

[4830-01-u]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1, 20, 25, 31, and 40

[REG-100729-98]

RIN 1545-AW41

Electronic Funds Transfers of Federal Deposits

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the deposit of Federal taxes by electronic funds transfer (EFT). The proposed regulations affect certain taxpayers required to make deposits of Federal taxes. For calendar years beginning after 1999, the proposed regulations provide rules under which certain taxpayers must make deposits by EFT.

DATES: Written and electronic comments must be received by May 24, 1999. Outlines and topics to be discussed at the public hearing scheduled for May 11, 1999, at 10 a.m. must be received by April 20, 1999.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-100729-98), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-100729-98), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC.

Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to http://www.irs.ustreas.gov/prod/tax_regs/comments.html (the IRS Internet address). The public hearing will be held in room 2615, Internal Revenue Building, 1111 Constitution Ave. NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Vincent Surabian, (202) 622-4940; concerning submission of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Michael Slaughter, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1), the Estate Tax Regulations (26 CFR part 20), the Gift Tax Regulations (26 CFR part 25), the Employment Taxes and Collection of Income Tax at Source Regulations (26 CFR part 31), and the Excise Tax Procedural Regulations (26 CFR part 40).

On July 14, 1997, the IRS issued final regulations under section 6302(h) of the Internal Revenue Code relating to the deposit of Federal taxes by EFT (TD 8723, 62 FR 37490). Those final regulations gradually phase taxpayers into the EFT system through 1999. In the final stages of the phase-in under those regulations, taxpayers with more than \$50,000 in employment

tax deposits during calendar year 1995, 1996, or 1997, and taxpayers that, in any of those years, had no employment tax deposits but made deposits of other depository taxes exceeding \$50,000, were required to begin to deposit by EFT.

At present, the regulations do not require EFT use by a new or growing taxpayer with annual deposits that did not exceed the prescribed threshold for the first time before 1998.

Explanation of Provisions

1. Increase in Current \$50,000 Threshold

Section 6302(h) requires that in fiscal year 1999 and subsequent years 94 percent of employment taxes and 94 percent of other depository taxes be collected by EFT. The IRS and Treasury Department previously concluded that the deposit threshold had to be set at \$50,000 to satisfy this statutory requirement. More recent experience suggests, however, that the statutory requirement can be satisfied even if the threshold is set at a substantially higher level. Moreover, an increase in the threshold would allow small businesses to make the transition to the EFT system at their own pace as they adopt electronic funds transfer in their other business operations. Accordingly, the proposed regulations increase the deposit threshold to \$200,000 in aggregate Federal tax deposits during a calendar year.

The new threshold will be applied initially to 1998 deposits, and taxpayers that exceed the threshold in 1998 will be required to deposit by EFT in 2000 and subsequent years. Taxpayers that first exceed the threshold in 1999 or a subsequent

year will similarly be required to deposit by EFT after a one-year grace period. A taxpayer that exceeds the threshold will not be permitted to resume making paper coupon deposits if its deposits fall below \$200,000 in a subsequent year. Although a similar rule applies under the current regulations, taxpayers that are currently required to deposit by EFT will be given a fresh start and will not be required to use EFT unless they exceed the \$200,000 threshold in 1998 or a subsequent calendar year.

Under the new rules, only 9 percent of all business taxpayers that make Federal tax deposits will be required to deposit by EFT. The fresh start will allow 65 percent of the taxpayers subject to the EFT requirement under the current regulations to resume making paper coupon deposits beginning in 2000. The IRS and Treasury Department are confident, however, that most of these taxpayers have come to appreciate the simplicity and convenience of the EFT system and will continue to deposit by EFT on a voluntary basis. The continued participation of these taxpayers, coupled with ongoing efforts to encourage voluntary enrollment, should assure 94 percent collections by EFT notwithstanding the increase in the threshold.

2. Taxes Taken into Account in Applying Threshold

The current regulations prescribe one threshold (\$50,000 in employment taxes) for depositors liable for employment taxes and a separate threshold (\$50,000 in other taxes) for taxpayers with no employment tax liability. Thus, taxpayers that deposit

employment taxes but do not exceed the applicable \$50,000 threshold are not subject to the EFT requirement even if they deposit large amounts of other depository taxes. In Notice 97-43 (1997-2 C.B. 294), the IRS and Treasury Department invited public comment on two alternatives to these rules and also welcomed any suggestions for a different rule. The first alternative presented in Notice 97-43 is a two-pronged test under which a taxpayer that deposits more than the threshold amount of the employment taxes imposed by chapters 21, 22, and 24 or more than the threshold amount of other depository taxes would be required to deposit by EFT. The second alternative is an aggregate deposits test under which a taxpayer that deposits more than the threshold amount of employment and other taxes combined would be required to deposit by EFT.

The IRS received six comments in response to Notice 97-43. Two commentators stated that the aggregate deposits test would be the most satisfactory. One of these commentators stated that an aggregate test (1) is simple for taxpayers to calculate; (2) is easy for financial institutions to calculate; and (3) is easy for the IRS to monitor and maintain. The second commentator favored an aggregate deposits test because it would introduce a larger number of taxpayers to the advantages and efficiencies of the EFT system.

Two commentators stated that the present system should be retained because of its simplicity. One of these commentators stated that a taxpayer need consider only one set of figures, its

employment taxes, to determine if it is subject to EFT. If the taxpayer has no employment taxes, then the taxpayer would simply look at its other depository taxes. The second commentator favored the present rule because of its belief that the adoption of either of the two proposals described in Notice 97-43 would bring additional smaller employers into the EFT system. The commentator stated that it is unnecessary to bring additional employers into the EFT system because, under the current rule, the IRS is satisfying the requirement of section 6302(h) that more than 94 percent of all depository taxes be deposited by EFT for fiscal year 1999 and thereafter.

The proposed regulations adopt an aggregate deposits test. As the comments illustrate, there is disagreement concerning the relative simplicity of the various options. The view of the IRS and Treasury Department, based on experience with the current system, is that an aggregate deposits test would be, on balance, simpler, less confusing to taxpayers, and more easily administered than a two-threshold rule. The aggregate deposits test also has the advantage of eliminating the anomalous current treatment of taxpayers that deposit small amounts of employment taxes and large amounts of other taxes as if they were smaller than taxpayers that deposit no employment taxes but are otherwise similarly situated. The IRS and Treasury Department believe that the other concern expressed in the comments, that the aggregate deposits test would unnecessarily extend the EFT system to additional small employers, has been adequately addressed by the

proposed increase in the threshold.

A fifth commentator suggested that a rule be considered under which a taxpayer could be relieved of the EFT deposit requirement if the taxpayer, after being mandated into the system, fails to deposit the threshold amount during succeeding calendar years. This suggestion has not been adopted because of concerns that it would be more complex and more difficult to administer than the proposed rule.

A final commentator stated that the current regulations make no provision for the consciences of persons whose religious beliefs restrict the use of computer equipment in their businesses. The IRS and Treasury Department are continually sensitive to the limited nature of the technology available to many taxpayers and, for that reason, have developed a system under which, using the ACH debit option, equipment no more complex than a rotary or touch-tone telephone is all that is necessary to make an EFT deposit. A computer is not required.

3. Expansion of Voluntary Payments by EFT

Finally, the current regulations allow the voluntary payment by EFT of certain nondepository taxes, specifically individual income taxes (including estimated taxes). These proposed regulations expand the types of nondepository tax payments for which voluntary payment by EFT is allowed to include nondepository payments of Federal income, estate and gift, employment, and various specified excise taxes.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose a collection of information requirement on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Proposed Effective Date

The regulations are proposed to become effective on the date final regulations are published in the **Federal Register**.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic and written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed regulations and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for May 11, 1999, beginning at 10 a.m. The hearing will be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW.,

Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the FOR FURTHER INFORMATION CONTACT section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments by May 24, 1999, and submit an outline of topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by April 20, 1999.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Vincent Surabian, Office of Assistant Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 20

Estate taxes, Reporting and recordkeeping requirements.

26 CFR Part 25

Gift taxes, Reporting and recordkeeping requirements.

26 CFR Part 31

Employment taxes, Income taxes, Penalties, Pensions, Railroad retirement, Reporting and recordkeeping requirements, Social security, Unemployment compensation.

26 CFR Part 40

Excise taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1, 20, 25, 31, and 40 are proposed to be amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by revising the entry for §1.6302-4 to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.6302-4 also issued under sections 6302(a), (c), and (h). * * *

Par. 2. Section 1.6302-4 is revised to read as follows:

§1.6302-4 Use of financial institutions in connection with income taxes; voluntary payments by electronic funds transfer.

Any person may voluntarily remit by electronic funds

transfer any payment of tax imposed by subtitle A of the Internal Revenue Code, including any payment of estimated tax. Such payment must be made in accordance with procedures prescribed by the Commissioner.

PART 20--ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Par. 3. The authority citation for part 20 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 20.6302-1 also issued under sections 6302(a) and (h). * * *

Par. 4. Section 20.6302-1 is added to read as follows:

§20.6302-1 Voluntary payments of estate taxes by electronic funds transfer.

Any person may voluntarily remit by electronic funds transfer any payment of tax to which this part 20 applies. Such payment must be made in accordance with procedures prescribed by the Commissioner.

PART 25--GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

Par. 5. The authority citation for part 25 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 25.6302-1 also issued under sections 6302(a) and (h). * * *

Par. 6. Section 25.6302-1 is added to read as follows:

§25.6302-1 Voluntary payments of gift taxes by electronic funds

transfer.

Any person may voluntarily remit by electronic funds transfer any payment of tax to which this part 25 applies. Such payment must be made in accordance with procedures prescribed by the Commissioner.

PART 31--EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Par. 7. The authority citation for part 31 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 8. Section 31.6302-1 is amended as follows:

1. The heading for paragraph (h)(2) is revised.
2. A heading is added for paragraph (h)(2)(i).
3. New paragraph (h)(2)(i)(C) is added.
4. Paragraph (h)(2)(ii) is revised
5. Paragraph (h)(2)(iii) is added.
6. Paragraph (m) is redesignated as paragraph (n).
7. Paragraph (k) is redesignated as paragraph (m).
8. Paragraph (j) is redesignated as paragraph (k).
9. New paragraph (j) is added.

The additions and revisions read as follows:

§31.6302-1 Federal tax deposit rules for withheld income taxes and taxes under the Federal Insurance Contributions Act (FICA) attributable to payments made after December 31, 1992.

* * * * *

(h) * * *

(2) Applicability of requirement--(i) Deposits for return

periods beginning before January 1, 2000. * * *

(C) This paragraph (h)(2)(i) applies only to deposits required to be made for return periods beginning before January 1, 2000. Thus, a taxpayer, including a taxpayer that is required under this paragraph (h)(2)(i) to make deposits by electronic funds transfer beginning in 1999 or an earlier year, is not required to use electronic funds transfer to make deposits for return periods beginning after December 31, 1999, unless deposits by electronic funds transfer are required under paragraph (h)(2)(ii) of this section.

(ii) Deposits for return periods beginning after December 31, 1999. Unless exempted under paragraph (h)(5) of this section, a taxpayer that deposits more than \$200,000 of taxes described in paragraph (h)(3) of this section during a calendar year beginning after December 31, 1997, must use electronic funds transfer (as defined in paragraph (h)(4) of this section) to make all deposits of those taxes that are required to be made for return periods beginning after December 31 of the following year and must continue to deposit by electronic funds transfer in all succeeding years. Thus, a taxpayer that exceeds the \$200,000 deposit threshold during calendar year 1998 is required to make deposits for return periods beginning in calendar year 2000 by electronic funds transfer.

(iii) Voluntary deposits. A taxpayer that is not required by this section to use electronic funds transfer to make a deposit of taxes described in paragraph (h)(3) of this section

may voluntarily make the deposit by electronic funds transfer, but remains subject to the rules of paragraph (i) of this section, pertaining to deposits by Federal tax deposit (FTD) coupon, in making deposits other than by electronic funds transfer.

* * * * *

(j) Voluntary payments by electronic funds transfer. Any person may voluntarily remit by electronic funds transfer any payment of tax imposed by subtitle C of the Internal Revenue Code. Such payment must be made in accordance with procedures prescribed by the Commissioner.

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PART 40--EXCISE TAX PROCEDURAL REGULATIONS

Par. 9. The authority citation for part 40 is amended by adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 40.6302(a)-1 also issued under 26 U.S.C. 6302(a) and (h). * * *

Par. 10. Section 40.6302(a)-1 is added to read as follows:

§40.6302(a)-1 Voluntary payments of excise taxes by electronic funds transfer.

Any person may voluntarily remit by electronic funds transfer any payment of tax to which this part 40 applies. Such payment must be made in accordance with procedures prescribed by the Commissioner.

Deputy Commissioner of Internal Revenue