

Office of Chief Counsel
Internal Revenue Service
memorandum

CC:PA:APJP:B02:EBBerndt
POSTN-128511-04

date: August 18, 2004

to: Douglas H. Rogers
Program Manager
Small Business/Self Employed, Payment Compliance
SE:S:C:CP:P:P
Attn: Robert H. Curran

from: Ashton P. Trice *Ashton P. Trice*
Chief, Administrative Provisions & Judicial Practice, Branch 2
(Procedure & Administration) CC:PA:APJP:B02

subject: RIS Proposal - Application of Failure to Pay Penalty While Installment Agreement in Effect



Section 6651(a)(2) provides for a penalty of 0.5 percent of the unpaid amount shown on the return for each month or fraction thereof that the failure to pay continues, not to exceed 25 percent in the aggregate. Section 6651(a)(3) provides for a penalty of 0.5 percent of the unpaid amount that should have been shown on the return but that was not shown for each month or fraction thereof that the failure to pay continues after notice and demand for payment, not to exceed 25 percent in the aggregate.

Section 6651(h) provides that, for taxpayers who file timely returns and enter installment agreements, the failure to pay penalty imposed under section 6651(a)(2) and (3) shall be reduced by substituting 0.25 percent for 0.5 percent each place it appears. The reduction of the failure to pay penalty is effective for any month during which an installment agreement is in effect. I.R.C. § 6651(h).

Treas. Reg. § 301.6651-1(a)(4) requires the Service to compute for any month or fraction thereof the failure to pay penalty under sections 6651(a)(2) and (3) using 0.25 percent instead of 0.5 percent if at any time during the month an installment agreement is in effect. As stated under Issue 1 in our attached memorandum dated February 21, 2003, this means that when the taxpayer enters into an installment agreement, the Service should reduce the FTP penalty for the first day of the month in which the

PMTA: 00675

installment agreement is effective, assuming that the taxpayer otherwise qualifies for the reduced FTP penalty under section 6651(h). The proposed RIS does not do this, but rather will calculate the FTP penalty at 0.25 percent beginning on the first day of the monthly period following the date the taxpayer enters into an installment agreement, beginning January 2005.



Please contact Emly Berndt at (202) 622-7495 if you have any questions or need additional assistance.

Attachments (1)

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:PA:APJP:2:POSTS-100921-03
EBBerndt

date. FEB 21 2003

to: Division Counsel, Small Business and Self-Employed CC:SB
Attn: Patricia A. Donahue

from: *Ashton P. Trice*
Ashton P. Trice, Senior Technician Reviewer, Branch 2
Administrative Provisions and Judicial Practice CC:PA:APJP:Br2

subject: **Advice on Calculation of FTP Penalty—TIGTA Audit**

This memorandum responds to your email request for advice dated January 8, 2003.

ISSUES

1. If the Service accepts an installment agreement, does the reduction of the failure-to-pay penalty to 0.25 percent provided under section 6651(h) take effect on the first day of the following month, or on the first day of the month in which the Service accepts the installment agreement?
2. Does the taxpayer receive the reduction of the failure-to-pay penalty to 0.25 percent provided under section 6651(h) when the Service accepts an installment agreement during the 10-day period between issuance of a notice of intent to levy under section 6331(d) and the penalty rate increase to 1 percent under section 6651(d)?

CONCLUSIONS

1. When the Service accepts an installment agreement, the Service should reduce the failure-to-pay penalty to 0.25 percent for the first day of the month in which the installment agreement is effective.
2. Yes, if the Service accepts an installment agreement during the 10-day period between issuance of a notice of intent to levy and the failure-to-pay penalty increase under section 6651(d), the taxpayer should receive the reduction of the failure-to-pay penalty to 0.25 percent provided under section 6651(h) and the penalty increase under section 6651(d) will not apply.

FACTS

Section 6651(d) provides that ten days after the Service issues a notice of intent to levy under section 6331(d), the failure-to-pay penalty rate increases from 0.5 percent to 1 percent. Section 6651(h) provides that the failure-to-pay penalty decreases from 0.5 percent to 0.25 percent for taxpayers who timely file and enter into an installment agreement. The Service does not reduce the penalty rate to 0.25 percent under section 6651(h) if the taxpayer enters into an installment agreement after the Service issues a notice of intent to levy, even if the Service accepts the installment agreement during the 10-day period after the issuance of the notice and before application of the 1 percent rate under section 6651(d).¹ Also, when the Service has issued a notice of intent to levy and taxpayers enter into installment agreements, the Service's computer program does not reduce the failure-to-pay penalty to 0.25 percent until the month² after it approves the installment agreement.

In a draft audit report, TIGTA concludes that these procedures are incorrect and result in the overassessment of the failure-to-pay penalty. TIGTA states in the report that the Service should reduce the failure-to-pay penalty to 0.25 percent in the first month that taxpayers enter into installment agreements, not at the beginning of the first month following approval of the installment agreement. Secondly, TIGTA believes that, if a taxpayer enters into an installment agreement during the 10-day waiting period after the Service issues a notice of intent to levy, the taxpayer is entitled to the reduction in the failure-to-pay penalty to 0.25 percent provided under section 6651(h) and the penalty should not be increased to 1 percent under section 6651(d). The Service has requested Chief Counsel's opinion on whether the Service's current method of calculating the failure-to-pay penalty or TIGTA's proposed method is correct.

LAW AND ANALYSIS

ISSUE 1

Section 6651(h) provides that, for taxpayers who file timely returns and enter into installment agreements, the failure-to-pay penalty imposed under section 6651(a)(2) and (3) shall be reduced by substituting 0.25 percent for 0.5 percent each place it appears.

¹The Service's current interpretation of section 6651(h) was based on previous advice provided by the Office of Chief Counsel. See CCA 200051038.

²For purposes of section 6651, Treas. Reg. 301.6651-1(b)(1) defines a month to be a calendar month only if the date prescribed for paying the tax is the last day of a calendar month. Otherwise, under Treas. Reg. 301.6651-1(b)(2), the first day of each month is tied to the numeric date prescribed for paying the tax.

The reduction of the failure-to-pay penalty is effective for any month during which an installment agreement is in effect.

Treas. Reg. § 301.6651-1(a)(4) requires the Service to compute for any month or fraction thereof the failure-to-pay penalty under section 6651(a)(2) and (3) using 0.25 percent instead of 0.5 percent, if at any time during the month an installment agreement is in effect. Therefore, the Service should reduce the failure-to-pay penalty from 0.5 percent to 0.25 percent on the first day of the month in which an installment agreement takes effect, even though the installment agreement was not in effect on the first day of the month.

ISSUE 2

Section 6651(d) provides, in part, that for each month beginning more than 10 days after the date the Service issues a notice of intent to levy under section 6331(d), the failure-to-pay penalty under section 6651(a)(2) and (3) shall be increased by substituting 1 percent for 0.5 percent each place it appears. Congress passed Section 6651(d) to compensate the Service for the additional cost of collection, such as telephoning or visiting the taxpayer, that the Service generally incurs after it sends out the notice of intent to levy. See H.R. Rep. No. 99-426, at 832 (1985). Currently the Service imposes the increased failure-to-pay penalty on the first day of the month following the expiration of the 10-day waiting period set forth in section 6651(d)(2)(A).

As previously stated, section 6651(h) reduces the failure-to-pay penalty from 0.5 percent to .25 percent for taxpayers who file timely returns and enter into installment agreements. In passing section 6651(h) Congress intended to encourage voluntary payment of an outstanding tax liability. See H.R. Conf. Rep. No. 599, 105th Cong., 2d Sess. 258-59 (1998). Congress believed that it was "inappropriate to apply the full penalty for failure-to-pay taxes to taxpayers who are in fact paying their taxes through an installment agreement." H.R. Rep. No. 105-364, at 81 (1997); S. Rep. No. 105-174, at 63 (1998).

Previously, the Service has interpreted section 6651(h) not to require application of a 0.25 percent penalty rate instead of the .5 percent rate specified in section 6651(a)(2) and (3) if section 6651(d) has already changed the penalty rate from 0.5 percent to 1 percent. The rationale for this interpretation appears to be that the 0.5 percent rate no longer exists and, therefore, section 6651(h) cannot operate to change a 0.5 percent rate to 0.25 percent. Even applying this rationale, however, the issuance of a notice of intent to levy should not bar application of section 6651(h) when the 10-day period has not expired. Therefore, if the Service accepts an installment agreement from the taxpayer before expiration of the 10-day period in section 6651(d), the Service should reduce the failure-to-pay penalty to 0.25 percent as provided in section 6651(h).

This reduction of the failure-to-pay penalty is consistent with the purpose underlying section 6651(d). When a taxpayer enters into an installment agreement prior to the expiration of

the 10-day period, the Service does not have to resort to the more expensive collection methods for which Congress intended section 6651(d) to compensate.

More fundamentally, we do not agree with the apparent assumption that the reduction of the failure-to-pay penalty under section 6651(h) to 0.25 percent cannot be applied when section 6651(d) has already increased the penalty to 1 percent. A literal reading of the wording of section 6651(h) allows for the reduction in the failure-to-pay penalty anytime a taxpayer who timely filed enters into an installment agreement, even when section 6651(d) has increased the penalty. Under conditions stated in section 6651(h), the penalty under section 6651(a)(2) and (3) "shall each be applied by substituting '0.25' for '0.5' each place it appears." Section 6651(d) uses the same language to increase the failure-to-pay penalty from 0.5 percent to 1 percent. Because both subsections 6651(h) and (d) address only how to "apply" section 6651(a)(2) and (3), we do not believe that the application of subsection (d) operates to change the language of subsections (a)(2) and (3) in a manner that precludes the application of subsection (h). Instead, we believe that one should apply the general rules of statutory construction to determine whether subsection (d) or (h) applies when a taxpayer enters into an installment agreement after the expiration of the 10-day period provided in section 6651(d).

In interpreting these conflicting provisions we should consider the intent of the conflicting statutes, and then apply them in a way that harmonizes them and avoids a result that the legislature did not intend. See United States v. United Continental Tuna Corp., 425 U.S. 164, 169 (1976). Section 6651(h) was added to the Internal Revenue Code in 1998, more than a decade after the enactment of section 6651(d). Congress would have been aware of the provision of section 6651(d) to increase the failure-to-pay penalty. Yet Congress made no explicit exception to the application of section 6651(h) when the failure-to-pay penalty was already increased under section 6651(d). Applying section 6651(h) to all taxpayers who have filed timely and entered into installment agreements satisfies both the legislative intent of sections 6651(d) and 6651(h) and the policy objective of encouraging compliance with the Internal Revenue Code. Installment agreements reduce the cost of collection. Therefore, the purpose of section 6651(d) is not thwarted through the application of the reduction of the failure-to-pay penalty under section 6651(h) to those taxpayers who enter into installment agreements, even after the higher failure-to-pay penalty has been imposed under section 6651(d). When a taxpayer previously subject to the 1 percent failure-to-pay penalty enters into an installment agreement, applying the reduced penalty provided for by section 6651(h) is consistent with the congressional policy of reducing the burden on timely filers who are attempting to fulfill their tax obligations through a series of voluntary payments. This result is also consistent with Policy Statement P-1-18, which provides that the Service should apply penalties in the manner that best encourages voluntary compliance.

Accordingly, we believe that whenever a taxpayer who filed a timely return enters into an installment agreement, section 6651(h) applies to that taxpayer even if section 6651(d) has already increased the penalty rate applied against that tax.

Please contact Emly Berndt at 202-622-4088 if you have any further questions.

cc: Robert H. Curran, S:C:CP:RC:P
Sam Berman, CC:SBSE