

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

CC:SB:HDHorton

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subject: Proper Treatment Of Tax, Payments, Credits, And Refunds In Determining "Amount Shown As Tax" And "Tax Required To Be Shown, Which Is Not So Shown" For Computing The Additions to Tax Under IRC § 6651(a)(2) and (3)

ISSUES

1. Whether the intent of adding I.R.C. §§ 6651(a)(2) and (a)(3) to the Internal Revenue Code was to penalize taxpayers for failing to comply with I.R.C. §§ 6151 and 6155, respectively.
2. Analysis of the definition of "amount shown as tax" in I.R.C. § 6651(a)(2).
3. Analysis of the definition of "tax required to be shown..., which is not so shown" in I.R.C. § 6651(a)(3).
4. Whether I.R.C. §§ 6651(a)(2) and/or 6651(a)(3) apply to Examples 1 through 7.

DISCUSSION

Issue 1

I.R.C. § 6651(a)(2) provides that an addition to tax applies to a taxpayer who reports an amount of tax due on his return but fails to pay it by the payment due date. On the other hand, I.R.C. § 6651(a)(3) provides for an addition to tax upon the failure to pay any amount in respect of any tax required to be shown on a return, which is not so shown, within 21 calendar days from the date of notice and demand therefor (10 business days if the amount for which notice and demand is made equals or exceeds \$100,000). The failure to pay addition to tax under I.R.C. § 6651(a)(3), therefore, applies to amounts subsequently assessed while the failure to pay

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addition to tax under I.R.C. § 6651(a)(2) applies to unpaid amounts showing due on the return as originally filed. Accordingly, an I.R.C. § 6651(a)(2) addition to tax penalizes taxpayers for failing to pay the amount shown as tax on the return by the payment due date under I.R.C. § 6151(a), which is generally the same as the due date for filing the return without regard to extensions of time for filing. In contrast, no I.R.C. § 6651(a)(3) addition to tax can be owed for the period that precedes 21 calendar days after notice and demand for payment of tax is made (10 business days for amounts at or above \$100,000). Thus, the I.R.C. § 6651(a)(3) addition to tax penalizes taxpayers for failing to pay the tax required to be shown on a return which is not so shown by the last date specified on the notice and demand for payment under I.R.C. § 6155.

Issue 2

The definition of “amount shown as tax” in I.R.C. § 6651(a)(2) is the total amount of tax shown on a return. See Feller v. Commissioner, 135 T.C. No. 25 (Nov. 8, 2010); Upchurch v. Commissioner, T.C. Memo. 2010-169; Conners v. Commissioner, 277 F. App’x 122 (2nd Cir. 2008). It is the amount of total tax shown on the line immediately above the payments section of Form 1040 less reported refundable credits located in the payments section for which overstatements are considered negative tax under I.R.C. § 6211(b)(4). See Voccola v. Commissioner, T.C. Memo. 2009-11 (“[R]eductions to non-refundable credits would not trigger the § 6651(a)(2) penalty.”).

This amount is then reduced, for the purpose of computing the addition to tax, by the amount of any part of the tax which is paid on or before the date prescribed for payment of the tax. I.R.C. § 6651(b)(2); Treas. Reg. § 301.6651-1(d)(1). This includes application of section 31 withholding credits to which the taxpayer is entitled, which may not be the amount reported. See I.R.C. § 6211(b)(1). The amount of tax shown on the return for purposes of I.R.C. § 6651(a)(2) shall also, for the purpose of computing the addition for any month, be reduced by the amount of any part of the tax which is paid after the date prescribed for payment and on or before the first date of such month. Treas. Reg. § 301.6651-1(d)(2)(i).

The I.R.C. § 6651(a)(2) addition to tax is based upon the amount shown as tax on the original return, not an amended return. See Stewart v. Commissioner, 66 T.C. 54 (1976)(I.R.C. § 6653 fraud penalty calculated using difference between correct tax and tax shown on original return, amended return irrelevant).

The analysis of the various examples in Issue 4 will detail how to compute the net amount due with respect to mathematical errors, reductions in EIC, erroneous refunds, or overstatements/understatements of withholding credits.

Issue 3

“Tax required to be shown..., which is not so shown” in I.R.C. § 6651(a)(3) is the same amount that should have been shown as tax (in accordance with the analysis provided in Issue 2 above) but is not shown on the return filed. This amount includes deficiencies and other amounts subsequently assessed but not shown on the original return filed. See United States v. Krasnow, 548 F.Supp. 686 (S.D.N.Y. 1982); Burke v. Commissioner, T.C. Memo. 2009-282; Kimball v. Commissioner, T.C. Memo. 2008-78; Widner v. Commissioner, T.C. Memo. 2003-114. Also, as the overstatement of credits listed in section 6211(b)(4) is considered a negative amount of tax, such an overstatement could, alone, give rise to the I.R.C. § 6651(a)(3) addition to tax.

The failure to pay addition to tax under I.R.C. § 6651(a)(3) is based upon the net amount due, which is the amount in the notice and demand unpaid within the specified time period, reduced by payments made before the beginning of the month. I.R.C. §§ 6651(a)(3), (b)(3); Treas. Reg. § 301.6651-1(d)(2)(ii). The I.R.C. § 6651(a)(3) addition to tax is imposed on the failure to pay tax owed from an amended return because the additional amount from the amended return is an amount required to be shown on the original return that was not shown.

The analysis of the various examples in Issue 4 will detail how to compute the net amount due with respect to mathematical errors, reductions in EIC, erroneous refunds, or overstatements/understatements of withholding credits.

Issue 4

Example 1:

Taxpayer *M*, an individual, files a 2009 return reflecting total tax of \$2,000 and claiming estimated tax payments of \$1,600. The "amount you owe" line of his return reflects a balance due of \$400 which he paid with his return on the due date for payment. However, during processing of the return, it becomes apparent that *M* only paid \$1,200 in estimated tax, and not \$1,600 as claimed. IRS issues notice and demand for the difference of \$400 plus interest.

Questions:

- Should the notice also include penalty for paying late under IRC 6651(a)(2)(computed from the due date of the return to the date of the notice) on the amount that should have been shown as owed, but which was not?

Or:

- Would only the penalty for paying late under IRC 6651(a)(3) apply, and then only if *M* fails to remit the additional \$400 within 21 days from the date of notice and demand?

Solution 1:

The amount shown as tax on the return is \$2,000. Although *M* claimed that he made estimated tax payments of \$1,600 and paid \$400 with the timely filed return, he only made total payments of \$1,600, estimated tax payments of \$1,200 and a \$400 payment with the return. Since the amount shown as tax remained unchanged, *M* is liable for the failure to pay addition to tax under I.R.C. § 6651(a)(2) based on the net amount due of \$400 (\$2,000 - \$1,600). I.R.C. § 6651(a)(3) is not applicable because *M* accurately reported his tax liability on his return.

To the extent that I.R.C. § 6654 required *M* to pay estimated tax, I.R.C. § 6651 does not apply to *M*'s failure to pay estimated tax before the due date of the return. See I.R.C. § 6651(e).

Example 2:

Taxpayers *R* and *T*, a married couple filing jointly, file a 2009 return reflecting a refund of \$600 based on—

- total tax of \$600,
- I.R.C. § 31 credit (withholding) of \$900, and
- I.R.C. § 32 credit (Earned income credit) of \$300.

After receiving and cashing their refund check, *R* & *T* receive an amended Form W-2. The resulting amended return reflects total income tax of \$400, credit for withheld tax of \$200, and no earned income credit, resulting in a balance due of \$800. IRS adjusts the taxpayer's account based on the amended return and issues notice and demand for \$800 plus interest.

Question A:

- Should the notice also include penalty for paying late under IRC 6651(a)(2)(computed from the due date of the return to the date of the notice)?

If "Yes," then

- Which amount should the penalty be based on?
 - The excess of total tax shown on the return (\$600) less EIC shown on the return (\$300) over corrected withholding (\$200)? [(\$600 - \$300) - \$200 = \$100]

- The excess of total tax shown on the return (\$600) less EIC shown on the return (\$300) over corrected withholding reduced by any refund, but not below zero? $[(\$600 - \$300) - \$0 = \$300]$

If "No," then

- Would only the penalty under IRC 6651(a)(3) apply, and then only if *R & T* fail to pay the amount shown in the notice (\$800) within 21 days from date of notice and demand?

Question B:

If none of the amount shown in the notice and demand (\$800) is paid within 21 days, does the penalty under IRC 6651(a)(3) apply to

- the full \$800 shown in the notice, or
- only to total corrected tax after the amended return (\$400)?

Solution 2:

Question A: The amount shown as tax on the return is \$300. The amount shown begins with total tax reported of \$600 less the \$300 claimed EITC because I.R.C. § 6211(b)(4) includes overstatements of the EITC in the definition of a deficiency. As I.R.C. § 6211(b)(1) excludes withholding credits from the definition of a deficiency. However, the Service reduces the amount shown, per I.R.C. § 6651(b)(2), by only the \$200 of withholding credits to which the taxpayer is entitled, not the \$900 claimed. Thus, an addition to tax under I.R.C. § 6651(a)(2) applies to the unpaid \$100.

Question B: The overstated EITC could give rise to the I.R.C. § 6651(a)(3) addition to tax because, pursuant to I.R.C. § 6211(b)(4), the amount shown on the return is \$300. The amount required to be shown per the amended return, \$400, exceeds the amount shown, \$300. If the taxpayer fails to pay the notice and demand within the applicable time period, then the (a)(3) addition to tax is applicable to the \$100 difference.

Example 3:

Taxpayer Z, a corporation, files a 2009 return reflecting total tax of \$500,000. The return does not claim any credit for estimated tax payments, nor for any other payments. The taxpayer files the return on time, but does not pay any tax until 45 days after the due date, at which time the taxpayer remits \$507,471.70 to pay the tax shown on the return, plus interest and penalty. Subsequently, IRS examines Z's return and determines that there is a deficiency of \$100,000. The deficiency is assessed 90 days after a notice of deficiency was mailed to Z, and IRS issues notice and demand for \$100,000 plus interest. Z does not pay any part of the amount shown in the notice within 10 business days.

Questions:

- What is the amount subject to IRC 6651(a)(3)?
 - Does IRC 6651(a)(3) apply to the full \$100,000 deficiency?

OR

- Does IRC 6651(a)(3) apply only to \$92,528.30? (In other words, can the \$7,471.70 payment in excess of \$500,000 tax shown on the return be treated as payment of the amount required to be shown as tax on the return, which was not so shown?)

Solution 3:

The amount subject to I.R.C. § 6651(a)(3) is the full \$100,000 deficiency. We concur that the Service credited the previous payment of \$507,471.70 to pay a legally assessed liability of tax, penalty and interest collectible before the issuance of the notice of deficiency. In practice, the Service applies the payment first against any unpaid tax liability and then applies any remaining amount to penalties, additions, and interest due.

To the extent that I.R.C. § 6655 required Z to pay the estimated tax, I.R.C. § 6651 does not apply to Z's failure to pay that estimated tax before the due date of the return. See I.R.C. § 6651(e).

Example 4:

Taxpayer J, an individual, files a 2009 income tax return reflecting a refund of \$1,000, based on total tax of \$9,000, and claimed estimated tax payments of \$10,000. After the taxpayer has received and cashed the refund check, the taxpayer files a claim stating that a \$2,000 estimated tax payment was incorrectly applied to his individual income tax, and that that payment should have been applied to his employment tax return, Form 941.

Question A:

- If the taxpayer concedes that the mistake was all his, can his claim be allowed? (I.e., the taxpayer mailed the payment in question with Form 1040-ES and included the payment in total estimated tax payments on his return.)
- If yes,—
 - does the penalty under IRC § 6651(a)(2) apply to—
 - \$1,000 of the resulting underpayment, or to
 - \$2,000 of the resulting underpayment, or to

- none of the resulting underpayment; and
- (providing J does not pay the resulting balance within 21 calendar days) does the penalty under IRC § 6651(a)(3) apply to—
 - \$1,000 of the resulting underpayment, or to
 - \$2,000 of the resulting underpayment, or to
 - none of the resulting underpayment.

Question B:

- If the taxpayer shows that the mistake was in part due to IRS error, can his claim be allowed? (I.e., the taxpayer mailed the payment with voucher Form 944-V, listing his newly assigned employer ID number, and IRS misapplied the payment to his individual income tax account. At the same time, the taxpayer erroneously included his \$2,000 payment submitted with his 2009 Form 4868 in total estimated tax payments.)
- If yes,—
 - does the penalty under IRC § 6651(a)(2) apply to—
 - \$1,000 of the resulting underpayment, or to
 - \$2,000 of the resulting underpayment, or to
 - none of the resulting underpayment; and
 - (providing J does not pay the resulting balance within 21 calendar days) does the penalty under IRC § 6651(a)(3) apply to—
 - \$1,000 of the resulting underpayment, or to
 - \$2,000 of the resulting underpayment, or to
 - none of the resulting underpayment.

Solution 4:

Question A: It does not appear from your facts that the taxpayer could use Form 843 to reclaim his estimated tax payment. If the taxpayer concedes responsibility for the error, his claim will not be allowed.

Question B: The taxpayer reported total tax of \$9,000. The taxpayer made estimated tax payments of \$8,000. The addition to tax under I.R.C. § 6651(a)(2) would apply to the late payment of \$1,000, from the due date of the payment until the payment date. If IRS was part of the reason for the error, then the taxpayer likely qualifies for abatement of the addition and/or for reasonable cause.

I.R.C. § 6651(a)(3) is not applicable because, according to your facts, the taxpayer reported his full tax liability on his return. The overstated estimated tax payment is not treated as negative tax for the purpose of determining the amount shown.

To the extent that I.R.C. § 6654 required *J* to pay estimated tax, I.R.C. § 6651 does not apply to *J*'s failure to pay estimated tax before the due date of the return. See I.R.C. § 6651(e).

Example 5:

Taxpayer *X*, an individual, files a 2009 return reflecting a balance due of \$300 based on total tax of \$1,300, and credit claimed for estimated tax payments of \$1,000. *X* pays \$300 with his return which is filed on 4/15/2010. On 7/2/2010 *X* receives a refund of \$1,007.26, which he cashes. On 5/20/2011, IRS notices that an error was made, and that a refund should not have been issued. The erroneous refund was the result of IRS allowing credit for withheld tax even though none had been claimed, and no tax had been withheld. Several months after the refund is cashed, IRS identifies its mistake, assesses the erroneously allowed credit for withheld income tax, and issues notice and demand for payment.

Question: If *X* fails to repay the erroneous refund within 21 days after notice and demand, does the penalty under IRC 6651(a)(3) apply to the amount in the notice?

Solution 5:

If *X* fails to repay the erroneous refund within 21 days after notice and demand, the addition to tax under I.R.C. § 6651(a)(3) does not apply to the amount in the notice. The erroneous refund is not tax required to be shown on a return.

Also, to the extent that I.R.C. § 6654 required *X* to pay the estimated tax, I.R.C. § 6651 does not apply to *X*'s failure to pay that estimated tax before the due date of the return. See I.R.C. § 6651(e).

Example 6:

Same circumstances as example 5, except that the taxpayer erroneously entered his estimated tax payments on line where the credit for withheld income tax is to be entered.

Question: If *X* fails to repay the erroneous refund within 21 days after notice and demand, does the penalty under IRC 6651(a)(3) apply to the amount in the notice?

Solution 6:

The fact that the taxpayer erroneously entered his estimated tax payments on the line for withholding credits results in the same solution set forth for Example 5. Both withholding credits and estimated tax payments are shown in the total payments section of the return. In practice, if the taxpayer made estimated tax payments during the tax year, those amounts would show on the taxpayer's transcript for that year prior to the Service's input of the return. The amount shown

as tax on the return is still \$1,300. The erroneous refund is not tax required to be shown on a return.

Also, to the extent that I.R.C. § 6654 required *X* to pay the estimated tax, I.R.C. § 6651 does not apply to *X*'s failure to pay that estimated tax before the due date of the return. See I.R.C. § 6651(e).

Example 7:

Taxpayer *H*, a corporation, files a timely return reflecting a refund of \$6,000 based on tax of \$42,000 and estimated tax payments of \$48,000. The refund is issued more than 45 days after the due date of the return, and includes \$150 in credit interest, for a total refund amount of \$6,150. Subsequent to the refund, the return is examined, and it is determined that a deficiency exists in the amount of \$7,000. The deficiency is assessed after the taxpayer signs a waiver of the stay of assessment and collection, and IRS issues notice and demand for the deficiency plus interest, plus an adjustment in credit interest pursuant to IRC § 6511(d) in the amount of \$150. The taxpayer does not pay any part of the amount shown in the notice within 21 calendar days from the date of notice and demand.

Question:

- Does the adjustment to credit interest pursuant to IRC § 6511(d) factor into the computation of the penalty under IRC § 6651(a)(3)? (In other words, since the amount of the refund now exceeds the overpayment of tax shown on the return by \$150, is the "tax required to be shown, which was not so shown" increased by an equal amount?)

Solution 7:

The \$150 affects neither the applicability nor the computation of the I.R.C. § 6651(a)(3) addition to tax because it is not an amount of tax. It will appear on the notice as a separate item along with the interest on the deficiency in tax.

To the extent that I.R.C. § 6655 required *H* to pay estimated tax, I.R.C. § 6651 does not apply to *H*'s failure to pay estimated tax before the due date of the return. See I.R.C. § 6651(e).