



## Recommendation 75-7

### **Internal Revenue Service Procedures: Civil Penalties**

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(Adopted December 11-12, 1975)

(a) *Analysis of Effectiveness of Civil Penalties.* The Internal Revenue Service should annually compile and publish, for each taxpayer class and by year of tax returns, statistical data, together with analytic discussions, pertaining to the assessment and collection of civil penalties for underpayment of tax due to each of the different types of conduct now or hereafter provided as the basis for such penalties. Such data should be compiled for the purpose of evaluating the significance, effectiveness, and fairness of these civil penalties and should include: (1) the number and dollar amounts of penalties assessed; (2) the number and dollar amounts of penalties voluntarily paid by taxpayers; (3) the number and dollar amounts of penalties contested by taxpayers; (4) the number and dollar amounts of penalties sustained by court action and collected. In addition to making such data and analyses available to the public and to the Congress, the Service should consider and determine whether additional data and analyses should be compiled and prepared pertaining to the significance, effectiveness, and fairness of these and other civil penalties from the standpoint of the administration of the tax laws by the Service, enforcement of the laws by the courts, and compliance with the laws by taxpayers.

(b) *Structure and Application of Civil Penalties for Underpayment of Tax.* Legislation should be enacted which would restructure and alter application of the civil penalties for underpayment of tax, established in Section 6653 of the Internal Revenue Code, as follows:

(1) (i) The penalty for "negligence" should be retained. Negligence should be defined as failure to exercise reasonable care in keeping records or in preparing the tax return.

(ii) A taxpayer against whom this penalty is assessed should have the burden of proof to establish by a preponderance of the evidence that his conduct was not negligent.

(2) The present five percent penalty for "intentional disregard of rules and regulations (but without intention to defraud)" should be repealed.

(3) (i) A new penalty should be established for "reckless or intentional conduct (but without willful attempt to evade payment of tax)." The rate of this penalty should be fixed at a



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level near the midpoint (say 25%) between the rates of the penalties for negligence (now 5%) and for willful attempts to evade payment of tax (now 50%). Reckless conduct should be defined as meaning that in keeping records or preparing the tax return, the taxpayer has consciously disregarded a substantial risk that an underpayment would occur; provided, that it is not intended that the penalty to be established pursuant to this paragraph would apply to an underpayment resulting from a bona fide disagreement with the Internal Revenue Service as to the interpretation of the tax law or its application to facts disclosed on a tax return. Intentional conduct should be defined as meaning that in keeping records or preparing the tax return, the taxpayer knew that an underpayment would occur or was substantially certain to occur.

(ii) A taxpayer against whom this penalty is assessed should have the burden of proof to establish by a preponderance of the evidence that his conduct was not reckless or intentional. In any case where the taxpayer succeeds in persuading the court that his conduct was not reckless or intentional, the court should be empowered to impose the lesser penalty for negligence, even though it had not theretofore been assessed by the Internal Revenue Service.

(4) (i) The present 50 percent penalty for "fraud" should be restated to apply only to "willful attempt to evade payment of tax," which should be understood to have the same meaning as under Section 7201 of the Internal Revenue Code.

(ii) The Internal Revenue Service should have the burden of proof to establish by clear and convincing evidence that an underpayment is attributable to the taxpayer's willful attempt to evade payment of tax. If the Service succeeds in persuading the court that a part of the underpayment is so attributable, the burden of proof should shift to the taxpayer to establish by a preponderance of the evidence that the remainder of the underpayment is not so attributable. In any case where the court is not persuaded that the taxpayer engaged in a willful attempt to evade payment of tax, the court should be empowered to impose the penalty for reckless or intentional conduct (proposed in (3) above) or the penalty for negligence, provided that, before the court may impose either of such lesser penalties, the Service shall have so proposed and the taxpayer shall have had the opportunity to present evidence to establish that he is not liable therefor.

(5) In imposing the penalties for underpayment of taxes described above, each penalty rate should be applied only to the portion of the total underpayment that is attributable to conduct liable for penalty at such rate.



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(c) *Publicity of Civil Penalty for Underpayment of Tax Because of Fraud.* The Internal Revenue Service should seek statutory instruction with respect to publicizing the imposition of the 50 percent civil penalty for underpayment of tax because of fraud (or, as recommended in paragraph (b)(4) of this section, restated as "willful attempt to evade payment of tax").<sup>1</sup>

(d) *Structure and Application of Civil Penalties for Failure to File Tax Return or to Pay Tax.*  
(1) Legislation should be enacted which would restructure and alter application of the civil penalties for failure to file a tax return or to pay a tax, established in Section 6651 of the Internal Revenue Code, as follows:

(i) The phrase "and not due to willful neglect" should be deleted from paragraphs (1), (2), and (3) of subsection 6651(a).

(ii) (A) The monthly rate of the penalty for failure to file a return, established in subsection 6651(a)(1), should be modified so as to extend the time period of lateness in filing a return which must elapse before the rate of penalty to be applied reaches the present aggregate maximum rate of 25 percent. The table below sets forth three options for so modifying the monthly penalty rate, compared with present law.

	Penalty for first month (percent)	Penalty for each succeeding month (percent)	Period of lateness to reach maximum penalty (months)
Present law	5	5	5
Option 1	5	2	11
Option 2	5	1 $\frac{1}{4}$	16
Option 3	5	1	21

The penalty for failure to pay tax established by subsection 6651(a)(2) should be imposed in addition to, and not offset against, the foregoing penalty.

(B) The monthly rate of the penalty for each month after the first month of failure to file a return should be prorated on a semi-monthly basis.

<sup>1</sup> Issuance of such publicity should be carried out in a manner consistent with Conference Recommendation 73-1, Adverse Agency Publicity.



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(2) The Internal Revenue Service should set forth, in the regulations under Section 6651 of the Internal Revenue Code, or in other form readily available to the public, the listing of acceptable reasons for late filing of a tax return that are set forth in the Internal Revenue Manual.

(e) *Procedures for Appealing Civil Penalties for Failure to File Tax Return or to Pay Tax.* With regard to civil penalties for failure to file a tax return or to pay tax established in Section 6651 of the Internal Revenue Code, taxpayers should be accorded administrative settlement procedures and the right to Tax Court review similar to those accorded with regard to civil penalties for underpayment of tax established in Section 6653 of the Code.

### **Citations:**

41 FR 3984 (January 27, 1976)

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