Office of Chief Counsel
Internal Revenue Service
memorandum

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Date of Communication: Not Applicable

UILC: 6721.00-00, 6722.00-00

date: December 20, 2012

to: (Appeals Officer)
(Internal Revenue Service, Domestic Operations)

from: (Senior Technician Reviewer)
(CC:PA:01)

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subject: Divisibility of I.R.C. Section 6721 and Section 6722 Penalties

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

X =

Amount 1 =

Amount 2 =

Years 1-5 =

ISSUES

Whether penalties assessed pursuant to the current versions of section 6721 and section 6722 are divisible for purposes of establishing refund suit jurisdiction.

CONCLUSIONS

The current section 6721 and section 6722 penalties are both divisible penalties for the purpose of establishing refund suit jurisdiction.

FACTS

Taxpayer, X, is a . X operates a large facility ( ) on contiguous to X's . Mainly from funds derived from this facility, X made numerous payments which were required to be reported on Form 1099. These payments included distributions of income to and non-employee compensation to service providers. X, however, failed to report any of the payments to the payees or to the Service. Additionally, X operated a large check cashing operation but failed to comply with any of the registration and reporting requirements under Title 31 and failed to file any forms reporting the currency transactions.

Based on X's repeated failures to file and furnish appropriate information returns, the Service imposed penalties under section 6721 in the amount of Amount 1 and section 6722 in the amount of Amount 2 for taxable Years 1-5.[1] X has expressed interest in seeking review of these penalties in federal district court. Thus your office asked whether a taxpayer must pay the current section 6721 or 6722 penalty amounts in full in order to establish refund suit jurisdiction. As a general rule, a taxpayer can only institute a refund suit in a federal district court or the United States Claims Court if the taxpayer pays the tax liability in full prior to the commencement of the suit. Flora v. United States, 362 U.S. 145 (1960). Courts have recognized a limited exception to this so-called "full payment rule" when the taxes are deemed divisible. In that case, the taxpayer need only pay a divisible portion of the tax to satisfy the payment prerequisite to jurisdiction. Thus, you have requested guidance from this office concerning whether the current versions of section 6721 and section 6722 are divisible for the purpose of establishing refund suit jurisdiction. This memorandum responds to your request.

LAW AND ANALYSIS

To meet the jurisdictional requirements of a refund suit, a taxpayer must generally make full payment of assessed taxes due before the matter may be adjudicated. See Flora, 362 U.S. at 177. In general, the partial payment of assessed taxes or a proposed deficiency is insufficient to support refund suit jurisdiction. Id. The majority opinion in Flora, however, noted that one possible exception to the full payment rule might exist where certain "tax assessments may be divisible into a tax on each transaction or event, so that the full-payment rule would probably require no more than payment of a small amount." Flora, 362 U.S. at 175-78, n.38. The Court was referring at that time to excise taxes. The Court's analysis, however, hinged divisibility on a tax being levied on each transaction or event.

Over time a limited exception to the "full payment rule" of Flora has developed with respect to divisible tax assessments. A divisible tax is one that may be divided into

[1] The penalties imposed were for cases of intentional disregard; as such, the "total amount imposed" limits of $1,500,000 per penalty per year were not applied. See discussion below.

separate portions or transactions, and only a portion of the tax must be paid before a claim is filed. See Steele v. United States, 280 F.2d 89, 91 (8th Cir. 1960); Korobkin v. United States, 988 F.2d 975, 976 (9th Cir. 1993); Univ. of Chicago v. United States, 547 F.3d 773, 785 (7th Cir. 2008).

In Steele v. United States, which involved penalties assessed under section 6672, the Eighth Circuit, noting Flora, adopted the "partial payment rule" holding that a taxpayer assessed a penalty under section 6672 need only pay the divisible amount of the penalty assessment attributable to a single employee's withholding before instituting a refund action. The taxpayer, therefore, only has to pay the withholding tax of one employee for each taxable period in order to establish refund suit jurisdiction. Steele, 280 F.2d at 91. See also Boynton v. United States, 566 F.2d 50, 52 (5th Cir. 1977) (same); Nordbrock v. United States, 173 F.Supp.2d 959 (D.Ariz. 2000), aff'd 248 F.3d 1172 (9th Cir. 2001) (found section 6695(d) tax preparer list penalties are divisible).

The hallmark of a divisible tax is that the gross tax imposed is composed of the accumulation of discrete assessments based on separate underlying transactions, rather than being one assessment flowing from a single underlying event. By way of example, the Ninth Circuit stated that "[t]he paradigm [of a divisible tax] is excise taxes: If you're assessed $100 for each of a thousand widgets, you can pay $100 – the whole tax on one of the widgets – and then go to court." Korobkin, 988 F.2d at 976 (citing to Flora, 362 U.S. at 171, n.37, 176, n.38). In like manner, the Eighth Circuit cited examples of divisible taxes calculated "with respect to each document" and applied "to each such failure" in contrast to the non-transactional penalty at issue before it. Gates v. United States, 874 F.2d 584, 587, n.3 (8th Cir. 1989). In sum, divisible assessments are those taxes or penalties that are composed of several independent assessments created by separate transactions. Thus, in order to determine if section 6721 and section 6722 are divisible penalties, one must determine if the penalties can be divided into separate transactions.

Section 6721, "Failure to file correct information returns" provides in part that "[i]n the case of a failure described in paragraph (2) by any person with respect to an information return, such person shall pay a penalty of $100 for each return with respect to which such a failure occurs, but the total amount imposed on such person for all such failures during any calendar year shall not exceed $1,500,000." I.R.C. § 6721(a)(1). Section 6721(a)(2) provides that for purposes of paragraph (1) the "failures described" are "any failure to file an information return with the Secretary on or before the required filing date, and any failure to include all of the information required to be shown on the return or the inclusion of incorrect information." Section 6721(b) provides for reduced penalties in the case of correction within specified periods. For correction within 30 days, the reduced penalty is "$30 in lieu of $100" for each failure, with the "total amount imposed" reduced to $250,000. I.R.C. § 6721(b)(1). For correction after the 30th day but "on or before August 1 of the calendar year in which the required filing date occurs" the amounts are "$60 in lieu of $100" and $500,000. I.R.C. § 6721(b)(2). Section 6721(e) provides for higher penalties in the case of intentional disregard of the filing

requirement. The intentional disregard penalty is $250 or the greater of a percentage depending on the particular information reporting requirement. I.R.C. § 6721(e).

Section 6722, "Failure to furnish correct payee statements" provides in part that "[i]n the case of each failure described in paragraph (2) by any person with respect to a payee statement, such person shall pay a penalty of $100 for each statement with respect to which such a failure occurs, but the total amount imposed on such person for all such failures during any calendar year shall not exceed $1,500,000." I.R.C. 6722(a)(1). Section 6722(a)(2) provides that for purposes of paragraph (1) the "failures described" are "any failure to furnish a payee statement on or before the date prescribed therefor to the person to whom such statement is required to be furnished, and any failure to include all of the information required to be shown on a payee statement or the inclusion of incorrect information." Section 6722(b) provides for reduced penalties in the case of correction within specified periods. For correction within 30 days, the reduced penalty is "$30 in lieu of $100" for each failure, with the "total amount imposed" reduced to $250,000. I.R.C. § 6722(b)(1). For correction after the 30th day but "on or before August 1 of the calendar year in which the required filing date occurs" the amounts are "$60 in lieu of $100" and $500,000. I.R.C. § 6722(b)(2). Section 6722(e) provides for higher penalties in the case of intentional disregard of the requirement to furnish correct payee statements. The intentional disregard penalty is $250 or the greater of a percentage depending on the particular payee statement requirement. I.R.C. § 6722(e).

There are at least three reasons why penalties imposed under section 6721 and section 6722 can be divided into separate transactions and are thus divisible. First, each assessment under both 6721 and 6722 is imposed with respect to a distinct failure that is a separate "transaction" for purposes of the penalty. Under the general rules of both penalties, a $100 penalty is imposed per failure with respect to the document at issue (an information return or payee statement, as applicable). I.R.C. §§ 6721(a), 6722(a). This is precisely the type of transaction-based penalty as those described by the Gates court as calculated "with respect to each document" and applied "to each such failure." Gates, 874 F.2d at 587, n.3. The penalty structure follows the paradigm offered by the Ninth Circuit, "If you're assessed $100 for each of a thousand [failures], you can pay $100 – the whole tax on one of the [failures] – and then go to court." Korobkin, 988 F.2d at 976.

Second, not only are both penalties applied on a per-failure basis, but the amount of the penalty applicable to each failure is adjusted based on the circumstances surrounding the individual failure. Subsection (b) of both 6721 and 6722 provides that the penalty imposed by subsection (a) of the applicable penalty "shall be $30 in lieu of $100" if "any failure described in subsection (a)(2) is corrected on or before the day 30 days after the required filing date." And subsection (e) of both 6721 and 6722 provides that "[i]f 1 or more failures…are due to intentional disregard" then "with respect to each such failure" the penalty shall be $250 or greater. This determination of penalty amount based on the circumstances of each failure shows that each failure is a separate, distinct transaction upon which the 6721 and 6722 penalties are based.

Third, the section 6724 reasonable-cause waiver applicable to sections 6721 and 6722 shows that these are transaction-based penalties. The waiver reads in relevant part: "No penalty shall be imposed under this part with respect to any failure if it is shown that *such failure* is due to reasonable cause and not to willful neglect." I.R.C. § 6724(a) (emphasis added). Thus, like the penalty amount, penalty waiver is determined on a per-transaction basis.

In sum, based on the foregoing, the current section 6721 and section 6722 penalties should be treated as divisible penalties. A taxpayer assessed with a penalty under either of these sections need only pay the divisible amount of the penalty attributable to a single failure, or $100 under the general rule, before filing a refund claim and instituting a refund suit under section 7422.

It should be noted that under both sections 6721 and 6722 the "total amount imposed" per section on a person "for all such failures during any calendar year shall not exceed $1,500,000." I.R.C. §§ 6721(a), 6722(a). This maximum is reduced in the case of corrected failures, and does not apply to cases of intentional disregard. I.R.C. §§ 6721(b), (e); 6722(b), (e). While an argument might be made that the "total amount imposed" becomes a single lump penalty rather than a penalty based on separate underlying transactions, this argument is without merit. A cap on the gross penalty amount actually imposed on a taxpayer does not change the fact that the penalty is calculated first and foremost by adding up the individual penalties assessed on each separate underlying failure.

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Please call at if you have any further questions.