

#33 REDUCE THE FEDERAL TAX DEPOSIT PENALTY IMPOSED ON CERTAIN TAXPAYERS WHO MAKE TIMELY TAX DEPOSITS

Present Law

IRC § 6656(a) imposes a penalty, as a percentage of the underpayment, for the failure to deposit (FTD) taxes in a manner prescribed by regulation, unless such failure is due to reasonable cause and not due to willful neglect. Treasury Regulation § 31.6302-1(h) requires federal tax deposits to be made electronically via electronic funds transfer. Most taxpayers use the Electronic Federal Tax Payment System (EFTPS), a free service offered by the Department of Treasury. The penalty rate for FTD varies, depending on the length of the taxpayer's delay in making the deposit. IRC § 6656(b)(1) provides that the penalty is two percent for a FTD of not more than five days, five percent for a FTD of more than five days but not more than 15 days, and ten percent for a FTD of more than 15 days. Thus, taxpayers must make deposits on time, in full, and in the correct manner to avoid a penalty for FTD.¹¹⁹

Reasons for Change

The IRS has taken the position that the maximum ten percent penalty rate automatically applies if a deposit is not made in the manner prescribed by the regulation.¹²⁰ As a result, taxpayers who timely remit full payment to the IRS but who do not do so in the manner prescribed are subject to a higher penalty rate than taxpayers who do not make a timely payment at all. The National Taxpayer Advocate believes it is inappropriate to penalize taxpayers who make timely payments more harshly than taxpayers who do not, and the Ways and Means Committee has observed that this approach “does not reflect the intent of the Congress.”¹²¹

Recommendation

Amend IRC § 6656 to establish a penalty rate of two percent for FTD in the manner prescribed by the Secretary of Treasury.¹²²

119 See *F.E. Schumacher Co. v. U.S.*, 308 F. Supp.2d 819, 830 (N.D. Ohio 2004) (“penalties assessed pursuant to Section 6656 are appropriate even where taxes are timely paid, albeit by means other than [Electronic Funds Transfer]”).

120 Rev. Rul. 95-68, 1995-2 C.B. 272; IRM 20.1.4.2, *Authorized Deposit Methods* (Jan. 6, 2012).

121 H.R. REP. NO. 108-61, at 36 (2003).

122 H.R. 1528, 108th Cong. § 108 (2003), passed in the House, contains language that is consistent with this recommendation. S. 1793, 115th Cong. § 309 (2017) also contains language that is substantially similar to this recommendation.