

INTERNAL REVENUE SERVICE

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MEMORANDUM FOR DISTRICT COUNSEL MIDWEST DISTRICT, MILWAUKEE

FROM: Kathryn A. Zuba
Chief, Branch 2
(Collection, Bankruptcy & Summonses)

SUBJECT: Failure to Pay Penalty & Defaulted Installment Agreements

This responds to your request for advice, dated June 15, 2000. This opinion is advisory in nature and not to be cited as a precedent.

ISSUES:

1. When is an installment agreement considered in effect for the purpose of a reduction in failure to pay penalty under I.R.C. § 6651(h)?
2. What impact does the issuance of Letter 2975, *Notice of Defaulted Installment Agreement under I.R.C. § 6159(b)*, or Notice CP-523, *Defaulted Installment Agreement, Notice of Intent to Levy*, have on the computation of failure to pay penalty under I.R.C. § 6651(h)?
3. When is an installment agreement considered no longer in effect for the purpose of computing the failure to pay penalty under section 6651?

CONCLUSIONS:

1. An installment agreement is in effect when it is approved by an authorized employee of the Internal Revenue Service.
2. The issuance of the Letter 2975 or Notice CP-523, in and of itself, does not have any impact on the computation of the failure to pay penalty under I.R.C. § 6651(h).
3. An installment agreement is no longer in effect after it has been properly terminated by the Service. According to the Service's current policy and procedures, an installment agreement is considered terminated 30 days after the

issuance of the Letter 2975 or Notice CP-523.

LAW & ANALYSIS:

Section 6651(a)(2) of the Internal Revenue Code imposes a penalty for failure to pay an amount shown as tax on a return on or before the due date prescribed for payment of such tax (determined with regard to extensions). Section 6651(a)(3) imposes a penalty for failure to pay any amount in respect of any tax required to be shown, but not shown, on a return, within 21 calendar days from the date of notice and demand.¹ The penalty is not imposed if the taxpayer shows that the failure to pay was due to reasonable cause and not to willful neglect. I.R.C. §§ 6651(a)(2); 6651(a)(3).

Section 6651(h), added to the Code by section 3303 of the Internal Revenue Restructuring and Reform Act (RRA) of 1998, provides for a reduced rate of failure to pay penalty under subsection (a)(2) and (a)(3) during any month an installment agreement under section 6159 is in effect for the payment of any tax for which a timely return (including extensions) has been filed. This provision applies for purposes of determining additions to tax beginning after December 31, 2000. The provision does not apply if the penalty has been increased under section 6651(d).² Likewise, it does not apply to taxes for which a timely return has not been filed as defined in section 6651.

The first question that you pose with respect to the application of section 6651(h) is when an installment agreement is “in effect.” An installment agreement is in effect once it is approved by an authorized official of the Service. See Treas. Reg. § 301.6159-1(b)(3). An offer by a taxpayer to satisfy its tax liability in installments, thus, will not trigger the application of the lower rate of failure to pay penalty under section 6651(h). While an installment agreement is considered pending when the taxpayer submits an offer to enter into an installment agreement, see IRM 5.14.1.3, the Service must first determine that the taxpayer’s proposal will result in full payment and that the proposed amount and the length of the agreement meet the Service’s criteria as set forth in IRM 5.14, *Installment Agreement Handbook*. Consequently, an installment agreement is not considered “in effect” until it is approved by an authorized official within the Service.

The second issue that you pose is whether the issuance of Letter 2975, *Notice of*

¹ Taxpayer has 10 business days to pay if the amount for which the notice and demand is issued equals or exceeds \$100,000. I.R.C. §§ 6601(e)(3); 6651(a)(3).

² Section 6651(d) increases the penalty under subsection (a)(2) and (a)(3) from 0.5 percent to 1 percent for every month or fraction thereof that the taxpayer fails to pay after the day which is 10 days after the date on which notice of intent to levy is given under I.R.C. § 6331(d) or the day on which notice and demand for immediate payment is given under the last sentence of section 6331(a), whichever is earlier.

Defaulted Installment Agreement under I.R.C. § 6159(b), or Notice CP-523, Defaulted Installment Agreement, Notice of Intent to Levy, has any effect on the computation of failure to pay penalty under I.R.C. § 6651(h). We conclude that it does not.

Section 6159(b) requires the Service to provide the taxpayer with a notice of intent to terminate the installment agreement at least 30 days prior to its termination. I.R.C. § 6159(b)(5)(A). Taxpayers with an IDRS monitored installment agreements receive Notice CP 523, while taxpayers with manually monitored installment agreements receive Letter 2957(DO). See IRM 5.14.8.5. These letters serve to notify the taxpayer of the reason for the proposed termination and give the taxpayer 30 days to comply with the terms of the installment agreement. If the taxpayer fails to cure the default within the prescribed time frame, the installment agreement will be considered terminated. While the Letter 2957 and Notice CP-523 set forth the date of termination, they do not, in and of themselves, affect the calculation of the failure to pay penalty under section 6651.

This brings us to the third and last issue which you have raised, that is, when is an installment agreement is no longer “in effect” for purposes of determining the appropriate rate of failure to pay penalty under section 6651(h). An installment agreement is no longer in effect when it is properly terminated by the Service. Currently, the Service does not provide the taxpayer with a termination letter setting forth the date when the taxpayer’s installment agreement was terminated. As stated above, however, an installment agreement is considered terminated 30 days after the issuance of Letter 2957 or Notice CP-523 to the taxpayer.³ See generally IRM 5.14.8.4.

Consequently, if an individual taxpayer enters into an installment agreement for the payment of tax for a timely filed return, prior to the date the increase rate of penalty under section 6651(d) is triggered, the failure to pay penalty under section 6651(a)(2) and (3) will be at the reduced .25% rate for any month or fraction thereof during which an installment agreement is in effect. As indicated above, section 6651(h) provides for a reduced penalty “for any month during which an installment agreement is in effect.” The purpose of reducing the penalty during the period an individual taxpayer is paying

³ Please note that the Service has made an administrative decision to grant taxpayers an additional 15 days to appeal the proposed termination. See, e.g., IRM 5.14.8.4(3). In some instances, therefore, a taxpayer may be able to cure a default and, thus, continue with the installment agreement, after the date which is 30 days after the issuance of the Letter 2957 or Notice CP-523.

a liability pursuant to an installment agreement is to encourage payment of the outstanding liability. See H.R. Conf. Rep. No. 599, 105th Cong., 2d Sess. 258-59 (1998). To effectuate this purpose, this provision has been interpreted to mean that if an installment agreement is in effect at any time during a month the entire month receives the reduced failure to pay rate. See Prop. Treas. Reg. § 301.6651-1(a)(4).

To illustrate the above principle, consider the following two situations where a taxpayer meets all of the requirements under section 6651(h) and the monthly period for calculating the failure to pay penalty is from the 15th of the month through the 14th of the next month:

1) The taxpayer enters into an installment agreement on May 13th. Although the taxpayer enters into the installment agreement at the end of the monthly period for calculating the failure to pay penalty, the taxpayer receives the benefit of the reduced failure to pay rate for the entire month. Thus, the failure to pay penalty is calculated at the reduced rate under section 6651(h) for the monthly period beginning on April 15th and ending on May 14th.

2) The taxpayer's installment agreement is terminated on August 16th. Although the taxpayer's installment agreement is terminated at the beginning of the monthly period for calculating the failure to pay penalty, the taxpayer receives the benefit of the reduced failure to pay rate for the entire month. Thus, the failure to pay penalty is calculated at the reduced rate for the monthly period beginning on August 15th and ending on September 14th.

This advice was coordinated with the Office of the Assistant Chief Counsel (Administrative Provisions and Judicial Practice). If you have any comments or questions, please direct them to the attorney assigned to this matter at 202-622-3620.

cc: Division Counsel (Small Business/Self Employed)