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SC TECHNICAL ADVICE MEMORANDUM #88-22

TO: Mr. William F. Bray, Director  
Office Services Division

FROM: John Swearingen, Manager  
Tax Policy and Procedures Department

DATE: December 14, 1988

SUBJECT: Penalties

REFERENCE: S.C. Code Section 12-54-40(b)(1)  
S.C. Code Section 12-54-40(b)(2)(a) & (b)  
S.C. Code Section 12-54-155

AUTHORITY: S.C. Code Ann. Section 12-3-170  
SC Revenue Procedure #87-3

SCOPE: A Technical Advice Memorandum is a temporary document issued to an individual within the Commission, upon request, and it applies only to the specific facts or circumstances related in the request. Technical Advice Memoranda have no precedential value and are not intended for general distribution.

Questions:

- 1) Is the maximum monthly penalty for failure to file a return and pay tax 5% or 5 1/2%?
- 2) Is the 1/2% per month penalty in Section 12-54-40(b)(2)(a) imposed on the failure to pay the tax shown on the return or the tax required to be shown in the return?
- 3) Is the substantial understatement penalty applicable to all taxes?

Law:

Act 660 of 1988 was passed to more closely conform State penalty provisions to the Federal penalty provisions.

Section 12-54-40(b)(1) provides a failure to file penalty of 5% per month or fraction of a month that the failure to file continues not to exceed 25%. The penalty is applied against the tax required to be shown on the return reduced by any tax paid on or before the due date of the return and any applicable credits. This penalty is similar to the failure to file penalty of IRC Section 6651(a)(1).

Section 12-54-40(b)(2)(a) provides a failure to pay penalty of 1/2% per month or fraction of a month that the failure to pay continues not to exceed 25%. The penalty is applied against the tax shown on the return that remains unpaid after the due date of the return. This penalty is similar to the failure to pay penalty of IRC Section 6651(a)(2).

Section 12-54(b)(2)(b) provides penalty a failure to pay within 10 days of notice and demand of 1/2% per month or fraction of a month that the failure to pay continues not to exceed 25%. This failure to pay penalty applies to the amount required to be shown on the return and begins on the eleventh day following the notice and demand for payment of unpaid taxes. This penalty is similar to IRC Section 6651(a)(3)

Section 12-54-155 provides a penalty of 25% of the underpayment if there is a substantial understatement of tax for any taxable period. This penalty is similar to IRC Section 6661 which provides a penalty if there is a substantial understatement of income tax.

#### Discussion:

- 1) IRC Section 6651(c) provides that if the failure to file penalty of 5% and the failure to pay the tax shown on the return are applicable, then the failure to file is reduced by 1/2%. Thus, for the first five months the maximum penalty is 5% instead of 5 1/2%. This provision was not included in 12-54-40, thus for the first five months the State penalty is 5 1/2% per month.
- 2) The failure to pay penalty of 12-54-40(b)(2)(a) applies when there is a failure to pay "the amount shown as tax in any return on or before the date prescribed by law..." This differs from the failure to file in 12-54-40(b)(1) and the failure to pay in 12-54-40(b)(2)(b) as they both apply to the amount of tax required to be shown on a return.

If a delinquent return is filed two months late the penalty will be 5 1/2% for 2 months. If the same return is subsequently audited, any additional taxes due (required to be shown) will be subject to the failure to file penalty of 5% for the two months delinquency. The failure to pay the tax shown on the return will not apply to the taxes due on audit, as the taxpayer had paid the tax shown on the return when the return was filed.

- 3) The substantial understatement of penalty of IRC Section 6661 is applicable "If there is a substantial understatement of income tax for any taxable year." The substantial understatement penalty of Section 12-54-155 is applicable "If this is a substantial underpayment of tax for any taxable period..." Thus, while the Federal substantial understatement penalty is applicable only to income tax, the State substantial understatement penalty applies to all taxes.

Conclusion:

- 1) The maximum monthly penalty for failure to file a return and pay tax is 5 1/2% for State purposes.
- 2) The 1/2% per month penalty in Section 12-54-40(b)(2)(a) is imposed on failure to pay the tax shown on the return.
- 3) The substantial understatement penalty of Section 12-54-155 is applicable to all taxes.