

**COMPARISON OF JOINT COMMITTEE STAFF AND TREASURY  
RECOMMENDATIONS RELATING TO PENALTY AND INTEREST PROVISIONS  
OF THE INTERNAL REVENUE CODE**

Scheduled for a Public Hearing  
Before the  
SUBCOMMITTEE ON OVERSIGHT  
of the  
HOUSE COMMITTEE ON WAYS AND MEANS  
on November 9, 1999

Prepared by the Staff  
of the  
JOINT COMMITTEE ON TAXATION



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## INTRODUCTION

The Subcommittee on Oversight of the House Committee on Ways and Means has scheduled a public hearing on November 9, 1999, on the penalty and interest provisions of the Internal Revenue Code. The Internal Revenue Service Restructuring and Reform Act of 1999 directed the Joint Committee on Taxation and the Department of the Treasury to undertake separate studies of such provisions, and make any legislative and administrative recommendations they deem appropriate to simplify penalty administration and reduce taxpayer burden. The staff of the Joint Committee on Taxation released its study<sup>1</sup> on July 22, 1999, and the Treasury Department released its study on October 25, 1999.<sup>2</sup>

This document,<sup>3</sup> prepared by the staff of the Joint Committee on Taxation, provides a comparison of the legislative changes to the penalty and interest provisions of the Code recommended<sup>4</sup> by the Joint Committee staff and the Department of the Treasury.<sup>5</sup>

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<sup>1</sup> Joint Committee on Taxation, *Study of Present-Law Penalty and Interest Provisions as Required by Section 3801 of the Internal Revenue Service Restructuring and Reform Act of 1998 (including Provisions Relating to Corporate Tax Shelters)* (JCS-3-99), July 22, 1999.

<sup>2</sup> Department of the Treasury, *Report to The Congress on Penalty and Interest Provisions of the Internal Revenue Code*, October 1999.

<sup>3</sup> This document may be cited as follows: Joint Committee on Taxation, *Comparison of Recommendations of the Joint Committee on Taxation Staff and the Treasury Relating to Interest and Penalties* (JCX-79-99), November 5, 1999.

<sup>4</sup> As used in the “Recommendation” columns of this document, “Retain present law” means that an explicit recommendation was made that present law be retained. “No recommendation” means that no explicit recommendation was made with respect to that item.

<sup>5</sup> This document does not reflect recommendations directly relating to tax shelters.

PROVISION	PRESENT LAW	JCT STAFF RECOMMENDATIONS	TREASURY RECOMMENDATIONS
<b>I. INTEREST (secs. 6601-6621)</b>			
A. Rates on Underpayments and Overpayments	Different interest rates apply to overpayments and underpayments and depending on whether the taxpayer is a corporation. For individuals and other non-corporate taxpayers, the interest rate on both overpayments and underpayments is equal to the short-term Applicable Federal Rate (“AFR”) plus three percentage points. For corporations, the interest rate on overpayments equals the short-term AFR plus two percentage points, unless the overpayment exceeds \$10,000 in which case the interest rate equals the short-term AFR plus one-half a percentage point. For corporations, the interest rate on underpayments equals the short-term AFR plus three percentage points, unless the underpayment	Provide a single interest rate equal to the short-term AFR plus five percentage points for underpayments and overpayments of all taxpayers.	Retain present law; rates should be in range of AFR plus two to five percentage points.

PROVISION	PRESENT LAW	JCT STAFF RECOMMENDATIONS	TREASURY RECOMMENDATIONS
	exceeds \$100,000 in which case the interest rate equals the short-term AFR plus five percentage points.		
B. Federal Income Tax Treatment of Interest on Underpayments and Overpayments			
1. Individuals	Individuals are generally required to include overpayment interest received in income, but <u>no</u> deduction is allowed for underpayment interest paid.	Exclude overpayment interest from individuals' gross income.	Retain present law.
2. Corporations	Corporations are generally required to include overpayment interest received in income and allowed to deduct underpayment interest paid.	No recommendation.	No recommendation.

PROVISION	PRESENT LAW	JCT STAFF RECOMMENDATIONS	TREASURY RECOMMENDATIONS
C. Interest Netting	A special rule provides for a net interest rate of zero to the extent interest is both payable by and allowable to a taxpayer on equivalent amounts of underpayment and overpayment.	Interest netting would not be necessary on a prospective basis, because under the JCT staff recommendation the Federal income tax treatment and interest rate on underpayments and overpayments would be the same.	Retain present law.
D. Abatement of Interest Charges			
1. Unreasonable error or delay by IRS	Interest may be abated if attributable to unreasonable error or delay by IRS in the performance of a ministerial or managerial act.	Allow abatement if interest is attributable to <u>any</u> unreasonable error or delay by IRS.	Retain present law.
2. Erroneous refunds	Interest must be abated if refund did not exceed \$50,000 and taxpayer did not cause the refund.	Allow abatement for all erroneous refunds the taxpayer did not cause.	Consider modification only in concert with assuring that the IRS has adequate means to recover erroneous refunds.
3. Taxpayer reliance on written IRS statements	If an underpayment results from taxpayer reliance on written IRS statements penalties, but not interest, may be abated.	Abate <u>both</u> penalties and interest if underpayment results from taxpayer reliance on written IRS statements.	Same as JCT staff recommendations, with same restrictions for interest abatement as under present law for penalty abatement.

<b>PROVISION</b>	<b>PRESENT LAW</b>	<b>JCT STAFF RECOMMENDATIONS</b>	<b>TREASURY RECOMMENDATIONS</b>
4. Other abatements	<p>Abatement of interest is also allowed (and under certain circumstances is required) if the taxpayer is serving in a combat zone or located in a designated disaster area.</p> <p>For individuals, the accrual of interest is suspended if the IRS does not provide notice of the taxpayer's liability within one year (18 months for taxable years beginning before 2004).</p>	Retain present law and also allow abatement if a gross injustice would otherwise result if interest were to be charged.	Retain present law.

<b>PROVISION</b>	<b>PRESENT LAW</b>	<b>JCT STAFF RECOMMENDATIONS</b>	<b>TREASURY RECOMMENDATIONS</b>
E. Dispute Reserve Accounts	In order to avoid the accrual of interest on a disputed item, the taxpayer may make a non-interest bearing deposit in the nature of a cash bond (as described in Rev. Proc. 84-58).	Permit deposits to be made to an interest bearing account within Treasury to cover tax underpayments related to issues potentially subject to dispute with the IRS. Funds deposited would be treated as a payment of tax if an underpayment of tax is ultimately found. If there is no resulting underpayment or, at the election of the taxpayer, the deposit is withdrawn prior to resolution of the IRS dispute, interest would be paid by the Treasury at a rate equal to the short-term AFR.	No recommendation.

PROVISION	PRESENT LAW	JCT STAFF RECOMMENDATIONS	TREASURY RECOMMENDATIONS
<b>II. FAILURE TO PAY ESTIMATED TAX (secs. 6654 and 6655)</b>	Individuals generally are required to make estimated tax payments at least equal to (1) 90 percent of current year's tax or (2) 100 percent of prior year's tax. Corporations generally are required to make estimated tax payments at least equal to (1) 100 percent of the current year's tax or (2) 100 percent of the prior year's tax.		
A. Penalty for Individuals and Corporations (secs. 6654 and 6655)	A penalty is imposed by applying the underpayment interest rate to the amount of the underpayment for the period of underpayment.	Repeal penalty and replace with an interest provision.	Retain present law.
B. Exception to Penalty for Individuals (sec. 6654(e)(1))	There is no penalty if the tax shown on the return, reduced by withholding, is less than \$1,000. Estimated tax is not considered in determining whether the threshold is satisfied.	Increase threshold to \$2,000, and consider estimated tax payments made in four equal installments in determining whether the threshold is satisfied.	Retain present law threshold of \$1,000, and consider estimated tax payments made under a new proposed simplified averaging method in determining whether the threshold is satisfied.

<b>PROVISION</b>	<b>PRESENT LAW</b>	<b>JCT STAFF RECOMMENDATIONS</b>	<b>TREASURY RECOMMENDATIONS</b>
C. Modified Safe Harbor for Certain Individuals (sec. 6654(d)(1))	Individuals with prior year's AGI above \$150,000 (\$75,000 for married individuals filing separately) who make estimated payments based on prior year's tax generally must do so based on 110 percent of prior year's tax.	Repeal the modified safe harbor; thus, all taxpayers making estimated payments based on prior year's tax would do so based on 100 percent of prior year's tax.	No recommendation.
D. Applicable Interest Rate for Individuals and Corporations (secs. 6621, 6654(a)(1), and 6655(a)(1))	The underpayment interest rate is subject to change on the first day of each calendar quarter. A change in rates requires the use of multiple interest rates when calculating the interest on an underpayment of estimated tax.	Apply only one interest rate per estimated tax underpayment.	No recommendation, but consider general computational simplifications.

<b>PROVISION</b>	<b>PRESENT LAW</b>	<b>JCT STAFF RECOMMENDATIONS</b>	<b>TREASURY RECOMMENDATIONS</b>
E. Calculation of Underpayment Balances for Individuals and Corporations (secs. 6654(a) and 6655(a))	Penalty is equal to the underpayment interest rate multiplied by the number of days the underpayment is outstanding, which is the number of days between when the taxpayer should have made the payment and the earlier of (1) actual date of payment or (2) the following April 15 (for calendar-year taxpayers).	Provide that underpayment balances are cumulative; thus, taxpayers would calculate a cumulative estimated tax underpayment for each period.	No recommendation, but consider general computational simplifications.
F. Estimated Tax Underpayments Extending from Leap Year to Non-Leap Year for Individuals and Corporations	Under IRS procedures, taxpayers with outstanding underpayment balances that extend from a leap year through a non-leap year must make separate calculations to account for the different number of days in each year.	Require 365-day year for all estimated tax penalty calculations.	No recommendation, but consider general computational simplifications.

<b>PROVISION</b>	<b>PRESENT LAW</b>	<b>JCT STAFF RECOMMENDATIONS</b>	<b>TREASURY RECOMMENDATIONS</b>
G. Waiver of Penalty for Failure to Pay Estimated Tax for Individuals (sec. 6654(e)(3))	A waiver is available to the extent the Treasury Secretary determines that a taxpayer suffered a casualty (e.g., fire or disaster) or other unusual circumstance if imposition of a penalty would be against equity and good conscience. There is no general reasonable cause waiver for the failure to pay estimated tax.	See JCT staff recommendations regarding abatements of interest (pages 4-5).	Permit a reasonable cause waiver for first-time payers of estimated tax, provided the balance due on the return is below a threshold amount (unspecified) and is paid with a timely-filed return.
H. Waiver of De Minimis Penalties for Individuals and Corporations	There is no statutory provision allowing the Treasury Secretary to waive estimated tax penalties below a de minimis amount.	See JCT staff recommendations regarding abatements of interest (pages 4-5).	Provide penalty waiver authority for individual estimated tax penalties below a de minimis amount, e.g., \$10 to \$20.

PROVISION	PRESENT LAW	JCT STAFF RECOMMENDATIONS	TREASURY RECOMMENDATIONS
<b>III. PENALTY FOR FAILURE TO PAY TAXES (sec. 6651(a)(2) and (3))</b>			
A. In General	Penalty is one-half percent of net amount of tax due for each month the return is not filed, up to a maximum of 25 percent. Interest also applies to the unpaid tax.	Repeal penalty. Interest would continue to apply.	Retain present law, except increase penalty percentage rate after six months from one-half percent a month to one percent a month.
B. Encourage Installment Agreements	Penalty rate is reduced to one-quarter percent per month for any month an installment agreement is in effect (provided return is timely filed). IRS imposes \$43 user fee on installment agreements.	Impose a 5-percent late payment service charge if no installment agreement is in effect by the fourth month after assessment; waive \$43 IRS user fee if taxpayer agrees to automated withdrawal of installment payments from bank account.	Reduce penalty rates by one-half for any month an installment agreement is in effect. Consideration should be given to using a fixed interest rate to avoid possible balloon payment at end of agreement.

PROVISION	PRESENT LAW	JCT STAFF RECOMMENDATIONS	TREASURY RECOMMENDATIONS
<b>IV. PENALTY FOR FAILURE TO FILE TAX RETURNS (sec. 6651(a)(1))</b>			
A. In General	Penalty is five percent of net amount of tax due for each month return is not filed, up to a maximum of 25 percent. This penalty is coordinated with the failure to pay penalty, by reducing the failure to file penalty by the amount of the failure to pay penalty for that month.	Retain present law.	Lower rates to one-half percent for first five months, then increase to one percent; retain 25 percent maximum; eliminate coordination with failure to pay penalty, which has the effect of potentially doubling combined penalties for taxpayers who delay filing and paying for lengthy periods of time.
B. Penalty for Failure to File “No Balance” Returns	No penalty is imposed on the failure to file returns that do not show a balance due the IRS.	No recommendation.	Impose new service charge, possibly only after IRS contact (amount unspecified).

PROVISION	PRESENT LAW	JCT STAFF RECOMMENDATIONS	TREASURY RECOMMENDATIONS
<b>V. TAX RETURN ACCURACY PENALTIES (secs. 6662 and 6694)</b>			
A. Standards Applicable to Disclosed Positions			
1. Taxpayers	Penalty may apply if there is no reasonable basis for a disclosed position taken on a return. (Generally, at least a 20 percent likelihood of success if challenged.)	Penalty may apply if there is no substantial authority for a disclosed position taken on a return. (Generally, at least a 40 percent likelihood of success if challenged.)	Penalty may apply if there is no realistic possibility of success on the merits. (Generally, at least a 33-1/3 percent likelihood of success if challenged.)
2. Practitioners	Penalty may apply unless a disclosed position is not frivolous. (Generally, at least a 5 to 10 percent likelihood of success if challenged.)	Penalty may apply if there is no substantial authority for a disclosed position taken on a return. (Generally, at least a 40 percent likelihood of success if challenged.)	Penalty may apply if there is no realistic possibility of success on the merits. (Generally, at least a 33-1/3 percent likelihood of success if challenged.)

<b>PROVISION</b>	<b>PRESENT LAW</b>	<b>JCT STAFF RECOMMENDATIONS</b>	<b>TREASURY RECOMMENDATIONS</b>
B. Standards Applicable to Undisclosed Positions			
1. Taxpayers	Penalty may apply if there is no substantial authority for the undisclosed position. (Generally, at least a 40 percent likelihood of success if challenged.)	Penalty may apply unless the taxpayer reasonably believes that the tax treatment is more likely than not the correct tax treatment under the Code. (Generally, more than 50 percent likelihood of success if challenged.)	Penalty may apply if there is no substantial authority for the undisclosed position. (Generally, at least a 40 percent likelihood of success if challenged.)
2. Practitioners	Penalty may apply if there is no realistic possibility of being sustained on the merits. (Generally, at least a 33-1/3 percent likelihood of success if challenged.)	Penalty may apply unless the taxpayer reasonably believes that the tax treatment is more likely than not the correct tax treatment under the Code. (Generally, more than 50 percent likelihood of success if challenged.)	Penalty may apply if there is no substantial authority for the undisclosed position. (Generally, at least a 40 percent likelihood of success if challenged.)

PROVISION	PRESENT LAW	JCT STAFF RECOMMENDATIONS	TREASURY RECOMMENDATIONS
<b>VI. RETURN PREPARER PENALTIES (sec. 6694)</b>			
A. Unrealistic Position	If an understatement is due to a position for which there was not a realistic possibility of being sustained on its merits and the position was not disclosed or was frivolous, the preparer penalty is \$250.	Impose penalty equal to greater of \$250 or 50 percent of preparer's fee.	Similar to JCT staff recommendation but exact percentage of penalty is unspecified.
B. Willful or Reckless Conduct	If an understatement is due to willful or reckless conduct, the preparer penalty is \$1,000.	Impose penalty equal to greater of \$1,000 or 100 percent of preparer's fee.	Similar to JCT staff recommendation but exact percentage of penalty is unspecified.

<b>PROVISION</b>	<b>PRESENT LAW</b>	<b>JCT STAFF RECOMMENDATIONS</b>	<b>TREASURY RECOMMENDATIONS</b>
<b>VII. PENALTY FOR FILING A FRIVOLOUS TAX RETURN (sec. 6702)</b>	The penalty for filing a frivolous income tax return is \$500.	No recommendation.	Increase the penalty to \$1,500; permit abatement for first time occurrence if nonfrivolous return is filed within a reasonable period of time after filing the frivolous return.

PROVISION	PRESENT LAW	JCT STAFF RECOMMENDATIONS	TREASURY RECOMMENDATIONS
<p><b>VIII. PENALTY FOR FAILURE TO DEPOSIT TAXES (sec. 6656)</b></p>	<p>There is a four-tier penalty rate structure for failure to deposit taxes:</p> <p>(1) A depositor is subject to a penalty equal to two percent of the amount of the underpayment if the failure is corrected on or before the date that is five days after the prescribed due date.</p> <p>(2) A depositor is subject to a penalty equal to five percent of the amount of the underpayment if the failure is corrected after the date that is five days after the prescribed due date but on or before the date that is fifteen days after the prescribed due date.</p> <p>(3) A depositor is subject to a penalty equal to ten percent of the amount of the underpayment if the failure is corrected after the date that is</p>	<p>No new legislation for at least two years to allow scheduled statutory and regulatory changes to be reviewed and implemented. However, consideration should be given to revising regulations to permit penalty abatement for inadvertent failures occurring when taxpayer changes to a different deposit schedule.</p>	<p>Few intermediate changes should be made at this time to the deposit rules or penalties to provide a sufficient period of time for changes to the deposit rules to take effect. The penalty for failure to use the correct deposit method should be reduced from ten percent to two percent. Consideration should be given to reducing the present-law two percent penalty if failure to deposit is corrected within one banking day.</p>

<b>PROVISION</b>	<b>PRESENT LAW</b>	<b>JCT STAFF RECOMMENDATIONS</b>	<b>TREASURY RECOMMENDATIONS</b>
	<p>fifteen days after the due date but on or before the date that is ten days after the date of the first delinquency notice to the taxpayer.</p> <p>(4) A depositor is subject to a penalty equal to fifteen percent of the amount of the underpayment if the failure is not corrected on or before the date that is ten days after the date of the first delinquency notice to the taxpayer.</p> <p>Many taxpayers are required to make deposits of taxes; the frequency of the deposits depends on the type of tax and the amount required to be deposited.</p>		

<b>PROVISION</b>	<b>PRESENT LAW</b>	<b>JCT STAFF RECOMMENDATIONS</b>	<b>TREASURY RECOMMENDATIONS</b>
<p><b>IX. PENALTIES FOR FAILURE TO FILE FORM 5500 SERIES ANNUAL RETURN FOR PENSION AND OTHER DEFERRED COMPENSATION PLANS (secs. 6652(d)(2), 6652(e), 6692(e))</b></p>	<p>The Code and Titles I and IV of ERISA impose 3 separate penalties for failure to file a timely and complete return; the Code imposes separate penalties for failure to file Schedule SSA, Schedule B, and notification of plan status change.</p> <p>The IRS, Department of Labor, and Pension Benefit Guaranty Corporation administer the separate penalties.</p>	<p>Consolidate the separate Code and ERISA penalties for failure to file timely and complete return into one penalty.</p> <p>Designate the IRS as the agency responsible for administration of the consolidated penalty.</p>	<p>Consolidate the separate Code and ERISA penalties for failure to file timely and complete return into one penalty.</p> <p>Designate the Department of Labor as the agency responsible for administration of the consolidated penalty.</p>

<b>PROVISION</b>	<b>PRESENT LAW</b>	<b>JCT STAFF RECOMMENDATIONS</b>	<b>TREASURY RECOMMENDATIONS</b>
<b>X. PENALTY FOR FAILURE TO FILE ANNUAL INFORMATION RETURNS FOR CHARITABLE REMAINDER TRUSTS (sec. 6652(c)(2)(A))</b>	Split-interest trusts (and certain other organizations) are required to file Form 1041-A (Trust Accumulation of Charitable Amounts). The penalty for failure to file Form 1041-A is \$10 for each day return is not filed, up to a maximum of \$5,000 for any one return. Split-interest trusts are also required to file Form 5227 (Split-Interest Trust Information Return). It is not clear under present law that any penalty applies to the failure to file Form 5227.	Provide that the penalty for failure to file Form 5227 is equivalent to the penalty for failure to file Form 990. Consider increasing penalties applicable to failure to file Form 1041-A.	No recommendation.