska Permanent Fund Dividend Levy Program (AKPFP).

The Electronic Federal Tax Payment System (EFTPS) is often used to process levied funds received from federal agencies and states. Not all states participating in the SITLP participate in EFTPS, and Alaska does not use EFTPS to transmit levied funds under the AKPFP. States participating in EFTPS can use the single-debit feature to debit a single account controlled by the state. Non-EFTPS states are permitted to send levied funds to the Service by check.

Your office requested guidance regarding whether the Service should assert a penalty under section 6657 if it receives an instrument from a state or federal agency under the ALPs that is dishonored. For example, assume a state captured a number of individual state income tax refunds because the taxpayers had outstanding federal tax liability. If the state attempted to submit the levied funds using the EFTPS single-debit option, but the submission was not honored due to insufficient funds and was returned, your office wanted to know whether the Service should assess a penalty under section 6657 against the taxpayers.

LAW AND ANALYSIS

Section 6657 of the Internal Revenue Code imposes a penalty on any “person who tender[s]” any instrument, by any commercially acceptable means, “in payment” of a tax that is not fully paid, unless the person tendered the instrument in good faith and with reasonable cause to believe that it would be paid. The amount of the penalty is either (1) two percent of the amount of the instrument or (2) if the amount of the instrument is less than \$1,250, the lesser of \$25 or the amount of the instrument.

When interpreting a statute, the first step is to determine if the language of the statute is “clear and unambiguous.” Robinson v. Shell Oil Co., 519 U.S. 337, 349 (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). 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 does not apply to instruments issued in response to a levy. The statute imposes a penalty on the “person who tender[s]” an instrument in “payment” of a tax liability. Black’s law dictionary defines the term “tender” to mean “something unconditionally offered to satisfy a debt.” In the context of a levy, the taxpayer does not offer an instrument to pay a tax liability. Moreover, payments received as a result of any levy are involuntary and do not require the consent of the taxpayer. See Muntwyler v. United States, 703 F.3d 1030, 1032-33 (7th Cir. 1983); Amos v. Commissioner, 47 T.C. 65, 69 (1966) (“An involuntary payment of Federal tax means any payment received by agents of the United States as a result of distraint or levy . . .”). Because the taxpayer does not turn over the funds that are subject to the ALPs to satisfy his or her tax liability, section 6657, on its face, unambiguously does not apply to the taxpayer when an instrument is transferred to the Service as a result of a levy.

In addition, instruments surrendered by third parties via the ALPs do not constitute instruments “tendered” in “payment” of a tax liability, and, therefore, do not trigger the bad check penalty under section 6657. In LaRosa's Int'l Fuel Co. v. United States, the Federal Circuit held that a levy itself could not be treated as a payment of tax liabilities. 499 F.3d 1324, 1329 (Fed Cir. 2007). The court explained that section 6331, levy and distraint, and section 6332, surrender of property subject to levy, are provisional remedies that “merely bring the property into the Service's legal custody,” rather than transferring ownership of the property to the Service, and are not equivalent to payment of tax liabilities. Id. (quoting United States v. Whiting Pools, Inc., 462 U.S. 198, 210-11 (1983)). The court held that cash and cash equivalents are not treated any differently than other property for purposes of sections 6331 and 6332. Id.

While the Service ordinarily applies levied assets against the taxpayer's tax liability under section 6342(a)(2), a levy does not in and of itself result in the collection of taxes owed, even where the levied assets are cash or cash equivalents. LaRosa's, 499 F.3d at 1329; Stead v. United States, 419 F.3d 944, 947-48 (9th Cir. 2005). In fact, the Service may return levied amounts under section 6343. These amounts, therefore, would not result in payment of a tax liability. A tax payment does not occur until the government takes affirmative steps to administer the levied upon property. Stead, 419 F.3d at 948-9. This affirmative step includes more than mere receipt of the funds through an ALP. See LaRosa's, 56 Fed. Cl. 102, 104 (following a levy, tax payment occurs when the Service actually applies funds to a particular tax liability), aff'd 499 F.3d 1324 (Fed. Cir. 2007). Therefore, even if the Service immediately applies proceeds received from a levy to a taxpayer's account in accordance with section 6342, it does not follow that the proceeds were “tendered” in “payment” of the tax liability. Rather, they were proceeds surrendered to the Service in response to the levy, as required by section 6332. Because an instrument that a third party transfers to the Service under the ALPs does not constitute an instrument “tendered” in “payment” of a tax liability, the section 6657 penalty should not be asserted against the taxpayer or a third party in the context of a levy.

Although the statute is clear on its face, we also examined the legislative history of section 6657 and searched for case law interpreting it. The legislative history to section 6657 does not speak to the provision's application to a dishonored instrument submitting levied funds and merely parrots the statutory language. See H.R. Rep. No. 1337, at 420 (1954); S. Rep. No. 1622, at 595 (1954). Additionally, we were not able to locate any case that directly addresses this issue.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 622-4910 if you have any further questions.