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CHIEF COUNSEL

DEPARTMENT OF THE TREASURY  
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INTERNAL REVENUE SERVICE NATIONAL OFFICE SERVICE CENTER ADVICE  
MEMORANDUM FOR REGIONAL COUNSEL, SOUTHEAST REGION (CC:SER)  
REGIONAL COUNSEL, WESTERN REGION (CC:WR)

FROM: Acting Assistant Chief Counsel (Income Tax & Accounting)  
CC:DOM:IT&A

SUBJECT: Failure to Pay Penalty and Automated Substitute for Returns

This responds to your request for Significant Service Center Advice in connection with several questions posed with regard to the Automated Substitute for Return function of the Service Center. The issues raised concern the imposition of the failure to pay penalty under § 6651(a)(2) of the Internal Revenue Code in the case of returns prepared by the Service under the Automated Substitute for Return procedures.

ISSUES:

1. Whether the failure to pay penalty under § 6651(a)(2) of the Code may be imposed with regard to a return prepared by the Service under the Automated Substitute for Return procedures.
2. If the § 6651(a)(2) penalty can be imposed on a return prepared under the Automated Substitute for Return procedures, whether the penalty is subject to deficiency procedures.
3. If the § 6651(a)(2) penalty is subject to deficiency procedures, how should the penalty be expressed on the notice of deficiency?

CONCLUSIONS:

1. Pursuant to § 6651(g) of the Code, the failure to pay penalty under

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§ 6651(a)(2) may be imposed with regard to a return prepared by the Service under the Automated Substitute for Return procedures.

2. The § 6651(a)(2) penalty imposed with regard to a return prepared under the Automated Substitute for Return procedures is subject to deficiency procedures.

3. The § 6651(a)(2) penalty on the notice of deficiency is expressed with an asterisk with reference to a statement that explains that the amount of the penalty cannot be calculated at this time and that an addition to tax of 0.5 percent will be imposed for each month from the due date of the return, up to a maximum of 25 percent, based on the amount of tax shown on the return and not paid. However, if the § 6651(a)(2) penalty has reached the maximum of 25 percent, then the full amount of the penalty is expressed on the notice of deficiency.

#### FACTS:

Under the authority of § 6020(b) of the Code, the Service prepares income tax returns for individuals who fail to file returns or who file fraudulent returns. The Service prepares these returns using manual procedures and automated procedures called Automated Substitute for Return (ASFR) procedures. Under ASFR procedures, the Service establishes a taxpayer account on a computer system with a Transaction Code (TC) of 150, and simultaneously prepares and mails a thirty-day letter to the taxpayer. Attached to the thirty-day letter is an explanation of proposed adjustments, as well as a tax calculation summary report. The information used to compute the tax is gathered from past filings and/or third party information returns. The thirty-day letter is signed by the Chief of the Collection Branch (a GM-14 employee). If the taxpayer fails to respond to the thirty-day letter, the Service mails a statutory notice of deficiency to the taxpayer with the same explanation of adjustments and tax calculation summary report that was attached to the thirty-day letter. For returns due (without regard to extensions) after July 30, 1996, both the thirty-day letter and the notice of deficiency issued with regard to a return prepared under the ASFR procedures include the failure to pay penalty under § 6651(a)(2).

#### DISCUSSION:

##### Issue 1:

Section 6651(a)(2) of the Code imposes a penalty for failure to pay the amount shown as tax on a return on or before the due date prescribed for payment of such tax (with regard to extensions), unless it is shown that such failure is due to reasonable cause and not due to willful neglect. Except as provided under § 6651(g), the § 6651(a)(2) penalty only applies if a return is filed by the taxpayer.

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For returns due (without regard to extensions) after July 30, 1996, § 6651(g)(2) of the Code provides that for purposes of § 6651(a)(2) a return prepared by the Service under § 6020(b) is treated as a return filed by the taxpayer. Thus, the question is whether a return prepared under ASFR procedures is a return made by the Service under § 6020(b).

Section 6020(b)(1) of the Code provides that the Service may execute a return for a taxpayer who fails to make any return required by any internal revenue law or regulation at the time prescribed, or who makes, willfully or otherwise, a false or fraudulent return.

Section 6020(b)(2) of the Code provides that a return prepared under the authority of § 6020(b) is prima facie valid for all legal purposes. However, a return prepared by the Service under § 6020(b) is not a return for purposes of the statute of limitations, the failure to file penalty, and the election to file a separate return. See § 6501(b)(3) (for statute of limitations); § 6651(g)(1) (for failure to file penalty); Millsap v. Commissioner, 91 T.C. 926 (1988), acq. in result in part, 1991-2 C.B. 1 (for election to file a separate return).

A return prepared by the Service pursuant to § 6020(b) of the Code must meet three requirements. First, the return must contain taxpayer identifying information, including the taxpayer's name, address, and social security number. Second, the return must contain sufficient data to compute the taxpayer's liability. Third, the Secretary or his delegate must sign the return. <sup>1</sup> See Millsap, at 930.

An ASFR with the thirty-day letter (including the attachments to the thirty-day letter) meet the requirements of a return prepared by the Service under § 6020(b). First, the taxpayer's name, address, and social security number appear on the ASFR and the letter. Second, the letter and its attachments contain sufficient information to compute the taxpayer's liability. Third, a Service employee

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<sup>1</sup> See Hartman v. Commissioner, 65 T.C. 542, 545, 546 (1975), which states that § 6020(b)(2) requires that the return be subscribed, but need not be signed under oath. Section 7701(a)(11) defines the Secretary as the Secretary of the Treasury or his delegate. Under § 7701(a)(12)(A)(i) a delegate includes any officer, employee or agency of the Department of the Treasury authorized by the Secretary of the Treasury to perform functions described in the context. Section 301.6020-1(b)(1) of the Regulations on Procedure and Administration provides that such a return may be executed by the district director or other authorized internal revenue officer or employee. The Internal Revenue Manual provides that Service employees such as revenue agents and tax auditors, as well as revenue officers and collection office function managers, who are at least at the GS-9 level may execute a § 6020(b) return. I.R.M., Handbook No. 1229, Handbook of Delegation Orders, Order No. 182. See also I.R.M. 5290-5293.3.

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authorized to execute a § 6020(b) return, the Chief of the Collections Branch, signs the thirty-day letter.

Thus, an ASFR and a thirty-day letter (with its attachments) prepared and mailed to the taxpayer pursuant to the ASFR procedures is a valid § 6020(b) return. Because a valid § 6020(b) return is prepared by the Service under the ASFR procedures, § 6651(g)(2) provides that the Service may impose the failure to pay penalty under § 6651(a)(2) with regard to that return.

#### Issue 2:

Section 6211 provides that in the case of income, estate, and certain gift and excise taxes, the term “deficiency” means the amount by which the tax imposed exceeds the excess of the sum of the amount of tax shown on the taxpayer return, plus the amount previously assessed (or collected without assessment) as a deficiency over the amount of any rebates (defined in § 6211(b)).

Section 6665 of the Code provides, in pertinent part, that penalties and additions to tax will be assessed, collected, and paid in the same manner as taxes, except in the case of an addition to tax under § 6651 if the underlying tax is not attributable to a deficiency.

As discussed above, § 6651(g) of the Code provides that an individual income tax return prepared by the Service using the ASFR procedures is a return filed by the taxpayer for purposes of calculating the failure to pay penalty under § 6651(a)(2). However, the § 6020(b) return is not considered a return filed by the taxpayer for any other purpose. Therefore, for purposes of determining what constitutes a deficiency a § 6020(b) return is not considered to be the return of the taxpayer. A “deficiency,” as defined in § 6211(a), includes the difference between the correct amount of income tax and the amount shown as tax by the taxpayer on his or her return, if such a return was made. Thus, because the taxpayer did not make a return, a deficiency would include the correct amount of tax, not reduced by the amount reflected on the § 6020(b) return.

Because the amount of underlying tax reflected on the § 6020(b) return constitutes a deficiency, the failure to pay penalty under § 6651(a)(2) of the Code is attributable to the deficiency, and thus will also be subject to deficiency procedures pursuant to § 6665. This conclusion is supported by the legislative history of § 6651(g), which provides that for purposes of a § 6020(b) return, the tax on which the § 6651(a)(2) penalty is measured is considered to be a deficiency. H.R. Rep. No. 104-506, at 53 (1996), 1996-3 C.B. 101. See also Millsap, at 938 (Service’s preparation of § 6020(b) return does not foreclose taxpayer’s right to deficiency procedures). Thus, in the context of a § 6020(b) return prepared using ASFR

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procedures, the failure to pay penalty under § 6651(a)(2) is subject to deficiency procedures.

Issue 3:

Under § 6651(a)(2) of the Code the amount of the addition to tax for failure to pay the amount shown on the return is 0.5 percent of the amount of such tax if the failure is not for more than one month, with an additional 0.5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate.

The notice of deficiency should, in all cases where the penalty under § 6651(a)(2) of the Code applies, state that the Service has imposed the § 6651(a)(2) penalty for failure to pay, as of the due date of the return, and that taxpayer has not shown that the failure to pay is due to reasonable cause. If a notice of deficiency is issued prior to the addition to tax under § 6651(a)(2) reaching the maximum of 25 percent, the Service will not be able to determine the full amount of the addition to tax because the addition will continue to accrue until the amount is paid. Thus, the notice of deficiency should not provide an amount, but instead show an asterisk with reference to the following statement, "the amount of the addition to tax cannot be determined at this time, and an addition to tax of 0.5 percent will be imposed for each additional month, or fraction thereof, of nonpayment, up to 25 percent." However, if the addition under § 6651(a)(2) has reached the maximum of 25 percent, then this amount will be expressed on the notice of deficiency.

If you have any questions or concerns regarding this reply, please call Brad Taylor at (202)622-4940.

By: HEATHER C. MALOY  
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