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Congress of the United States

JOINT COMMITTEE ON TAXATION

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NOV 05 2009

Honorable Dave Camp
House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Camp:

This is in response to your request for information relating to enforcement through the Internal Revenue Code ("Code") of the individual mandate of H.R. 3962, as amended, the "Affordable Health Care for America Act." You specifically inquired about penalties for a willful failure to comply.

Tax on individuals without acceptable health care coverage

H.R. 3962 provides that an individual (or a husband and wife in the case of a joint return) who does not, at any time during the taxable year, maintain acceptable health insurance coverage for himself or herself and each of his or her qualifying children is subject to an additional tax.¹ The tax is equal to the lesser of (a) the national average premium for single or family coverage, as applicable, as determined by the Secretary of Treasury in coordination with the Health Choices Commissioner, or (b) 2.5 percent of the excess of the taxpayer's modified adjusted gross income over the threshold amount of income required for the income tax return filing for that taxpayer. This tax is in addition to both regular income tax and the alternative minimum tax, and is prorated for periods in which the failure exists for only part of the year. In general, the additional tax applies only to United States citizens and resident aliens. The additional tax does not apply to those who are residents of the possessions or who are dependents, nor does it apply to those whose lapses in coverage are de minimis or those with religious conscience exemptions. The additional tax does not apply if the maintenance of acceptable coverage would result in a hardship to the individual or if the person's income is below the threshold for filing a Federal income tax return.

Range of civil and criminal penalties for noncompliance

You asked that I discuss the situation in which the taxpayer has chosen not to comply with individual mandate and not to pay the additional tax. The Code provides for both civil and

¹ Joint Committee on Taxation, *Technical Explanation of the Revenue Provisions Contained in H.R. 3962, The "Affordable Health Care for America Act," as Amended*, (JCX-47-09), November 5, 2009 provides a more detailed description of this provision.

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criminal penalties to ensure complete and accurate reporting of tax liability and to discourage fraudulent attempts to defeat or evade tax. Civil and criminal penalties are applied separately. Thus, a taxpayer convicted of a criminal tax offense may be subject to both criminal and civil penalties, and a taxpayer acquitted of a criminal tax offense may nonetheless be subject to civil tax penalties. In cases involving both criminal and civil penalties, the IRS generally does not pursue both simultaneously, but delays pursuit of civil penalties until the criminal proceedings have concluded.

The majority of delinquent taxes and penalties are collected through the civil process. In determining whether a penalty applies along with an adjustment to a tax return, the examining agent is constrained not only by the applicable statutory provisions, but also by the written policy of the IRS not to treat penalties as bargaining points but instead to develop the facts sufficiently to support the decision to assert or not to assert a penalty.² The goal is consistency, fairness and predictability in administration of penalties.

If the government determines that the taxpayer's unpaid tax liability results from willful behavior, the following penalties could apply.

Civil penalties

- Section 6662(a) - an accuracy related penalty of 20 percent of the underpayment attributable to the health care tax, based on negligence or disregard (the former includes lack of a reasonable attempt to comply and the latter includes any intentional disregard of rules or regulations) or substantial understatement, if the understatement of tax is sufficiently large.
- Section 6663 - a fraud penalty of 75 percent of the underpayment, if the government can prove fraudulent intent to avoid taxes by clear and convincing evidence.
- Section 6702 - a \$5,000 penalty for taking a frivolous position on a tax return, if the underpayment is intended to delay or impede tax administration and the return on its face indicates that the self-assessment is substantially incorrect.
- Section 6651 - delinquency penalty of .5 percent of the underpayment, each month, up to a maximum of 25 percent of the underpayment.

² Policy Statement 20-1, Internal Revenue Manual sec. 1.2.20.1.1.

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Criminal penalties

Prosecution is authorized under the Code for a variety of offenses. Depending on the level of the noncompliance, the following penalties could apply to an individual:

- Section 7203 - misdemeanor willful failure to pay is punishable by a fine of up to \$25,000 and/or imprisonment of up to one year.
- Section 7201 - felony willful evasion is punishable by a fine of up to \$250,000 and/or imprisonment of up to five years.³

Application of penalties under current practice

The IRS attempts to collect most unpaid liabilities through the civil procedures described above. A number of factors distinguish civil from criminal penalties, in addition to the potential for incarceration if found guilty of a crime. Unlike the standard in civil cases, successful criminal prosecution requires that the government bear the burden of proof beyond a reasonable doubt of all elements of the offense. Most criminal offenses require proof that the offense was willful, which is a degree of culpability greater than that required in a civil penalty cases. For example, a prosecution for willful failure to pay under section 7203 requires proof beyond a reasonable doubt both that the taxpayer intentionally violated a known legal duty⁴ and that the taxpayer had the ability to pay.⁵ In contrast, in applying the civil penalty for failure to pay under section 6651, the burden is on the taxpayer: the penalty applies unless the taxpayer can establish reasonable cause and lack of willful neglect with respect to his failure to pay.

³ Although section 7201 provides for a maximum fine of up to \$100,000 for an individual, 18 U.S.C. sec. 3571, a general statute on fines as punishment, raises the maximum penalty to \$250,000.

⁴ *United States v. Pomponio*, 429 U.S. 10 (1976). But see, *Cheek v. United States*, 498 U.S. 192 (1991), in which the Supreme Court vacated and remanded a conviction, holding that the defendant charged with tax evasion was entitled to an instruction to the jury on good faith misunderstanding of the tax laws, other than with respect to supposed unconstitutionality of the tax laws, regardless of whether or not his beliefs could be considered objectively reasonable.

⁵ *Spies v. United States*, 317 U.S. 492 (1943).

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Criminal prosecution is not authorized without careful review by both the IRS and the Department of Justice. In practice the application of criminal penalties is infrequent. In fiscal year 2008, the total cases referred for prosecution of legal source tax crimes were as follows.

Investigations initiated	1,531
Indictments and informations	757
Convictions	666
Sentenced	645
Incarcerated	498
Percentage of those sentenced who were incarcerated	77.2

Of the 666 convictions reported above for fiscal year 2008, fewer than 100 were convictions for willful failure to file or pay taxes under section 7203. Civil penalties outnumber criminal penalties imposed. For example, in fiscal year 2008, compared to the 666 convictions, approximately 392,000 accuracy related penalties were assessed on individual returns. Also in fiscal year 2008, the IRS assessed 5,502 penalties under section 6702 for frivolous positions taken on returns.

I hope this information is helpful for you. If I can be of further assistance, please contact me.

Sincerely,



Thomas A. Barthold