

## Penalty and Interest Study

### Notice 99-4

#### PURPOSE

This notice invites public comment in connection with a study being conducted by the Department of the Treasury and the Internal Revenue Service regarding the administration and implementation of the penalty and interest provisions of the Internal Revenue Code. This study is required by § 3801 of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 782 (RRA).

#### BACKGROUND

The Code contains numerous provisions imposing civil tax penalties upon taxpayers and tax return preparers for certain conduct. Chapter 68 divides many of these civil penalties into two categories: Additions to the Tax and Additional Amounts (Subchapter A) and Assessable Penalties (Subchapter B). In addition, many other penalty provisions are contained in other chapters of the Code. Prior to the enactment of the Improved Penalty Administration and Compliance Act of 1989, included as part of the Omnibus Budget Reconciliation Act of 1989 (OBRA 1989), the Commissioner established a task force to study civil tax penalties. The task force recommended many improvements to penalty administration that were adopted.

Congress, through OBRA 1989, attempted to simplify the penalty structure and address legislative inconsistencies. Congress also made general administrative recommendations regarding the administration and implementation of the civil tax penalties. H.R. Conf. Rep. No. 386, 101st Cong., 1st Sess. 661 (1989). These general administrative recommendations included requiring the Service to develop a policy statement emphasizing that civil tax penalties exist for the purpose of encouraging voluntary compliance and to develop a handbook on penalties for employees. *Id.*

Subsequent to OBRA 1989, the Service developed a penalty handbook located in Part XX of the Internal Revenue Manual.

In that handbook, the Service stated that “penalties are used to enhance voluntary compliance.” IRM (20)121. Furthermore, the handbook states that “the Service uses penalties to encourage voluntary compliance by: (1) helping taxpayers understand that compliant conduct is appropriate and that noncompliant conduct is not; (2) deterring noncompliance by imposing costs on [noncompliance]; and (3) establishing the fairness of the tax system by justly penalizing the noncompliant taxpayer.” *Id.*

Section 6601 of the Code provides that taxpayers who underpay their taxes generally must pay interest to the government for the period of the underpayment. Various other provisions of the Code provide for the payment of interest by the government on tax overpayments (*see* § 6611), the abatement of underpayment interest in certain circumstances (*see* § 6404), and the payment of interest on erroneous refunds recoverable by suit (*see* § 6602). Other provisions allow for crediting or refunding of certain overpayments without interest (*see, e.g.*, § 6416(b)).

Section 3801 of RRA calls for the Joint Committee on Taxation and the Secretary of the Treasury to each conduct studies: (1) reviewing the administration and implementation by the Internal Revenue Service of the interest and penalty provisions of the Internal Revenue Code of 1986 (including the penalty reform provisions of the Omnibus Budget Reconciliation Act of 1989); and (2) making any legislative and administrative recommendations the Committee or the Secretary deems appropriate to simplify penalty or interest administration and to reduce taxpayer burden. These studies are to be reported to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate not later than July 22, 1999.

#### REQUEST FOR PUBLIC COMMENT

The Conference Committee Report for RRA with respect to § 3801 states that the “conferees expect that the Joint Committee on Taxation and the Treasury Department will consider comments from taxpayers and practitioners on the issues relevant to the studies.” H.R. Conf. Rep.

No. 599, 105th Cong., 2d Sess. 323 (1998). Accordingly, the Department of the Treasury and the Service request comments with respect to issues relevant to penalties and interest, and in particular, the following:

1. whether the penalty and interest provisions of the Code encourage voluntary compliance (i.e., whether they are effective deterrents to noncompliance, tax avoidance, and fraud);

2. whether administration of these provisions by the Service encourages voluntary compliance;

3. whether the penalty and interest provisions are designed in a manner that promotes efficient and effective administration by the Service;

4. whether and how the Service’s penalty and interest administration should be simplified or the burden modified on taxpayers and other third parties such as tax return preparers;

5. whether the penalty and interest provisions are designed to operate, and are administered by the Service, fairly such that similarly situated taxpayers are treated alike;

6. whether the current penalty and interest provisions allow taxpayers to generate overpayments or underpayments in order to take advantage of disparities between commercial borrowing rates and the rates imposed by § 6621;

7. whether communications from the Service to taxpayers provide an adequate explanation of why penalties and interest were imposed so that taxpayers can avoid penalties and interest in the future;

8. the sources and scope of the Commissioner’s authority to waive or not enforce penalties, and whether such authority should be modified;

9. whether the Commissioner’s authority to abate interest under § 6404 should be modified;

10. whether the Service’s administration of its penalty waiver and interest abatement authority is accomplished uniformly and fairly and the effect of the Service’s administration of its penalty waiver and interest abatement authority (including the effect on compliance);

11. whether certain provisions of the Code should be clarified to identify whether they impose a penalty or tax

(given that the characterization may effect the determination of when interest accrues thereon);

12. whether and how the penalty and interest regimes of voluntary tax systems of other countries compare to the U.S. federal tax penalty and interest regime; and

13. whether different entities should be subject to different penalty regimes; and whether penalty regimes should align with the four operating units of the Service's future structure.

The Department of the Treasury and the Service would appreciate written comments on the above issues or other issues relevant to this study, including specific recommendations on ways to (i) simplify the present-law penalty and interest provisions, (ii) make the administration of such provisions more efficient, (iii) reduce inequities and burdens on taxpayers, and (iv) deter noncompliance, tax avoidance and fraud. Comments should be submitted by Friday, February 26, 1999, to:

Internal Revenue Service

P.O. Box 7604

Ben Franklin Station

Attn: CC:DOM:CORP:T:R:IT&A

(Branch 4)

Room 5228

Washington, DC 20044

or by submitting comments directly to [http://www.irs.ustreas.gov/prod/tax\\_regs/comments.html](http://www.irs.ustreas.gov/prod/tax_regs/comments.html) (the IRS Internet site).

The comments you submit will be available for public inspection and copying.

## DRAFTING INFORMATION

The principal author of this notice is Charles A. Hall of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this notice contact Mr. Hall at (202) 622-4940 (not a toll-free call).