

IRS PENALTY MANUAL

(20)100

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Editor's note: The Internal Revenue Service has completed its revision of the penalties handbook. The OneDisc Professional Research Library now includes the fully reorganized and renumbered handbook.

Chapter (20)100 Introduction

(20)110 (7-15-96) Comprehensive Strategy

(20)111 (7-15-96) Background

(1) In 1955 there were about 14 penalty provisions in the Internal Revenue Code. There are now over ten times that many. With the increasing number of penalty provisions, the Service recognized the need to develop a fair, consistent, and comprehensive approach to penalty administration.

(2) The Commissioner established a task force in November 1987 to study civil penalties. The task force could not reach a consensus on many basic issues: how should the term "penalty" be defined; what are the purposes of penalties; what are the characteristics of those penalties that work well as opposed to those that do not. In addition, the task force found many inconsistencies with the law as it existed prior to the Omnibus Budget Reconciliation Act of 1989 (Public Law 101-239, OBRA 1989) and in the way the Service administered the penalty programs.


(a) Inconsistencies existed among regions, service centers, district offices, and the many functions within each of these. These inconsistencies were due to such factors as varying degrees of training and experience, the functional procedures available, competing priorities, and the allocation of resources within a function.

(b) Inconsistencies also existed between personnel within a given function; these were due to differing attitudes about noncompliant behavior, the perceived fairness of the penalty, an individual's personal experience with a similar situation, or an individual's beliefs about the purpose of penalties.

(3) The Commissioner's Executive Task Force issued the "Report on Civil Tax Penalties" in February 1989. The report established a philosophy concerning penalties, provided a statutory analysis of the three broad categories of penalties (filing of returns, payment of tax, accuracy of information), and made recommendations where warranted to resolve the inconsistencies. Those recommendations were, in part:

(a) the Service should develop and adopt a single penalty policy statement emphasizing that civil tax penalties exist for the purpose of encouraging voluntary compliance;

(b) the Service should develop a single consolidated handbook on penalties for all



employees. The handbook should be sufficiently detailed to serve as a practical everyday guide for most issues of penalty administration and provide clear guidance on computing penalties;

(c) the Service should revise existing training programs to ensure consistent administration of penalties in all functions for the purpose of encouraging voluntary compliance.

(d) the Service should examine its communications with taxpayers (including penalty notices and publications) to determine whether these communications do the best possible job of explaining why the penalty was imposed and how to avoid the penalty in the future;

(e) the Service should finalize its review and analysis of the quality and clarity of machine-generated letters and notices used in the Adjustments and Correspondence Branches of the service centers; and

(f) the Service should consider ways to develop better information concerning the administration and effects of penalties. The Service should develop a master file database to provide statistical information regarding the administration of penalties. That information would be continuously reviewed for the purpose of suggesting changes in compliance programs, educational programs, penalty design and penalty administration.

(4) Public Law 101-239, OBRA 1989, consolidated and restructured many penalty Code sections to address inconsistencies. In addition, the committee reports for OBRA 1989 included the points in (2) above as general administrative recommendations to the Service.

(5) In keeping with the Commissioner's Executive Task Force Report and Congressional recommendations, the consolidated penalty IRM was developed.

(20)112 (7-15-95) Penalty Program

(1) The Service is committed to evaluating and improving the penalty program. It is an ongoing process which takes into account changing statutory rules, economic and financial conditions, and taxpayer attitudes.

(2) The Service is developing a penalty management information system to monitor penalty administration on an ongoing basis. Diagnosing noncompliance and formulating plans for better compliance requires information based on assessment and abatement data.

(a) Evaluating and improving the taxpayer's perceptions of fair treatment requires information on the way penalty cases are administered and an insight into taxpayer attitudes and conduct.

(b) Changing the penalties themselves requires information regarding compliance levels and the characteristics of effective penalties.

(3) Penalty programs should continually identify the most effective way to encourage compliance through the administration of penalties. Those who deviate the greatest from a standard of behavior should be the ones who receive a more severe penalty.

(4) The Service will identify and work with groups of taxpayers that are at risk of incurring penalties, (such as small businesses,) in an effort to assist in preventing penalty assertions.

(5) The Service maintains a consolidated penalty manual that serves as the source of all technical and procedural information for penalties, desk procedures, training material (internal and external), and locally adopted material. Prior to implementing changes to penalty procedures, the changes must be reviewed for consistency with Policy Statement P-1-18 and approved by the Office of Penalty Administration.

(20)113 (7-15-96) Purpose of IRM (20)000

(1) The purpose of the consolidated penalty handbook is to provide guidance to all areas of the Service for all penalties imposed by the Internal Revenue Code. It sets forth procedures both for assessing and abating penalties and contains discussions on topics such as various types of relief from the penalties.

(2) IRM Part XX replaces all other internal management documents dealing with the administration of penalties, such as IRMs and handbooks developed by various functions. Part XX is the primary source of authority for the administration of penalties by the Service. Service functions may develop reference materials for their individual needs, such as desk guides. However, such reference material must receive approval from the Office of Penalty Administration prior to distribution and remain consistent with:

- (a) the procedures set forth in this IRM, and
- (b) the philosophy of the penalty policy statement.

(3) The penalty manual serves as the foundation for addressing inconsistent administration of penalties by various Service functions. By providing one source of authority for the administration of penalties, the Service greatly reduces inconsistencies regarding attitudes and procedures.

(20)114 (7-15-96) Organization of IRM (20)000

(1) This manual is arranged in a user-friendly format. The chapters follow the logical sequence of events when working a penalty case. Appropriate headings are provided which describe the text that follows.

(2) The manual is designed for use both as an everyday reference guide and as a training document. Figures and examples are included in the text where they are most useful. Figures which are referenced frequently throughout the text are included as chapter exhibits to conserve space.

(3) The manual contains criteria, guidelines, and procedures for asserting, not asserting, and abating penalties. Chapters are included covering the penalty policy statement and philosophy, the application of reasonable cause, and the procedures for penalty appeals. The chapters in Part XX are:

- (a) (20)100 Introduction
- 1 (20)110 Comprehensive Strategy

2	(20)120	Purpose of Penalties
3	(20)130	Relief from Penalties
4	(20)140	Methods of Appealing Penalties
5	(20)150	Master File Indicators
6	(20)160	Administrative Procedures
7	Exhibits	
(b)	(20)200	Failure to File/Failure to Pay IRC section 6651
1	(20)210	Failure to File (FTF)
2	(20)220	Failure to Pay (FTP)
(c)	(20)300	Estimated Tax Penalties (ES) IRC section 6654 and 6655
1	(20)310	Individual Estimated Tax Penalties
2	(20)350	Corporate Estimated Tax Penalties
(d)	(20)400	Failure to Deposit Penalties (FTD)
(e)	(20)500	Return Related Penalties
(f)	(20)600	Preparer/Promoter Penalties
(g)	(20)700	Information Return Penalties
(h)	(20)800	Employee Plans/Exempt Organizations
(i)	(20)900	International Penalties
(j)	(20)(10)00	Miscellaneous Penalties

(4) IRM(20)100 contains Exhibits to assist the user in researching penalty issues:

(a)	(20)100-1	Penalty Policy Statement
(b)	(20)100-12	Penalty Relief Application Chart
(c)	(20)100-13	Penalty Reason Code Chart
(d)	(20)100-14	Reserved
(e)	(20)100-15	Penalty Transaction Codes
(f)	(20)100-16	Penalty Reference Numbers -- 500 Series
(g)	(20)100-17	Penalty Reference Numbers -- 600 Series
(h)	(20)100-18	Table of Abbreviations and Acronyms
(i)	(20)100-19	Dictionary of Key Terms (Reserved)

(20)115 (7-15-96) Responsibilities

(1) Overall responsibility for penalty programs is assigned to the Office of Penalty Administration (OPA). The OPA is a matrix organization residing in the Examination function (CP:EX:ST:P). The OPA is charged with coordinating policy and procedures concerning the administration of penalty programs, ensuring consistency with the penalty policy statement, reviewing and analyzing penalty information, researching taxpayer attitudes and opinions, and determining appropriate action necessary to promote voluntary compliance.

(2) Every function in the Service has a role in proper penalty administration. It is essential that each function conduct its operations with an emphasis on promoting voluntary compliance. Appropriate business reviews should be conducted to ensure consistency with the penalty policy statement and philosophy. Attention should be given to the coordination of penalty programs between offices and functions, to make sure that their approaches are consistent and to use penalty information for identifying and responding to compliance problems.

(3) Managers should continuously review information to suggest changes in compliance programs, training courses, educational programs, penalty design, and penalty administration. Managers should institute, on an ongoing basis, a quality review system that evaluates the timely

and correct disposition of penalty cases and encourages consistent administration of penalties.

(4) All employees should keep the following objectives in mind when handling each penalty case:

- (a) similar cases and similarly situated taxpayers should be treated alike;
- (b) each taxpayer should have the opportunity to have their interests heard and considered;
- (c) strive to make a good decision in the first instance. A wrong decision, even though eventually corrected, has a negatively impact on voluntary compliance;
- (d) provide an adequate opportunity for incorrect decisions to be corrected;
- (e) treat each case in an impartial and honest way. (i.e., approach the job, not in the interest of the government's or the taxpayer's perspective, but in the interest of impartial and fair enforcement of the tax laws);
- (f) use each penalty case as an opportunity to educate the taxpayer,
 - 1 help the taxpayer understand their legal obligations and rights, and
 - 2 assist the taxpayer in understanding their appeal rights and, in all cases, observe the taxpayer's procedural rights;
- (g) endeavor to promptly process and resolve each taxpayer's case; and
- (h) resolve each penalty case in a manner which promotes voluntary compliance.

(20)116 (7-15-96) Administrative Information

(20)116.1 (7-15-96) Requesting Changes and Updating IRM (20)000

(1) The Office of Penalty Administration (OPA) has overall responsibility for coordinating and approving any update to IRM Part XX. OPA's role is to ensure consistency in penalty administration.

(2) The offices of the assistant commissioner, division of directors, and branch chiefs in the functional areas are responsible for the initiation and content of Policy Statements, Manual Transmittals, and Manual Supplements necessary to maintain Part XX on a current basis. This responsibility includes:

- (a) initially determining the need for an amendment of, or announcement calling attention to, provisions in Part XX of the IRM;
- (b) deciding whether a revision will be in the form of a Manual Transmittal for a direct and immediate update to the Manual or a Manual Supplement prescribing procedures for a temporary implementation period before inclusion in the Manual (direct amendment by Manual Transmittal is preferable);
- (c) ensuring accuracy and completeness of any revision and providing a statement

regarding the effect on functional documents and other provisions of the Manual;

(d) ensuring revisions and announcements conform with the style and format of the IRM;

(e) coordinating proposed revisions and announcements with other units within a function, other functions as appropriate, and the OPA; and

(f) prior to implementing these changes, obtaining approval from the OPA.

(3) If special instructions are issued "in an emergency situation", see text 420 of IRM 1230, Internal Management Document System Handbook. A copy of the document must also be furnished to the OPA within 30 days of issuing the special instructions.

(20)116.2 (7-15-96) Submitting Proposed Changes to IRM (20)000

(1) Functions in the field (district, region, or service center) should follow the instructions currently in IRM 1230, Internal Management Document System Handbook. This IRM will provide local instructions for submission of proposed changes to Headquarters Office.

(2) Headquarters Office personnel in the appropriate areas will forward the corrections as appropriate.

(a) All areas must forward the requested change, in writing, to OPA.

(b) OPA will coordinate the requested change through the document clearance process.

(c) Corrections and updates will be verified, as appropriate, before they are incorporated into IRM (20)000.

(20)116.3 (7-15-96) Security Standards

(1) Service officials and managers must communicate security standards contained in IRM 1(16)12, Manager's Security Handbook, to subordinate employees and establish methods to enforce them.

(2) Employees are responsible for taking required precautions to provide security for the documents, information, and property which they handle in performing official duties.

(3) Employees using IDRS should only access those accounts required to accomplish their official duties. Any unauthorized access or browsing of tax accounts by employees is prohibited by the Service.

(a) Browsing is defined as looking at a tax account to satisfy a personal curiosity or for fraudulent reasons.

(b) Unauthorized access to taxpayer information is subject to disciplinary action including dismissal from the Service.

(20)117 (7-15-96) Problem Resolution Program (PRP)

(20)117.1 (7-15-96) PRP Guidelines

(1) While the Service is always striving to improve its systems and provide better service, some taxpayers still have difficulty obtaining a solution to a problem or an appropriate response to an inquiry. The purpose of PRP is to give taxpayers someone to speak for them within the Service -- an advocate. PRP guarantees that taxpayers will have someone to make sure their rights are protected, someone to turn to when the system is not responsive to their needs. PRP steps in and takes action on behalf of taxpayers when their complaints or inquiries on problems relating to Federal taxes meet PRP criteria. The purpose of the criteria is to make sure that problems and complaints which have not been handled properly through normal channels are included in PRP.

(2) To make sure that all taxpayer problems receive equal consideration, employees should accept the taxpayer's statement of the problem at face value when deciding if the complaint or inquiry meets PRP criteria. However, employees should be aware that PRP is not intended to circumvent their responsibility for resolving overage or difficult cases.

(3) In applying the criteria, it is necessary to use good judgement and to screen or probe the situation to determine if the complaint or inquiry should be included in the program.

(4) A complaint or inquiry which meets any of the following conditions will be included in the PRP:

(a) Any Service contact on the same case at least 30 days after an initial inquiry or complaint; or the second contact after 60 days from filing an original or amended return or claims.

(b) Any contact that indicates the taxpayer has not received a response by the date promised (including commitment dates on IRS forms).

(c) Any contact that indicates established systems have failed, or it is in the best interest of the taxpayer or the Service that the case be worked in PRP.

(5) A complaint or inquiry does not need to be sent to PRP if the problem has been corrected or will be resolved by completing all required actions and responding to the taxpayer (by telephone, preparing written correspondence, or sending an IDRS letter) on the same date the case is identified as meeting PRP criteria.

(6) Although the complaint or inquiry may appear to meet PRP criteria, e.g., second contact on the same issue, there will be instances when certain contacts should not be included in PRP.

(a) When it can be determined that the taxpayer has not used, or refuses to use, established administrative or formal appeals procedures, or

(b) when the complaint or inquiry only questions the constitutionality of the tax system.

(7) Please keep in mind that a "tax protestor" can have a legitimate problem which should be

handled by PRP.

(8) Items meeting PRP criteria may be discovered at any point in the processing cycle. If the item or case meets PRP criteria, the case should be referred to the supervisor for referral to PRP.

(20)117.2 (7-15-96) Form 911-ATAO

(1) Form 911, Application for a Taxpayer Assistance Order to Relieve Hardship (ATAO) may be initiated by a Service employee on behalf of the taxpayer to request review of an account if:

(a) the taxpayer is experiencing or about to experience a "significant hardship"; and,

(b) the non-PRP employee dealing with the problem cannot or will not relieve that hardship immediately.

(2) The Service may receive cases that qualify for an ATAO:

(a) directly from the taxpayer or the taxpayer's authorized representative (Form 911);
or,

(b) through telephone contact or letter.

(3) Use normal procedures and the appeal processes before resorting to an ATAO. However, if these procedures or processes are not appropriate because they will not be timely in resolving the hardship or were not followed and a "significant hardship" exists, consider requesting an ATAO. It is never wrong to consider whether an ATAO is appropriate.

(4) "Significant hardship" is a highly subjective determination. A number of factors must be considered when making a determination of "significant hardship". Enforcement action, in and of itself, is not a hardship without additional factors. For this reason, using good judgement after reviewing the pertinent facts and circumstances is the most important element in reaching the fair and reasonable decision.

(a) Significant hardship consideration must be made on a case by case basis. The following points and others may be relevant in determining if a significant hardship exists. The Problem Resolution Officer (PRO) will make the final decision on significant hardship. This determination must always be made on a case by case basis.

(b) To properly evaluate a hardship situation, consider the following points:

1 will the taxpayer be able to retain housing?

2 will the taxpayer be able to obtain food?

3 will the taxpayer be able to retain utilities?

4 will the taxpayer be able to retain or obtain transportation to and from work?

5 will the taxpayer be able to remain employed?

6 will the taxpayer be able to obtain essential medical treatment and/or

medication?

7 will the taxpayer be able to obtain reasonable clothing and/or shoes?

8 will the taxpayer sustain an avoidable loss of education?

9 will irreparable damage be caused to the taxpayer's credit rating?

10 will the taxpayer be unable to meet payroll and/or be in imminent bankruptcy?

11 is the hardship imminent?

(5) Below are some examples of potential "significant hardship" cases.

(a) A wage levy that impaired the taxpayer's ability to purchase needed medication or medical care. The Service's lack of awareness causes an unintentional negative impact and would qualify for an ATAO if the employee contacted cannot or will not relieve the hardship.

(b) A payment is improperly applied to a taxpayer's account, thus blocking the taxpayer's receipt of a refund. After many contacts with the Service, substantiated with dates, the taxpayer is suffering emotional stress and files a Form 911 for relief. An ATAO is appropriate to request action to substantiate the credit and authorize the refund.

(6) Below are some examples of cases which DO NOT show "significant hardship".

(a) A taxpayer is experiencing a significant hardship because of a bank levy on his sole source of funds. The employee contacted is able to release the levy and initiate a payment agreement with the taxpayer. Because the employee resolved the hardship, an ATAO would not be warranted.

(b) The taxpayer complains that he will not be able to pay both the tax liability and the rent this month. The taxpayer has been current on previous rent payments, and the landlord has not contacted the taxpayer about the rent. The state where the tax-payer lives requires 60 days prior notice before eviction proceedings can begin. Because there is no imminent hardship, an ATAO would not be warranted.

(7) Action required:

(a) Immediately prepare Form 911 upon receipt of any telephone call, correspondence, or claim which shows need for an ATAO for which the non-PRP employee cannot or will not provide relief.

1 Prepare Form 911 even if the taxpayer does not specifically ask for an ATAO. Attach the source document, if any, to Form 911.

2 Functional management review is permissible, but should not delay the Form 911 in getting to the PRO. If functional management decides to provide the relief requested for internally identified Forms 911, they need not go to the PRO.

(b) Route all Forms 911 (including statute cases) to the PRP office immediately.

(c) Do not advise the taxpayer that their case is being made an ATAO. The PRP office will respond to the taxpayer as necessary.

(d) Refer to IRM 1279, Problem Resolution Program Handbook, for additional information on "significant hardship" and ATAO processing instructions.

(8) You may discover items meeting PRP criteria at any point in the processing cycle. If the issue or case meets any of the criteria, forward it to PRP.

(9) Note: the ATAO procedure will not result in forgiveness of a valid tax liability. It only a delays enforcement action, if appropriate.

(20)120 (7-15-96) Purpose of Penalties

(20)121 (7-15-96) General

(1) Penalties exist to encourage voluntary compliance by supporting the standards of behavior expected by the Internal Revenue Code.

(2) This section provides background information and examines the philosophy of penalties and their role in our tax system. Because voluntary compliance is the major goal of penalties, this section also discusses the process of encouraging behavior.

(20)122 (7-15-96) Behavior and Voluntary Compliance

(1) For most taxpayers, voluntary compliance consists of preparing an accurate return, filing it timely, and paying any tax due. Efforts made to fulfill these obligations constitute compliant behavior. Most penalties apply to behavior that falls to meet any or all of these obligations.

(2) Penalties encourage voluntary compliance by:

(a) defining standards of compliant behavior,

(b) defining remedial consequences for noncompliance, and

(c) providing monetary sanctions against taxpayers who do not meet the standard.

(3) These three factors support the public conviction that the tax system is fair and the penalty is in proportion to the severity of the noncompliance.

(20)123 (7-15-96) Encouraging Voluntary Compliance

(1) Taxpayers in the United States assess their tax liabilities against themselves and pay them voluntarily. This system of assessment and payment is based on the principle of voluntary compliance. Voluntary compliance exists when taxpayers conform to the law without compulsion or threat.

(2) Compliant self-assessment requires a taxpayer to know the rules for filing returns and paying

taxes. The Service is responsible for providing information to taxpayers, which includes:

- (a) written materials that clearly explain the rules,
- (b) forms that permit the self-computation of tax liability.

(3) In addition to (2) above, the Service must also provide a means to preserve and enhance our voluntary compliance by fairly, consistently, and accurately administering a system of penalties.

(4) Although penalties support and encourage voluntary compliance, they also serve to bring additional revenues into the Treasury, impose remedial charges against taxpayers, and indirectly fund enforcement costs. However, these results are not reasons for creating or imposing penalties.

(5) Penalties advance the mission of the Service when they encourage voluntary compliance. The Service has formalized this obligation to the public in its Mission Statement.

(6) Compliance is achieved when a taxpayer makes a good faith effort to meet the tax obligations defined by the Internal Revenue Code.

(7) Penalties support voluntary compliance by assuring compliant taxpayers that tax offenders are identified and penalized.

(8) The Service has the obligation to advance the fairness and effectiveness of the tax system. Penalties should:

- (a) be severe enough to deter noncompliance,
- (b) encourage noncompliant taxpayers to comply,
- (c) be objectively proportioned to the offense, and
- (d) be used as an opportunity to educate taxpayers and encourage their future compliance. Service personnel may educate taxpayers and encourage their future compliance by:

1 discussing causes for the delinquency and listening to taxpayer's reasons and concerns for noncompliance,

2 ensuring that taxpayers understand their filing and paying responsibilities, and

3 being alert to information received in discussions with taxpayers that indicate possible reasons for abatement of a penalty.

(9) Penalties should relate to the standards of behavior they encourage. Penalties best aid voluntary compliance if they support belief in the fairness and effectiveness of the tax system. This belief encourages compliance in areas that cannot be reached through audits or other programs. The Service's approach to penalties is embodied in Penalty Policy Statement P-I-1 (See Exhibit (20)100-1.)

(20)124 (7-15-96) Fair and Consistent Approach to Penalty Administration

(1) The Service's approach to penalty administration must ensure:

(a) **Consistency:** The Service should apply penalties equally in similar situations. Taxpayers base their perceptions about the fairness of the system on their own experience and the information they receive from the media and others. If the Service does not administer penalties uniformly (guided by the applicable statutes, regulations, and procedures) overall confidence in the tax system is jeopardized.

(b) **Accuracy:** The Service must arrive at the correct penalty decision. Accuracy is essential because erroneous penalty assessments and incorrect calculations confuse taxpayers and misrepresent the overall competency of the Service.

(c) **Impartiality:** Service employees are responsible for administering the penalty statutes in an even-handed manner that is fair and impartial to both the government and the taxpayer.

(d) **Representation:** Taxpayers must be given the opportunity to have their interests heard and considered. Employees need to take an active and objective role in case resolution so that all factors are considered.

(20)130 (7-15-96) Relief From Penalties

(20)131 (7-15-96) General

(1) Generally, relief from penalties falls into four separate categories. They are:

- (a) Reasonable Cause,
- (b) Statutory Exceptions,
- (c) Administrative Waivers, and
- (d) Correction of Service Error.

(2) Appeals may recommend the abatement or nonassertion of a penalty based on these four criteria as well as "Hazards of Litigation."

(3) This chapter discusses each of these categories and related criteria. Also, see 131 of LEM XX-100.

(4) In the interest of fairness, the Service will consider requests for penalty relief received from third parties, including requests from representatives without an authorized power of attorney. While information may be accepted, NO taxpayer information may be discussed with a third party, unless a power of attorney or other acceptable authorization is secured in writing from the taxpayer. See 131 of LEM XX-100.

(a) If additional information is needed, contact the taxpayer or the taxpayer's authorized representative.

(b) If the validity of the request is questionable contact the taxpayer.

(c) In all cases involving third party requests for penalty relief, advise the taxpayer of the request and the action taken.

(20)132 (7-15-96) Reasonable Cause

(20)132.1 (7-15-96) General

(1) Reasonable cause is based on all the facts and circumstances in each situation and allows the Service to provide relief from a penalty that would otherwise be assessed. Reasonable cause relief is generally granted when the taxpayer exercises ordinary business care and prudence in determining their tax obligations but is unable to comply with those obligations.

(2) In the interest of equitable treatment of the taxpayer and effective tax administration, the nonassertion or abatement of civil penalties based on reasonable cause or other relief provisions provided in this IRM must be made in a consistent manner and should conform with the considerations specified in the Internal Revenue Code (IRC), Regulations (Treas. Regs.), Policy Statements, and Part XX.

(3) Reasonable cause relief is not available for all penalties; however, other exceptions may apply.

(a) For those penalties where reasonable cause can be considered, any reason which establishes that the taxpayer exercised ordinary business care and prudence, but was unable to comply with a prescribed duty within the prescribed time, will be considered.

(b) See Exhibit (20)100-2, Penalty Relief-Application Chart. If a reasonable cause provision applies only to a specific code section, that reasonable cause provision will be discussed in the IRM (20)000 chapter relating to that IRC section.

(c) When considering the information provided in the following pages, remember that an acceptable explanation is not limited to those given in IRM (20)000. Penalty relief granted because the taxpayer provided an "other acceptable explanation" is identified by use of PRC 30 on either the closing or adjustment document.

(4) The wording used to describe reasonable cause provisions varies. Some IRC penalty sections also require evidence that the taxpayer acted in good faith or that the taxpayer's failure to comply with the law was not due to willful neglect. See specific IRM sections for the rules that apply to a specific code section.

(5) Taxpayers have reasonable cause when their conduct justifies the nonassertion or abatement of a penalty. Each case must be judged individually based on the facts and circumstances at hand. Consider the following in conjunction with specific criteria identified in the remainder of IRM (20)130.

(a) What happened and when did it happen?

(b) During the period of time the taxpayer was non-compliant, what facts and circumstances prevented the taxpayer from filing a return, paying a tax, or otherwise complying with the law?

- (c) How did the facts and circumstances prevent the taxpayer from complying?
- (d) How did the taxpayer handle the remainder of their affairs during this time?
- (e) Once the facts and circumstances changed, what attempt did the taxpayer make to comply?

(6) Reasonable cause does not exist if, after the facts and circumstances that explain the taxpayer's noncompliant behavior cease to exist, the taxpayer fails to comply with the tax obligation within a reasonable period of time.

(20)132.2 (7-15-96) Standards

(1) Any reason that establishes a taxpayer exercised ordinary business care and prudence but was unable to comply with the tax law may be considered for penalty relief.

(2) The following regulations contain examples of circumstances that may be helpful in determining if a taxpayer has established reasonable cause:

- (a) Accuracy-Related Penalty: 1.6664-4
- (b) Failure to Pay Penalty: 301.6651-1(c)
- (c) Failure to File: 301.6651-1(c)
- (d) Failure to Deposit Penalty: 301.6656-1(b); 301.6656-2(c)
- (e) Information Returns Penalty: 301.6723-1A(d); 301.6724-1
- (f) Preparer/Promoter Penalties: 1.6694-2(d); 301.6707-1T

(2) The following Internal Revenue Service Policy Statements contain specific criteria that may affect the imposition of penalties.

- (a) P-2-4, Penalties and interest not asserted against Federal agencies;
- (b) P-2-7, Reasonable cause for late filing of return or failure to deposit or pay tax when due;
- (c) P-2-9, Timely mailed returns bearing foreign postmarks; and
- (d) P-2-11, Certain unsigned returns will be accepted for processing.

(20)132.3 (7-15-96) Ordinary Business Care and Prudence

(20)132.31 (7-15-96) General

(1) Ordinary business care and prudence includes making provision for business obligations to be met when reasonably foreseeable events occur. A taxpayer may establish reasonable cause by providing facts and circumstances showing the taxpayer exercised ordinary business care and prudence (taking that degree of care that a reasonably prudent person would exercise), but nevertheless was unable to comply with the law.

(2) In determining if the taxpayer exercised ordinary business care and prudence, review available information including the following:

(a) Taxpayer's Reason. The taxpayer's reason should address the penalty imposed.

1 To show reasonable cause, the dates and explanations should clearly correspond with events on which the penalties are based.

2 If the dates and explanations do not correspond to the events on which the penalties are based, request additional information from the taxpayer that may clarify the explanation (See IRM (20)132.1:(5)).

(b) Compliance History. Check the preceding tax years (at least 2) for payment patterns and the taxpayer's overall compliance history.

1 The same penalty, previously assessed or abated, may indicate that the taxpayer is not exercising ordinary business care.

2 If this is the taxpayer's first incident of noncompliant behavior, weigh this factor with other reasons the taxpayer gives for reasonable cause, since a first time failure to comply does not by itself establish reasonable cause.

(c) Length of Time. Consider the length of time between the event cited as a reason for the noncompliance and subsequent compliance. See IRM (20)132.1:(6). Consider:

1 when the act was required by law,

2 the period of time during which the taxpayer was unable to comply with the law due to circumstances beyond the taxpayer's control, and

3 when the taxpayer complied with the law.

(d) Circumstances Beyond the Taxpayer's Control. Consider whether or not the taxpayer could have anticipated the event that caused the noncompliance.

1 Reasonable cause is generally established when the taxpayer exercises ordinary business care and prudence but, due to circumstances beyond the taxpayer's control, the taxpayer was unable to timely meet the tax obligation.

2 The taxpayer's obligation to meet the tax law requirements is ongoing. Ordinary business care and prudence requires that the taxpayer continue to attempt to meet the requirements, even though late.

(3) Abatement of a penalty because the taxpayer established ordinary business care and prudence is identified by the use of Penalty Reason Code (PRC) 22.

(20)132.32 (7-15-96) Ignorance of the Law

(1) In some instances taxpayers may not be aware of specific obligations to file and/or pay taxes. The ordinary business care and prudence standard requires that taxpayers make reasonable efforts

to determine their tax obligations.

(a) Reasonable cause may be established if the taxpayer shows ignorance of the law in conjunction with other facts and circumstances. For example, consider:

- 1 the taxpayer's education,
- 2 if the taxpayer has been subject to the tax,
- 3 if the taxpayer has been penalized, or
- 4 if there were recent changes in the tax forms or law which a taxpayer could not reasonably be expected to know.

(b) The level of complexity of a tax or compliance issue is another factor that should be considered in evaluating reasonable cause because of ignorance of the law.

(2) Reasonable cause should never be presumed, even in cases where ignorance of the law is claimed.

(3) The taxpayer may have reasonable cause for noncompliance if:

- (a) a reasonable and good faith effort was made to comply with the law, or
- (b) the taxpayer was unaware of a requirement and could not reasonably be expected to know of the requirement.

(20)132.33 (7-15-96) Mistake was Made

(1) The taxpayer may try to establish reasonable cause by claiming that a mistake was made.

(a) Generally, this is not in keeping with the ordinary business care and prudence standard and does not provide a basis for reasonable cause.

(b) However, the reason for the mistake may be a supporting factor if additional facts and circumstances support the determination that the taxpayer exercised ordinary business care and prudence.

(20)132.34 (7-15-96) Forgetfulness

(1) The taxpayer may try to establish reasonable cause by claiming forgetfulness or an oversight by the taxpayer or another party caused the noncompliance. Generally, this is not in keeping with ordinary business care and prudence standard and does not provide a basis for reasonable cause.

(a) Relying on another person to perform a required act is generally not sufficient for establishing reasonable cause.

(b) It is the taxpayer's responsibility to file a timely and accurate return and to make timely deposits or payments. This responsibility cannot be delegated.

(2) Information to consider when evaluating a request for an abatement or nonassertion of a

penalty based on a mistake or a claim of ignorance of the law includes, but is not limited to:

- (a) when and how the taxpayer became aware of the mistake,
- (b) the extent to which the taxpayer corrected the mistake,
- (c) the relationship between the taxpayer and the subordinate;
- (d) if the taxpayer took timely steps to correct the failure after it was discovered; and
- (e) the supporting documentation.

(20)132.4 (7-15-96) Death, Serious Illness, or Unavoidable Absence

(1) Death, serious illness or unavoidable absence of the taxpayer may establish reasonable cause for late filing, payment, or deposit, for:

- (a) an Individual,

1 if there was a death, serious illness, or unavoidable absence of the taxpayer or a death or serious illness in that taxpayer's immediate family (i.e. spouse, sibling, parents, grandparents, children).

2 PRC 24 indicates the incident occurred to the individual or a member of that individual's immediate family for filing, paying, or depositing.

- (b) a corporation, estate, trust, etc.,

1 if there was a death, serious illness, or other unavoidable absence of the taxpayer (or a member of such taxpayer's immediate family), and that taxpayer had sole authority to execute the return, make the deposit, or pay the tax (person responsible).

2 PRC 26 indicates the incident occurred to the person responsible for filing, paying or depositing.

(2) If someone, other than the taxpayer or the person responsible, is authorized to meet the obligation, consider the reasons why that person did not meet the obligation when evaluating the request for relief, in the case of a business, if only one person was authorized, determine whether this was in keeping with ordinary business care and prudence.

(3) Information to consider when evaluating a request for penalty relief based on reasonable cause due to death, serious illness, or unavoidable absence includes, but is not limited to, the following:

- (a) the relationship of the taxpayer to the other parties involved;
- (b) the date of death;
- (c) the dates, duration, and severity of illness;

- (d) the dates and reasons for absence;
- (e) how the event prevented compliance;
- (f) if other business obligations were impaired; and
- (g) if tax duties were attended to promptly when the illness passed, or within a reasonable period of time after a death or absence.

(20)132.5 (7-15-96) Unable to Obtain Records

(1) Explanations relating to the inability to obtain the necessary records may constitute reasonable cause in some instances, but may not in others.

(2) Consider the facts and circumstances relevant to each case and evaluate the request for penalty relief.

(3) If the taxpayer was unable to obtain records necessary to comply with a tax obligation, the taxpayer may or may not be able to establish reasonable cause. Reasonable cause may be established if:

- (a) the taxpayer exercised ordinary business care and prudence, but
- (b) due to circumstances beyond the taxpayer's control they were unable to comply.

(4) Information to consider when evaluating such a request includes, but is not limited to, the following:

(a) an explanation as to:

- 1 why the records were needed to comply;
 - 2 why the records were unavailable and what steps were taken to secure the records;
 - 3 when and how the taxpayer became aware that they did not have the necessary records;
 - 4 if other means were explored to secure needed information;
 - 5 why the taxpayer did not estimate the information;
 - 6 if the taxpayer contacted the Service for instructions on what to do about missing information;
 - 7 if the taxpayer promptly complied once the missing information was received;
- and

(b) supporting documentation such as copies of letters written and responses received in an effort to get the needed information.

(5) Use PRC 25 if the taxpayer establishes reasonable cause because of an inability to obtain the

records necessary to comply with a tax or information filing requirement.

(20)133 (7-15-96) Statutory Exceptions and Administrative Waivers

(20)133.1 (7-15-96) General

These two very separate categories are placed together because in many instances an Administrative Waiver is an extension of rules that were provided for by statute.

(20)133.2 (7-15-96) Statutory Exceptions

(1) Tax legislation (Internal Revenue Code (IRC)) may provide an exception to a penalty. Specific statutory exceptions can be found in either the penalty-related IRC section or the accompanying regulations. For example:

(a) IRC section 6654(e)(1), (2), or (3), Estimated Tax Penalties for Individuals (IRM (20)300),

(b) IRC section 7502(a) and 7502(e), Timely Mailing Treated as Timely Filing and Paying (IRM (20)200),

(c) IRC section 6724(a) or 6724(c), Waiver, Definitions and Special Rules, Information Return Penalties (IRM (20)700):

(d) IRC section 6404(f), Abatement of Penalty or Addition to Tax Attributable to Written Advice of the Internal Revenue Service (see IRM (20)133.31),

(e) IRC section 7508, Time for performing certain Acts Postponed by Reason of Service in Combat Zone. This provision applies only in a Presidentially-declared "Combat Zone."

(2) Legislation with retroactive provisions may provide guidance on associated penalties. As a result of that retroactive provision, the Service may issue a News Release or other guidance with instructions for the disposition of the related penalties.

(3) Some Statutory Exceptions are assigned their own Penalty Reason Code (see the specific topic). However, many are not. Statutory Exceptions in general are identified by the use of a PRC 44.

(20)133.3 (7-15-96) Administrative Waiver

(1) The Service may formally interpret or clarify a provision to provide administrative relief from a penalty that would otherwise be assessed. An administrative waiver may be addressed in either a Policy Statement, News Release, or other formal communication stating that the policy of the Service is to provide relief from a penalty under specific conditions.

(2) An administrative waiver may be necessary when there is a delay by the Service in:

(a) printing or mailing of forms,

- (b) publishing guidance, writing of regulations, or
- (c) other conditions.

(3) An example of an administrative waiver is Notice 93-122, 1993-11 C.B. 305. This allowed Individuals who requested an automatic 4-month extension of time to file an income tax return, an extension of time without remitting the unpaid amount of any tax properly estimated to be due.

(4) An administrative waiver is identified by PRC 43.

(20)133.4 (7- 15-96) Undue Hardship

(1) An undue hardship may support the granting of an extension of time for paying a tax or deficiency. Treas. Reg. 1.6161-1(b), provides that an undue hardship must be more than an inconvenience to the taxpayer. The taxpayer must show that they would sustain a substantial financial loss if forced to pay a tax or deficiency on the due date.

(2) The extension of time to pay does not provide the taxpayer with an extension of time to file. Nor does the extension of time to pay relieve the taxpayer of any appropriate penalties.

(3) Undue hardship generally does not affect a person's ability to file and therefore would not provide a basis for penalty relief in a failure to file situation. However, each request must be considered on a case-by-case basis. Undue hardship may establish reasonable cause for failure to file on magnetic media, under Treas Reg. 301.6724-1.

(4) Undue hardship may also support relief from the addition to tax for failure to pay tax if, the explanation for the noncompliance supports such a determination. However, the mere inability to pay does not ordinarily provide the basis for granting penalty relief. Under Treas. Reg. 301.6651-1(e), the taxpayer must also show that they exercised ordinary business care and prudence in providing for the payment of the tax liability.

(a) The taxpayer may claim that enough funds were on hand but, as a result of unanticipated events, the taxpayer was unable to pay the taxes.

(b) Consider an individual taxpayer's inability to pay a factor when considering penalty relief if:

1 the taxpayer shows that, had the payment been made on the payment due date, undue hardship (as defined in Treas. Reg. 1.6161-1(b)) would have resulted.

2 In the case where a taxpayer files bankruptcy, consider inability to pay a factor if the insolvency occurred before the tax payment date.

(5) If a payroll was met, taxes were withheld and should be available for deposit. Employers must reserve money withheld from employees' wages in trust until deposited. The employer should not use the money for any other purpose. Undue hardship does not support relief from the IRC section 6672, Failure to Collect and Pay Over Tax, or attempt to Evade or Defeat Tax (Trust Fund Recovery Program).

(6) Information to consider when evaluating a request for penalty relief includes, but is not

limited to, the following:

- (a) when did the taxpayer know they could not pay;
- (b) why was the taxpayer unable to pay;
- (c) did the taxpayer explore other means to secure the necessary funds;
- (d) what did the taxpayer supply in the way of supporting documentation, such as copies of bank statements, and
- (e) did the taxpayer pay when the funds became available?

(7) An abatement of a penalty because the taxpayer experienced e "undue hardship" is identified by the use of PRC 29.

(20)133.5 (7-15-96) Advice

(20)133.51 (7-15-96) General

(1) This section discusses three basic types of advice: written and/or oral advice provided by the Service, and advice provided by a tax professional.

(2) Information to consider when evaluating a request for abatement or nonassertion of a penalty due to reliance or advice, includes, but is not limited to, the following:

(a) Was the advice in response to a specific request and was the advice received related to the facts contained in that request?

(b) Did the taxpayer reasonably rely on the advice?

1 Example: The taxpayer timely filed the return. After filing the return, the taxpayer received written advice from the Service regarding an item on that return.

a The taxpayer did not reasonably rely on the advice regarding an item included on a return if the advice was received after the date the return was filed.

b A taxpayer may be considered to reasonably relied on advice received after the return was filed if they then file an amended return that conforms with such written advice.

c A taxpayer may not be considered to have reasonably relied on written advice unrelated to an item included on a return, such as advice on the payment of estimated taxes, if the advice is received after the estimated tax payment was due.

(c) Did the taxpayer provide the Service or the tax professional with adequate and accurate information?

(3) The taxpayer is entitled to penalty relief for the period during which they relied on the advice.

(a) The period continues until the taxpayer is placed on notice that the advice is no

longer correct or no longer represents the Service's position.

(b) The taxpayer is placed on notice as the result of any of the following events that present a contrary position and occur after the issuance of the written advice.

1 With regard to advice from the Service, written correspondence from the Service that its advice is no longer correct or no longer represents the Service's position;

2 enactment of legislation or ratification of a tax treaty;

3 a U.S. Supreme Court decision;

4 the issuance of temporary or final regulations; or

5 the publication of a revenue ruling, revenue procedure, or other statement in the Internal Revenue Bulletin.

(4) Taxpayers should submit the necessary supporting information and documentation with Form 843, Claim. However, if the information provided demonstrates that abatement of the penalty is warranted, the penalty should be abated, whether or not a Form 843 is provided.

(20)133.52 (7-15-96) Written Advice from the Service

(1) The Service is required by IRC section 6404(f) and Treas. Reg. 301.6404-3 to abate any portion of any penalty attributable to erroneous written advice furnished by an officer or employee of the Service acting in their official capacity.

(2) if the taxpayer does not meet the criteria for penalty relief under IRC section 6404, the taxpayer may qualify for other penalty relief. For instance, taxpayers who fail to meet all of the above criteria may still qualify for relief under reasonable cause if the Service determines that the taxpayer exercised ordinary business care and prudence in relying on the Service's written advice.

(3) Penalties abated as the result of reliance on erroneous written advice from the Service should be identified by PRC 44, Statutory Exception.

(20)133.53 (7-15-96) Oral Advice from the Service

(1) The Service may provide penalty relief based on a taxpayer's reliance on erroneous oral advice from the Service. The Service is required by IRC section 6404(f) and Treas. Reg. 301.6404-3 to abate any portion of any penalty attributable to erroneous written advice furnished by an employee acting in their official capacity. Administratively, the Service has extended this relief to include erroneous oral advice when appropriate.

(2) In addition to considering the criteria provided in (20)133.31, consider the following:

(a) Did the taxpayer exercise ordinary business care and prudence in relying on that advice?

(b) Was there a clear relationship between the taxpayer's situation, the advice

provided, and the penalty assessed?

(c) What is the taxpayer's prior tax history and prior experience with the tax requirements?

(d) Did the Service provide correct information by other means (such as tax forms and publications)?

(e) What type of supporting documentation is available? For example:

- 1 a notation of the taxpayer's question to the Service,
- 2 documentation regarding the advice provided by the Service,
- 3 information regarding the office and method by which the advice was obtained,
- 4 the date the advice was provided, and
- 5 the name of the employee who provided the information.

(3) Penalties abated as the result of reliance on erroneous oral advice provided by the Service should be identified by using PRC 31 in the fourth reason code position.

(20)133.54 (7-15-96) Advice from a Tax Advisor

(1) Reliance on the advice of a tax advisor generally relates to the reasonable cause exception in IRC section 6664(c) for the accuracy-related penalty under IRC section 6662. See IRM (20)000, Preparer Promoter Penalty and Treas. Reg. 1.6664-4(c).

(2) However, in very limited instances, reliance on the advice of a tax advisor may apply to other penalties when the tax advisor provides advice on a substantive tax issue. For example,

(a) the employer:

- 1 researched all available Service publications on the subject of contract labor,
- 2 provided clear and convincing documentation as to the duties of the workers to the tax advisor, and
- 3 requested an opinion from the tax advisor as to whether the workers were "contract labor" or employees,

(b) As a result the tax advisor advised the employer that the workers were "contract labor".

(c) However, the Service later determined that the workers were "employees" and not "contract labor".

(3) Reliance on the advice of a tax advisor is limited to issues generally considered technical or complicated. The taxpayer's responsibility to file, pay or deposit taxes cannot be excused by reliance on the advice of a tax advisor.

(20)133.6 (7-15-96) Fire, Casualty, Natural Disaster, or Other Disturbance

(1) Relief from a penalty may be requested if there was a failure to timely comply with a requirement to file a return or pay a tax as the result of a fire, casualty, natural disaster, or other disturbance.

(2) Relief from a penalty because the taxpayer suffered from a fire, casualty, natural disaster, or other disturbance should be identified by the use of the appropriate PRC. It could be that as a result of the fire the taxpayer was unable to access their records (PRC 25) or as the result of an accident, the responsible party was hospitalized and unable to file the return or pay the tax (PRC 24 or 26).

(3) Fire, casualty, natural disaster, or other disturbance are factors to consider. One of these circumstances by itself does not necessarily provide penalty relief.

(4) Penalty relief may be appropriate if:

(a) the taxpayer exercised ordinary business care and prudence, but

(b) due to circumstances beyond the taxpayer's control they were unable to comply with the law.

(5) Factors to consider include:

(a) timing;

(b) effect on the taxpayer's business;

(c) steps taken to attempt to comply;

(d) if the taxpayer complied when it became possible.

(6) The determination to grant relief from each penalty must be based on the facts and circumstances surrounding each individual case.

(20)133.7 (7-15-96) Official Disaster Area

(1) When a significant disaster occurs affecting a wide area of taxpayers, the Service often issues special instructions to facilitate evaluating the request for penalty relief.

(a) Because these are one-time instructions, they will not be incorporated in this IRM. Districts, service centers, and customer service sites will be kept informed of any special instructions affecting their areas.

(b) Penalty Relief granted because the taxpayer was located in an Official Disaster Area is identified by the use of PRC 28.

(20)134 (7-15-96) Service Error

(1) A Service error can be any error made by the Service in computing or assessing tax, crediting accounts, etc. See Exhibit (20)100-3, Penalty Reason Code Chart, for the appropriate PRC to be

used when abating either a computer-generated or manually-input penalty.

(a) General Service Error (computer generated--PRC 15). This PRC should be used to identify penalties abated as the result of a Master File Recovery.

1 When an analyst, from any area of the Service, identifies a computer programming application that caused a penalty to be assessed in error, that analyst should:

a contact Information Services (IS) to resolve the inadequate computer application, and

b include on the Request for Information Services (RIS) a statement indicating that PRC 15 must be used to identify any abatement of a penalty resulting from reversal of the computer application.

(b) Other Service Error (manual input--PRC 45). This PRC should be used to identify penalties abated as the result of service errors that occur individually. For example:

1 a math error when manually computing a penalty,

2 an extension of time to file that did not post to the Master File, or

3 any other error, when it can be shown that:

a the taxpayer did in fact comply with the law, and

b the Service did not initially recognize that fact.

(20)135 (7-15-96) Requesting Penalty Relief

(20)135.1 (7-15-96) Initial Requests for Relief

(1) The initial request for relief may occur either after an examination, but before a penalty is actually assessed, or with a return that is either filed or paid late.

(2) When the request is received carefully analyze the taxpayer's reasons to determine if penalty relief is warranted. The burden of proof is generally upon the taxpayer.

(3) Each request must be evaluated on its own merit including:

(a) the events or parties involved, and

(b) if the taxpayer exercised ordinary business care and prudence, but due to circumstances or events beyond the taxpayer's control the taxpayer was unable to meet the tax requirement or if other penalty relief criteria apply.

(4) The taxpayer's obligation to meet the requirement is ongoing. Ordinary business care and prudence requires that the taxpayer continue to attempt to meet the requirements, even though late.

(5) Determine if the taxpayer's explanation addresses the penalty imposed.

(a) To show that the taxpayer is entitled to relief from the penalty, the dates and explanations should clearly correspond with events on which the penalties are based.

(b) If the dates and explanations do not correspond with the events on which the penalty are based, request additional information from the taxpayer to clarify the explanation.

(6) In determining whether or not the taxpayer exercised ordinary business care and prudence, review available Service information (see IRM (20)132.3).

(a) Check the preceding tax years (at least two) for payment patterns and the taxpayer's overall compliance history.

1 The same penalty, previously assessed, may indicate that the taxpayer is not exercising ordinary business care.

2 If this is the taxpayer's first incident of noncompliant behavior, weigh this factor with other reasons the taxpayer gives for relief, since a first time failure to comply does not by itself establish reasonable cause.

(7) Consider the length of time between the event cited as a reason for the noncompliance and subsequent compliance. The length of time between events may serve to cancel or reduce the event's effect. Penalty relief may not be appropriate if after considering all facts and circumstances the taxpayer fails to timely correct noncompliant behavior. For example:

(a) if the taxpayer claims that they were unable to comply with the filing requirement due to a death in the family,

1 that death occurred several months prior to the due date of the return, and

2 the return was not filed until a year after the due date of the return.

(b) Or the taxpayer claims that they were unable to comply with the filing requirement because the records necessary for filing were in the control of a third party, i.e., a bankruptcy trustee or an accountant,

1 the records were returned to the taxpayer well in advance of time the return was required to be filed, however,

2 the return was not filed until several months after the records were returned.

(c) In both of the examples, the timing of the event may prevent the taxpayer from receiving penalty relief unless other factors justify the delay in filing.

(8) Consider if the taxpayer could have anticipated the event that caused the non-compliance. See IRM (20)132.3.

(20)135.2 (7-15-96) Subsequent Requests for Penalty Relief

(1) A second or subsequent request for penalty relief may be received after the initial request for relief has been denied.

(2) If the review of the account indicates that the taxpayer's request for penalty relief was previously disallowed, review the circumstances of the previous denial.

(a) Is the taxpayer submitting new information?

1 If yes, consider the facts and circumstances discussed in the new information. Abate the penalty, disallow the request, or send a letter informing the taxpayer that you are unable to consider (no consider) the request for penalty relief based on the new information provided and the information contained in the original disallowance.

2 If the taxpayer is not submitting new information then:

(b) is the taxpayer requesting an appeal of the previous determination?

1 If yes, forward the request to Appeals.

2 If no, send the taxpayer a letter stating that you are unable to consider (no consider) the case on the grounds of the previous determination.

(c) If it is unclear what the taxpayer wants, contact the taxpayer to request clarifying information.

(3) If the penalty was previously sustained in Appeals, forward the request to the appropriate Appeals office. (This may be identified by the presence of a TC 290 for \$0.00 with a blocking series 96X on the account.)

(20)135.3 (7-15-96) Determining Relief Entitlement

(20)135.31 (7-15-96) Taxpayer Entitled to Relief

(1) If the taxpayer provides an explanation that supports their request, waive or abate the applicable penalties. If the explanation applies to only a portion of the penalty, only that portion of the penalty should be waived or abated.

(2) Document the decision and the basis for providing relief according to functional guidelines. Attach a copy of the information to the original return (if available) or other transaction (input) document.

(3) Decisions made by compliance personnel, with respect to penalties, should not ordinarily be changed by personnel within another functional area. Before considering relief for a penalty asserted by compliance personnel, contact that office to determine if the case should be returned to the originating office.

(4) If relief is granted prior to assertion of the penalty, use computer condition codes to suppress the automatic assertion of penalties.

(a) Functional areas that forward returns to be processed must request that the service

center prevent the assessment of the penalty. This may be done by:

- 1 writing "Reasonable Cause" or "Penalty Relief" (as appropriate) in the preprinted penalty block on the return or on Form 4364, Delinquency Computations,
- 2 requesting the penalty assessment transaction code be input for zero amount,
- 3 editing a computer condition code on the return (See LEM XX, Exhibit 100-1),
or
- 4 preparing other forms appropriate for forwarding returns or penalty computations for processing.

(b) In addition, annotate the appropriate PRC on the respective form or return.

(5) If relief is granted after the assessment of a penalty, follow procedures for abating the penalty or the appropriate portion of the penalty. Adjustments to penalties that are due to reasonable cause should include Reason Code 62 and the appropriate PRC. See Exhibit (20) 100-3.

(6) If relief is warranted for only a portion of the penalty, manually compute and assess or abate the applicable penalty amount. This will prevent automatic assertion of the penalty for the full amount. Follow applicable penalty procedures in IRM (20)000.

(20)135.32 (7-15-96) Taxpayer Not Entitled to Relief

(1) If the criteria for penalty relief has not been met, determine if additional information would be helpful to evaluate the taxpayer's request (See IRM (20)132.1:(5)).

(2) If a final determination that the criteria for granting penalty relief was not established:

(a) document the decision and its basis according to functional guidelines, and

(b) attach a copy of the information to the original return (if available) or other transaction (input) document.

(3) Employees denying a request for preassessment relief (prior to assessment) or abatement (after assessment), must provide written notification to the taxpayer of the denial and of the taxpayer's appeal rights, regardless of whether the request was received:

(a) in person,

(b) over the phone, or

(c) in writing.

(4) The notice should include:

(a) a complete explanation of the Service's decision and the basis for denial;

(b) information on the appeal procedures, including instructions on how to submit a written protest; and

(c) power of attorney information.

(5) The Service has developed standardized letters that are used by various offices. They include:

(a) IDRS Correspondex letter 854(C), which is generally used by service centers and district offices;

(b) ACS LT38, which is used by the Automated Collection System, and;

(c) Pattern letters 2413(P) and 2414(P), which are used by Collection District Offices.

(6) Functions that process returns through the service center will need to alert the service center of their decision to deny penalty relief. This can be done by writing "Penalty Relief Denied" in the appropriate preprinted penalty block on the return or on Form 4364, Delinquency Computations.

(7) If a request for penalty relief is denied after assessment, request or input TC 290 for zero amount, using blocking series 98/99 (Appeals uses blocking series 96X) with Reason Code 62 and hold code 3.

(20)140 (7-15-96) Methods of Appealing Penalties

(20)141 (7-15-96) General

(1) Various administrative and legislative remedies are provided for taxpayers who disagree with the Service's determination that they are liable for a particular penalty. Generally, when a taxpayer disagrees with our determination regarding a penalty they have the right to an administrative appeal.

(2) Taxpayers have the right to challenge the assertion or assessment of a penalty, and generally may do so at any stage in the penalty process. Taxpayers may request:

(a) a review of the penalty prior to assessment (e.g. deficiency procedures),

(b) a penalty abatement after it is assessed and either before or after it is paid (postassessment review),

(c) an abatement and refund after payment (claim for refund).

(3) Taxpayers may indicate their disagreement with the Service either verbally, in writing, or if paid, by filing a claim for refund or credit.

(4) If agreement cannot be reached at the district or service center, the taxpayer may request a conference with the employee's immediate manager or in most cases the taxpayer may request that the case be forwarded to Appeals. Taxpayers should provide a written request for consideration by Appeals.

(5) The taxpayer may also file suit in court. Depending on the procedural circumstances of the taxpayer's case, the taxpayer may petition the United States Tax Court or file a complaint with either the United States District Court having jurisdiction or the United States Court of Federal Claims, as appropriate. See IRM 8100, General Information.

(20)142.1 (7-15-96) General

(1) The Appeals Office is an independent administrative body within the Service that is the only formal level of appeal within the Service.

(2) The review of a penalty determination by Appeals is not automatic. Appeals will only review a penalty if the request for relief has been previously denied by a Service employee and the taxpayer requests an appeal.

(3) In addition, Appeals may make a determination that the taxpayer did not commit the prohibited action or failure to act for which the penalty is asserted (charged). Issues of basic liability for a penalty may be considered in the appeals process, and should be considered before considering if reasonable cause or other relief criteria exist.

(4) Appeals has the authority to settle penalties for less than the full amount based on the hazards of litigation.

(20)142.2 (7-15-96) When Appeals Will Consider a Case

(20)142.21 (7-15-96) Preassessment Appeals

(1) Generally, Appeals will consider the following type of penalties prior to assessment:

(a) penalties which are asserted by the Service in the course of an examination of a taxpayer's income tax return,

(b) penalties which are granted a specific preassessment appeal right such as the Trust Fund Recovery penalty under IRC 6672 (see IRM section 5630 for Trust Fund Recovery penalty guidelines) or the preparer penalties under IRC 6694, and

(c) the intentional disregard penalty of IRC section 6721(e) when it is asserted for failures to comply with the cash reporting requirements of IRC section 60501.

(2) Generally, if Appeals considers a penalty before it is assessed, Appeals will not reconsider the penalty after it is assessed.

(a) However, at its discretion, Appeals may reconsider its prior decision if evidence becomes available that indicates further consideration is warranted.

(b) Taxpayers may also pay the penalty previously upheld by Appeals, and file a claim for refund. The claim for refund may be brought to Appeals if denied.

(3) More detailed Appeals procedures are described in IRM 8(11)00 and text 600 of IRM 8114, Appeals Returns Processing and Control Handbook.

(20)142.22 (7-15-96) Postassessment Appeals

(1) To request abatement of a penalty after assessment, the taxpayer must submit a written request to the Service.

(2) The employee must consider all the facts and circumstances to determine if the taxpayer's

explanation meets the penalty relief criteria. See IRM (20)130.

(3) If a taxpayer orally requests the abatement of a penalty, advise the taxpayer to submit the request in writing. See 131 of LEM XX.

(4) If a taxpayer orally requests an appeal of a decision, advise the taxpayer to submit the request in writing.

(5) Certain penalties such as failure to file, failure to pay, and failure to deposit are routinely assessed at the time a return is filed or the tax is paid. When one of these penalties is assessed, the taxpayer may submit a statement requesting an abatement of the penalty.

(20)143 (7-15-96) Deficiency and Nondeficiency Procedures

(20)143.1 (7-15-96) Deficiency Procedures

(1) IRC section 6211 generally defines a deficiency as the excess of the correct amount of income, estate or gift taxes owed less the sum of the amount shown on the return and the amounts previously assessed (or collected without assessment) less rebates. In general, deficiency procedures are used when additional income, estate, or gift taxes and/or related penalties are proposed. The Service generally:

(a) cannot assess an additional amount of income, estate, or gift tax, including related penalties unless it complies with deficiency procedures;

(b) can assess additional amounts of employment and certain excise tax and related penalties without providing a notice of deficiency;

(c) can assess penalties not related to a tax (e.g., IRC sections 6700, 6701, 6702) without providing a notice of deficiency;

(d) can assess estimated tax penalties (IRC sections 6654 and 6655) if a return was filed for the tax year without providing a notice of deficiency; and

(e) can assess the failure to file and failure to pay (IRC section 6651) applicable to the portion of the tax liability which is not a tax deficiency without providing a notice of deficiency. Example:

1 Taxpayer files the return one month late and reports and pays a tax of \$4,000. On audit, the Service determines a tax deficiency of \$1,000.

a The late filing penalty is 5 percent, per month, (for up to 5 months) of the amount of tax. The total failure to file penalty is \$250 (5 percent of \$5,000 for one month).

b If the taxpayer contests the deficiency, the taxpayer will be entitled to a notice of deficiency for \$1,050 (\$1,000 tax deficiency and \$50 failure to file penalty (5 percent of \$1,000),

c The remaining \$200 failure to file penalty which was attributable to the

original tax assessment is not part of the deficiency and is collectible by immediate assessment.

(2) A penalty is subject to deficiency procedures, if the related tax underpayment being assessed is subject to deficiency procedures. For example, if the negligence penalty was assessed on an underpayment of income tax, the deficiency procedures would apply to the negligence penalty as well as income tax deficiency. However, if the penalty was the result of an underpayment of employment tax, deficiency procedures would not apply to the penalty.

(a) The taxes and related penalties subject to deficiency procedures include income, gift and estate tax as well as certain excise taxes.

(b) The taxes and related penalties not subject deficiency procedures include employment taxes imposed by Subtitle C, and certain excise taxes.

(3) The procedure called "notice of deficiency" provides the taxpayer a method of appealing tax and/or penalties prior to their assessment.

(20)143.2 (7-15-96) Non-Deficiency Procedures

(1) Most employment and excise taxes are not subject to deficiency procedures. No statutory notice of deficiency is issued and the taxpayer cannot petition the Tax Court.

(2) Generally, nondeficiency procedures are as follows:

(a) If penalties are proposed and the taxpayer agrees, the penalties are assessed.

(b) If penalties are proposed and the taxpayer disagrees:

1 a 30 day letter is issued and

2 the taxpayer may file a protest with Appeals.

(c) If Appeals sustains the penalty proposal, the penalties are assessed.

(3) If penalties are assessed and the taxpayer cannot or does not file a protest with Appeals, the taxpayer must pay the penalty, then they may file a claim for credit or refund,

(4) If a 30 day letter was not issued, or if a claim for refund was denied, the taxpayer should be given the opportunity for an appeal.

(20)150 (7-15-96) Master File Indicators

(20)151 (7-15-96) Master File Reason Codes

(1) Penalty reason codes were adopted to enable the Service to track penalties. Accurate reporting of these reason codes is vital. Penalty reason codes provide the basis for determining a taxpayer's compliance history and the foundation of the Penalty Management Information System. Penalty reason codes are used with both BMF and IMF document code 54 and 47 transactions.

(2) Penalty reason codes are divided into two categories, systemically generated and manually

input. When manually abating a penalty, use only those reason codes identified as available for manual input on Exhibit (20)100-3.

(3) If an abatement or partial abatement of a penalty is appropriate, either input the abatement transaction or complete the appropriate form to request that the support area abate the penalty using the specified penalty reason code.

(a) Taxpayer Service -- IDRS (ADJS4) -- The Penalty Reason Code **MUST** be used only in the fourth reason code position.

(b) Compliance -- The penalty reason code must be used to identify the reason for the abatement or nonassertion of a penalty when completing any of the following forms.

1 Form 5344, Examination Closing Record (ADJ47).

2 Form 5599, EO Examined Closing Record (ADJ47).

3 Form 8278, Computation and Assessment of Miscellaneous Penalties (ADJS4).

(c) Appeals -- The penalty reason code must be used when abatement or non-assertion of a penalty when completing any of the following forms.

1 Form 5403, Appeals Closing Record (ADJ47),

2 Form 9120, Appeals Transmittal Memorandum and Supporting Statement -- Penalty (ADJS4),

3 Form 8278, Computation and Assessment of Miscellaneous Penalties (ADJS4).

(4) There are four main categories of Penalty Reason Codes available for manual input. They are:

(a) Penalty Relief, to be used in conjunction with IRM (20)130 or other specific penalty provisions provided throughout IRM (20)000 (see Exhibit (20)100-3),

(b) Appeals, the following three reason codes are to be used only by Appeals and only when the other criteria referenced in Exhibit (20)100-3 are inappropriate. For example:

1 RC 40 -- Hazards of Litigation or other Appeals Settlement when all of the penalty is abated,

2 RC 41 -- penalties are sustained by Appeals,

3 RC 42 -- partial abatement (Settlements where part of the penalty is abated).

(c) Statutory Exception or Administrative Waivers, (to be used when written procedures have been established) and

(d) Service Error, (to be used when it is determined that the Service computed the penalty incorrectly or inappropriately).

(5) If more than one penalty is abated for more than one reason, each abatement action must reference its own penalty reason code. This will require a separate adjustment for each penalty

reason code. For example:

- (a) 16X Reasonable Cause -- PRC 25
- (b) 27X Partially abated -- PRC 42
- (c) 18X Hazards -- PRC 40

(6) If all penalties are abated for the same reason, only one PRC must be referenced. For example:

- (a) 16X Reasonable Cause -- PRC 25
- (b) 27X Reasonable Cause
- (c) 18X Reasonable Cause

(20)152 (7-15-96) Penalty Transaction Codes

(1) Penalty transaction codes (see Exhibit (20)100-5) indicate assessment or abatement actions. Generally, return related penalties are based on an underpayment of tax.

(a) When the penalty is assessed on the Tax Module,

1 generally, each penalty is assigned a Transaction Code (TC) which identifies the type of penalty,

2 however, some penalties assessed on a Tax Module will use a TC 240 with a reference number (RN) which identifies the type of penalty. These reference numbers are between 680 and 699.

(b) There are usually four potential transaction codes for each penalty, one each for manual and computer assessments with the related abatement codes. For example, Failure to File (FTF):

- 1 160 -- Manually assessed FTF,
- 2 161 -- Manually abated FTF,
- 3 166 -- Computer generated assessment of the FTF,
- 4 167 -- Computer generated abatement of the FTF.

(c) Related penalty Transaction Codes in a series are shown in Exhibit (20)100-5, with the first two digits plus an X. For example, in the FTF example series above the TC will be shown as 16X.

(2) Exhibit (20)100-5, provides:

- (a) Penalty Transaction Codes (TC),
- (b) their related IRC section, and

(c) a description of the penalty.

(20)153 (7-15-96) Penalty Reference Numbers

(1) Penalty Reference Numbers are used to identify penalties that are not based on information from a tax return. These penalties are based on a failure to perform an act required by the Internal Revenue Code (IRC):

(a) The penalty is assessed on MFT 13 (Individual) or 55 (Business), and

(b) identified by a Reference Number.

(2) At times several reference numbers will be used to identify one code section, though the failure may be the same or similar. This is done to identify the area or program responsible for assessing or abating the penalty. For example, both reference numbers 500 and 600 are used to identify a penalty assessed as the result of IRC section 6721.

(a) Reference number 500 is used if the failure was identified on the Payer Master File.

(b) Reference number 600 is used if the failure was identified during an examination, audit, or other compliance determination based on the taxpayers books and records.

(c) Reference numbers between 680 and 699 are used to identify return related penalties. These reference numbers will appear on tax related MFT's (not MFT 13 or 55).

(3) See Exhibits (20)100-6 and 7 for:

(a) Penalty Reference Numbers,

(b) their related IRC section,

(c) a description of the penalty, or

(d) the computer paragraph inserted in the balance due notice.

(4) The following are examples of reference numbers assigned for various failures relating to IRC section 6721.

(a) Reference numbers 500 through 514 are used to assess/ abate penalties based on Payer Master File information. See IRM (20)700, Information Return Penalties.

(b) Reference number 549 is used to assess/abate penalties based on the CAWR Program. See IRM (20)700, Information Return Penalties.

(c) The 600 series reference numbers are used to assess or abate a penalty as the result of an examination or a determination made by a compliance employee:

1 600 -- failure to timely and correctly file an information return.

2 609 -- failure to timely and correctly file a Form 8300 -- responses to Detroit

Computing Center.

3 651 -- Failure to File -- Form 8300

4 652 -- Interntional Disregard -- Form 8300.

(20)160 (7-15-96) Administrative Procedures

(20)161 (7-15-96) General

See Exhibit 100-8 for the Table of Abbreviations and Acronyms and Exhibit 100-9 for the Dictionary of Key Terms.

(20)162 (7-15-96) Corporate Files on Line (CFOL)

(1) CFOL provides on-line research of master file account and return data. The use of command codes such as IMFOL, BMFOL, and RTVUE is an alternative to MFTRA/ACTRA/ESTAB requests.

(2) However, since master file does not carry all information available on the IDRS screen displays (IDRS notice status, case control information, pending transaction, etc.), it is imperative that IDRS research be initiated before accessing master file information via CFOL command codes. Also IDRS input command codes that will cause a change to master file data cannot be preceded by BRTVUE or RTVUE.

(3) CFOL command codes should be used to research entity and/or tax data which may not be available on IDRS. In most cases, the response will appear on the screen in five seconds or less.

(a) It is recommended that CFOL command codes be used in lieu of MFTRA/ACTRA/ESTAB when the case can be resolved from information provided by the CFOL command codes.

(b) This will reduce the need to order MFTRA transcripts on some cases

(4) IMFOL accesses the IMF and allows several screen displays based on an input definer code. These include:

(a) An index screen which shows whether a specific tax period is available on-line or not. The index screen also includes a balance due field showing if the account is in debit, credit, or zero balance.

(b) A screen which shows entity type information (similar to INOLE).

(c) A screen which has specific data from the tax account (similar to TXMOD and MFTRA).

(d) A screen titled IMF Adjustment Transaction Screen which includes detailed information about adjustment transactions input.

(e) A screen which includes retention register account information.

(f) A posted TC 150 return screen which displays return data that is transcribed along with computer generated fields.

(g) A status history screen which includes extension to file data.

(h) A help screen which displays information to assist in using IMFOL/BMFOL.

(5) RTVUE accesses the Return Transaction File (RTF). It contains all edited, transcribed, and error corrected data from data entry lines of returns and related forms and schedules filed in the current processing year (including returns for prior tax years). At a later date, this file will contain information for the current year and two prior year returns. This command code requires a definer to access a particular screen and has an index type screen.

(6) For further explanation of the screen displays and applicable definer codes, refer to IRM 3(25)(77)0, IDRS Terminals Inquiries. Exhibit (20)100-1

Penalty Policy Statement

PENALTY POLICY STATEMENT

Penalties constitute one important tool of the Internal Revenue Service in pursuing its mission of collecting the proper amount of tax revenue at the least cost. Penalties support the Service's mission only if penalties enhance voluntary compliance. Even though other results, such as raising of revenue, punishment, or reimbursement of the costs of enforcement, may also arise when penalties are asserted, the Service will design, administer, and evaluate penalty programs solely on the basis of whether they do the best possible job of encouraging compliant conduct.

In the interest of an effective tax system, the Service uses penalties to encourage voluntary compliance by: (1) helping taxpayers understand that compliant conduct is appropriate and that non-compliant conduct is not; (2) deterring noncompliance by imposing costs on it; and (3) establishing the fairness of the tax system by justly penalizing the non-compliant taxpayer. To this end, the IRS administers a penalty system that is designed to:

- ensure consistency;
- ensure accuracy of results in light of the facts and the law;
- provide methods for the taxpayer to have his or her interests heard and considered;
- require impartiality and a commitment to achieve the correct decision;
- allow for prompt reversal of initial determinations when sufficient information has been presented to indicate that the penalty is not appropriate;
- ensure that penalties are used for their proper purpose and not as bargaining points in the development or processing of cases.

The Service maintains an ongoing effort to develop, monitor, and revise programs designed to assist taxpayers in complying with legal requirements and, thus, avoid penalties.

To ensure consistency, the Service prescribes and uses a single set of guidelines in a Penalty Handbook which will be followed by all operational and processing functions. Prior to implementation, changes to the Penalty Handbook must be reviewed for consistency

with Service Policy and approved by the Office of Penalty Administration.

The Service collects statistical and demographic information to evaluate penalties and penalty administration and how they relate to the goal of voluntary compliance. The Service continually evaluates the impact of the penalty program on compliance and recommends changes when the statutes or administration of penalties are not effectively promoting voluntary compliance.

Exhibit (20)100-2 Penalty Relief -- Application Chart

PENALTY RELIEF -- APPLICATION CHART

IRC Section	Type of Penalty	Reasonable Cause	Relief	Relief
	to File	Yes	Yes	6651(a) (1) Failure
6651(a) (2)	Failure to Pay when due	Yes	Yes	
6651(a) (3)	Failure to Pay within 10 Days of	Yes	Yes	Notice of Additional Tax Due
6651(d)	Failure to Pay within 10 Days of	Yes	Yes	Final Notice and Demand
6651(f)	Fraudulent Failure to File	Yes	Yes	
6652(a) (1)**	Failure to File Information Returns	Yes	Yes	
6652(c) (1)	Failure to File Annual Return by	Yes	Yes	Exempt Organization
6652(c) (2)	Failure to File Returns under IRC	Yes	Yes	Section 6034 or 6043(b)
6652(d) (2)	Notification of Change in Status of	Yes	Yes	a Plan
6652(a)	Information Required in Connection	Yes	Yes	with Certain Plans of Deferred Compensation-Form 5500
6652(h)	Failure to Give Notice to	Yes	Yes	Recipients of Certain Pension, etc, Distributions
6652(i)	Failure to Give Written Expiration	Yes	Yes	to Recipients of Certain Qualifying Rollover Distributions
6653(a) *	Negligence	No	Yes*	
6653(b) *	Fraud	No	Yes*	
6654	Estimated Tax Penalty on	No	Statutory	Individuals Exception
6655	Estimated Tax Penalty	No	No	on Corporations
6656(a)	Failure to Deposit	Yes	Yes	
6657	Bad Check		Yes	Yes

Exhibit (20)100-2 Cont

Penalty Relief -- Application Chart

PENALTY RELIEF -- APPLICATION CHART

IRC Section	Type of Penalty	Reasonable Cause	Relief	Other Cause	Relief
6651(a)(1)	Failure to File	Yes	Yes		
6659*	Valuation Overstatement	No	Yes		
6659A*	Overstatement of Pension Liabilities	No	Yes		
6661*	Substantial Understatement	No	Yes		
6662	Accuracy-Related	Yes	Yes		
6663	Fraud	Yes	Yes		
6692	Failure to File Actuarial Report	Yes	Yes		
6698	Failure to File Partnership Return	Yes	Yes		
6721	Failure to File Correct Information	Yes	Yes	Reporting Returns	
6722	Failure to Furnish Correct Payee	Yes	Yes	Statements	
6723	Failure to Comply with other	Yes	Yes	Information Reporting Requirements	

* Repealed for tax returns filed after December 31, 1989
 ** Repealed for tax returns filed after December 31, 1986

Exhibit (20)100-3 Penalty Reason Code Chart

PENALTY REASON CODE (PRC) CHART COMPUTER GENERATED

PENALTY ORIGIN	REASON CODE	DEFINITION	Systemic
	01	Suppressed/Abated - LEM criteria	
	02	Penalty adjusted due to computational error	
	03	Master File Recovery Taxpayer	
	10	Corrected/Amended return, Original return taxpayer prepared	
	13	Corrected/Amended return, Original return prepared by the Service (SFR/6020B)	
	14	Misapplied/misdated payment (TP/Bank)	
Service	15	General Service Error (134)	

Exhibit (20)100-3 Cont. Penalty Reason (Code) Chart

PENALTY REASON CODE CHART (PRC) MANUAL INPUT

ORIGIN PRC DEFINITION

Service

*21 LEM criteria

Reasonable Cause (RC62)

22 Taxpayer exercised ordinary business care and prudence. (20)132.3

24 Death, Serious illness or Unavoidable absence of taxpayer or immediate family member of the party responsible. (IMF) (20)132.4

25 Records Inaccessible. (20)132.5

26 Death, Serious illness or Unavoidable absence of party responsible (or member of immediate family). (BMF) (20) 132.4

*30 Other (20)131

General Penalty Relief

*43 Administrative Waiver (20)133

*31 Erroneous oral advice from the Service (20)133.33

*44 Statutory Exception (20)133

23 Taxpayer relied on practitioner or third party (20)133.33

27 Timely mailed/timely filed (20)133.11

28 Disaster Area (20)133.5

29 Undue economic hardship/inability to pay (20)133.2)

*45 Service Error (20)134

Exhibit (20)100-3 Cont. Penalty Reason (Code) Chart

Appeals

*40 Appeals abatement (Hazards of Litigation)

*41 Appeals sustains penalty

*42 Appeals partially sustains penalty

Exhibit (20)100-4 (Reserved)

Exhibit (20)100-5 Penalty Transaction Codes

TC	IRC section	Description
16X	6651(a) (1)	Failure to File a Tax Return (FTF). The FTF penalty is equal to the appropriate percentage of the net tax due multiplied by each month or part of a month (not to exceed 5 months) the return is not filed: 4 1/2% if the FTP also applies, or 5% if only FTF applies.
17X	6654	Failure by an Individual to pay Estimated Income Tax, and 6655 Failure by a Corporation to pay Estimated Income Tax. excess of the required installment (either individual or corporate) minus the amount paid or credited on or before the due date of the installment is the underpayment. To determine the penalty for each installment, multiply: <ul style="list-style-type: none">- the penalty rate (the underpayment interest rate for the applicable quarter)- by the amount of the underpayment,- for the period of the underpayment (the earlier of the date the payment is received or the return due date.
18X	6656	Failure to Deposit. The penalty is based on the: <ul style="list-style-type: none">- underpayment of the under deposited amount, and- the number of days between the deposit liability due date and the date the deposit is received.<ul style="list-style-type: none">2%- 1 to 5 days late,5%- 6 to 15 days late,10%- more than 15 days but before 10 days after notice and demand, or15%- payments received more than 10 days after notice and demand.10%- FTD Avoidance Penalty Payments made directly to the IRS, or deposits made to a bank when the employer is required to deposit electronically.
20X	6723	Failure to provide a Taxpayer Identification Number (TIN). The penalty is \$50 per failure, not to exceed \$100,000.
23X	6652(c)	Daily Delinquency Penalty-\$10 times the number of days the return was filed after

		the due date or extended due date, not to exceed \$5,000.
240**		Assesses a Miscellaneous Penalty generally associated with a Reference Number.
241**		Abates a Miscellaneous Penalty generally associated with a Reference Number.
246	6698	Assesses the Failure to File a Partnership return or missing information associated with a partnership return. The penalty is \$50 per partner, per month, for not more than 5 months.
247		Abates the Failure to File a Partnership return or missing information penalty associated with a partnership return.
27X	6651(a)2	Failure to Pay (FTP) is 1/2 of 1% (.005) per month, for each month or part of a month, from the due date of the return to the date the tax is paid or the maximum of 25% of the unpaid tax is reached, or
	6651(a)3	Failure to Pay is 1/2 of 1% (.005) for each month or part of a month, from 10 days after notice and demand until the tax is paid or the maximum of 25% of the unpaid tax is reached, or
	6651(d)	Increases the penalty from 1/2 of 1% (.005) to 1% (.01) per month, the earlier of the day on which notice and demand for immediate payment is given or 10 days after the service has issued the notice of intent to levy.

Exhibit (20) 100-5 Cont. Penalty Transaction Codes

TC	IRC section	Description
28X	6657	Bad Check Penalty - If the check- is \$750 or more, the penalty is 2 percent of the amount of the check, is less than \$750, the penalty is the lesser of: \$15, or the amount of the check.
31X*	6652(b)	Failure to Report Tips Penalty - imposes a penalty on the employee (who received the tips) equal to 50 percent of the employee's portion of the FICA tax or Railroad Retirement tax applicable to the tip amount that was not reported at the time and in the manner required.
32X*	6653(b)R	Fraud Penalties assessed for returns with a due date prior to January 1, 1990.
	6663	Fraud Penalties assessed on returns due after December 31, 1989.
35X*	6662(c)	Negligence penalties assessed for returns with a due date after December 31, 1989, are 20% of the underpayment of tax due to negligence.

- R This IRC section was repealed, the law may or may not have been incorporated into another code section.
- * The penalty was assessed as the result on an examination or other compliance employee determination. These penalties should be abated only by the area responsible for assessing the penalty or by Appeals.
- ** See Reference Numbers in Exhibit (20) 100-5 and 6.

Exhibit (20) 100-6 Penalty Reference Numbers (600 Series)

Penalties assessed using the reference numbers of 500 through 514 are assessed using the following computational formula. Only one penalty, per return, can be assessed regardless of the number of failures associated with that return. Therefore, the computer paragraph associated with the respective reference number relates to the type of failure, not the way the penalty was computed.

RN IRC Description section

6721 Imposition of the Failure to Comply with Certain Information Reporting Requirements. - These reference numbers should only be used for returns and statements due after December 31, 1989. - \$50 per failure/maximum \$250,000. - \$15 per failure/maximum \$75,000, If a failure is corrected within 30 days, after the due date of the return of the information return, i.e., the penalty will be decreased to \$15 per failure. - \$30 per failure/maximum \$150,000, If the failure is corrected more than 30 days after the due date of the return, but on or before August 1 of the filing year, i.e., the penalty will be decreased to \$30 per failure.

500 6721 Late Filing Penalty - A penalty is charged for each Form 1098, 1099(1), W-2G, or W-2 that was not correctly and timely filed.

501 6721 Magnetic Media Penalty - A penalty is charged for each Form 1098, 1099, W-2G, or W-2 (after the first 250 forms of each type) required by IRC section 6011(e)(2)(a) not filed either electronically or by magnetic media.

502 6721 Missing or Incorrect TIN Penalty - A penalty is charged for each Form 1098, 1099, W-2G, or W-2 submitted with missing or incorrect TINs.

503 6721 Improper Format Penalty - A penalty is charged for each Form 1098, 1099, W-2G, or W-2 submitted in an improper format as provided for in either the IRC, Treas. Regs. or SSA procedures.

504 6721 Late and Magnetic Media Penalty A penalty is charged for each Form 1098, 1099, W-2G, or W-2 that was not filed: - correctly and timely, and - either electronically or using magnetic media. (over 250 forms)

505 6721 Late and Missing or Incorrect TIN Penalty - correctly and timely filed, and - submitted with a missing or incorrect TIN.

506 6721 Late and Improper Format Penalty A penalty is charged for each Form 1098, 1099, W-2G, or W-2 that was not: - correctly and timely filed, and

507 6721 Magnetic Media and Missing or Incorrect TIN Penalty A penalty is charged for each Form 1098, 1099, W-2G, or W-2 that was: - not filed either electronically or using magnetic media, (over 250C forms) and - filed with missing or incorrect TINs.

(1) Any applicable suffix

Exhibit (20)100-6 Cont. Penalty Reference Numbers (600 Series)

RN	IRC section	Description
508	6721	Magnetic Media and Improper Format Penalty A penalty is charged for each Form 1098, 1099, W-2G, or W-2 that was not: - filed either electronically or using magnetic media, and - submitted in the proper format as provided for in either the IRC, Treas. Regs. or SSA procedures.
509	6721	Missing or Incorrect TIN and Improper Format Penalty A penalty is charged for each Form 1098, 1099, W-2G, or W-2 that was filed: - with a missing or incorrect TIN, and - in an improper format as provided for in either the IRC, Treas. Regs. or SSA procedures.
510	6721	Late, Magnetic Media, and Missing or Incorrect TIN Penalty A penalty is charged for each Form 1098, 1099, W-2G, or W-2 that was: - not correctly and timely filed, - not filed either electronically or by magnetic media (after the first 250 forms of each type) required by IRC section 6011(e) (2) (a), and - filed with missing or incorrect TINs.
511	6721	Late, Magnetic Media, and Improper Format Penalty A penalty is charged for each Form 1098, 1099, W-2G, or W-2 that was not: - correctly and timely filed, - filed either electronically or by magnetic media (after the first 250 forms of each type) required by IRC section 6011(e) (2) (a), and - submitted in the proper format as provided for in either the IRC, Treas. Regs. or SSA procedures.
512	6721	Late, Missing or Incorrect TIN, and Improper Format Penalty A penalty is charged for each Form 1098, 1099, W-2G, or W-2 that was: - not correctly and timely filed, - filed with missing or incorrect TINs, and - not submitted in the proper format as provided for in either the IRC, Treas. Regs. or SSA procedures.
513	6721	Magnetic Media, Missing or Incorrect TIN, and Improper Format Penalty A penalty is charged for each Form 1098, 1099, W-2G, or W-2 that was: - not filed either electronically or using magnetic media - filed with missing or incorrect TINs, and - not submitted in the proper format as provided for in either the IRC, Treas. Regs. or SSA procedures.
514	6721	Late, Magnetic Media, Missing or Incorrect TIN, and Improper Format Penalty A penalty is charged for each Form 1098, 1099, W-2G, or W-2 that was: - not correctly and timely filed - either electronically or using magnetic media - filed with missing or incorrect TINs, and - not submitted in the proper format as provided for in either the IRC, Treas. Regs. or SSA procedures
549	6721(e)	Penalty in the Case of Intentional Disregard. (CAWR Penalty Program) - The penalty is assessed at \$100 per failure to file Form W-2 - A penalty is charged for each Form W -2 that was not filed as required by IRC section 6051.

Exhibit (20)100-7 Penalty Reference Numbers (600 Series)

RN	IRC section	Description
600	6721	Failure to File Correct Information Returns. - This reference number should only be used for returns and statements due after December 31, 1989. - \$50 per failure/maximum \$250,000. - \$15 per failure/maximum \$75,000. If a failure is corrected within 30 days, after the due date of the information return, the penalty will be

decreased to \$15 per failure. The maximum annual penalty per filer shall not exceed \$75,000. - \$30 per failure/maximum \$150,000. If the failure is corrected more than 30 days after the due date of the information return, the penalty will be decreased to \$15 per failure. The maximum annual penalty per filer shall not exceed \$150,000. - For other circumstances that may apply, see IRM (20)(10)00.

601 6723 Failure to Include Correct Information. - This reference number should only be used for return periods beginning after December 31, 1985 and ending prior to January 1, 1990. - \$5 per failure, with a maximum not to exceed \$20,000.

602 6676 Failure to Supply Identifying Numbers - This reference number should only be used for return periods beginning after December 31, 1985 and ending prior to January 1, 1990. - \$5 per failure, with a maximum not to exceed \$20,000.

602 6676 Failure to Supply Identifying Numbers. - This reference number should only be used for returns and statements due prior January 1, 1990. - This penalty was incorporated into IRC section 6723.

603 6676 Failure to Supply Identifying Numbers - This reference number should only be used for returns and statements due prior to January 1, 1990. - This TIN penalty was incorporated into IRC 6721 for information returns and IRC section 6723 for other documents.

604 6676 Failure to Supply Identifying Numbers. - This reference number should only be used for returns and statements due prior to January 1, 1990. - The TIN penalty was incorporated into IRC 6721 for information returns and IRC section 6723 for other documents.

605 6676 Failure to Supply Identifying Numbers. - This reference number should only be used for returns and statements due prior to January 1, 1990. - The TIN penalty was incorporated into IRC 6721 for information returns and IRC section 6723 for other documents.

606 6676 Failure to Supply Identifying Numbers. - This reference number should only be used for returns and statements due prior to January 1, 1990. - The TIN penalty was incorporated into IRC 6721 for information returns and IRC section 6723 for other documents.

607 6721 Failure to File a Correct Information Returns.
- This reference number should only be used for returns due after December 31, 1986 and before January 1, 1990.

Exhibit (20)100-7 Cont. (1) Penalty Reference Numbers (600 Series)

TC	IRC section	Description
	608 6721	Failure to File a Correct Information Returns. - This reference number should only be used for Forms 1099 INT, DIV, and PATR returns due after December 31, 1985 and before January 1, 1990.
	609 6721	Failure to File a Complete Form 8300, Report of Cash Payments Over \$10,000. (Detroit Computing Center)
	610 6721	Failure to Furnish Correct Payee Statement. - This reference number should only be used for returns due after December 31, 1986 and before January 1, 1990.

611 6722 Failure to Furnish Correct Payee Statement. - This reference number should only be used for Forms 1099 INT, DIV, OID, and PATR returns due after December 31, 1986 and before January 1, 1990.

612 6722 Failure to Furnish Correct Payee Statement. - For returns required to be filed after December 31, 1989, a penalty will be imposed for each failure to: - furnish a payee statement on or before the due date to the person to whom the statement must be furnished, - furnish all information required, and - furnish correct information. - The \$50 penalty for failure to furnish payee statements is not reduced if returns are corrected or filed after the due date. - Only one penalty per statement, regardless of the number of failures per statement. - The total penalty for all such failures during any calendar year shall not exceed \$100,000.

613 6679 Failure to File Returns, Etc, With Respect to Foreign Corporations or Foreign Partnerships. - Failure to File Form 5471 and Schedule O. - The penalty is assessed at \$1,000 per failure.

614 6679 Failure to File Returns, Etc, With Respect to Foreign Corporations or Foreign Partnerships. - Failure to File Form 5471 and Schedule N. - The penalty is assessed at \$1,000 per failure.

615 6682 False Information with Respect to Withholding. - False information on Form W-9. - \$500 for each false statement (W-9).

616 6682 False Information with Respect to Withholding: - False information on Form W-4. - \$500 for each false statement (W-4).

617 6723 Failure to Include Correct Information. This reference number should only be used for returns due after December 31, 1986, and before January 1, 1990. - See reference number 647 and 648 for 6723 penalty computation.

618 6672 Failure to Collect and Pay Over Tax, or an Attempt to Evade or Defeat Tax. - Trust Fund Recovery Program. The penalty is assessed against responsible corporate officers. - 100% of the tax required to be collected, accounted for, and paid over.

619 6679 Failure to File Returns with Respect to Foreign Corporations or Foreign Partnerships. - Failure to File such form as Treas. Reg. provides - The penalty is assessed at \$1,000 per failure.

620 6693 Failure to Provide Reports on Individual Retirement Accounts or Annuities.

6693(b) (1) Overstatement of Designated Nondeductible Contributions-\$100 per overstatement.

621 6723 Failure to Comply with Other Reporting Requirements. - For returns and statements required to be filed after December 31, 1989, - A penalty of \$50 per failure - to comply timely with specified information reporting requirements, or - to include correct information. - The maximum penalty is \$100,000 per year

622 6694(a) Understatement of Taxpayer's Liability by Income Tax Return Preparer. - This reference number should only be used for documents prepared prior to January 1, 1990. - Prior to January 1, 1990, this penalty was assessed at \$100 per return or claim for refund.

623 6038(b) Failure to Furnish Information with Respect to Certain Foreign Corporations. - Failure to File Form 5471 and Schedule M. - \$1,000 per accounting period. If the failure continues for more than 90 days after notice of failure mailed an additional \$1,000 for each subsequent 30-day period not to exceed \$24,000.

624 6695 Other Assessable Penalties with Respect to the Preparation of Income Tax Returns for Other Persons. - Any failure by the preparer to:

6695(a) furnish a copy of the return to the taxpayer,

6695(b) sign the return,

6695(c) furnish the preparer's identifying number,

6695(d) retain a copy, return or list, as required by IRC 6107(b),

6695(e) file a correct information return or other requirement of IRC 6060. - these penalties are assessed at \$50 per failure, not to exceed \$25,000 per year.

625 6038A(d) Information with Respect to Certain Foreign owned Corporations. - failure to furnish information or maintain records as required by IRC 6038A(a) and 6038A(b) - \$10,000 for each taxable year with respect to which the failure occurs. If the failure continues for more than 90 days after notice of failure mailed, an additional \$10,000 is imposed for each 30-day period during which the failure continues after the expiration of the original 90 day period.

626 6695(d). Other Assessable Penalties with Respect to the Preparation of Income Tax Returns for Other Persons. - endorses or otherwise negotiates a refund check (made with respect to income tax) issued to a taxpayer. - \$500 per check.

627 Reserved

628 6700 Promoting Abusive Tax Shelters - the lessor of \$1,000 or 100% of the gross income for each such activity.

629 Reserved

630 6701 Penalties for Aiding and Abetting Understatement of Tax Liability. - Aiding and abetting-Promoter - The penalty is assessed for each document that relates to the tax liability of: - noncorporate-at \$1,000, or - corporate-at \$10,000

631 6701 Penalties for Aiding and Abetting Understatement of Tax Liability.
- Aiding and abetting-Preparer
- The penalty is assessed for each document that relates to the tax liability of:
- non-corporate-at \$1,000, or
- corporate-at \$10,000.

Exhibit (20)100-7 Cont. (3) Penalty Reference Numbers (600 Series)

RN	IRC section	Description
633	6713	Disclosure or Use of Information by Preparer of Returns - \$250 per disclosure or use with a maximum of \$10,000 per calendar year.
634	6707	Failure to Furnish Information Regarding Tax Shelters - the greater of 1 percent of the amount invested, or - \$500.
635	7216	Disclosure or Use of Information by Preparers of Returns. - when convicted of knowingly or recklessly disclosing information (misdemeanor), the person shall be: - fined no more than \$1,000, or - imprisoned not more than 1 year, or - both, plus - the cost of the prosecution.
636	6708	Failure to Maintain Lists of Investors in Potentially Abusive Tax Shelters. - \$50 per failure, - not to exceed \$100,000 per calendar year.

637 6676 Failure to Supply Identifying Numbers. This reference number should only be used for returns due prior to January 1, 1990. - The penalty was incorporated into IRC section 6721.

638 6652 Failure to Supply Identifying Numbers. This reference number should only be used for returns due prior to January 1, 1990. - The penalty was incorporated into IRC section 6721.

639 6652 Failure to Supply Identifying Numbers. This reference number should only be used for returns due prior to January 1, 1990. - The penalty was incorporated into IRC section 6721.

640 6652 Failure to Supply Identifying Numbers. This reference number should only be used for returns due prior to January 1, 1990. - The penalty was incorporated into IRC section 6721.

641 6652 Failure to Supply Identifying Numbers. This reference number should only be used for returns due prior to January 1, 1990. - The penalty was incorporated into IRC section 6721.

642 6673(a) Sanctions and costs awarded by Courts - A Tax Court determined that the taxpayer filed frivolous suit for damages against the United States. - Court awarded sanctions, penalties, or costs.

643 6673(b) Sanctions and costs awarded by Courts (IRC section 7433). - A Court (other than the Tax Court) determination that the taxpayer filed frivolous suit for damages against the United States. - Court awarded sanctions, penalties, or costs not to exceed \$10,000.

644 Reserved

645 6694(a) Understatement of Taxpayer's Liability by Income Tax Return Preparer. - This reference number is to be used for documents prepared after December 31, 1989. - The penalty is assessed against an income tax preparer. - The penalty is based on an understatement or return for which the preparer took a position that did not have a realistic possibility of being sustained on its merits, and - which was not disclosed or was frivolous. - The penalty is assessed at \$250 per return or claim.

646 6694(b) Understatement of Taxpayer's Liability by Income Tax Return Preparer.
- This reference number should only be used for documents prepared prior to January 1, 1990.
- The penalty is assessed:
if any part of the understatement is due to willful attempt to understate the tax liability or reckless conduct in preparing the return or claim.
any at \$500 per return or claim reduced by amount assessed under 6694(a).

Exhibit (20)100-7 Cont. (4) Penalty Reference Numbers (600 Series)

RN	IRC section	Description
647	6723	Failure to Include Correct Information. - This reference number should only be

used for returns prepared prior to January 1, 1990. - The penalty was self-assessed at \$5 for each return or statement that was reported incorrectly.

648 6723 Failure to Include Correct Information. - This reference number should only be used for returns due prior to January 1, 1990. - The penalty was at \$5 for each return or statement that was reported incorrectly.

649 6652(c) (2) Failure by Exempt Organization or Certain Trusts to file returns required by IRC 6034 or 6043(b). - For any one return, the penalty is assessed at \$10 per day, not to exceed \$5,000 for all persons for the failure to file any one return.

650 6694(b) Understatement of Taxpayer's Liability by Income Tax Return Preparer. - This reference number should only be used for documents prepared after December 31, 1989. - The penalty is assessed if any part of the understatement is due to willful or reckless conduct or intentional disregard of the rules or regulations in preparing the return or claim for refund. - After December 31, 1989 this penalty was assessed at \$1,000 per return or claim reduced by any amount of penalty paid under 6694(a).

651 6721 Failure to Comply with Certain Information Reporting Requirements -- Form 8300. - This penalty applies to returns required to be filed after December 31, 1989. - The penalty is assessed at \$50 per Form 8300 not timely and correctly filed.

652 6721(e) Intentional Disregard of the Failure to comply with Certain Information Reporting Requirements. - This reference number is used to assess the intentional disregard penalty when the Form 8300 is not timely or correctly filed. - This penalty applies to returns pertaining to amounts received after November 5, 1990. - The penalty is assessed at the greater of: - \$25,000, or - the amount of cash received in such transaction, to the extent the cash does not exceed \$100,000. - The \$250,000 yearly limitation under IRC 6721 shall not apply.

653 6722 Failure to Furnish Correct Payee Statements - This penalty applies to payee statements required to be filed after December 31, 1989. - The penalty is assessed at \$50 per payee statement not timely furnished or containing incorrect or incomplete information. - The maximum penalty shall not exceed \$100,000 per year.

654 6722(c) Intentional Disregard of the Requirement to Furnish a Correct Payee Statement -- Form 8300.
- This penalty applies to payee statements required to be filed after December 31, 1989.
- The intentional disregard penalty for failing to provide a payor of cash with a statement as required by IRC sections 60501(e) after December 31, 1989, is the greater of \$100 or 10 percent of the amount required to be reported correctly on the statement.
- The \$100,000 yearly limitation does not apply.

Exhibit (20)100-7 Cont. (5) Penalty Reference Numbers (600 Series)

RN	IRC section	Description
655	7342(c)	Penalty for Refusal to Permit Entry or Examination. - A penalty of \$500 for each refusal to admit or to permit examination. - A penalty of \$1,000 for each refusal to admit or to permit examination if the refusal is related to 4083(c), place where

taxable fuel is stored or produced.

656 6715 Dyed Fuel Sold For Use or Used in Taxable Use, Etc. - This penalty is effective beginning after December 31, 1993. - The penalty is assessed on any dyed diesel fuel (nontaxable use), sold or held for sale as taxable use of such fuel. - 1st offense: - The penalty is the greater of \$10 per gallon of dyed fuel involved, or \$1,000, - subsequent violations: - multiply the number of prior violations times the greater of \$10 per gallon per prior violation or \$1,000 per prior violation.

657 6715 Failure to Post or Provide Notice with Respect to any Dyed Diesel Fuel as required by IRC section 4082(c)j. - This penalty is effective beginning after December 31, 1993. - The penalty is assessed on any dyed diesel fuel (non-taxable use), sold or held for sale as taxable use of such fuel. - The penalty is the greater of: - 1st offense, \$10 per gallon, or \$1,000, - subsequent violations, multiply the number of violations times the greater of \$10 per gallon or \$1,000.

658 Reserved 659 Reserved 660 Reserved 661 Reserved 662 Reserved 663 Reserved 664 Reserved 665 6702 Frivolous Income Tax Return. - If any individual files what purports to be an income tax return, which either: - contains insufficient information, or - contains on its face substantially incorrect information, and - where the conduct will delay or impede the administration of Federal income tax laws or is a frivolous position. - The penalty is assessed at \$500 per return deemed to be frivolous.

Each of the following eight reference numbers relate to a specific type of frivolous return.

666 6702 Frivolous arguments (General) to reduce taxes or delay the collection of taxes. - The penalty is assessed at \$500 per return deemed to be frivolous.

667 6702 The "penalty of perjury" statement was altered or deleted - The penalty is assessed at \$500 per return deemed to be frivolous.

668 6702 The return did not contain enough information to be processed. - The penalty is assessed at \$500 per return deemed to be frivolous.

669 6702 The claim that wages not paid in gold or silver is frivolous. - The penalty is assessed at \$500 per return deemed to be frivolous.

670 6702 The war credit or deduction claimed is not provided for in the Internal Revenue Code. - The penalty is assessed at \$500 per return deemed to be frivolous.

Exhibit (20)100-7 Cont. (6) Penalty Reference Numbers (600 Series)

RN	IRC section	Description
671	6702	The credit claimed for the decrease or discounted value of Federal Reserve Notes represents a frivolous position. - The penalty is assessed at \$500 per return deemed to be frivolous.
672	6702	The claim that wages and payments for services are not income or profits because there was a fair exchange is a frivolous position. - The penalty is assessed at \$500 per return deemed to be frivolous.
673	6702	The refusal to furnish information needed to determine income tax liability on

constitutional grounds. - The penalty is assessed at \$500 per return.

674 6723 Failure to Comply with Other Reporting Requirements. Failure to Provide Notice of Partnership Exchange. - a penalty of \$50 is imposed for each failure to comply timely with specified information reporting requirements. - The maximum penalty for failure to comply with all specified information reporting requirements is \$100,000 per year.

675 6722(b) Failure to Notify Partnership of Exchange of Partnership Interest. - This penalty applies to statements required to be furnished before January 1, 1990. - The penalty is assessed at \$50 per payee statement not timely or correctly furnished.

676 6038B Notice of Certain Transfers to Foreign Persons (Failure to File Form 926) - The penalty is assessed at 25 percent of the amount of the gain realized on the exchange.

677 6677 Failure to File Information Returns with Respect to Certain Foreign Trusts. - 5 percent of the amount transferred to a trust, or - 5 percent of the value of the corpus of the trust at the close of the taxable year, but - not more than \$1,000.

678 6039E Failure to provide Information concerning Residence Status. - \$500 for each failure to provide the required information.

679 6039E Failure to provide information concerning Residence Status. (Taxpayer Identification Number). - \$500 for each failure to provide the required information.

6662 Imposition of Accuracy-Related Penalty

680 6662(f) Substantial Overstatement of Pension Liabilities

681 6662(d) Substantial Understatement of Income Tax.

682 6662(g) Substantial Estate or Gift Tax Valuation Understatement

683 Reserved

684 7519 Required Payments for Entities Electing Not to Have Required Taxable Year. - The penalty is assessed for failing to make an election payment. - The penalty is assessed at 10 percent of the under paid amount and is assessed on MFT 15.

685 6712 Failure to Disclose Treaty-Based Return Position. - The penalty is assessed at: - \$1,000, individual, - \$10,000, corporation.

686 6651(f) Increase in Penalty for Fraudulent Failure to File

- 15 percent per month,
- for a maximum of 5 months,
- not to exceed 75 percent of the total

tax.

Exhibit (20)100-7 Cont. (7) Penalty Reference Numbers (600 Series)

RN	IRC section	Description
687		Reserved
688		Reserved
689		Reserved
690		Reserved

691	Reserved
692	Reserved
693	Reserved
694	Reserved
695	Reserved
696	Reserved
697	Reserved
698	Reserved
699	Reserved

Exhibit (20)100-8 Table of Abbreviations and Acronyms

ABBR.	DEFINITION
23C	Assessment Date
ACH	Automated Clearing House
ACR	Audit Change Report
ADEPT	Automated Deposit of Electronic Payments for Taxes
ADP	Automatic Data Processing
AGI	Adjusted Gross Income
AICPA	American Institute of Certified Public Accountants
AIMS	Audit Information Management System
AO	Appeals Officer
AOC	Advice of Credit
ASED	Assessment Statute Expiration Date
ASFR	Automated Substitute for Return
ATAO	Application Taxpayer Assistance Order to Relieve Hardship
AT&F	Bureau of Alcohol, Tobacco and Firearms
BMF	Business Master File
BWH	Backup Withholding
CAF	Centralized Authorization File
CBAF	Commercial Bank Address File
CC	Command Code
CCD	Chief Compliance Division
CFR	Code of Federal Regulations
CID	Criminal Investigation Division
CSED	Collection Statute Expiration Date
CP	Computer Paragraph
CPA	Certified Public Accountant
CPM	Civil Penalty Module
CRS	Communication Replacement System
CSED	Collection Statute Expiration Date
CY	Calendar Year
CVPN	Civil Penalty Name Line
DCC	Detroit Computing Center
DLN	Document Locator Number
DP	Data Processing
EFC	Electronic Filing Coordinators
EFP	Electronic Filing Program
EIN	Employer Identification Number
EMIS	Enforcement Management Information System
EP/EO	Employee Plans/Exempt Organizations
EPMF	Employee Plans Master File
EQTRAS	Examination Quality Trends Analysis System
ERTA	Economic Recovery Tax Act of 1981
ES	Estimated Tax
ESP	Examination Support and Processing
ETE	Employment Tax Examiner
FFA	Fiduciary FTD Avoidance

FICA	Federal Insurance Contribution Act
FIFO	First-In-First-Out Inventory Method
FFF	Fraudulent Failure to File
FMS	Financial Management Service
FRB	Federal Reserve Bank
FRCS	Federal Reserve Communication System
FTD	Federal Tax Deposit
FTF	Failure to File
FTF	Failure to Pay

Exhibit (20)100-8 Cont. (1)

Table of Abbreviations and Acronyms

ABBR.	DEFINITION
FUTA	Federal Unemployment Tax Act
FY	Fiscal Year
GBP	Good Block Proof
IAC	Interagency Coordinator
IAC	Interest Abatement Coordinator
IDRS	Integrated Data Retrieval System
IDTCA	Interest and Dividend Tax Compliance Act of 1983
IEP	International Enforcement Program
IMF	Individual Master File
IMPACT	Improved Penalty Administration & Compliance Tax Act of 1989
IRA	Individual Retirement Account
IRAF	Individual Retirement Account File
IRC	Internal Revenue Code
IRM	Internal Revenue Manual
IR Regs	Internal Revenue Regulations
IRS	Internal Revenue Service
IRS	NO. Abstract Number
LEM	Law Enforcement Manual
LIFO	Last-In-First-Out Inventory Method
LMQAS	Line Management Quality Assurance System
MARS	Manual Accounting Replacement System
MCC	Martinsburg Computing Center
MCR	Master Control Records
MF	Master File
MFT	Master File Tax
MICRORAR	Revenue Agent Report-Computer Generated
MSN	Microfilm Serial Number
NASACT	National Association of State Auditors, Comptrollers, and Treasurers
NMF	Non-Master File
OBRA	Omnibus Budget Reconciliation Act
OCR	Optical Character Recognition
ODC	Ozone Depleting Chemicals
OPA	Office of Penalty Administration
PAS	Program Analysis System
PCC	Penalty Computation Code
PFN	Partnership Prefiling Notification
PIC	Penalty Indicator Code
PIL	Preparer's Inventory Listing
PINEX	Penalty and Interest Notice Explanations
PMF	Payer Master File
PNL	Prefiling Notification Letter
PNP	Presumptive Negligence Penalty
POA	Power of Attorney
PRP	Problem Resolution Program

PSC	Penalty Screening Committee
PSP	Planning and Special Programs
PVL	Preparer's Volume Listing
QAS	Quality Assurance Staff
OBRA	Omnibus Reconciliation Act
QR	Quality Review
RAR	Revenue Agent Report
RC	Reason Code

Exhibit (20)100-8 Cont. (1)

Table of Abbreviations and Acronyms

Table Omitted

Chapter (20)200

Failure to File Tax Return or Pay Tax

(20)210 Introduction

(20)211 General

(1) This section of the consolidated penalty IRM discusses the following Failure to File and Failure to Pay penalties:

(a)(20)220 IRC Section 6651(a)

Failure to File a Return of Tax Imposed by Chapter 1 within 60 Days

(b)(20)230 IRC Section 6651(a)(1)

Failure to File a Tax Return

(c)(20)240 IRC Section 6651(a)(2)

Failure to Pay a Tax

(d)(20)250 IRC Section 6651(a)(3)

Failure to Pay a Tax within 10 days of Notice and Demand

(e)(20)260 IRC Section 6651(d)

Increase in the Penalty for Failure to Pay in Certain Cases

(f)(20)270 IRC Section 6651(f)

Increase in the Penalty for Fraudulent Failure to File

(g)(20)280 IRC Section 6698

Failure to File a Partnership Return

(20)212 Common Features

(20)212.1 General

(1) Generally, a failure to file (FTF) and/or failure to pay (FTP) penalty discussed in this chapter is based on the amount of tax required to be shown on a late-filed or late paid return, reduced by any portion of the tax paid on or before the prescribed due date of the return. An exception to this general rule is the Failure to File a Partnership return, IRC section 6698, which is based on a penalty of \$50 per month, per partner for each month the return is late. See IRM (20)280.

(2) Coordination between FTF and FTP Penalty Rates:

(a) If both the FTF (under IRC section 6651(a)(1)) and FTP (under IRC section 6651(a)(2)) penalties apply, the FTP penalty amount is allowed as an offset against the FTF penalty for any month in which both apply. When this occurs, the combined penalty rate for the month will not exceed five percent. For example, if the FTP penalty rate of one-half of one percent (.005) is applicable, the FTF penalty would be assessed at 4.5 (.045) percent.

(b) When both the FTP penalty and minimum failure to file penalty apply (income tax returns only), the minimum failure to file penalty is not reduced by the amount of the FTP penalty. See IRM (20)220, Minimum Failure to File Penalty. See IRM (20)250 and (20)260 for a discussion of subsequent assessments.

(c) For periods prior to Cycle 8601, computer and MRS transcripts show the combined 5 percent FTF and FTP penalties under TC 166, FTF. The penalty transactions post separately for returns posting in Cycle 8601 and later.

(3) Who Asserts: Generally, all areas of the Service may assert or assess the penalty, based on the circumstances at the time the return is received.

(4) How Asserted:

(a) On a delinquent tax return mailed to the Service after the due date of the return:

1 Master File will assess any appropriate FTF and/or FTP penalty at the time the tax is assessed and the taxpayer will be sent a balance due notice. See IRM (20)262.1.

2 Additions to tax (penalty and interest) will accrue. See the related TRIDOC for specifics.

(b) On a delinquent return secured by Service personnel:

1 solicit an explanation for the late filing or late paying in order to determine if reasonable cause or other conditions exist that would support penalty relief;

2 provide the taxpayer with an explanation stating why the FTF/FTP penalty is or is not being asserted;

3 solicit full payment of the tax, penalties and interest.

4 If the additional tax is not collected at the time of assessment, the taxpayer will receive a balance due notice. See IRM (20)262.1.

(20)212.2 Extension of Time to File

(1)General Rule: IRC section 6081 and the related regulations provide for a reasonable extension of time to file a return.

(a) That "reasonable extension" is not to exceed 6 months (unless the taxpayer is overseas).

1 If the taxpayer has a valid extension of time for filing a return, that taxpayer is not liable for the FTF penalty for the duration of the extension period. The computation of the FTF penalty begins immediately after the extended due date.

2 However, an extension of time to file is not an extension of time to pay. Generally, once the signed return is received, the FTP penalty will be computed from the original due date of the return to the date the tax is paid.

(b)Denial of an extension of time to file: If a timely-filed request for an extension of time to file is denied, and the taxpayer files the return within 10 days from the date of the Service's denial, no further action by the Service is necessary.

(c)Voiding Previously Granted Extension of Time to File:

1 The Service may void a previously granted automatic extension where the taxpayer's Form 4868 or 7004 is invalid because the taxpayer did not properly estimate the tax liability and did not make a reasonable attempt to secure the information necessary to make this estimate as required by:

a Treas. Reg. 1.6081-4(a)(4), taxable years ending prior to December 31, 1995, and

b Treas. Reg. 1.6081-4T(4) for taxable years ending on or after December 31, 1995.

2 Thus, the taxpayer is liable for the FTF penalty because there was no reasonable cause for the failure to file by such date. See Revenue Ruling 79-113.

3 NOTE: Because the Examination function is the only functional area that has authority to sufficiently develop the issue in order to determine that a taxpayer did not properly estimate the tax liability, it is the only function that has the authority to void the automatic extension.

(2)Individual (Treas. Regs. 1.6081-1 and 1.6081-4 and 4T):

(a) To be granted the automatic four month extension of time to file, the individual must have:

1 completed Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return;

2 signed the request as required in IRC section 6061, Signing of returns and other documents by individuals;

3 filed the application on or before the due date of the return; and

4 effective for tax year 1991 and prior:

a the application must have shown the amount of tax properly estimated to be due; and

b the amount properly estimated to be due, must have been paid with the application.

5 Effective for the tax year 1992 and subsequent, Notice 93-22, 1993-1 C.B. 305, issued April 7, 1993, granted individuals a four month extension of time to file even if they are unable to pay the amount of tax properly estimated to be due. They must however:

a complete and file the Form 4868 prior to the original due date of the return;

b sign the request; and

c properly estimate the amount of tax due.

(c) For tax years ending after December 31, 1995, Treas. Reg. 1.6081-4T removed the requirement to sign the Form 4868.

(d) An additional two month extension may be requested by completing Form 2688, Application for Additional Extension of Time to File U.S. Individual Income Tax Return.

(e) Service in a Combat Zone IRC Section 7508: The time for filing a return or paying a tax should be automatically extended for 180 days after the period an individual:

1 serves (or supports) the Armed Forces of the United States in an area designated as a "combat zone" by the president of the United States, or

2 is hospitalized as a result of an injury received in an area designated as a combat zone.

(3) Partnership (Treas. Regs. 1.6081-2T):

(a) A partnership, required to file Form 1065, is granted an automatic three month extension of time to file when properly completing a Form 8736, Application for Automatic Extension of Time to File U.S. Return for a Partnership, REMIC, or for Certain Trusts.

(b) The request must be:

- 1 filed with the Service on or before the original due date of the return, and
- 2 signed by a general partner or other person authorized to file the application.

(c) The extension of time to file the Form 1065 does not extend the time to:

- 1 to make the required payment under IRC Section 7519, Required Payments for Entities Electing Not to Have Required Taxable Year, or

- 2 file a partner's income tax return, or pay a partner's income tax.

(4) Corporation (Treas. Reg. 1.6081-3):

(a) A corporation is granted an automatic extension of time to file until the fifteenth day of the sixth month following the due date of the return, when a Form 7004, Application for Automatic Extension of Time to File U.S. Corporation Income Tax Return:

- 1 is signed by the person authorized by Treas. Regs. 1.6062-1 to sign the form;

- 2 is filed on or before the original due date of the return; and

- 3 the amount of tax properly estimated to be due was either deposited during the year or remitted with the form requesting the extension of time to file.

(5) EP/EO Blanket extensions or filing exceptions have been granted to certain exempt organizations under Rev. Rul. 71-236, 1971-1 C.B.398, Rev. Proc. 83-23, 1983-1 C.B.687, as supplemented by Rev. Proc. 94-17, 1994-1 C.B. 579 and Rev. Proc. 86-23, 1986-1 C.B.564. See IRM (20)800 for EP/EO penalties.

(20)212.3 Unsigned Returns

(1) Timely-filed unsigned returns are not considered delinquent if:

- (a) the taxpayer files the proper form,

- (b) the taxpayer attaches proper payment,

- (c) the return contains sufficient information to be processed, and

- (d) the taxpayer later files a signed return within thirty days of the Service's request for a signature.

- (e) However, the Service may assert the FTF penalty if the facts of the case clearly show that the taxpayer demonstrated gross negligence or a willful intent to disobey the taxing statute involved. See Policy Statement P-2-11.

(2) Generally, the FTP penalty is computed from the original due date of the return to the date the tax is paid. See IRM (20)240, (20)250 and (20)260 for discussions of the various penalty rates and identifying the FTP start date in specific situations.

(20)212.4 Received Date

IRC Section 7502

(1) A return is considered timely, if received prior to, or on, the due date or extended due date of the return.

(a) U.S. Postal Service. Consider a return timely- filed if postmarked by the U.S. Postal Service by the original or extended due date. See 212.4 of LEM XX 200.

1 A postmark with a date after the prescribed due date is late.

2 When more than one United States Postal Service postmark date appears on an envelope, consider the earlier postmark date as the date the return was mailed.

(b) Privately Metered Mail. In general, consider a return timely filed if it contains a postal meter stamp that:

1 bears the date on or before the last date (or last day of the period) prescribed for filing the return, and

2 the return is received not later than the time the return would normally have been received if it had been mailed on the last date (or last day of the period) prescribed for filing the return. If the return is received after the normal time, the taxpayer must prove the factors in IRC section 301.7502-1(c)(iii)(b) which in general states:

a the document must show a postmarked date that is on or before the last day of the period prescribed for filing the document,

b the document must be received by the Service not later than the time the document would have been received if it were postmarked at the same point of origin by the United States Post Office, and

3 in addition, the person who is required to file the document must show:

1 the document was deposited before the last collection of the mail (from the place of deposit) on or before the last day prescribed for filing the document,

2 any delay in receiving the document was due to a delay in the transmission of the mail, and

3 caused the document to be received after the due date of the document.

(c) Designated Private Delivery Services. Section 1210 of the Taxpayer Bill of Rights 2 (TBOR 2), Pub. L. No. 104- 168, 110 Stat. 1452, added subsection (f) to IRC section 7502. This new provision authorizes the Service to expand the "timely mailing as timely filing/paying" rule to certain private delivery services.

(b) Privately Metered Mail. In general, consider a return timely filed if it contains a postal meter stamp that:

1 bears the date on or before the last date (or last day of the period) prescribed for filing the return, and

2 the return is received not later than the time the return would normally have been received if it had been mailed on the last date (or last day of the period) prescribed for filing the return. If the return is received after the normal time, the taxpayer must prove the factors in IRC section 301.7502-1(c)(iii)(b) which in general states:

a the document must show a postmarked date that is on or before the last day of the period prescribed for filing the document,

b the document must be received by the Service not later than the time the document would have been received if it were postmarked at the same point of origin by the United States Post Office, and

3 in addition, the person who is required to file the document must show:

a the document was deposited before the last collection of the mail (from the place of deposit) on or before the last day prescribed for filing the document,

b any delay in receiving the document was due to a delay in the transmission of the mail, and

c caused the document to be received after the due date of the document.

(d)Date Stamp. The Service date stamps the received date on returns filed after the original due date. Returns filed by the original due date carry the due date as the received date and are not date stamped when received. The received date for a late-filed return is the date a return reaches any IRS office or service center.

(2)A TC 610 may show the received date on the transcript. IDRS shows the received date under the posted return information section as RET-RECD-DT.

(20)212.5 Definition of Month

(1)If the date prescribed for filing a return is the last day of a calendar month, each succeeding calendar month or (fraction thereof) during which the failure to file or pay continues is a month for the purposes of the FTF/FTP penalty. For example, when a return is due January 31, 1989, the first month ended on February 28, and the succeeding months ended on March 31, April 30, etc.

(2)If the date prescribed for filing the return or paying the tax is other than the last day of the calendar month, the period ends with the corresponding day in the following month. If there is no corresponding day, consider the last day of the following month as the ending date.

(a)For example, the failure to pay due date falls on January 30, 1992;

(b)1992 is a leap year, and in February there is not a corresponding due date, therefore the period from January 30th through the last day of the following month (February 29,

1992) shall be considered a month for the purposes of the FTF and FTP penalty.

(c) If the tax remains unpaid, the FTP penalty due date will fall on the 30th day of each succeeding month.

(3) If a return is not timely filed or the tax is not timely paid, the fact that the date prescribed for filing the return or paying the tax, or the corresponding date in any succeeding calendar month, falls on a Saturday, Sunday, or a legal holiday is immaterial in determining the number of months for the FTF/FTP penalty. Treas. Reg. 301.6651-1(b)(3). See Exhibit 200-2.

(20) 212.6 Net Tax Due

(1) The net tax amount is the amount of tax required to be shown on the return less allowable credits, such as general business credits, foreign income tax credits, EIC and fuel tax credits. This amount is reduced by payments made on or before the prescribed due date of the return (excluding extensions), such as withholding credits, tax deposits, estimated tax payments, overpayments from prior periods, or other payments made on or before the prescribed due date of the return. See Exhibit 200-1.

(2) The penalty applies not only to tax shown on a taxpayer's original return, but also to any additional tax later found due on the return.

(3) The net tax amount required to be shown on the return includes all income taxes as well as employment taxes. For example, the uncollected employee FICA tax on tips is a tax required to be shown on Form 1040, Individual Tax Return; thus, this uncollected FICA tax on tips should be included in the net tax amount.

(4) Certain taxes may be paid in installments e.g. heavy vehicle use tax (Form 2290) and estate taxes (Form 706). If the taxpayer elects to pay this type tax in installments, the failure to pay penalty does not apply. If the required payment is not received, received late, or the amount submitted is less than the required amount, refer to IRM 3(15)(148)0.

(5) When computing the net tax amount, do not consider amounts which were paid after the due date of the return, but before the date of filing. See Exhibit 200-2.

(6) If an adjustment is made to a taxpayer's refundable credit (such as withholding), do not assert the FTP penalty, unless the adjustment reduces the timely credit below the original tax due.

(a) For example, a taxpayer's account has tax of \$1,000, withholding of \$2,000 and \$1,000 was refunded. If the credit is subsequently reversed for an amount \$1,000 or less, the FTP penalty is not asserted.

(b) If the credit is subsequently reversed for an amount greater than \$1,000, the FTP penalty is asserted on the amount over \$1,000. This is because the timely credit was reduced below the original tax due.

(7) In the case of a math error, if the amount of tax required to be shown on a return is less

than the amount shown, the FTP penalty is imposed on the lower amount.

(20)213 Penalty Relief

(1)IRM (20)130, provides guidance for determining if the taxpayer meets the criteria that will allow relief from a penalty. See Exhibit 100-3 of IRM (20)100 for a complete list of penalty reason codes (PRC).

(a)If the taxpayer provides information that will allow penalty relief before assessment, recommend non-assertion of the penalty only for the period for which the taxpayer meets the relief criteria.

(b)If the taxpayer provides information that will allow penalty relief after the penalty is assessed, abate the portion of the penalty only for the period for which the taxpayer meets the relief criteria.

(2)The Service will not impose the FTF/FTP penalty when the taxpayer shows reasonable cause and not willful neglect for the failure to file a return or pay a tax as required.

(a)Reasonable cause determinations MUST be made on the individual facts and circumstances of each case. IRM (20)130 provides guidance for determining if the taxpayer established reasonable cause.

(b)Generally, the taxpayer must pay the tax due before the Service will abate a FTP penalty for reasonable cause. The penalty continues to accrue until the tax is paid. The taxpayer may have reasonable cause for some months, but not for others. A correct determination cannot be made until after the tax is paid.

(3)Contact personnel should address the reason for the failure to file or pay penalty when securing or examining returns on which the penalty applies. Making this initial determination will prevent the need for subsequent abatements.

(a)If the taxpayer establishes any of the penalty relief criteria before assessment, recommend non-assertion of the penalty only for the applicable period.

(b)If the taxpayer establishes any of the penalty relief criteria after assessment, abate the portion of the penalty only for the period for the applicable period. Enter Reason Code (RC) 62 in any of the first three reason code fields for adjustments involving requests for reasonable cause consideration, and the applicable penalty reason code (PRC) in the fourth reason code field.

(4)In addition to the common reasons given for reasonable cause determinations in IRM (20)130, the following are examples of sound causes for delay in paying which, if established, will be accepted as "other" reasonable cause.

(a)Taxpayer was unable to determine the amount of tax due for reasons beyond the taxpayer's control.

(b)The taxpayer's ability to make payments was materially impaired by civil

disturbances. Consider this only if the area was declared a disaster area.

(c) Lack of funds is an acceptable explanation for failure to pay any tax only when the taxpayer can demonstrate the lack of funds occurred despite the exercise of ordinary business care and prudence.

(7) When the FTF/FTP penalties are abated for reasonable cause, TC 271 with RC 62, Master File will not restrict future computer computations of FTP penalty (provided it was not previously restricted). The computer continues to compute the FTP penalty but will waive the amount associated with RC 62.

(a) A TC 270 or 271 input without RC 62 restricts subsequent computation of the penalty.

(b) Input TC 272 with a zero amount to remove the manual restriction on failure to pay penalty, when you determine that a module was restricted in error. See IRM (20)240 for the procedures applicable when it is determined that the FTP penalty is to be computed from the original due date of the return.

(c) See 213:(7)(c) of LEM XX 200.

(20)214 Substitute for Return (SFR)

(1) A return, prepared for the taxpayer, pursuant to IRC section 6020(b) is a substitute for a return. The return is prepared by the Service when it is determined that a taxpayer is liable for filing the tax return but failed to do so after receiving notification from the Service.

(2) Within the Service:

(a) income, estate, gift and certain excise (IRC Chapters 41, 42, 43, and 44) tax deficiencies, are generally referred to as the SFR program. These returns are subject to statutory notice of deficiency procedures. See IRM (20)140 for a discussion of statutory notice of deficiency.

(b) employment and excise tax deficiencies (not IRC Chapters 41, 42, 43, and 44) are generally referred to as the 6020(b) program. These returns do not require a statutory notice of deficiency.

(3) If a taxpayer does not file a delinquent return when requested, SFR procedures will be followed.

(a) In considering the application of either the FTF or FTP penalty on these returns, the Service will:

- 1 recommend assertion or non-assertion of the FTF/FTP penalty;
- 2 explain the basis for the recommendation and comment on the taxpayer's statement in the report, report transmittal and/or workpapers, as appropriate;
- 3 compute any FTF/FTP penalty based on the total tax due for the period involved,

less any tax withheld at source on wages and any estimated tax payments (the total tax due, plus any penalty, will be considered as a deficiency); and

4 afford the taxpayer normal appeal rights.

(4) If a taxpayer fails to file a delinquent return when requested but executes an agreement to waive the restrictions on assessment of a deficiency (by signing a form such as Form 870, 4549E or 4549) the Service will determine if the FTF/FTP penalty should be asserted.

(5) For SFR returns (generally income tax returns), statutory notice of deficiency procedures apply:

(a) a dummy tax return (TC 150) is created to open the account on the master file. If the taxpayer does not respond to the statutory notice of deficiency, the appropriate tax is assessed.

1 The FTF penalty is computed from the return due date, or the extended due date, to the TC 290 or TC 300 assessment date (23(c) date), or 5 months, whichever is earlier.

2 Generally, the FTP penalty is computed from the original due date of the return to the date the tax is paid. See IRM (20)240 and (20)250 for discussions of various FTP penalty rates and identifying the FTP penalty start date in specific situations. See paragraphs (7) and (8) below.

(6) For 6020(b) program returns (generally employment or excise tax returns) statutory notice of deficiency procedures do not apply:

(a) Service Centers prepare the returns based on information obtained through various matching programs. The Service assesses the tax (TC 150) determined to be due and sends the taxpayer a completed employment or excise tax return.

1 The FTF penalty is computed from the due date of the return, to the 23(c) date of the assessment or for 5 months, whichever is earlier.

2 Generally, the FTP penalty is computed from the original due date of the return to the date the tax is paid. See IRM (20)240 and (20)250 for discussions of various FTP penalty rates and the FTP start date in specific situations.

(7) In both the SFR and 6020(b) program situations, the FTP penalty under IRC section 6651(a)(2) is computed from the original due date of the return until the date the tax is paid or the maximum penalty of 25 percent is reached.

(8) Taxpayer Bill of Rights 2 (TBOR2), Pub. L. 104-167, 110 Stat. 1152, added IRC section 6651(g) to the code.

(a) This provision applies the failure to pay penalty to substitute returns in the same manner as the penalty applies to delinquent returns.

(b) This provision applies to a substitute return with a due date (without regard to

extensions) after July 30, 1996.

(c) For any return with a due date after July 30, 1996, the failure to pay penalty will be computed from the original due date of the return.

(d) Prior to January 1, 1997, SFR/6020(b) program returns restricted the assessment of the FTP penalty until the tax was paid or the taxpayer provided a signed return. At that time the penalty had to be manually computed. After December 31, 1996, an enhancement to the Master File allows the FTP penalty the FTP penalty to be automatically calculated and assessed from the due date of the return until the date the tax is paid. To allow automatic generation of the FTP by master file, input an adjustment to tax (or 290/300 for a zero amount) with a:

1 Priority code 2 (ADJ54/TC290), or

2 Priority code 9 (ADJ47/TC300).

(20)215 Excise Tax

(1) The filing and paying of an excise tax covering the tax on one of the categories (Abstract Numbers/IRS No.s) listed on Form 720, Quarterly Federal Excise Tax Return, does not constitute the filing of a return or paying a tax for any of the other categories (Abstract Numbers).

(2) For example, if a manufacturer of bows and arrows and fishing rods files a timely return for the tax on bows and arrows only, do not consider this return as being a timely-filed return for the tax on fishing rods.

(20)216 Restrictions on Assertion

(20)216.1 General

(1) According to Policy Statement P-2-4, the Service does not assert penalties against federal agencies.

(2) The statute of limitations for assessing the penalty on a filed return is three years from the due date, or the date filed, whichever is later. There is no statute of limitations for assessing the penalty where no return has been filed.

(20)216.2 Coordination with the Civil Fraud Penalty

(1) For tax returns with a due date (without regard to extensions) after December 31, 1986 and before January 1, 1990, the FTF and civil fraud penalties were asserted on the same delinquent return but not on the same portion of the underpayment. Assert the FTF penalty only on the portion of the underpayment to which the civil fraud penalty does not apply. See IRM (20)270 for FTF penalty procedures.

(2) For returns (other than IRC section 6020(b)) due after December 31, 1989, the civil fraud penalty under IRC section 6651(f) will be imposed only after a return is filed.

less any tax withheld at source on wages and any estimated tax payments (the total tax due, plus any penalty, will be considered as a deficiency); and

4 afford the taxpayer normal appeal rights.

(4) If a taxpayer fails to file a delinquent return when requested but executes an agreement to waive the restrictions on assessment of a deficiency (by signing a form such as Form 870, 4549E or 4549) the Service will determine if the FTF/FTP penalty should be asserted.

(5) For SFR returns (generally income tax returns), statutory notice of deficiency procedures apply:

(a) a dummy tax return (TC 150) is created to open the account on the master file. If the taxpayer does not respond to the statutory notice of deficiency, the appropriate tax is assessed.

1 The FTF penalty is computed from the return due date, or the extended due date, to the TC 290 or TC 300 assessment date (23(c) date), or 5 months, whichever is earlier.

2 Generally, the FTP penalty is computed from the original due date of the return to the date the tax is paid. See IRM (20)240 and (20)250 for discussions of various FTP penalty rates and identifying the FTP penalty start date in specific situations. See paragraphs (7) and (8) below.

(6) For 6020(b) program returns (generally employment or excise tax returns) statutory notice of deficiency procedures do not apply:

(a) Service Centers prepare the returns based on information obtained through various matching programs. The Service assesses the tax (TC 150) determined to be due and sends the taxpayer a completed employment or excise tax return.

1 The FTF penalty is computed from the due date of the return, to the 23(c) date of the assessment or for 5 months, whichever is earlier.

2 Generally, the FTP penalty is computed from the original due date of the return to the date the tax is paid. See IRM (20)240 and (20)250 for discussions of various FTP penalty rates and the FTP start date in specific situations.

(7) In both the SFR and 6020(b) program situations, the FTP penalty under IRC section 6651(a)(2) is computed from the original due date of the return until the date the tax is paid or the maximum penalty of 25 percent is reached.

(8) Taxpayer Bill of Rights 2 (TBOR2), Pub. L. 104-167, 110 Stat. 1152, added IRC section 6651(g) to the code.

(a) This provision applies the failure to pay penalty to substitute returns in the same manner as the penalty applies to delinquent returns.

(b) This provision applies to a substitute return with a due date (without regard to

(20)216.3 Taxpayer is in Bankruptcy (FTP)

(1) IRC section 6658 prohibits the assertion of the failure to pay penalty on tax liabilities, other than those for withheld or collected taxes, while a taxpayer is involved in a bankruptcy proceeding filed on or after October 1, 1979, if:

(a) the tax was incurred by the estate and the failure occurred pursuant to an order of the court finding probably a probable lack of funds of the estate to pay administrative expenses, or

(b) the tax was incurred by the debtor before the order of relief or the appointment of a trustee in an involuntary case, whichever is earlier and

1 the petition was filed before the due date for filing the tax return, including extensions, or

2 the date for making the addition to the tax occurs on or after the day on which the petition was filed.

(2) No FTP penalty will be asserted at any time in the case of:

(a) a tax incurred by the bankruptcy estate, or

(b) a pre-petition tax for which a return becomes due during the proceeding, no FTP penalty will be asserted at any time.

(c) In the case of a tax assessed before the start of a proceeding:

1 no FTP penalty will be asserted for the period during which the bankruptcy case is pending,

2 the FTP penalty will stop accruing at the start of the bankruptcy proceeding;

3 it will resume after the bankruptcy is resolved and continue until the tax is paid or the 25 percent maximum penalty is reached.

(20)217 Assessment/Abatement Procedures

(20)217.1 Examination

(1) Delinquent Return Secured by Examiner

(a) When an examiner secures a delinquent return, the examiner should determine whether the failure to file (FTF) and failure to pay (FTP) penalties are to be asserted. See IRM (20)130 for a discussion of penalty relief. Penalty relief should be considered by the examiner prior to assertion of the penalty. The examiner should explain the basis for the recommendation and comment on any taxpayer statements in the report, report transmittal and/or workpapers, as appropriate.

(b) District examination functions are solely responsible for determining the FTF

penalty on delinquent returns secured by district examination personnel.

(c) Once an examiner makes a recommendation about asserting any penalty, including the FTF penalty, it cannot be changed by other functions in the Service. If the taxpayer disagrees with the examiner's decision and presents additional supporting information, the case should be returned to the examiner for reconsideration.

(2) Examination of Delinquent Returns NOT Secured by Examiner

(a) When an examiner adjusts the tax on a delinquent return on which the FTF penalty applies, corresponding adjustments to the penalty are necessary.

1 The examiner will not adjust the penalty for that part of the tax liability which is decreased because of a carryback, such as a net operating loss carryback, an investment credit carryback, a foreign tax credit carryback or a capital loss carryback (for corporations).

2 In the case of a carryback, the delinquency penalty is adjusted by reference to the potential tax liability (either a deficiency or an overassessment) which is computed prior to application of the carryback.

(b) When a delinquent return is assigned to an examiner, that examiner is responsible for determining not only the taxpayer's correct tax, but also the taxpayer's liability for the FTF penalty. This responsibility exists even though a service center or collection function may have determined reasonable cause for the delay in filing, or may have asserted the FTF penalty. The examiner may find that the asserted penalty was based on incomplete facts or on a misstatement of facts.

(c) The examiner should ask the taxpayer to explain the reason for the delay in filing the return. The FTF issue will be considered in the same manner and to the same extent as any other issue affecting determination of tax liability. Based on the explanation the taxpayer provides, a previously asserted penalty will either be upheld or adjusted. (See IRM (20)130 for Penalty Relief criteria).

(d) When examining a delinquent return showing no tax liability, the examiner's findings may result in a tax deficiency. If reasonable cause for delay in filing is not established, the FTF/FTP penalty will be asserted as a part of the deficiency.

(e) A delinquent return assigned for examination may have attached to it a copy of Form 4135, Criminal Investigation Control Notice.

1 This copy of Form 4135 notifies the examiner that the delinquency penalty was suppressed initially by Criminal Investigation Division because another penalty, such as fraud, might be asserted.

2 When such a case is transferred to an examining function, the examiner will take any action necessary with respect to asserting the delinquency FTF/FTP penalty.

(1)Manual Computation of the Penalty:

(a) In many instances, Master File calculates and computer generates the FTP penalty (TC 276), as applicable. It does this by performing an analysis of the information on the tax module.

(b) When manual adjustments of the penalty are required, Service personnel are responsible for determining the correct penalty amount for assessment. Attach documentation of the manual FTP penalty computation to the source document and associate with the original return or assessment document.

(c) IDRS Command Code (CC) INTST is available for determining the amount of assessed and accrued FTP penalty on accounts not previously restricted (TC 270/271). CC INTST may be used to compute FTP penalty amounts to a certain date. In such cases, CC INTST can aid in determining the amount of the penalty that should be assessed or abated to correct the FTP penalty amount.

(d) IDRS CC COMPAF is available for computing the FTP penalty. CC COMPAF can aid in determining the amount of penalty which should be assessed or abated. The COMPAF print may be used to document a manual assessment.

(e) When there is a difference between computer generated and manual computations, manual computations take precedence.

(2)Transaction Codes

(a) The following transaction codes (TC) identify assessment or abatement of the FTF and FTP penalties:

- 1 TC 166/167-computer generated assessment/abatement of the FTF penalty ,
- 2 TC 160/161-manual assessment/manual abatement of the FTF penalty,
- 3 TC 162-manual removal of computation restriction of the FTF penalty,
- 4 TC 276/277-computer generated assessment/abatement of the FTP penalty, and
- 5 TC 270/271-manually assessment/abatement of the FTP penalty.

(3)Blocking Series

(a) When making an adjustment and you:

- 1 have the original return, use BS 000,
- 2 do not have the original return, use BS 180.

(b) Other specific situations require specific blocking series.

(4)Priority Codes

(a) After December 31, 1996, to remove a prior restriction and allow automatic

generation of the FTP penalty by master file, input an adjustment to tax (or 290/300 for a zero amount) with a:

1 Priority code 2 (ADJ54/TC290), or

2 Priority code 9 (ADJ47/TC300).

(5) Assessments/abatements - computer generated

(a) Assessment or abatements of a FTF/FTP penalty may result from adjustments to tax on a module.

(b) Master File may analyze a tax module and adjust the FTF/FTP penalty when timely credits are moved into a tax module.

(6) Assessments/abatements - manual

(a) Assertion or non-assertion of the FTF/FTP penalty may be recommended on secured delinquent returns. This recommendation accompanies the return to the appropriate processing function at the service center, along with Form 3198, Special Handling Notice.

(b) Since the FTP penalty accrues until the earlier of the date the tax is paid or the maximum penalty is assessed, it is important that employees do not unnecessarily restrict the penalty.

(7) System errors

(a) Prompt action is needed to correct FTF/FTP penalties erroneously assessed or accrued due to system errors.

1 When a system error involving the assessment of the FTP penalty in a significant number of cases is discovered, the Service issues special instructions identifying the problem and provides the steps needed to correct the situation. Usually, these system errors are quickly resolved. Districts, service centers, and regions will be kept informed of any special instructions.

2 When a system error on an individual case is identified, such as a tax account suspended in notice status longer than it should have been, an adjustment to assessed and accrued FTP penalty may be needed. If it is determined that the penalty should have been assessed from the original due date of the return, remove the restriction as indicated in (20)217.2.

(8) Before adjusting restricted FTF/FTP assessments, the original assessment documents should be obtained (or other local procedures followed), to check the penalty computation and rationale for restricting the penalty.

(a) Assessed and accrued FTP penalties should be manually computed (CC COMPAF may be used) and abated from the cycle of the last status update through the 23C date of

the posting TC 271.

(b) After January 1, 1990, except for IRAF adjustments, all manual adjustments to FTP penalty (TC 270, TC 271 or TC 272) must be input in a blocking series (BS) that will create a refile DLN.

(c) Notify the taxpayer of the action taken and the balance due, if any.

(20)217.3 PINEX

(1) The Taxpayer Correspondence Study recommended that the IRS provide explanations of all penalty and/or interest charges to the taxpayer when a balance due notice or a refund is issued. This recommendation resulted in the development of the Penalty and Interest Notice Explanation (PINEX) Project.

(2) Upon request, command code PINEX generates a notice of explanation to the taxpayer. The specific tax module requested must be on the TIF data base and at least one unreversed penalty or interest transaction posted.

(3) This notice includes a computation and explanation of selected computer generated penalties, interest charged and interest paid except for computations and explanations of failure to deposit penalty.

(4) PINEX notices must be reviewed by the tax examiner requesting the notice, and, if correct, mailed to the taxpayer.

(5) PINEX also provides screen displays of penalty and interest computations for an immediate response to telephone inquiries or walk-in requests made to District Offices. IRS personnel may find the screen displays helpful in analyzing penalty and interest transactions in general.

(20)220 Minimum Failure to File Penalty

(1) For returns due after December 31, 1982, a minimum FTF penalty applies to all individual and corporate income tax returns delinquent for more than 60 days. The minimum FTF penalty shall not be less than the lesser of: \$100.00 or 100 percent of the amount required to be shown as tax on the return.

(2) The reduction in the FTF penalty by the FTP penalty does not apply when the minimum failure to file penalty is asserted. See Exhibit 200-3.

(20)230 Failure to File a Tax Return

IRC Section 6651(a)(1)

(20)231 General

(1) IRC section 6651(a)(1) imposes a penalty for failure to file (FTF) a tax return, by the date prescribed (taking into consideration any extension of time for filing), unless it is shown that the failure is due to reasonable cause and not due to willful neglect. See IRM (20)130 for

a discussion of Penalty Relief.

(2) Penalties for failure to file information returns, such as Forms 1099 or 5500, are discussed in Chapters (20)700, Information Return Penalties and (20)800, EP/EO Penalties.

(20)232 Penalty Computation

(20)232.1 General

(1) To calculate the penalty:

(a) determine the penalty period (number of months including a part of a month (see IRM (20)212.5);

(b) determine the penalty rate (4½ or 5 percent);

(c) determine the net tax due for each month (including a part of a month) the penalty is applicable; and

(d) Multiply the:

1 number of months (including a part of a month) the return is past due,

2 times the penalty rate,

3 times the net tax due.

(20)232.2 Penalty Period

(1) The penalty period extends from the prescribed due date, including valid extensions, to the date the Service receives the return.

(a) The prescribed due date is the date taxpayers are required to file their returns.

(b) If the due date falls on a Saturday, Sunday, or legal holiday, and the return is filed by the next business day, consider it filed on the due date.

(c) If the taxpayer has a valid extension of time for filing a return, he/she is not liable for the FTF penalty for the duration of the extension period. An extension of time is identified by the following transaction codes:

1 TC 460 for all Master File returns;

2 TC 620 for BMF accounts with MFTs 02, 05, and 33. This TC credits the module with the remittance received with the Form 7004/2758/8736 and posts a tentative liability.

(d) See 212.4 of LEM XX 200.

(20)232.3 Penalty Rate

(1) Generally, the FTF penalty is 5 percent of the amount of the tax required to be shown

on the return for each month, or fraction thereof, that the failure continues, not to exceed 25 percent of the tax.

(2) When the FTP penalty under IRC section 6651(a)(2) also applies, the FTF penalty of 5 percent (.05) is reduced by $\frac{1}{2}$ of 1 percent per month to $4\frac{1}{2}$ (.045) percent for each month or part of a month that the FTF and FTP both apply.

(3) Be aware, that both the FTF and the FTP penalties may apply at the full rate, for the same amount of money, but for different periods in time. See the FTP penalty portion of this chapter (IRM (20)230, (20)240, (20)250, and (20)260).

(20)232.4 Net Amount Due

(1) See IRM (20)212.6 for a definition of the Net Amount Due.

(2) Coordination with the Failure to Pay (FTP) Penalty

(a) IRC section 6651(a)(2) (See IRM (20)240):

1 In general, when the FTF penalty and the FTP penalty apply at the same time on an original assessment, the FTF penalty is reduced by the FTP penalty.

a In most situations this will result in an assertion of a FTF penalty of 4.5 (.045) percent and the FTP penalty at 0.5 (.005) percent.

b Although this does not change the maximum amount of penalty that can legally be assessed, it will in effect limit the amount of the failure to file penalty to 22.5 percent of the tax.

(b) IRC section 6651(a)(3) (See IRM (20)250):

1 In general, the FTF penalty is not reduced by the FTP penalty for the failure to pay any amount required to be shown on a return which was not so shown. The FTF penalty (if applicable) would apply from the original or extended due date of the return for 5 months or until the return was filed. The FTP penalty would apply from the assessment date until the date the tax was paid.

2 The FTP penalty under IRC section 6651(a)(3) applies only when a subsequent assessment (TC 290/300) of tax is made.

3 See IRM (20)251:(3).

(20)233 Examples of FTF Penalty Calculations

(1) FTF Penalty Only. For the example in Exhibit 200-3, Example 1, only FTF is being considered and the minimum FTF penalty does not apply because the return is less than 60 days delinquent.

(2) Original Assessment of FTF and FTP Penalties

(a) When both the FTF and FTP penalties apply to an original assessment for any

month or (fraction of a month), reduce the FTF penalty by the amount of the FTP penalty. See IRM (20)240 for FTP penalty information.

(b) The combined total of the two penalties must not exceed 5 percent for any month. For example, if the FTP penalty is 0.5 percent, then the FTF penalty would be 4.5 percent. See Exhibit 200-3, Example 3.

(3) Computation FTF and FTP Penalties After Tax Adjustment

(a) In calculating the additional FTF penalty when tax adjustments have been made, consideration must be given to the total rate of 5 percent per month that is allowed under IRC section 6651(a)(1). See 233 of LEM XX 200.

(b) The 5 percent (.05) FTF penalty may not be reduced by the one-half-of-one percent (.005) FTP as the result of an assessment of additional tax, when the FTF and FTP penalties apply for different periods of time:

1 the FTF penalty, if applicable, will apply from the original or extended due date of the return for five months.

2 the FTP penalty will apply from the 23C date of assessment, until the additional tax is paid.

3 See IRM (20)240 and (20)250 and Exhibit 200- 3, Examples 4 and 5 for additional information.

4 See IRC section 6651(a)3.

(20)240 Failure to Pay Tax (FTP)

IRC Sections 6651(a)(2)

(20)241 General

(1) IRC section 6651(a)(2) imposes a FTP penalty if the tax shown on any return, other than an information return, is not paid by the due date of that return. The FTP penalty under this provision applies to original and amended returns filed by the taxpayer.

(a) This penalty applies to the following returns:

1 income tax returns;

2 employment tax returns;

3 excise tax returns;

4 gift tax returns;

5 estate tax returns;

(b) It does not apply to:

- 1 information returns required under Chapter 61, Subchapter A, Part III;
- 2 payments of estimated tax;
- 3 partnership returns.

(2) The Service does not assert this penalty when the failure to pay is due to reasonable cause and not willful neglect or the taxpayer qualifies under other penalty relief criteria. See IRM (20)130 for a complete discussion of penalty relief.

(20)242 Penalty Computation

(20)242.1 General

(1) To calculate the penalty:

(a) determine the penalty period (number of months including a part of a month (see IRM (20)212.5)) from the original due date of the return until the tax is paid;

(b) determine the penalty rate (one-half of one percent);

(c) determine the net tax due for each month (including a part of a month) the penalty is applicable; and

(d) Multiply the:

- 1 number of months (including a part of a month) to which the penalty applies,
- 2 times the penalty rate,
- 3 times the net tax due.

(20)242.2 Penalty Period

The period for computing the IRC Section 6651(a)(2) penalty, which applies to original returns, is from the due date of the return until the tax is paid.

(20)242.3 Penalty Rate

(1) IRC section 6651(a)(2) provides that the FTP penalty be assessed at one-half of 1 percent (.005) of the unpaid tax for the first month the penalty applies and an additional one-half of 1 percent (.005) for each additional month or fraction of the month the tax is unpaid, not to exceed 25 percent of the tax.

(2) For purposes of computing the penalty the first month begins on the due date of the return. See IRM (20)212.5 for the definition of a month.

(3) To compute the penalty, multiply the number of months (including a part of a month) the tax remains unpaid, times one-half of one percent (.005), times the unpaid tax. For example:

(a) the taxpayer files the 1995 return on 05/13/96. The return shows a balance due of

\$575.00, which is paid on 05/13/96.

(b) The penalty under IRC section 6651(a)(2) applies because the tax was not paid by the due date of the return (April 15, 1996).

1 April 15 until May 13 is treated as one month for the purposes of computing the penalty,

2 one month at one-half of one percent (.005) times the balance due of \$575.00 equals \$2.88.

(20)242.4 Net Amount Due

See IRM (20)212.6 for a definition of the Net Amount Due.

(20)250 Failure to Pay Tax

IRC Sections 6651(a)(3)

(20)251 General

(1) IRC section 6651(a)(3) imposes a FTP penalty on any tax required to be reported on a return, other than information returns, but was not reported on the return.

(2) The FTP penalty is not reduced by the FTP penalty imposed under IRC section 6651(a)(3).

(a) The FTP penalty will be computed from the original due date of the return for up to five months.

(b) The FTP penalty imposed under IRC section 6651(a)(3) begins with the assessment (23C) date and continues until the additional tax is paid, not to exceed 25 percent of the tax.

(c) Therefore the FTP and FTF penalties may be assessed on the same amount of unpaid tax, but for different periods of time.

(3) For the first notice and demand (first balance due notice) made:

1 prior to January 1, 1997, the FTP penalty, under IRC section 6651(a)(3), was assessed when payment was not made within 10 days of notice and demand,

2 after December 31, 1996, the FTP penalty, under IRC section 6651(a)(3), will be assessed if payment is not made within 21 calendar days (or 10 business days if the balance due amount equals or exceeds \$100,000) of notice and demand.

3 See 251:(3) of LEM XX 200.

(20)252 Penalty Computation

(20)252.1 General

(1) To calculate the penalty:

(a) determine the penalty period (number of months including a part of a month (see IRM (20)212.5) from the 23C date (assessment date) of additional tax until the tax is paid);

(b) determine the penalty rate (one half of one percent);

(c) determine the net tax due for each month (number of months including a part of a month (see IRM (20)212.5) the penalty is applicable; and

(d) Multiply the:

1 number of months (including a part of a month) the tax remains unpaid,

2 times the penalty rate,

3 times the net tax due.

(20)252.2 Penalty Period

The penalty period is the number of months (including a part of a month (see IRM (20)212.5)) from the date of assessment (23C date) to the date the additional tax is paid.

(20)252.3 Penalty Rate

The penalty rate is one half of one percent (.005) for each month or part of a month the tax remains unpaid.

(20)252.4 Net Amount Due

(1) See IRM (20)212.6 for a general definition of the Net Amount Due.

(2) Net amount due as it relates to IRC section 6651(a)(3) is the amount of tax stated in the balance due notice. For purposes of computing the FTP penalty, the net amount due may be reduced by any payments made after the balance due notice but prior to the beginning of the following month.

(20)260 IRC Section 6651(d)

Increase in the FTP

(20)261 General

(1) IRC section 6651(d) increases the FTP penalty under IRC section 6651(a)(2) or (3) on any tax required to be reported on a return, from one-half of one percent (.005) to one percent (.01) of the tax after either:

(a) the day, 10 days after the date notice of intent to levy (IRC section 6331(d)), or

(b) the day on which notice and demand for immediate payment is given (IRC section

6631(a).

(2) See IRM (20)262.2 for information on how to identify the notice of intent to levy.

(3) The increased penalty rate (1 percent) applies to all subsequent assessments on that module. However, once a module is fully paid, a later assessment will accrue at the one-half of one percent rate until notice of intent to levy is sent.

(4) The increased rate does not change the monthly period for accruing the penalty. For example, a penalty which is accruing on the 16th day of the month at the one-half percent rate will first accrue at the 1 percent rate on the 16th day of the month following the trigger date. It will then continue to accrue at 1 percent until paid or until the 25 percent maximum penalty is reached.

(20)262 Penalty Computation

(20)262.1 General

(1) To calculate the penalty:

(a) determine the penalty period (number of months (or part of a month) from the date of the notice of intent to levy until the tax is paid).

(b) determine the penalty rate (one percent);

(c) determine the net tax due for each month or part of a month the penalty is applicable; and

(d) Multiply the:

1 number of months (including a part of a month (see IRM (20)212.5)) the tax remains unpaid,

2 times the penalty rate,

3 times the net tax due.

(20)262.2 Penalty Period

(1) The period for computing the penalty under IRC section 6651(d), is:

(a) for returns due after December 31, 1986, the monthly FTP penalty rate increases from one-half of one percent to 1 percent on the earlier of:

1 the 11th day after the notice of intent to levy is given under IRC section 6331(d). A notice of intent to levy can be identified on Master File by:

a Notice Status 58, or

b TC 971 with Action Code 35. This is input when the notice status 58 was bypassed and the Collection employee requests issuance of either ACS Letter 11

or DO Letter 1058.

2 the date notice and demand for immediate payment is given on a jeopardy assessment under IRC section 6331(d)(3). A jeopardy assessment can be identified on the Master File by a TC 370, Doc Code 51, Blocking Series 100 - 119.

(2) If the taxpayer subsequently files an amended return or other document changing the tax, allow the computer to correct the FTP penalty.

(3) For jeopardy assessments, compute the FTP penalty from the date of the notice and demand to the date of payment. See Exhibit (20)200-3, Example 6.

(20)262.3 Penalty Rate

The penalty is assessed at one percent (.01) per month or part of a month until the tax is paid or the maximum penalty amount (25 percent of the tax) is reached.

(20)262.4 Net Amount Due

Under IRC section 6651(d), the FTP penalty for the first month is imposed on the amount of tax stated in the notice and demand, reduced by any amount paid before the beginning of the first month. For subsequent months, the penalty is imposed on the amount of tax unpaid at the beginning of each penalty period.

(20)270 Fraudulent Failure to File

IRC section 6651(f)

(20)271 General

(1) For returns due after December 31, 1989 (determined without regard to extensions), the civil fraud penalty, IRC section 6663, can only apply to situations when a return has been filed. This restriction was legislated in IRC section 6664(b) by OBRA 89.

(2) OBRA 89 enacted IRC section 6651(f), Increase in Penalty for Fraudulent Failure to File (FFTF). This penalty generally has an impact equal to the severity of the civil fraud penalty.

(3) The burden of proof is on the government to establish FFTF.

(4) The FFTF penalty is a counterpart of the civil fraud penalty under IRC section 6663 and should be investigated and asserted in the same manner.

(5) The fraud components of the FFTF and the fraud penalties are generally similar. The civil fraud penalty requires an underpayment which is attributable to the willful and knowing intent to defraud. The FFTF penalty requires a "net amount due". The intent element of the fraud and the FFTF penalties should be interpreted the same.

(6) Assertion Criteria

(a) The FFTF penalty is asserted on a case-by-case basis after considering all the facts

and circumstances surrounding the failure to file. There must be clear and convincing evidence that the failure to file was done with the intent to evade taxes.

(b) The following factors should be considered when developing a FTF case:

- 1 the taxpayer refuses to, or is unable to, explain the failure to file;
- 2 the taxpayer's statement does not meet or agree with the facts of the case;
- 3 there is a history of failing to file or late filing, but an apparent ability to pay;
- 4 the taxpayer fails to reveal or tries to conceal assets;
- 5 the taxpayer pays personal and business expenses in cash when cash payments are not usual, or cashes rather than deposits checks which are business receipts; and
- 6 the taxpayer is aware of the filing requirement. This factor should not be used as the sole factor for asserting the penalty. Rather it should be used in conjunction with one of the above factors.

(c) The 75 percent fraud and FTF penalties may be asserted for the same tax year. The criteria for proving fraudulent failure to file under IRC section 6651(f) and civil fraud under IRC section 6663, are the same. Although there is no specific prohibition against asserting penalties under both IRC sections 6651(f) and 6663, caution should be used when considering this action. See IRM (20)572.2 for a discussion of civil fraud under IRC section 6663.

(7) When Asserted/Who Asserts

(a) Only examination functions assert this penalty. If the Collection, Returns Processing, or Taxpayer Service functions suspect FTF on any return, a referral should be made to Examination or EP/EO functions depending on the type of return.

1 This procedure was established because Service personnel who initially review these cases generally will not have sufficient taxpayer information available to determine FTF.

2 However, if any of the indicators in IRM (20)271.2:(1)(b) exist, refer it to the Examination or EP/EO.

(b) The examining officer determines the amount of the FTF penalty and reflects it on the audit report.

(c) If the taxpayer does not agree with the assertion of the FTF penalty, the examiner should prepare an unagreed report. The report should include the FTF penalty as an alternative position, in the event that the FTF penalty is not sustained upon appeal.

(8) Effective for returns due after December 31, 1989 (determined without regard to extensions), if the failure to file is due to fraud, assert the fraudulent FTF penalty (FFTF) rather than the regular FTF penalty.

(20)272 Penalty Computation

(20)272.1 General

(1)The period for computing the FFTF penalty is from the return due date, or the extended due date of the return, until the date the return is filed. Assess the FFTF penalty using Reference Number 686 with the corresponding amount on Item 15 of Form 5344, 5403 or 5599. See Exhibit 200-4.

(2)Interest

(a)The interest computation period for the penalty begins on the later of: the return due date, or the extended due date.

(b)The interest computation period ends on the earlier of: the date of payment, waiver plus 30 days, or 23C Assessment Date (per IRC section 6601(a)(2)(B)).

(c)Interest will be computer generated by Master File based on input of Reference Number 686.

(d)If a quick assessment is warranted, interest is manually computed and input with TC 190, unless the account is already restricted or otherwise requires restricted interest computations.

(20)272.2 Penalty Period

The period for computing the FFTF penalty is from the return due date, or the extended due date of the return, until the date the return is filed or for a maximum of 5 months, whichever is earlier.

(20)272.3 Penalty Rate

(1)The FFTF penalty is 15 percent per month of the net amount due for each month the return is delinquent, up to a maximum of five months or 75 percent.

(2)How to Compute the Penalty

(a)The FFTF penalty is computed in the same manner as the FTF penalty only the applicable percentage is different. See IRM (20)270 for specific instructions on computing the penalty.

(b)As is the case with the FTF penalty, the FFTF penalty applies to tax shown on a taxpayer's original return and to the tax on any subsequent adjustments to the return.

(3)If an abatement request is approved, input Reference Number 686 in the negative (-) column of the adjustment document. The Examination function and Appeals can abate this penalty.

(20)272.4 Methods of Appealing Penalties

The FFTF penalty is generally subject to the post- assessment appeal procedure. The Service has the burden of proving the fraud issue by clear and convincing evidence. Even though it is not

authorized explicitly by statute, the Service may provide the taxpayer with the opportunity to appeal the penalty determination prior to the time it is assessed, either with the revenue agent (the agent's manager) or with the Office of Appeals .

(20)280 Failure to File Partnership Return

IRC section 6698

(20)281 General

(1)IRC section 6698 imposes a penalty against a partnership that fails to file a timely or complete return as required by IRC section 6031.

(a)The penalty is imposed on those partnerships that fail to file a timely or complete partnership return (Form 1065).

(b)The penalty also applies to those U.S. Real Estate Mortgage Investment Conduit Income Tax Return (REMIC) that fail to file a timely or complete return (Form 1066).

(2)Although the penalty is asserted against the partnership or REMIC, the partners or investors are individually liable for the penalty to the extent of their liability for partnership debts generally.

(20)282 Assertion Criteria

(1)When Asserted. Generally, this penalty is imposed on a partnership which did not timely file or provide the information required on Form 1065 or 1066. This penalty is applicable to tax years beginning after December 31, 1978. The penalty will not be imposed if the partnership can show that failure to file a complete or timely return is due to reasonable cause.

(2)Who Asserts. The penalty is generally imposed by the following:

- (a)Service center
- (b)Examination function
- (c)Collection function
- (d)Taxpayer Service.

(20)283 Penalty Computation

(20)283.1 Penalty Period

(1)The penalty period for the failure to file a Partnership/REMIC return is the number of months (including a part of a month (see IRM (20)212.5)) that the failure continues, up to a maximum of five (5) months.

(2)The penalty period for the failure to file a complete (i.e., missing information) Form 1065 or 1066 is the number of months (including a part of a month (see IRM (20)212.5)) that

the failure continues, up to a maximum of five (5) months. If the taxpayer provides the information prior to the end of the five month period, abate the penalty assessment for the period subsequent to the received date of the information.

(20)283.2 Penalty Rate

(1) For any month that the return is late or contains incomplete information, the penalty is computed at the rate of:

(a) \$50 per partner (persons who were partners during any part of the taxable year),

(b) per month, or fraction of a month (not to exceed five months).

(20)284 How to Assert/Assess

(1) Service Center

(a) The penalty may be assessed either automatically or manually when a taxpayer fails to timely file a complete Form 1065 or Form 1066, or when a substitute for partnership return is prepared by the Service and reasonable cause is not established.

(b) The late filing penalty is assessed manually with a TC 160 or automatically with a computer-generated TC 166.

(c) The missing information penalty is assessed manually with a TC 240 or automatically with a computer-generated TC 246.

(2) Examination function

(a) When Examination secures a delinquent Form 1065 or Form 1066, or where a "Substitute for Return" is prepared with respect to a non-filed return, the following steps should be taken before the case is forwarded to Examination PSP for processing:

1 When available, include Form 1065, Schedule K-1, "Partners Shares of Income, Credits, Deductions, Etc." when processing a Substitute for Return (SFR). This provides the information to compute and assess the penalty.

2 If the partnership does not show the number of partners, and accurate information cannot be obtained, compute the penalty assuming there are two partners. See IRM (20)280.

(b) When a Form 1065 or Form 1066, on which the penalty has been assessed, is subsequently examined, the penalty issue should be reconsidered.

1 If the examiner determines that reasonable cause for late filing exists, or that the service center's computation of the penalty is incorrect, the following will be done when closing the case:

2 When abating the penalty, attach a Form 3198 to the front of the case file with the instruction in the "Other" section to "Prepare Form 3870 (Request for

Adjustment)-Abate Failure to File Penalty.”

3 When increasing or decreasing the penalty due to a service center computation error, attach a Form 3198 to the front of the case file with the following instruction in the “Other” section: “Correct FTF Penalty should be \$---,” prepare Form 3870.

4 The examiner's workpapers should clearly document the basis for the determination regarding the failure to file penalty.

5 The ESP/Processing function will be responsible for preparing the Form 3870/8485.

(3)Collection and Taxpayer Service functions

(a)Employees who can not directly input the penalty assessment to IDRS need to prepare an appropriate document to request input of the assessment. Various documents are available for this purpose, such as:

1 the preprinted penalty and interest block found on some tax forms;

2 Form 4844, Request for Terminal Action, and

3 Form 4364, Delinquency Computations.

(20)285.1 General

(1) If the taxpayer (partnership or REMIC) provides information that will allow penalty relief for failure to file a complete or timely partnership return, abate the penalty. See IRM (20)130 for a discussion of penalty relief.

(a)If the taxpayer is eligible for penalty relief, allow the abatement. Attach all documentation supporting the abatement to the adjustment document.

(b)If the partnership is not eligible for penalty relief (20)130), disallow the request for abatement. Attach copies of any documents, transcripts or research to the adjustment document.

(2)If it can be demonstrated that the taxpayer is not required to file a particular schedule for which the penalty was charged, abate the penalty. See IRM (20)285.2 for Statutory Exceptions applicable to Partnership or REMIC returns.

(3)See 285 of LEM XX 200.

(20)285.2 Statutory Exceptions

(1)Abatement Based on Rev. Proc. 84-35 1984-1 C.B. 509, relating to a small partnership.

(a)A small partnership, as defined under IRC section 6231(a)(1)(B):

Is considered to have met the reasonable cause provisions, if the partnership or any of the partners establishes that all partners have fully reported their share of the income, deductions, and

credits of the partnership on their timely filed income tax returns.

2 is considered to qualify as a small partnership, if it is a domestic partnership that is composed of 10 or fewer partners each of whom is a natural person (other than a nonresident alien) or an estate and each partner's share of each partnership item is the same as each share of every other item.

(b) If the partnership is assessed the penalty for a missing balance sheet, and that partnership establishes that:

1 it was extremely difficult or impossible to complete a balance sheet, or

2 it cannot complete a balance sheet because it uses single entry accounting, then

3 that partnership may be considered to have met the reasonable cause test (ordinary business care and prudence). Abate the penalty.

(c) The following action will be taken when considering this revenue procedure:

1 Form 1065 or Form 1066 must be obtained for the tax period in question unless information on BMF CC RTVUE can be used to determine the number of partners. Use STAUP and interim responses as necessary.

2 Verify the number of partners (husband and wife or their estates are counted as one partner) when the returns are received from files, review the partnership forms to verify the number of partners. (DO not rely on the number of partners recorded on CC ACTRA/MFTRA/TXMOD)

3 If there are more than ten partners, or if any of the partners are trusts, corporations, a nonresident alien, or if each partner's share of each partnership item is not the same as such partner's share of every other item, the partnership does not qualify for reasonable cause abatement under Rev. Proc. 84-35.

(2) Abatement of a Penalty for Missing Information/Schedule Assessments

(a) When a missing information assessment is abated because the taxpayer submits the requested information, do not use RC 62. The taxpayer has complied with the requirement to provide the information rather than providing a reason why he/she did not comply.

(b) If the taxpayer supplies the missing information prior to the second balance due notice, abate the entire assessment.

(c) If the taxpayer supplies the missing information after the second notice has been issued, but within five months of the due date of the return, abate only the portion of the penalty which accrued after the requested information was submitted. If the taxpayer provides the information more than five months from the due date of the return, and the second notice has been issued, the penalty should not be abated unless penalty relief criteria is established. See IRM (20)130.

(3)IRC section 6032 Common Trust Fund Filers. IRC section 6032 requires banks maintaining a common trust fund to file annual information returns by the period ending three months and 15 days after the end of the fiscal year (or April 15th for calendar year filers). No particular form is prescribed for making this return, but if Form 1065 is used, it should reflect all items of gross income and deductions of the fund, and identify all participants and their proportionate share. See 285:(3) of LEM XX 200.

Exhibit 200-1 Net Amount Due

Table omitted.

Exhibit 200-2 Definition of a Month

Reference: IRM (20)212.5

Example 1

Form 1040 (MFT 30)

Return Due Date 041594

Return Received Date 060393

041594 to 051594 equals one month

051594 to 060394 equals one month

For the purposes of computing the penalty, consider a part of a month as an entire month. In the above example, the return would be considered two months late.

Example 2

Form 1040 (MFT 30)

Return Due Date 041594

Extended Due Date 081594

Return Received Date 100394

081594 to 091594 equals one month

091594 to 100394 equals one month

For the purposes of computing the failure to file penalty, the return is two months late (the taxpayer had a four month extension of time to file). For the purposes of computing the failure to pay penalty, any payment received with the return would be six months late, because an extension of time to file is not an extension of time to pay. All tax is due by the due date of the return. Tax not received by the due date of the return is subject to the failure to pay penalty.

Exhibit 200-3 Penalty Calculations

Example 1 (IRM (20)220)

Minimum Failure to File - the lesser of \$100 or the total tax due

Form 1040 (MFT 30)

Return Due Date 041594

Return Received Date 071694

The return is three months late; there was no extension of time to file

Tax paid with the return - \$75.00

Penalty Assessed - \$75.00

Example 2 (IRM (20)230)

Failure to File Penalty "only" - The return was filed one month and 23 days late showing a tax due of \$250.00.

one month, 23 days equals two months

2 months times 5 percent per month equals 10 percent

10 percent times \$250.00 equals \$25.00

Example 3 (IRM (20)240)

Failure to File and Failure to Pay Penalties - The same factors as stated apply as stated in Example 2.

one month, 23 days equals two months

Failure to File

- 2 months times 4.5 percent (.045) equal nine percent (.09)

Failure to Pay

- 2 months times one-half of one percent (.005) equals one percent (.01)

.09 times \$250.00 equals \$22.50

.01 times \$250.00 equals 2.50

\$25.00

In this example, we see that the failure to file and the failure to pay both apply for the same period of time so both penalties together cannot equal more than 5 percent per month.

10 percent times \$250.00 equals \$25.00

Exhibit 200-3 (Con't-1) Penalty Calculations

Table omitted.

Exhibit 200-4 Penalty Calculations

Table omitted.

Exhibit 200-5 Penalty Calculations

Reference: IRM (20)280

The Failure to File a Form 1065/1066 return or provide the information requested on that return is assessed at \$50 per partner, per month until the return is filed or five months, which ever is earlier.

\$ 50.00

x 25 number of partners

\$ 1,250.00

x 5 number of months the failure continues

\$ 6,250.00 Total penalty

Chapter (20)300 Estimated Tax Penalties

(20)310 (8-14-95) IRC Section 6654

(20)311 (8-14-95) Individual (& Fiduciary) Estimated Tax Penalty Description

(1) IRC section 6654 provides for a penalty when individuals, estates and most trusts underpay any required installment(s) of estimated income tax liabilities reportable on Forms 1040, U.S. Individual Income Tax Return and Forms 1041, U.S. Fiduciary Income Tax Return.

(2) Qualified settlement funds, as defined in Treas. Regs. 1.468B-1 are also covered under IRC section 6654.

(3) However, private foundations and charitable trusts that are taxed on amounts of unrelated business income are covered under IRC section 6655 penalties for corporations.

(4) Taxpayers will not be subject to estimated tax penalties if their tax liability minus tax amounts withheld from wages during the year is less than \$500.

(20)312 (8-14-95) Assertion Criteria

(1) Taxpayers make estimated quarterly tax payments to pay for income tax liabilities not paid through withholding.

(2) Taxpayers must make estimated tax payments in order to avoid the estimated tax penalty if their tax liability, minus withholding from wages during the year, will be \$500 or more unless an exception in IRM (20)321 applies.

(3) To avoid the estimated tax penalty under IRC section 6654, the annual estimated tax (including withholding) required to be paid is the lesser of:

(a) 90 percent of the tax shown on the current year's return (80 percent for taxable years beginning prior to January 1, 1988); or

(b) If no return is filed, then 90 percent of the tax required to be shown on the current years return, or

(c) 100 percent of the tax shown on the preceding year's return (without adjustments, if any are on the module) for tax years beginning after December 31, 1987 and through

December 31, 1991.

1 NOTE: For tax years beginning after December 31, 1992, certain individuals, estates and trusts may not be able to use 100 percent of the preceding year tax as their basis for current year estimated tax payments, other than for the first installment.

2 For tax years beginning after December 31, 1993:

a Married filing separately for the current year. If the AGI shown on the preceding year's return exceeds \$75,000, the taxpayer qualified for the safe harbor by making estimated tax payments equal to 110 percent of the tax shown on the preceding year's return.

b Filing status other than married filing separately. If the AGI shown on the preceding year's return exceeds \$150,000, the taxpayer qualifies for the safe harbor by making estimated tax payments equal to 110 percent of the tax shown on the preceding year's return.

3 See IRM section (20)321 and Exhibit (20)300-3 for complete guidelines.

(d) the amount determined under the annualized installment method described in IRM section (20)321.6.

(20)320 (8-14-95) Determining the Required Annual Payment

(20)321 (8-14-95) Exceptions to the Annual Payment Requirements

(20)321.1 (8-14-95) General

(1) No estimated tax penalty shall be imposed if the taxpayers' tax liability minus tax amounts withheld from wages and other payments/credits during the year is less than \$500.

(2) No estimated tax penalty shall be imposed on taxpayers if for any tax year:

(a) they had NO liability for tax for the preceding tax year, and

(b) they were a citizen or resident of the United States throughout the preceding tax year, and

(c) the preceding tax year was a 12 month year.

(3) The exception in (2) above is available for Form 1040 and Form 1041 returns subject to IRC section 6654. This exception does not require that a return be filed for NO liability for the prior year.

(4) Master File usually can determine whether the taxpayer qualifies for this exception. The computer will assess the penalty if the taxpayer incorrectly claims this exception.

(20)321.2 (8-14-95) Payments Based on Prior Year's Tax

(1) Generally, taxpayers may base their annual estimated tax amounts on 100 percent of the

preceding year's tax. The preceding tax year must have covered a full 12 months. (Beginning January 1, 1992, certain taxpayers may not be able to use this option. See (2) below.) See Exhibit (20)300-3.

(a) The preceding year's tax for purposes of estimated tax payments refers to the tax assessed with the original or amended (superseding) returns. A superseding return is an amended return filed on or before the return due date (including extensions).

(b) The preceding year's tax does not include tax increases or decreases from amended returns or audits after the return due date (including extensions). See, however, the exceptions to this rule in (20)327.1:(3)(b).

(2) Section 403 of P. L. 102-164, Emergency Unemployment Compensation Act of 1991, limits the use of the 100 percent of the preceding year's tax as a safe harbor for the current year's estimated taxes.

(a) See 321.2:(2)(a) of LEM XX-300.

(b) The law covers tax years beginning after December 31, 1991, and is not applicable to tax years beginning after December 31, 1993. Taxpayers (other than farmers and fishers) meeting ALL of the following conditions cannot use 100 percent of the preceding year's tax (see Exhibit (20)300-3) as the basis for the current year's estimated tax installments:

1 adjusted gross income for the current year exceeds \$75,000 (\$37,500 in the case of a married individual filing a separate return) and

2 the "modified adjusted gross income" for the current year exceeds the amount of the adjusted gross income shown on the return of the preceding tax year by more than \$40,000 (\$20,000 in the case of a married individual filing a separate return) {see Exhibit (20)300-4 for explanation of "modified adjusted gross income"}, and

3 taxpayers who made estimated tax payments (other than by application of withholding or credit from the prior year's return) during any of the preceding three years, or taxpayers who had a penalty assessed for failure to pay estimated tax during the preceding three years, and

4 90 percent of the current year's "modified expected tax" will be greater than 100 percent of the preceding year's tax.

(3) If 90 percent of the current year's "modified expected tax" is greater than 100 percent of the preceding year's tax, then the required current year's payment is the smaller of 90 percent of the current year's tax or 90 percent of the year's "modified expected tax", unless the taxpayer uses the annualized income installment method. See Exhibit (20)300-4 for a definition of "modified expected tax".

(4) Under these rules, the first installment of the current year's estimated tax may be based on 100 percent of the preceding year's tax. However, if the penalty is to be avoided, the difference between the first installment payment and the portion of the required annual payment that

otherwise would have been due, must be added to the next installment payment.

(5) For tax years beginning after December 31, 1993, the Omnibus Budget Reconciliation Act (OBRA) of 1993 changed the estimated tax installment rules of high income taxpayers. Application of the new safe harbor depends on the filing status of the taxpayer for the current year, but the adjusted gross income (AGI) for the preceding year as indicated below:

(a) If the adjusted gross income (AGI):

1 Married filing separately for the current year. If the AGI shown on the preceding year's return exceeds \$75,000, the taxpayer qualified for the safe harbor by making estimated tax payments equal to 110 percent of the tax shown on the preceding year's return.

2 Filing status other than married filing separately for the current year. If the AGI shown on the preceding year's return exceeds \$150,000, the taxpayer qualifies for the safe harbor by making estimated tax payments equal to 110 percent of the tax shown on the preceding year's return.

(b) In the case of an estate or trust, adjusted gross income will be determined as provided in IRC section 67(e) (relating to the 2 percent floor for miscellaneous itemized deductions).

(20)321.3 (8-14-95) Non-resident Aliens and U.S. Citizens Residing or Living Abroad

(1) Non-resident aliens (other than those whose U.S. wages are

subject to withholding) are required to make three installments of estimated tax. In the case of a calendar year individual, the installment requirements are:

(a) Due Dates:	Prior to 1/1/86	After 12/31/85
1 June 15	33 1/3 percent	50 percent
2 Sept 15	33 1/3 percent	25 percent
3 Jan 15 of the following year	33 1/3 percent	25 percent

(2) Prior to Section 12314 of Public Law 103-66, Omnibus Budget Reconciliation Act of 1993 (OBRA '93), nonresident aliens' limitation

on the use of the prior years liability as a safe harbor did not apply. For taxable years beginning after December 31, 1993, non-resident aliens are subject to the same limitations as in

(20)321.2, Payments Based on Prior Year's Tax.

(20)321.4 (8-14-95) Deceased Taxpayers

Deceased taxpayers are liable for estimated tax payments due on installment due dates occurring prior to the date of death. The penalty is computed on underpaid installments from their due date to the earlier of the date paid or the date of death.

(20)321.5 (8-14-95) Fiduciaries of Estates and Trusts

(1) An estate is created by the filing for bankruptcy, or upon the death of an individual. A trust may be created during an individual's life or upon his/her death. An estate or trust computes its gross income in much the same manner as an individual. However, an estate or trust is allowed an income deduction for distributions to the beneficiaries.

(2) The Tax Reform Act of 1986, effective for tax years beginning after December 31, 1986, provided that all estates and most trusts are required to make estimated tax payments in the same manner as individuals. NOTE EXCEPTION: Charitable trusts and any private foundation organized as a trust, will be subject to the corporate estimated tax provisions under IRC section 6655, rather than IRC section 6654, of the Internal Revenue Code. See IRM (20)550.

(3) Waive the estimated tax penalties under IRC section 6654, for estates and trusts (Form 1041 U.S. Fiduciary Income Tax Return) for estimated tax payments due by July 1, 1987, provided the fiduciary makes a good faith effort to accurately determine and make estimated tax payments due before that date.

(4) Form 1041 is used by the fiduciary of a domestic estate, trust (including foreign trusts subject to the provisions of the Internal Revenue Code [Rev. Notice 87-32, 1987-1 CB 477]) or bankruptcy estate to report the income (that is either accumulated and held for future distribution, or distributed currently to the beneficiaries) as well as any applicable tax liability of the estate or trust.

(5) The following are exempt from paying estimated tax for tax years, ending before two years from the date of death:

(a) decedent's estates,

(b) grantor trusts that receive the residual of a probate estate under the decedent's will, and

(c) for tax years beginning after December 31, 1986, if there is no will to probate, a trust that is primarily responsible for paying taxes, debts and expenses of administration.

(6) Fiduciaries that have a Treasury Tax and Loan (TT&L) account for deposited Federal taxes and administer at least 200 taxable trusts are required to submit the data on estimated tax payments on magnetic tape. (See Rev. Proc. 89-49, 1989-2 C.B. 615).

(7) Fiduciaries may elect to treat any portion of estimated tax payments made by the trust or estate as payments made by a beneficiary. Such an amount is treated as a payment of the estimated tax made by the beneficiary on January 15 of the year following the taxable year. Fiduciaries must make these elections on Form 1041-T, Transmittal of Estimated Taxes Credited to Beneficiaries. These election MUST be filed on or before the 65th day after the close of the

trust's tax year. [IRC section 643(g)].

(20)321.6 (8-14-95) Annualized Income Installment Method

(1) Taxpayers who do not receive income evenly throughout the year (for example, taxpayers involved in seasonal businesses) may use the annualized installment income method for determining estimated tax payments. This method allows estimated payments that actually reflect the income earned in the period immediately before the installment due date. Form 2210 includes Schedule B which is used to determine the required installments using the annualized income installment method.

(2) Section 403 of P.L. 102-164, effective for tax years beginning in 1992, allows taxpayers to continue to use the preceding year's liability as a safe harbor for any installments where certain income thresholds would not be exceeded if the taxpayer annualized AGI for the months of the current year ending before the installment due date. The threshold amounts are exceeded if:

(a) the taxpayer has a modified adjusted gross income in the current year that exceeds the taxpayer's adjusted gross income as shown on the prior year return by more than \$40,000 (\$20,000 in the case of a separate return by a married individual), and

(b) the taxpayer has an adjusted gross income shown on the current year return that exceeds \$75,000 (\$37,500 in the case of a separate return by a married individual).

(c) For annualization under this rule, qualified pass-through items from the prior year are deemed to accrue evenly during the current year. Any reduction in an installment as a result of this exception is recaptured by increasing the amount of the next installment (with respect to which the above requirements are not met) by the amount of such reduction.

(3) Annualized income installment is computed by placing on an annualized basis the income for months in the taxable year ending on the last day of the month before the due date for the installment.

This means the income will be annualized from the first of January for each installment period. For example:

(a)	Installment Due:	Income Annualized From:	Through
1	4/15	1/01	3/31
2	6/15	1/01	5/31
3	9/15	1/01	8/31
4	1/15	1/01	12/31

(4) Estates and trusts electing to use the annualized income installment method have the same estimated tax payment due dates as other individuals. However, the installment is computed by placing on an annualized basis the income for months in the taxable year ending before the date one month before the due date for the installment. This means that income is annualized as follows:

(a)	Installment Due:	Income Annualized From:	Through
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1	4/15	1/01	2/28
2	6/15	1/01	4/30
3	9/15	1/01	7/31
4	1/15	1/01	11/31

(5) If the annualized income installment method is used for one installment, and the regular method is used for the next installment, any reduced amount realized under the annualized installment versus the regular method installment, must be made up in the following regular method installment. (The annualized worksheet included in the "Instructions for Form 2210" package, as well as schedule B, Form 2210, recaptures any shortfall.) See Exhibit (20)300-17 for examples.

(6) For tax years prior to 1987, taxpayers were not required to attach a worksheet to Form 2210. If working those periods, do not request Form 2210's or worksheets. If the taxpayer claimed installment amounts that are not equal, assume the taxpayer annualized. For tax years 1987 through 1991, taxpayers MUST attach a worksheet and Form 2210 to their return. For tax years 1992 and later, taxpayers must complete Schedule B, of Form 2210 and attach the Form 2210 to their return. When working these cases, worksheets/schedule B should be math verified, when computing or checking the estimated tax penalty.

(7) For service center personnel working penalty cases, if the taxpayer's calculation is incorrect do the following:

- (a) Prepare a letter explaining error(s) in the taxpayer's calculations.
- (b) Adjust the penalty based on your computation.

(8) Estimated tax penalties based on the Annualized Income Installment Method must be computed manually.

(20)321.7 (8-14-95) Farmers and Fishers

(1) Taxpayers with at least two-thirds of their gross income derived from farming or fishing, (see Publications 225, Farmer's Tax Guide and 595, Tax Guide for Commercial Fishermen, for defining gross income) in the current or preceding tax year (see Exhibits (20)300-5, (20)300-6 and (20)300-7) are required to either:

(a) make a lump sum estimated tax payment by the 15th day of the month following the close of the tax year (January 15 for calendar year returns) or

(b) file their return and pay the total tax due by the first day of the third month following the close of the tax year (March 1 for calendar year returns).

(c) See 321.7:(1)(c) of LEM XX-300.

(2) The required annual payment is the smaller of

(a) 66 2/3 percent of the current year's tax, or

(b) 100 percent of the total tax shown on the preceding year's return (assuming the

return covered all 12 months).

(3) For joint returns, the spouse's income must be considered in determining if the taxpayer meets the two-thirds gross income from farming or fishing requirement.

(4) If a taxpayer qualifies as a farmer/fisher, an indicator is placed on the Taxpayer Information File (TIF). The indicator will thereafter appear on IDRS screens for CC TXMOD, CC PIEST, CC ACTRA, CC MFTRA, CC IMFOL, RTVUE and/or other transcripts as they are developed.

(5) The Service will waive the penalty for farmers for the 1987 tax year, if the farmer did not receive a Form 1099-A, Information Return for Acquisition or Abandonment of Secured Property, and/or Forms 1099-G, Statement for Recipients of Certain Government Payments (or substitute forms CCC-182) from the U.S. Department of Agriculture by February 15, 1988. See Notice 88-28 1988-1 C.B. 496.

(20)322 (8-14-95) Period of Underpayment

(1) Taxpayers are generally required to pay 25 percent (see Exhibit (20)300-2) of their annual estimated taxes on or before each installment payment due date.

(a) If there is no estimated tax liability during the first three months of the tax year, but a liability develops later in the year, determine when the required installment(s) is due using Exhibit (20)300-2.

(b) Taxpayers whose income varies during the year may benefit by using the annualized income installment method. If they use this method, the amount of the required installments usually will vary based on when the income is received. Refer to IRM (20)321.6.

(2) The underpayment period is determined by the number of days (see Exhibit (20)300-10 and (20)300-11) from the payment due date to either:

(a) the date on which the underpayment is paid (See 322:(2)(a)) of LEM XX-300, or

(b) the 15th day of the 4th month following the close of the taxable year (due date of return without regard to extensions) whichever is earlier.

(3) Each underpaid installment period must be separately computed. See Exhibits (20)300-10 and (20)300-11.

(20)323 (8-14-95) Payment Due Dates

(1) Most taxpayers make estimated tax payment in four installments. For calendar year returns, the due dates are:

(a) 1st installment -- April 15th

(b) 2nd installment -- June 15th

(c) 3rd installment -- September 15th

(d) 4th installment -- January 15th of the following year.

(2) For fiscal year returns, the installment due dates are the 15th day of the fourth, sixth, and ninth months of the tax year with the fourth installment due on the 15th day of the first month following the close of the fiscal year. (See Exhibit (20)300-1)

(3) If an installment due date falls on a Saturday, Sunday or legal holiday, payments received the next business day are considered paid on the due date. NOTE: throughout this text the term "payments received" equates to payments made in accordance with IRC Section 7502.)

(4) To calculate the number of days see the Perpetual (Exhibit (20)300-10) and the Leap Year (Exhibit (20)300-11) Julian Date Calendars.

(5) Taxpayers do not have to make the fourth installment if they file their return and pay the tax due on or before the last day of the 1st month following the end of the tax year. See IRC section 6654(h).

(20)324 (8-14-95) Application of Estimated Tax Payments, Credits and Withholding

(20)324.1 (8-14-95) General

(1) Credits claimed on Forms 2210, Underpayment of Estimated Tax by Individuals and Fiduciaries or 2210F, Underpayment of Estimated Tax by Farmers and Fishermen, must be verified against the taxpayer's account record. This can be done by checking the appropriate CFOL, IDRS (i.e. CC TXMOD), or MRS transcripts. Review both the payment dollar amounts and the received dates on the taxpayer's record. Consider only payment amounts credited to the taxpayer's account on or before installment payment due dates.

(2) See 324.1:(2) of LEM XX-300,

(20)324.2 (8-14-95) Credits applied within the Tax Year

(1) For periods beginning after December 31, 1984,

(a) installment payments are applied against the earliest underpayment within a tax period, regardless of the date the payment was received.

(b) When the first installment is satisfied, any excess will be applied to the next installment until all liabilities within a given tax period are satisfied.

(20)324.3 (8-14-95) Credits Applied from a Prior Year

(1) TC 716 or 710 (overpayment arising on or before the due date of the prior year's return) are applied against the first required installment of the next year's estimated tax unless the taxpayer notifies the Service that the overpayment should be applied to another installment.

(2) To properly notify the Service that the overpayment should be applied against another installment, taxpayers MUST attach a statement to the income tax return showing the overpayment, indicating which installment of estimated tax the overpayment should be applied against.

(20)324.4 (8-14-95) Withholding

Withholding is divided evenly among the four installments, unless the taxpayer chooses to apply the withholding to the installment in which it was actually withheld, and so informs the Service. If the withholding is to be treated as paid when it was actually withheld, the taxpayer must complete and attach Form 2210 to the return.

(20)324.5 (8-14-95) Additional Payment Information

- (1) If the taxpayer claims IRS did not properly credit the account, review the canceled check, bank data, or other information the taxpayer provides about the payment(s). Determine if the payment(s) in question posted correctly to the account.
- (2) If it has not posted to the account, follow functional procedures for tracing payments. If the payment posted after the penalty assessment and the penalty was manually assessed (TC 170), recompute the penalty using the latest payment information.
- (3) If there is a change in the taxpayer's withholding taxes allowable as a credit under IRC section 31 and/or the estimated tax payments, the penalty **MUST** be corrected even though the affected taxpayer does not request the correction. If the penalty was manually computed or there is otherwise a restricting condition in the module, manually recompute the penalty using the new credit/payment amounts. The computer will automatically recompute estimated tax penalty when an adjustment to TC 806 or TC 807 is made and there are no restrictive conditions, such as TC 170/171, in the module, or when TC 43X, 61X, 62X, 66X, 67X, 700, 702, 71X, 760, 762, or 97X posts prior to the return due date, also assuming there are no restrictive conditions in the module.
- (4) If the taxpayer claims that an overpayment was refunded in error, request the prior year return. If the taxpayer's statement is verified, the taxpayer may be entitled to have a portion of the penalty abated. Also, if the taxpayer made an estimated tax payment that was erroneously refunded by the Service, they may be entitled to have the penalty or a portion thereof abated. See IRM (20)341.7.

(20)324.6 (8-14-95) Verifying Credits on Master File

- (1) Credits claimed by the taxpayer should be verified. This can be done by checking the appropriate CFOL, IDRS (i.e. TXMOD), or MRS transcripts. Review both the dollar amounts and the received dates of any payments.
- (2) TC 800 or TC 806 credits a tax module for the amount of withholding taxes claimed on a Form 1041.
- (3) TC 710 or TC 716 credit is a "credit elect" overpayment received from the prior tax period. It will be applied as a credit to the first required installment period.
- (4) TC 660 deposits are made using an 8109 or 8109-B deposit coupon. This deposit will post to the tax module with the date the payment was received at the Federal Depository.
- (5) TC 670 subsequent payments will be credited to a tax period with the received date of that

payment.

(6) TR 610 is a payment that is received with the return. This payment will also post to the tax module with the date the payment was received.

(20)325 (8-14-95) Determining the Amount of Underpayment

The amount of the underpayment is the required installment payment minus the amount (if any) paid or credited on or before the due date of the installment.

(20)326 (8-14-95) Penalty Rate

(1) Although the estimated tax penalty is not interest, it is computed in the same manner as interest, except it is **NOT COMPOUNDED DAILY**. Use the debit interest rate in effect for the appropriate time period.

(a) In accordance with IRC section 6621, the debit interest rate is determined quarterly. This means that the penalty on a \$1000 underpayment for one quarterly tax period may be different from the penalty on a \$1000 underpayment for a different quarterly tax period.

(b) Interest rates can be found in the Internal Revenue Bulletin (IRB), News Releases, TAXNEWS, Taxpayer Service Electronic Bulletin Board (TEBB) and Notice 433, Yearly Interest and Certain Penalty Rates. See Exhibit (20)300-8.

(2) **RATE EXCEPTION UNDER IRC SECTION 6621(b)(2)(B)**: The rate which applies during the third month following the taxable year also applies for the first 15 days of the fourth month. For example, for tax year ending December 31, 1992, the debit interest rate in effect during the first quarter of 1993 will be used for the period April 1 through 15, regardless of interest rate determined for the Second quarter of 1993.

(20)327 (8-14-95) Determining the Penalty Amount

(20)327.1 (8-14-95) General

(1) For each installment, the penalty is determined by multiplying:

(a) the penalty rate (is the same as the underpayment (debit interest) rate established under IRC section 6621. That rate is a simple interest rate that is **NOT** compounded daily). See Exhibits (20)300-8 and (20)300-12.

(b) by the amount of the underpayment,

(c) for the period of underpayment. (The period of underpayment will end with the earlier of payment received date or due date of the return without regard to extensions, usually April 15th of the following year. **NOTE: THIS IS A PENALTY and cannot be claimed as a deduction or business expense on any return.**) See Exhibit (20)300-12.

(2) See 327.1:(2) of LEM XX-300.

(3) Estimated tax penalties are computed on the amount of tax reported on the original return.

(a) If an adjustment is made to the tax of an original return, including extensions, as a result of the taxpayer filing an amended (superseding) return, the penalty amount may be adjusted, based on the new tax amount. A superseding (a second return filed on or before the due date of the return) is considered an original return.

(b) If an adjustment is made to the tax of an original return, after the return due date, including extensions, as a result of either an audit or the taxpayer filing an amended return, the penalty amount will generally (see the following exceptions) not be adjusted.

1 If an amended joint return is filed after separate returns (i.e. an individual files joint return after filing a separate return for a taxable year in which they could have filed a joint return), the estimated tax penalty is based on the joint return.

a This is the case, even if it is filed after the time for filing the return (including extensions), as long as a joint return is filed before the expiration of the statute of limitations.

b For additional information refer to IRM 3(15)(129)0, "IMF and IRAF Data Processing Tax Adjustments".

2 If there is a math error on the return, the computer is programmed to compute the penalty on the lesser amount of tax as computed by the taxpayer or corrected by IRS.

a Example: The original return shows the taxpayer computed the tax to be \$1,300.

b Due to a math error, the tax was corrected to \$1,800.

c The estimated tax penalty would be computed on the lesser amount of tax, \$1,300.

(4) Revenue Agents, Revenue Officers, and Tax Examiners with access to IDRS may use command codes:

(a) COMPAE/COMPAS to facilitate the computation of the estimated tax penalty.

(b) PINEX (PIEST) to explain a computer generated estimated tax penalty computation to the taxpayer. Once the penalty has been restricted (either with TC 170/171 or a computer condition code) PINEX is no longer able to explain the penalty computation.

(c) For restrictions to Master File see, 327.1:(4)(c) of LEM XX-300.

(d) Specific instructions regarding the input of both the COMPA and PINEX command codes are contained in IRM 3(25)(77)0, IDRS Terminal Inquiries and IRM 3(25)(78)0, IDRS Terminal Input.

(20)327.2 (8-14-95) Form 2210 or 2210F

(1) Taxpayers use Forms 2210, Underpayment of Estimated Tax by Individuals or Fiduciaries and 2210F, Underpayment of Estimated Tax by Farmers and Fishermen to:

(a) determine if they are liable for an estimated tax penalty on Form 1040 or Form 1041 returns (except private foundations and charitable trusts), and

1 compute the penalty, if they wish to "self-assess," or

2 allow IRS to compute the penalty,

(b) use the annualized income installment method,

(c) claim an exception to or waiver of the penalty,

(d) treat income tax withheld from wages as paid when actually withheld, rather than in four equal amounts or,

(e) use 100 percent of the preceding year's tax if the adjusted gross income for the current year exceeds the adjusted gross income for the prior year by more than \$40,000, but the modified adjusted gross income for the current year does NOT exceed the adjusted gross income for the prior years by more than \$40,000.

(2) Service employees use Forms 2210 and 2210F as worksheets when manually computing the penalty. See Exhibit (20)300-7.

(3) Revenue Procedure 83-79, 1983-2 C.B. 597, allows taxpayer's to use either the tax table or the tax rate schedule, whichever is more advantageous, when using exceptions 2, 3, and 4 on Form 2210 or exception 2 on Form 2210F.

(4) To determine if an estimated tax penalty is applicable where one or more of the required installments are based on the prior year's tax and the taxpayer filed or is filing a joint return for either the prior year or current year, but not for both years, one should do the following:

(a) If the taxpayer filed the prior year return as married filing separately, combine the two tax amounts.

1 Ask the question, for the current year, did the taxpayer make estimated tax payments equaling at least 100 percent of the combined prior year tax liability?

2 If no, compute the penalty.

(b) If the taxpayer filed a joint prior year return, separate the liabilities appropriate to each spouse.

1 Compute the tax both spouses would each have paid had they filed separate returns for the prior year using the same filing status as they are using for the current year.

2 Ask the question, for the current year, did the taxpayer make estimated tax

payments equaling at least 100 percent of the separated prior year tax liability.

3 If no, compute the penalty.

(20)327.3 (8-14-95) "Substitute for Return"

(1) Estimated tax penalties in the Substitute for Return program (SFR) are assessed as if no return was filed. Usual processing of SFRs includes issuance of a statutory notice of deficiency after the return due date (including extensions). If no response is received to the statutory notice of deficiency, the assessment is made, including estimated tax penalty as appropriate.

(2) Many taxpayers file amended returns after the SFR is processed. The Service is under no legal or regulatory obligation to abate previously assessed taxes or penalties where documentation was not timely submitted and the taxpayer received legal notification from the Service.

(a) The taxpayer's only legal recourse in these situations is to pay the tax and file a claim under IRC section 6404.

(b) This avenue in many cases would not best serve the mission of the Service, which is to collect the proper amount of tax at the least cost.

(c) We also must consider the impact of erroneous assessments on our relationship with our customers.

(3) Based on the above, the Service may recompute the estimated tax penalty when the taxpayer files a subsequent return that increases or decreases the tax, even if filing occurs after the due date of the return (including extensions). In the SFR situation, the taxpayer's signed return is considered the original return.

(4) Estimated tax penalty adjustments to SFR modules (i.e. TC 150 of 00 \$'s, with tax assessed by a TC 290/300) must be manually computed and assessed.

(20)330 (8-14-95) Penalty Transaction Codes

(1) ES Penalty Transaction Codes are:

(a) TC 176--Computer generated assessment of an ES penalty,

(b) TC 177--Computer generated abatement of an ES penalty,

(c) TC 170--Manual assessment of an ES penalty,

(d) TC 171--Manual abatement of an ES penalty.

(2) Manual assessments are determined by District or Service center employees and are input through IDRS. Employees who cannot directly input the penalty assessment to IDRS need to follow functional guidelines to request input of the assessment.

(3) If an incorrect return (i.e., wrong taxpayer or wrong tax period) posts to an account first, then, when the correct return posts, the ES penalty must be manually computed.

(4) When taxpayers use the Annualized Income Installment Method any adjustment to the penalty must be computed manually.

(20)340 (8-14-95) Adjustments after Penalty Assessment

(20)341 (8-14-95) Waivers

(20)341.1 (8-14-95) Evaluating Taxpayer Claims for Abatement or Waiver of Estimated Tax Penalties

(1) For periods prior to January 1, 1984, there was NO basis for reasonable cause abatement of the estimated tax penalty. For periods after December 31, 1983, specific waiver provisions under IRC section 6654(e) were adopted.

(2) To evaluate these requests use data available via the various CFOL commands, if possible, as it should expedite processing of the request. In some cases it may be necessary to secure the original return. Review taxpayer's request and the return data for the following items:

- (a) the amount of estimated tax penalty requested to be waived; and
- (b) taxpayer's explanation of eligibility for estimated tax penalty waiver.

(3) Request additional information from the taxpayer, as needed.

(4) If the taxpayer establishes the waiver criteria take the necessary action to suppress or adjust the penalty as appropriate.

(5) When a determination is made to cancel an estimated tax penalty because the individual is entitled to a waiver, the appropriate Penalty Reason Code must be entered either on the case file or the input document and entered into the Master File.

(20)341.2 (8-14-95) Procedures for Claiming an Abatement or Waiver of the Estimated Tax Penalty

(1) Taxpayers may claim abatement or waiver on their tax return or on Form 2210 or 2210F. They may send a letter or other correspondence requesting abatement or waiver of the estimated tax penalty. The request could also be made by telephone or by personal (face to face) contact. See (20)341.3, Waivers based on Legislative Action.

(2) To claim a waiver, based on a change to the tax law, the affected taxpayers should:

- (a) compute the penalty (by completing Form 2210 or 2210F),

1 on the basis of the law in effect before the changes were made, and

2 on the basis of the law in effect after the changes were made.

3 the penalty amount eligible for the waiver is the difference between 1 and 2.

- (b) If preparing Form 2210 or 2210F, follow the instructions for completing the form.

(c) The taxpayer should attach an explanation showing their computation and the amount of penalty to be waived.

(d) If the required information is available:

1 verify the computation (math) and attachments.

2 review the explanation of "waiver eligibility". The explanation must show what caused the tax increase and related underpayment of estimated tax.

(20)341.3 (8-14-95) Waivers based on Legislative Action

(1) For any period beginning before April 16, 1994, the service will waive the estimated tax penalty to the extent an underpayment was created or increased by the Omnibus Budget Reconciliation Act (OBRA) of 1993.

(2) In Notice 92-6, 1992-1 C.B. 495, the Service announced the waiver of penalties for tax year 1992, to the extent the underpayment by an employee or retiree is attributable to a reduction in Federal income tax withholding for 1992 caused by the new withholding tables/rates effective for wages paid after February 1992.

(3) For 1988, estimated tax penalty relief was provided because of changes made by the Technical and Miscellaneous Revenue Act of 1988. These changes allowed individuals until April 15, 1989, to pay any underpayment on estimated tax due to changes made by Titles I and/or II of this Act.

(a) The taxpayer's needs to specify which provisions of Titles I and/or II of the Act Sections 1001 through 2006 resulted in a tax increase that was the cause of the underpayment.

(b) See Announcement 89-2, IRB 1989-2, 19.

(4) For first quarter 1988 estimated tax payment(s) only, the estimated tax penalty under IRC section 6654 may be waived against owners of a partnership or "S" corporation who were precluded from timely and accurately estimating and paying their 1988 individual first quarter payments, if they meet the following conditions:

(a) The partnership or "S" corporation was unable to make an IRC section 444 election to change its taxable year by April 15 1988, the due date of the owner's first quarter payment, because the regulations concerning the election had not been issued by IRS; and

(b) As a result of the delay in making an election, the partnership or "S" corporation was unable to provide the owners with the information necessary for accurately estimating the amount of the first quarter estimated tax payment.

1 Taxpayers in this situation who received an estimated tax penalty notice were instructed to return the notice to IRS with an explanation that they are eligible for a penalty waiver under Section 111-B of IR Bulletin Notice 88-49, 1988-C.B. 532.

2 They were also asked to include identification of the partnership(s) or "S" corporation(s) (or both) and the portion of the penalty attributable to each such entity.

(c) Allow the waiver on the first installment only, from its due date through August 15, 1988.

(d) Only the portion of the penalty attributable to IRC section 444 can be waived.

(5) For the 1987 taxable year the Service will waive the penalty due to under withholding of any individual who files, in good faith, a 1987 Form W-4 or W-4A with their employer on or before June 1, 1987.

(a) The amount of penalty to be waived is based on the ratio of wage and pension income to adjusted gross income (AGI).

(b) For example, a taxpayer whose wages equal 75 percent of AGI could have 75 percent of the penalty waived.

(6) For the 1987 taxable year, the Service will waive penalties attributable to taxable retirement income.

(7) For 1986, penalty relief was provided due to changes made by Tax Reform Act of 1986 (TRA '86). Taxpayers were given until April 15, 1987, to pay any underpayment resulting from TRA '86. See Rev. Rul. 86-146, 1986-2 C.B. 208.

(20)341.4 (8-14-95) Waivers based on Legislative Action--Form 1041

(1) The Tax Reform Act of 1986 placed certain trusts and estates (Form 1041) under the same rules as individuals for making payments of estimated tax, effective for tax years beginning after December 31, 1986.

(2) In implementing this provision, an administrative decision was made to waive Form 1041 estimated tax penalties for installments of estimated tax due before July 1, 1987, provided the fiduciary made a good fair effort to determine the amount of the required installment and timely pay the tax. See Notice 88-15, 1988-1 C.B. 482 and Notice 87-32, 1987-1 C.B. 477.

(20)341.5 (8-14-95) Waiver Criteria under IRC Section 6654(e)(3)(A)

(1) For tax years beginning after December 31, 1983, IRC Section 6654(e)(3)(A) provides that the estimated tax penalty may be waived if the failure to make the estimated tax payment is due to casualty, disaster or other unusual circumstances such that the imposition of the penalty would be against equity and good conscience. This is not equivalent to reasonable cause. For example, reliance on the advice of a competent tax advisor may constitute reasonable cause that would warrant relief from other penalties, but it does not provide a basis for a waiver of the estimated tax penalty under IRC Section 6654(e)(3)(A).

(2) In order for the waiver to be available, the failure to make the payment must be caused by:

(a) casualty,

- (b) disaster, or
- (c) other unusual circumstances, and
- (d) imposition of the penalty would be against equity and good conscience.

(3) Examples of situations where the waiver may be granted if it is determined that imposition of the penalty would be against equity and good conscience:

(a) The taxpayer's records are destroyed by fire or flood or other natural disaster. In many instances of natural disaster, area wide guidance on conditions for waivers will be issued.

(b) The taxpayer becomes seriously ill or is seriously injured and is unable to manage his affairs.

(c) The taxpayer designates that an overpayment of tax shown on a prior return is to be credited against his estimated tax, but the overpayment is offset for either past-due child support or nontax federal debt under IRC Section 6402(c), and

(d) the taxpayer is not notified of the offset before the due date of the estimated tax installment.

(4) Examples of situations where the waiver may not be granted:

(a) Reliance on the advice of a competent tax advisor.

(b) Retroactive application of a statute or regulation unless the statute or regulation specifically grants a waiver of the estimated tax penalty or the Service announces in the Internal Revenue Bulletin that such a waiver has been granted.

(c) Erroneous advice from the IRS unless such advice falls within the provisions of IRC section 6404(f), Abatement of Any Penalty or Addition to Tax Attributable to Erroneous Written Advice by the Internal Revenue Service, of the Internal Revenue Code or IRC section 301.6404-3 of the regulations. See IRM (20)333.9 for a fuller discussion of eligibility for this relief.

(5) Requests for a waiver of the estimated tax penalty under IRC section 6654(e)(3)(A) must be submitted in writing and signed by the taxpayer. Waivers may not be granted based on an oral request from the taxpayer. Waiver of the penalty must be specifically approved by a manager or managerial official.

(20)341.6 (8-14-95) Waiver Criteria under IRC Section 6654(e)(3)(B)

(1) Taxpayers may be eligible for a "waiver" of the penalty under IRC section 6654(e)(3)(B) if during the tax year they:

(a) retire after having attained age 62, or

(b) become disabled in the taxable year estimated payments are due, or during the

preceding taxable year, and

(c) the underpayment is due to reasonable cause and not willful neglect.

(d) Reasonable Cause, as it applies to the estimated tax penalty for an individual, is considered only when the individual meets the conditions in (20)341.6:(1)(a) or (b) and (c) above, and then only to determine if the taxpayer is eligible for a "waiver" of the penalty.

(2) When the individual qualifies for this legislative waiver, the estimated tax penalty should be abated using penalty reason code "44" to identify the abatement.

(20)341.7 (8-14-95) Bankruptcy

(1) IRC section 6658 prohibits the assertion of the estimated tax penalty on liabilities during the time the case is pending a Title 11 bankruptcy proceeding filed on or after October 1, 1979, if:

(a) the tax was incurred by the estate and the failure occurred pursuant to an order of the court finding probable lack of funds for the estate to pay administrative expenses, or

(b) the tax was incurred by the debtor before the order of relief or the appointment of a trustee in an involuntary case, whichever is earlier and

(c) the bankruptcy petition is filed before the due date of the return including extensions, or

(d) the date for making the addition to the tax occurs on or after the day on which the petition was filed.

(20)341.8 (8-14-95) Request for Abatement Due to an Erroneous Refund of Estimated Tax Payment, Offset, or Overpayment (Credit Elect)

(1) If the taxpayer claims that an overpayment (credit elect) was refunded in error or if an estimated tax payment was erroneously refunded by the Service, the taxpayer may be entitled to have a portion of the penalty abated. Verify the taxpayer's statement by requesting the prior year return and reviewing account information.

(a) Abate the penalty if the taxpayer promptly returns the refund check or repays the refund amount within 10 days of its issue. Consider each case individually to determine if the refund was returned or repaid promptly.

(b) If the overpayment (credit elect) was offset by IRS for either past-due child support or nontax amounts owed to other federal government agencies and the taxpayer was not notified prior to the estimated tax payment due date, abate the penalty if the taxpayer promptly repaid the amount offset.

1 Example: A taxpayer has an extension to October 15th to file the return. The return has an overpayment that the taxpayer elects as a credit to the next year's return.

2 If this overpayment is offset and the taxpayer does not receive a notice until December, the repayment may be considered prompt even if not received until

December or early January of the following year. This repayment should still be considered as the taxpayer's first quarterly installment for penalty consideration.

(20)342 (8-14-95) Denying the Request for a Waiver

If the waiver is denied, send a letter informing the taxpayer of the reason for denial and explaining his/her appeal rights.

(20)343 (8-14-95) Penalty Appeal Procedures

For a complete discussion of penalty appeals, refer to IRM (20)400.

(20)350 (8-14-95) Corporate Estimated Tax Penalty Reserved

(20)360 (8-14-95) IRC Section 6655

(20)361 (8-14-95) Corporate Estimated Tax Penalty Description

(1) IRC section 6655 imposes an addition to tax when a corporation (C or S), private foundation, private foundation organized as a trust, or tax exempt organization makes an underpayment of estimated tax. IRC section 6655 also applies to qualified settlement funds described in Treas. Regs. 1.468-B-1.

(2) After December 31, 1986, Treas. Reg. 301.6302-1 requires any organization subject to additions to tax under IRC section 6655, to deposit that tax with an authorized depository on or before the date prescribed for paying that tax. Committee Report on P.L. 101-239, (IRC section 6656, Failure To Make Deposit Of Taxes) states "The committee intends that this penalty not apply in circumstances in which the estimated tax penalties (IRC section 6655) apply."

(20)362 (8-14-95) Assertion Criteria

(1) For tax years beginning after December 31, 1987, to avoid the estimated tax penalty a corporation must make tax payments if its tax (income tax minus credits) will be \$500 or more. If the tax is less than \$500, no ES payments are required and a penalty will not be assessed.

(2) The Technical and Miscellaneous Revenue Act of 1988 (P.L. 100-647), enacted November 10, 1988, clarified that IRC section 6655 will apply to private foundations and private foundations organized as a trust or corporation.

(20)370 (8-14-95) Determining the Required Annual Payment

(20)371 (8-14-95) Exceptions to the Annual Payment Requirements

(20)371.1 (8-14-95) General

(1) For tax years beginning after December 31, 1987, and prior to January 1, 1992, unless exceptions or waivers exist, corporations and certain tax exempt organizations with unrelated business taxable income were required to prepay the lesser of:

- (a) 90 percent of its tax liability for the current year,
- (b) 100 percent of prior year tax liability, or
- (c) the amount determined under the annualized or adjusted seasonal income installment method.

(2) The corporation's prior tax year must have been a full 12 month period for which the corporation filed a return showing a tax liability greater than zero.

(a) Rev. Rul. 92-54, 1992-2 C.B. 320, states that IRC section 6655(d)(1)(B)(ii) of the Code, which allows a taxpayer to base required installment payments of estimated tax on the tax shown on the return for the preceding taxable year, does not apply to a corporation that filed a return for the preceding taxable year showing \$0 tax liability.

(b) For example, a corporation (other than a large corporation, see (20)371.6)) may use 100 percent of the prior year's tax to determine the current year's ES payments when the tax reported on the prior year's tax return was for an amount greater than zero.

(3) For tax years beginning after December 31, 1991, and before July 1, 1992, the applicable percentage of a corporation's current year tax liability increases to 93 percent.

(4) For tax years beginning after June 30, 1992, and before December 31, 1993, the applicable percentage of a corporation's tax liability increases to 97 percent.

(5) For tax years beginning after December 31, 1993, the percentage will decrease to 100 percent of the corporation's current-year tax liability.

(6) Corporations may use Form 1120-W, Corporation Estimated Tax Worksheet (see Exhibit (20)300-9), to determine the amount of the required payment for either the regular, annualized income installment, or the adjusted seasonal installment method. Tax exempt organizations may use Form 990-W, Estimated Tax on Unrelated Business Taxable Income for Tax-Exempt Organizations. These forms are designed to assist the corporation and should not be filed with the Internal Revenue Service.

(7) If a corporation wants to use certain annualization periods for estimated tax purposes, it must make an election on Form 8842, Election to Use Different Corporate Annualization Periods for Estimated Tax, by the due date of the first estimated tax installment (by the 15th day of the fourth month of the year for which the election is being made). Form 8842 will be processed by the Document Perfection Branch in the Service Centers using instructions in IRM 3(11)60, DP Tax Adjustments, Code and Edit.

(20)371.2 (8-14-95) Exception to the Annual Payment Requirement Where the Tax is Small

A corporation is not required to make estimated tax payments if its tax is less than \$500.

(20)371.3 (8-14-95) Domestic Corporations

(1) Domestic corporations shall be required to make estimated tax payments based on tax and

credit determined taxable under any of the following IRC sections:

- (a) IRC section 11--Tax Imposed, or
- (b) IRC section 1201 (a)--Alternative Tax for Corporations,
- (c) subchapter L of chapter 1--Insurance Companies,
- (d) IRC section 55--Alternative Minimum Tax Imposed,
- (e) IRC section 59A--Environmental Tax Credit, plus
- (f) IRC section 887--Imposition of Tax on Gross Transportation Income of Nonresident Aliens and Foreign Corporations,
- (g) any applicable credits against tax. (See IRC section 21, 22, 25 and 26 to determine applicable credits.)

(20)371.4 (8-14-95) Foreign Corporations

(1) A foreign corporation that has income described in IRC section 882 (Tax on Income of Foreign Corporations connected with United States business), which is subject to taxation under IRC section 11 or 1201(a), or under subchapter L of Chapter 1, must make estimated tax payments on this income in the same manner as a domestic corporation described in (20)371.2 above.

(2) A foreign corporation that has income described in IRC section 881 (Tax on Income of Foreign Corporations not connected with United States Business), in addition to income described in IRC section 882 must treat the tax imposed under IRC section 881 as an IRC section 11 tax on which estimated tax payments also must be made.

(3) For taxable years beginning after December 31, 1994, taxpayers using the annualization method to compute estimated tax payments must take into account income under section 936(h) and 951(a) in a manner specified in section 6655(e)(4). For more information see Rev. Proc. 95-23, 1995-18 I.R.B. 5.

(4) A foreign corporation that is not subject to tax under IRC section 882 is not required to make estimated tax payments on the tax imposed under IRC section 881.

(20)371.5 (8-14-95) Tax Exempt Organizations and Private Foundations

IRC section 6655(g)(3) requires estimated tax payment on the unrelated business taxable income or net investment income of tax exempt organizations and private foundations.

(20)371.6 (8-14-95) S Corporations

(1) Effective for taxable years beginning after December 31, 1989, IRC section 6655(g)(4) requires estimated tax payments on certain taxes imposed on S corporations.

- (a) 1371(d)(2) (Coordination with Subchapter C) shall be treated as taxes imposed by IRC section 11,

credit determined taxable under any of the following IRC sections:

- (a) IRC section 11--Tax Imposed, or
- (b) IRC section 1201 (a)--Alternative Tax for Corporations,
- (c) subchapter L of chapter 1--Insurance Companies,
- (d) IRC section 55--Alternative Minimum Tax Imposed,
- (e) IRC section 59A--Environmental Tax Credit, plus
- (f) IRC section 887--Imposition of Tax on Gross Transportation Income of Nonresident Aliens and Foreign Corporations,
- (g) any applicable credits against tax. (See IRC section 21, 22, 25 and 26 to determine applicable credits.)

(20)371.4 (8-14-95) Foreign Corporations

(1) A foreign corporation that has income described in IRC section 882 (Tax on Income of Foreign Corporations connected with United States business), which is subject to taxation under IRC section 11 or 1201(a), or under subchapter L of Chapter 1, must make estimated tax payments on this income in the same manner as a domestic corporation described in (20)371.2 above.

(2) A foreign corporation that has income described in IRC section 881 (Tax on Income of Foreign Corporations not connected with United States Business), in addition to income described in IRC section 882 must treat the tax imposed under IRC section 881 as an IRC section 11 tax on which estimated tax payments also must be made.

(3) For taxable years beginning after December 31, 1994, taxpayers using the annualization method to compute estimated tax payments must take into account income under section 936(h) and 951(a) in a manner specified in section 6655(e)(4). For more information see Rev. Proc. 95-23, 1995-18 I.R.B. 5.

(4) A foreign corporation that is not subject to tax under IRC section 882 is not required to make estimated tax payments on the tax imposed under IRC section 881.

(20)371.5 (8-14-95) Tax Exempt Organizations and Private Foundations

IRC section 6655(g)(3) requires estimated tax payment on the unrelated business taxable income or net investment income of tax exempt organizations and private foundations.

(20)371.6 (8-14-95) S Corporations

(1) Effective for taxable years beginning after December 31, 1989, IRC section 6655(g)(4) requires estimated tax payments on certain taxes imposed on S corporations.

(a) 1371(d)(2) (Coordination with Subchapter C) shall be treated as taxes imposed by IRC section 11,

(b) IRC sections 1374(a) (Tax Imposed on certain Built-in Gains),

(c) 1375(a) (Tax Imposed when Passive Investment Income of Corporation Subchapter C Earnings and Profits Exceeds 25 Percent of Gross Receipts), and

1 only ES payments under IRC section 1375(a) may be based on prior year tax,

2 prior year's tax does not have to be for an amount greater than zero.

(20)371.7 (8-14-95) Large Corporations

(1) A large corporation (or its predecessor) is defined as a corporation having taxable income of \$1,000,000 or more during any of the three years preceding the taxable year.

(2) Large corporations for tax years beginning after December 31, 1987, and prior to January 1, 1992, were required to pay 90 percent of the current years tax.

(3) For tax years beginning after December 31, 1991, and before June 1, 1992, the applicable percentage rate increased to 93 percent. For tax years beginning after June 30, 1992, and before December 31, 1993, the applicable percentage of a corporations tax liability increases to 97 percent. For tax years beginning after December 31, 1993, the applicable percentage increases to 100 percent.

(a) A large corporation may use 100 percent of prior year tax liability to determine the estimated tax payment required for only the first installment of any tax year. (IRC section 6655(d)(2)(B)).

(b) When the first estimated tax payment is based on 100 percent of:

1 the prior year's tax liability, and

2 that payment is less than the applicable percentage for the current year's tax liability, the result is considered an underpayment.

3 That underpayment from the first quarter must be added to what would otherwise be the required payment (applicable percentage for the current years tax liability) for the second quarter installment.

(4) For tax years beginning after December 31, 1991, and before July 1, 1992, the applicable percentage of a corporation's current year tax liability increases to 93 percent.

(5) For taxable years beginning after June 30, 1992, and before December 31, 1993, the applicable percentage of a corporation's tax liability increases to 97 percent.

(6) For tax years beginning after December 31, 1993, the percentage will decrease to 100 percent of the corporation's current-year tax liability.

(7) If any of the three preceding years were less than a full year, the corporation must multiply the taxable income for the short year by 12 and divide the resulting amount by the number of months in the short year to determine if the corporation meets the \$1,000,000 criterion.

(8) When the corporation is a member of a controlled group the \$1,000,000 amount specified shall be equally divided among the members of the controlled group, unless all members agree to an unequal allocation of the amount.

(9) Large corporation taxable income is determined without regard to any amount carried to the taxable year under IRC section 172 or 1212(a) (net operating loss carryback or carryover).

(20)371.8 (8-14-95) Annualized or Adjusted Seasonal Method of Determining the Required Payment

(1) A corporation may be able to lower one or more of its required deposits if its income is expected to vary during the year. In general, if a corporation establishes that either the annualized or adjusted seasonal method can reduce its required installment from what it would be if the regular method were used, the corporation may pay the lesser amount.

(a) OBRA 1993 provides for an election to be made if the corporation wants to use different annualization periods for taxable years beginning after December 31, 1993.

(b) To make this election the corporation must complete Form 8842, Election To use Different Corporate Annualization Periods for Estimated Tax, and file it by the due date of the first installment (by the 15th day of the fourth month of the year for which the election is being made).

(c) Form 8842 will be processed by Document Perfection Branch in the Service Centers using instructions in IRM 3(11)60, DP Tax Adjustments, Code and Edit. A TC 971 with action code 47 will be input to provide an indicator on IDRS that the election has been made and will be used by off-pipeline functions in estimated tax penalty determinations.

(2) The corporation must attach a completed Form 2220 to its return if the annualized or adjusted seasonal method of determining the payment is used.

(3) A corporation that reduces any required installment by annualizing its income, then switches to another method to determine a required deposit, must recapture 100 percent of any prior reduction in the next installment using the other method. See Exhibit (20)300-18 for examples of recapture computation.

(20)372 (8-14-95) Period of Underpayment

(20)372.1 (8-14-95) General

(1) For corporations the underpayment period is determined by the number of days (see Exhibit (20)300-10 and (20)300-11) from the payment due date to either:

(a) the date the payment or partial payment is received, or

(b) the due date of the return (15th day of the third month), without regard to extensions. See Exhibit (20)30-14.

(c) To determine the number of days see either the Perpetual (Exhibit (20)300-10)

and the Leap Year (Exhibit (20)30-11) Julian Date Calendars.

(d) If a payment due date falls on a weekend or a legal holiday, payments received the next business day are considered paid on the due date.

(20)372.2 (8-14-95) Tax Exempt Organization

(1) For certain tax exempt organizations with unrelated business income, the underpayment period shall be from the date the payment is due until either:

(a) the date the payment or partial payment is received, or

(b) due date of the return without regard to extensions (the 15th day of the fifth month rather than the third month) following the close of the tax year. See Exhibit (20)300-13.

(20)372.3 (8-14-95) Private Foundations

(1) For Private Foundations and Private Foundations organized as a Trust or Corporations the underpayment period is determined by the number of days (see Exhibit (20)300-10 and (20)300-11) from the payment due date to either:

(a) the date the payment or partial payment is received, or

(b) the due date of the return (15th day of the fifth month) after the end of the tax year without regard to extensions.

(20)372.4 (8-14-95) Excessive Adjustment

(1) IRC section 6425 allows for an adjustment to an overpayment of corporate estimated income tax. Form 4466, Corporation Application for Quick Refund of Overpayment of Estimated Tax, shall be filed after the last day of the taxable year, and

(a) on or before the 15th day of the third month after the close of the taxable year, and

(b) before the day on which the corporation files its return.

(2) In the event of an excessive adjustment, IRC section 6655(h) imposes a penalty. See Exhibit (20)300-10 for an example of an excessive adjustment.

(3) An excessive adjustment is equal to the lesser of:

(a) the amount of the adjustment, or

(b) the amount by which the income tax liability shown on the return for the taxable year exceeds the estimated income tax paid reduced by the amount of the adjustment.

(4) The penalty rate shall be determined using the information contained in IRM (20)376.

(5) The period of the underpayment as it relates to an excessive adjustment under IRC section

6425 is:

- (a) from the date that the credit is allowed (the 23C date), to
- (b) the return due date (without regard to extensions).

(20)373 (8-14-95) Payment Due Dates

(1) A corporation's estimated tax payment due dates are determined:

(a) For a full 12 month period:

1 12 month calendar year payments are due on the 15th day of April, June, September, and December. (see Exhibits (20)300-10 and (20)300-11).

2 12 month fiscal year payments are due on the 15th day of the 4th, 6th, 9th, and 12th months of the fiscal year (see Exhibits (20)300-10 and (20)300-11).

(b) For a period of less than 12 months (short period return) payment due dates are determined by the number of months in the short period. (see Exhibit (20)300-15).

1 for a short period return of less than 4 months the corporate taxpayer is not required to make estimated tax payments. (Proposed Treas. Reg. 1.6655-5 (b)(1)).

2 for a short period of 4 or more months the corporate taxpayer is not required to make estimated tax payments if it can be expected its liability (income tax minus credits) will be less than \$500 by the 1st day of the last month in the short taxable year. (Proposed Treas. Reg. 1.6655-5(b)(2)).

(2) A corporation filing a short period return that is either an initial or final return, is not required to annualize its taxable income to compute the penalty. (Treas. Reg. 1.441-1T).

(3) A corporation filing a short period return as a result of changes to its annual accounting period should annualize its taxable income to compute a penalty. (Proposed Treas. Reg. 1-6655-5(c)).

(20)374 (8-14-95) Application of Estimated Tax Payments and Credits

(20)374.1 (8-14-95) Credit Applications within the year

(1) Payment application for taxable years beginning prior to January 1, 1988:

(a) A payment that is not in excess of the amount due for the current installment cannot be used to credit an earlier installment liability.

(b) A payment that is in excess of a liability due for the current installment shall be considered a credit available, and can be used to satisfy the earliest outstanding liability within that tax period. A credit remaining after both current and prior liabilities have been satisfied, may be carried forward.

(c) A corporation may elect to satisfy an installment of estimated tax before it is due.

(2) Payment application for taxable years beginning on or after December 31, 1987:

(a) Installment payments are applied in received date order against the earliest liability within the tax period regardless of when the payment was received.

(b) When that installment is satisfied, any excess will be applied to the next liability until all liabilities within a given period are satisfied.

(20)374.2 (8-14-95) Credits Applied from a Prior Tax Year

(1) TC 716 or 710 (overpayment arising on or before the due date of the prior year's return) is applied against the first required installment of the next year's estimated tax unless the taxpayer notifies the Service that the overpayment should be applied to another installment.

(2) To properly notify the Service that the overpayment should be applied against another installment, taxpayers MUST attach a statement to the income tax return showing the overpayment, indicating which installment of estimated tax the overpayment should be applied against.

(20)374.3 (8-14-95) Verifying Credits on Master File

(1) Credits claimed by the corporation should be verified. This can be done by checking the appropriate CFOL, IDRS (i.e., TXMOD), or MRS transcripts. Review both the dollar amounts and the received dates of any payments.

(2) TC 710 or TC 716 credit is a "credit elect" overpayment received from the prior tax period. It will be applied as a credit to the first required installment period.

(3) TC 660 deposits are made using an 8109 or 8109-B deposit coupon. This deposit will post to the tax module with the date the payment was received at the Federal Depository.

(4) TC 670 subsequent payments will be credited to a tax period as of the received date of that payment.

(5) TC 610 is a payment that is received with the return. This payment will also post to the tax module as of the date the payment was received.

(20)375 (8-14-95) Determining the Amount of the Underpayment

The amount of the underpayment is the required installment payment minus the amount (if any) paid or credited on or before the due date of the installment.

(20)376 (8-14-95) Penalty Rate

(1) The estimated tax penalty rate is the underpayment interest rate as described in IRC section 6621 (Federal short-term interest rate plus three percentage points). The underpayment interest rate is determined quarterly. This means that the penalty on a \$1,000 underpayment for one quarterly tax period may be different from the penalty on a \$1,000 underpayment for a different quarterly tax period. See Exhibit (20)300-12.

(2) The underpayment interest rate or the estimated tax penalty rate can be obtained from the Internal Revenue Bulletin, New Releases, TAXNEWS, Taxpayer Service Electronic Bulletin Board (TEBB), and Notice 433, Yearly Interest and Certain Penalty Rates.

(3) The estimated tax penalty rate is NOT compounded daily.

(20)377 (8-14-95) Determining the Penalty Amount

(20)377.1 (8-14-95) General

(1) For each installment, the penalty is determined by multiplying:

(a) the amount of the underpayment, by

(b) the number of days the payment is late (see Exhibits (20)300-10 and (20)300-11),
by

(c) the applicable percentage rate. See Exhibit (20)300-12.

(2) See 377.1:(2) of LEM XX-300.

(3) Estimated tax penalties are computed on the amount of tax reported on the original return. A superseding return (a second return filed on or before the due date of the return) is considered an original return.

(a) If an adjustment is made to the tax of an original return, before the due date (including extensions), as a result of either an audit or the taxpayer filing an amended (superseding) return, the penalty amount may be adjusted, based on the new tax amount.

(b) If an adjustment is made to the tax of an original return, after the return due date, including extensions, as a result of either an audit or the taxpayer filing an amended return, the penalty amount cannot be adjusted.

(4) If a corporation did not timely make its required payments, Master File will compute the penalty unless the tax module is restricted (prior TC 170/171 or computer condition code).

(5) For additional restrictions to Master File see 377.1:(5) of LEM XX-300.

(6) Revenue Agents, Revenue Officers, and Tax Examiners with access to IDRS may use command codes:

(a) COMPAE/COMPAS to facilitate the computation of the estimated tax penalty.

(b) PINEX (PIEST) to explain a computer generated estimated tax penalty computation to the taxpayer. Once the penalty has been restricted (either with TC 170/171 or a computer condition code) PINEX is no longer able to explain the penalty computation.

(c) Specific instructions regarding the input of both the COMPA and PINEX command codes are contained in IRM 3(25)(77)0, IDRS Terminal Inquiries and IRM

3(25)(78)0, IDRS Terminal Input.

(20)377.2 (8-14-95) Form 2220, Underpayment of Estimated Tax by Corporations

(1) Corporations may complete Form 2220 to compute, reduce or eliminate an estimated tax penalty. See Exhibit (20)300-16. In some cases a corporation must file a Form 2220. See Instructions for Form 2220 for more information.

(a) Part I determines the amount of any underpayment for each of the four installment periods.

(b) Part II is used to compute any applicable penalty. Several of the last lines of part II provide the formula, but do not provide the applicable percentage rate for determining the penalty amount. To determine the appropriate penalty rate see IRM (20)376.

(c) If a corporation's income varies during the tax year, it may use the Annualized Income Installment Worksheet or the Adjusted Seasonal Installment Worksheet included with the Form 2220.

(20)380 (8-14-95) Penalty Transaction Codes

(1) ES Penalty Transaction Codes are:

(a) TC 176--Computer generated assessment of an ES penalty,

(b) TC 177--Computer generated abatement of an ES penalty,

(c) TC 170---Manual assessment of an ES penalty,

(d) TC 171--Manual abatement of an ES penalty.

(2) Manual assessments are determined by District or Service center employees and are input through IDRS. Employees who cannot directly input the penalty assessment to IDRS need to follow functional guidelines to request the input of an assessment.

(3) If an incorrect return (i.e. wrong taxpayer or wrong tax period) posts to an account first, then, when the correct return posts, the ES penalty must be manually computed.

(20)390 (8-14-94) Adjustments After the Penalty Assessment

(20)391 (8-14-95) Waivers

(20)391.1 (8-14-95) Evaluating Claims for Abatement or Waiver of Estimated Tax Penalties

(1) Reasonable Cause is not grounds for adjusting or abating BMF Estimated Tax Penalties.

(2) Estimated Tax Penalties may be adjusted or abated when:

(a) misapplied prepayments are located and applied to the correct tax period or identification number, or

(b) prepayments were refunded in error and are returned by the taxpayer within 10

days, or

(c) if it is determined the estimated tax penalty was assessed as the result of a Service error.

(3) Waivers are sometimes granted by legislation, regulation, or administrative pronouncements to provide relief from estimated tax penalties created by the retroactive application or a change in statute or Service position.

(20)391.2 (8-14-95) Procedures for Requesting a Waiver

(1) To claim a "waiver" the corporation must explain which provision of the Revenue Act of 1988, Titles I and/or II of Act sections 1001 through 2006 or other specific legislative or administrative provisions caused the tax increase and related underpayment. Only after this information is provided can a waiver be considered.

(2) To claim the waiver, affected corporations should:

(a) compute the penalty (by completing Form 2220),

1 on the basis of the law in effect before the changes were made, and

2 on the basis of the law in effect after the changes were made.

3 the penalty amount eligible for the waiver is the difference between 1 and 2.

(b) write the word "waiver" on the bottom margin of the return.

(c) write the "waiver amount" on the dotted line to the left of the column provided for the penalty amount.

(3) The corporation must attach an explanation showing its computation and the amount of penalty to be waived.

(a) Review the corporation's explanation of "waiver eligibility".

(b) Math verify the corporation's Form 2220 computation and attachments.

(20)391.3 (8-14-95) Waivers Based on Legislative Action

(1) For any underpayment period ending before March 16, 1994, the service will waive the estimated tax penalty to the extent an underpayment was created or increased by the Omnibus Budget Reconciliation Act (OBRA) of 1993. Instructions for claiming a waiver based on OBRA - 1993 are included in the 1993 Form 2220 instructions.

(2) The Revenue Reconciliation Act of 1990 changed the way an insurance company handles the amortization of policy acquisition expenses and the treatment of salvage. A penalty resulting from any underpayment of estimated tax attributable to the changes made by the Act to IRC sections 807(e), 832(b)4, 832(b)5, and 848 for any period before March 16, 1991, will be waived.

(3) If excise tax from a Real Estate Investment Trust is included with income tax on Form 1120, the estimated tax penalty will not be charged on the excise portion of the tax reported. The

amount of tax to be exempt from estimated tax payments should be included on the Schedule J of Form 1120 and coded REIT Income.

(4) P.L. 100-647 provided that corporations may obtain relief from estimated tax penalties to the extent they underpaid their 1988 estimated tax. They had until March 15, 1989, to correct any deficiency (pay any income tax in full) to the extent those under-payments were attributable to changes in the law made by Titles I and/or II of the Technical and Miscellaneous Revenue Act of 1988.

(5) Corporations may obtain a waiver of estimated tax penalties for any period before March 16, 1987, to the extent they underpaid their 1986 estimated tax as a result of any provision of the Tax Reform Act of 1986.

(a) The Tax Reform Act of 1986 made changes to the Internal Revenue Code that substantially impacted the determination of corporate tax liability.

(b) For taxable years beginning in 1987, a large corporation can base its estimated tax payments on the prior year's tax liability for the first two payments due on or before June 15, 1987 (or the first installment for a fiscal year corporation whose tax year began on or before March 1, 1987). Any underpayment due to this exception must be recaptured in the most recent installment of estimated tax due on or before September 15, 1987.

(c) For installment payments due on or before July 1, 1987, corporations whose first taxable year began before January 1, 1987, can use the "safe harbor" in IRC section 1.6655-2T of the regulations.

(d) Corporations using this "safe harbor" method must file Form 2220 showing the computation of the penalty based on this annualized method.

(20)391.4 (8-14-95) Bankruptcy: (IRC Section 6658)

(1) IRC section 6658 prohibits the assertion of the estimated tax penalty on liabilities during the time the case is pending a Title 11 bankruptcy proceeding filed on or after October 1, 1979.

(2) Abate corporate estimated tax payment penalties with respect to an order by the court finding probable insufficiency of funds of the estate to pay administrative expenses.

(3) Abate corporate estimated tax payment penalties where:

(a) the tax was incurred by the debtor before the earlier of:

1 the order for relief, or

2 the appointment of a trustee (in the involuntary case), and

(b) the bankruptcy petition was filed:

1 before the due date prescribed by law (including extensions) for filing a return of such tax, or

2 on or before the date for making the IRC section 6655 penalty was imposed.

(20)391.5 (8-14-95) Request for Abatement Due to an Erroneous Refund of Estimated Tax Payment, Offset, or Overpayment (Credit Effect)

(1) If the taxpayer claims that an overpayment (credit elect) was refunded in error or if an estimated tax payment was erroneously refunded by the Service, the taxpayer may be entitled to have a portion of the penalty abated. Verify the taxpayer's statement by requesting the prior year return and reviewing account information.

(2) Abate the penalty if the taxpayer promptly returns the refund check or repays the refund amount within 10 days of its issue. Consider each case individually to determine if the refund was returned or repaid promptly.

(20)392 (8-14-95) Denying the Request for a Waiver

If the waiver is denied, send a letter informing the taxpayer of the reason for denial and explaining their appeal rights. Input TC 290 for zero with blocking series 98/99.

(20)393 (8-14-95) Penalty Appeal Procedures

For a complete discussion of penalty appeals, refer to IRM (20)400.

Exhibit (20)300-1 1040/1041 Installment Due Dates

INSTALLMENT DUE DATES FOR FORMS 1040 AND 1041

PERIOD ENDING	1ST	2ND	3RD	4TH	RETURN DUE DATE
DEC. 31	4-15	6-15	9-15	1-15	4-15
JAN. 31	5-15	7-15	10-15	2-15	5-15
FEB. 28 (29)	6-15	8-18	11-15	3-15	6-16
MARCH 31	7-15	9-15	12-15	4-15	7-15
APRIL 30	8-15	10-15	1-15	5-15	8-15
MAY 31	9-15	11-15	2-15	6-15	9-15
JUNE 30	10-15	12-15	3-15	7-15	10-15
JULY 31	11-15	1-15	4-15	8-15	11-15
AUGUST 31	12-15	2-15	5-15	9-15	12-15
SEPT. 30	1-15	3-15	6-15	10-15	1-15
OCTOBER 31	2-15	4-15	7-15	11-15	2-15
NOV. 30	3-15	5-15	8-15	12-15	3-15

Exhibit (20)300-2 Percentage of Estimated Tax Due

Percentage of Estimated Tax Due for Calendar, Fiscal or Short Period Returns

PERCENTAGE OF ESTIMATED TAX DUE
FOR
CALENDAR, FISCAL OR SHORT PERIOD RETURNS

	4TH MONTH	6TH MONTH	9TH MONTH	12TH MONTH
LIABLE BEFORE 4TH MONTH	25%	25%	25%	25%
LIABLE AFTER 3RD MONTH AND BEFORE 6TH MONTH		50%	25%	25%
LIABLE AFTER 5TH MONTH AND BEFORE 9TH MONTH			75%	25%
LIABLE AFTER 8TH MONTH AND BEFORE 12TH MONTH				25%

Exhibit (20)300-3 Safe Harbor

The following flowchart is not included in this file
**SAFE HARBOR - 100 PERCENT OF PRIOR YEAR'S TAX
AFTER DECEMBER 31, 1991
AND
BEFORE JANUARY 1, 1994** Form 1040EZ

The following flowchart is not included in this file
**SAFE HARBOR - 100 PERCENT OF PRIOR YEAR'S TAX
AFTER DECEMBER 31, 1993**

Exhibit (20)300-4 Modified Adjusted Gross Income

Modified Expected Tax

Modified Adjusted Gross Income

For purposes of this provision, "modified adjusted gross income" is determined by making the following adjustments to the expected current year's adjusted gross income (AGI):

- do not include any taxable gain from the sale or exchange of a principal residence,

- do not include any taxable gain from a casualty, theft, condemnation, or other involuntary conversation,

- unless the taxpayer is a general partner or 10 percent owner in a passthrough entity (partnerships and/or S corporations), items from passthrough entities for the PRIOR year (if any) are to be treated as if occurring in current year and any actual passthrough items for the current year are disregarded.

- Items from passthrough entities include any item of income, gain, loss, deduction, or credit attributable to an

- Gain or loss from the disposition of a interest in a partnership or S corporation is not considered a passthrough item.

- If 90 percent of the current year's "modified expected tax", based on "modified adjusted gross income" is larger than 100 percent of the preceding year's tax, then the required current year's payment is the smaller of 90 percent of the current year's total expected tax or 90 percent of the current year's modified expected tax"

Modified Expected Tax

Generally you will compute your "modified expected tax" as you would your total estimated tax with the following exceptions:

- begin with the modified adjusted gross income, and
- do not include itemized deductions, credits or items affecting other taxes.

Review Publication 505, Tax Withholding and Estimated Tax each year for additional specific instructions regarding income to include or exclude.

Exhibit (20)300-5 Farmer/Fishers Gross Income

Taxpayers qualify as Farmers or Fishers if two-thirds of their gross income is from farming or fishing.

Determining Farmer/Fisher Gross Income

Analyze income items found on page 1 of Form 1040:

Wages,

Interest,

Dividends,

Refunds of state and local income tax,

Alimony received,

Capital gain distributions not reported on Schedule D (prior to January 1, 1987, 2 1/2 times the amount shown on Form 1040),

Fully taxable pensions, IRA Distributions, and annuities.

Taxable portion of other pensions and annuities,

Taxable amount of unemployment compensation,

Taxable amount of social security benefits,

Other income.

Analyze entries on schedules and forms:

Schedule C, gross income (losses are considered zero),

Schedule D, short term and long term capital gains (each must be considered separately, losses are considered zero,

Schedule E, rents, royalties, partnerships, and trusts (all gains are considered separately, losses are considered zero),

Schedule F, gross income, Part I, or gross income, Part III,

Form 4979, Supplemental Schedule of Gains and Losses,

Compute two-thirds gross income:

Gross income times .6667 = two-thirds gross income

Compare two-thirds gross income to gross farming or fishing income:

If the farming or fishing income is two-thirds of the gross income, the taxpayer qualifies as a farmer or fisher.

Exhibit (20)300-6 Qualified Farm Income

DETERMINING QUALIFIED FARM INCOME

TYPES OF INCOME	Qualifies as Farm Income	
	YES	NO
FORM 1040		
Wages, including farm wages		X
Interest		X
Dividends		X
Pensions, IRA Distributions, Annuities		X
Alimony		X
Capital Gains (not on Schedule D)		X
Unemployment Compensation		X
Social Security benefits		X
Schedule C		
Income from Nurseries, Stock, Dairy, Poultry, Bee, Fruit, and Truck Farms	X	
Income from oyster beds and related income	X	
Schedule D		
Gains from Sale of Livestock	X	
Gains from Sale of Land, Equipment, and Machinery		X
Gains from Farm Partnership	X	
Gains from Farming of Estate or Trust	X	
Form 4797		
Gains from Sale of Livestock Held for Draft, Breeding, Sport, or Dairy/Purposes	X	
Gains from Sale of Land, Equipment, and Machinery		X
Schedule E		
Farm Rental Income with Form 4925		

Crop Shares	X	
Material Participation in Farm Rental and Land Rental Income	X	
Royalties		X
Schedule F		
Part I - Gross Farm Income	X	
Part III - Gross Farm Income (Accrual)	X	

Exhibit (20)300-7 Determining Percentage of Farmer/Fisher Income

The following forms are not included in this file
 Form 2210-F - Underpayment of Estimated Tax by Farmers and Fisherman
 Form 1040 - U.S. Individual Income Tax Return
 Schedule F - Profit or Loss From Farming
 Schedule C - Profit or Loss From Business
 Schedule D - Capital Gains and Losses
 Schedule E - Supplemental Income and Loss
 Form 4797 - Sales of Business Property

Exhibit (20)300-7 Cont. (12) Determining Percentage of Farmer/Fisher Income

FARMER/FISHER DETERMINATION

Form 1040 Line Item	Gross Income	Farmer/Fisher Income
7) Wages, Salaries, tips, etc.	300.00	.00
8a) Taxable interest income	267.00	
9) Dividend income	200.00	
10) Refund of state or local income tax	100.00	
11) Alimony received	1,200.00	
12) Schedule C income	32,033.00	.00
13) Schedule D income	350.00	300.00
14) Capital gain distributions	100.00	
15) Form 4797 (not reported on Schedule D)	1,000.00	1,000.00
16b) Taxable IRA distributions	300.00	
17b) Taxable pensions and annuities	300.00	
18) Schedule E income	3,100.00	2,000.00
19) Schedule F income	92,008.00	92,008.00
20) Unemployment Compensation	200.00	
21a) Taxable social security benefits	300.00	
22) Other income	100.00	.00
Totals	131,858.00	95,308.00
	x .6667	
Compare:		
2/3 gross income to F/F income	87,910.00	95,308.00

Exhibit (20)300-8 Estimated Tax Penalty Rates

ESTIMATED TAX PENALTY RATES

EFFECTIVE DATE	RATE
January 1, 1988 - March 31, 1988	11%
April 1, 1988 - September 30, 1988	10%
October 1, 1988 - March 31, 1989	11%
April 1, 1989 - September 30, 1989	12%
October 1, 1989 - March 31, 1991	11%
April 1, 1991 - December 31, 1991	10%
1992 - LEAP YEAR	
January 1, 1992 - March 31, 1992	9%
April 1, 1992 - September 30, 1992	8%
October 1, 1992 - December 31, 1992	7%
January 1, 1993 - June 30, 1994	7%
July 1, 1994 - September 30, 1994	8%
October 1, 1994 - March 31, 1995	9%
April 1, 1995	10%

Exhibit (20)300-9 Form 1120-W

The following form is not included in this file
 Form 1120- W - Estimated Tax for Corporations

Exhibit (20)300-10 Perpetual Julian Date Calendar

DAY	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	DAY
1	001	032	060	091	121	152	182	213	244	274	305	335	1
2	002	033	061	092	122	153	183	214	245	275	306	336	2
3	003	034	062	093	123	154	184	215	246	276	307	337	3
4	004	035	063	094	124	155	185	216	247	277	308	338	4
5	005	036	064	095	125	156	186	217	248	278	309	339	5
6	006	037	065	096	126	157	187	218	249	279	310	340	6
7	007	038	066	097	127	158	188	219	250	280	311	341	7
8	008	039	067	098	128	159	189	220	251	281	312	342	8
9	009	040	068	099	129	160	190	221	252	282	313	343	9
10	010	041	069	100	130	161	191	222	253	283	314	344	10
11	011	042	070	101	131	162	192	223	254	284	315	345	11
12	012	043	071	102	132	163	193	224	255	285	316	346	12
13	013	044	072	103	133	164	194	225	256	286	317	347	13
14	014	045	073	104	134	165	195	226	257	287	318	348	14
15	015	046	074	105	135	166	196	227	258	288	319	349	15
16	016	047	075	106	136	167	197	228	259	289	320	350	16
17	017	048	076	107	137	168	198	229	260	290	321	351	17
18	018	049	077	108	138	169	199	230	261	291	322	352	18
19	019	050	078	109	139	170	200	231	262	292	323	353	19
20	020	051	079	110	140	171	201	232	263	293	324	354	20
21	021	052	080	111	141	172	202	233	264	294	325	355	21
22	022	053	081	112	142	173	203	234	265	295	326	356	22
23	023	054	082	113	143	174	204	235	266	296	327	357	23

24	024	055	083	114	144	175	205	236	267	297	328	358	24
25	025	056	084	115	145	176	206	237	268	298	329	359	25
26	026	057	085	116	146	177	207	238	269	299	330	360	26
27	027	058	086	117	147	178	208	239	270	300	331	361	27
28	028	059	087	118	148	179	209	240	271	301	332	362	28
29	029		088	119	149	180	210	241	272	302	333	363	29
30	030		089	120	150	181	211	242	273	303	334	364	30
31	031		090		151		212	243		304		365	31

Exhibit (20)300-11 Perpetual Julian Date Calendar--Leap Years

DAY	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	DAY
1	001	032	061	092	122	153	183	214	245	275	306	336	1
2	002	033	062	093	123	154	184	215	246	276	307	337	2
3	003	034	063	094	124	155	185	216	247	277	308	338	3
4	004	035	064	095	125	156	186	217	248	278	309	339	4
5	005	036	065	096	126	157	187	218	249	279	310	340	5
6	006	037	066	097	127	158	188	219	250	280	311	341	6
7	007	038	067	098	128	159	189	220	251	281	312	342	7
8	008	039	068	099	129	160	190	221	252	282	313	343	8
9	009	040	069	100	130	161	191	222	253	283	314	344	9
10	010	041	070	101	131	162	192	223	254	284	315	345	10
11	011	042	071	102	132	163	193	224	255	285	316	346	11
12	012	043	072	103	133	164	194	225	256	286	317	347	12
13	013	044	073	104	134	165	195	226	257	287	318	348	13
14	014	045	074	105	135	166	196	227	258	288	319	349	14
15	015	046	075	106	136	167	197	228	259	289	320	350	15
16	016	047	076	107	137	168	198	229	260	290	321	351	16
17	017	048	077	108	138	169	199	230	261	291	322	352	17
18	018	049	078	109	139	170	200	231	262	292	323	353	18
19	019	050	079	110	140	171	201	232	263	293	324	354	19
20	020	051	080	111	141	172	202	233	264	294	325	355	20
21	021	052	081	112	142	173	203	234	265	295	326	356	21
22	022	053	082	113	143	174	204	235	266	296	327	357	22
23	023	054	083	114	144	175	205	236	267	297	328	358	23
24	024	055	084	115	145	176	206	237	268	298	329	359	24
25	025	056	085	116	146	177	207	238	269	299	330	360	25
26	026	057	086	117	147	178	208	239	270	300	331	361	26
27	027	058	087	118	148	179	209	240	271	301	332	362	27
28	028	059	088	119	149	180	210	241	272	302	333	363	28
29	029	060	089	120	150	181	211	242	273	303	334	364	29
30	030		090	121	151	182	212	243	274	304	335	365	30
31	031		091		152		213	244		305		366	31

Use in 1988, 1992, 1996, 2000, etc.

Exhibit (20)300-12 Daily Rates For Estimated Tax Penalty Computation

Determine the number of days in the penalty period, then multiply the number of days by the Daily Penalty Rate.

6% Daily Penalty Rate (Non-Leap Year)	.000164384
7% Daily Penalty Rate (Non-Leap Year)	.000191781
8% Daily Penalty Rate (Non-Leap Year)	.000219178
9% Daily Penalty Rate (Non-Leap Year)	.000246575
10% Daily Penalty Rate (Non-Leap Year)	.000273972

11% Daily Penalty Rate (Leap Year)	.000300546
11% Daily Penalty Rate (Non-Leap Year)	.000301369
12% Daily Penalty Rate (Non-Leap Year)	.000328767
13% Daily Penalty Rate (Non-Leap Year)	.000356164
16% Daily Penalty Rate (Non-Leap Year)	.000438356
20% Daily Penalty Rate (Non-Leap Year)	.000547945

NOTE: Although interest is compounded daily effective January 1, 1983, Estimated Tax Penalty is NOT compounded. Computation Example Estimated Tax Penalty on \$781.00 from April 15, 1992, to December 27, 1992.

Julian Date of September 30, 1992	273
Julian Date of April 15, 1992	-105

Number of days @ 8%	168
Julian Date of December 27, 1992	361
Julian Date of September 30, 1992	-273

Number of days @ 7%	88
168 X .000219178 X \$781.00 =	\$28.76
88 X .000191781 X \$781.00 =	+\$13.18

Estimated Tax Penalty	\$41.94

Exhibit (20)300-13 EO Returns and Applicable Penalties

RETURN	TAX CLASS	MFT	DOC CODE	ORG CODE/**/	DUE DATE
990	4	67	90		4 1/2 months after end of taxable year
990EZ	4	67	09		4 1/2 months after end of taxable year
990-C/**/	3	33	92		2 1/2 months after end of taxable year
990-T/**/	3	34	93	1	4 1/2 months after end of taxable year (Exempt Trust, U.S. address)
990-T/**/	3	34	93	2	5 1/2 months after end of taxable year (Example Trust, Foreign Addresses)
990-T/**/	3	34	93	3	3 1/2 months after end of taxable year (Section 401(a) and/or Section 404(e) Trust, U.S. or Foreign Addresses)
990-T/**/	3	34	93	4	4 1/2 months after end of taxable year (Corporation, Foreign Addresses)

entered on Forms 990-T. (coded on form, transcribed from form and posted to Master File), to determine the due date and assess applicable penalties. Organization Code 0 is used very rarely. When it is used, it records account transfers or quick and prompt assessments. It is also used by BMF programming to determine due date and assess applicable penalties.

/**/ Nonresident corporations and trusts with books outside the U.S. have a due date of the 15th day of the 6th month following the close of the taxable year.

Exhibit (20)300-14 Form 1120--Installment Due Dates

ESTIMATED TAX INSTALLMENT DUE DATES -- FORM 1120

Period Ending	Return Due Date	1st	2nd	3rd	4th
Dec. 31	3-15	4-15	6-15	9-15	12-15
Jan. 31	4-15	5-15	7-15	10-15	1-15
Feb. 28 (9)	5-15	6-15	8-15	11-15	2-15
Mar. 31	6-15	7-15	9-15	12-15	3-15
Apr. 30	7-15	8-15	10-15	1-15	4-15
May 31	8-15	9-15	11-15	2-15	5-15
June 30	9-15	10-15	12-15	3-15	6-15
July 31	10-15	11-15	1-15	4-15	7-15
Aug. 31	11-15	12-15	2-15	5-15	8-15
Sept. 30	12-15	1-15	3-15	6-15	9-15
Oct. 31	1-15	2-15	4-15	7-15	10-15
Nov. 30	2-15	3-15	5-15	8-15	11-15

Exhibit (20)300-15 Short Period Return Installment Due Dates

MONTHS IN SHORT YEAR	FIRST INSTALLMENT DUE 15TH DAY OF		SECOND INSTALLMENT DUE 15TH DAY OF		THIRD INSTALLMENT DUE 15TH DAY OF		LAST INSTALLMENT DUE 15TH DAY OF	
	MONTH	% DUE	MONTH	% DUE	MONTH	% DUE	MONTH	% DUE
4	-	-	-	-	-	-	FOURTH MONTH	100
5	FOURTH MONTH	25	FIFTH MONTH	75	-	-	FIFTH MONTH	75
6	FOURTH MONTH	25	SIXTH MONTH	75	-	-	SIXTH MONTH	75
7	FOURTH MONTH	25	SIXTH MONTH	25	-	-	SEVENTH MONTH	50
8	FOURTH MONTH	25	SIXTH MONTH	25	-	-	EIGHTH MONTH	50
9	FOURTH MONTH	25	SIXTH MONTH	25	-	-	NINTH MONTH	50

990-T/**/	3	34	93	5	5 1/2 months after end of taxable year (Corporation, Foreign address)
990-PP/**/	4	44	91		4 1/2 months after end of taxable year
5227/**/	4	37	83		3 1/2 months after end of taxable year
1041-A	4	36	81		3 1/2 months after end of taxable year
4720	4	50	71		Same as due date of 990, 990EZ, or 5227 filed by same organization

RETURN	STATUTORY PERIOD OF LIMITATIONS	TAX-ABLE	16X FTF	17X ES	18X FTD	27X FTP	23X DDP
990	3 yrs after due date of return or 3 yrs after the date return was actually filed, whichever is later	No	No	No	No	No	Yes
990EZ	Same as for Form 990	No	No	No	No	No	Yes
990-C/**/	Same as for Form 990	Yes	Yes	Yes	No	Yes	No
990-T/**/	Same as for Form 990	Yes	Yes	Yes	No	Yes	No
990-T/**/	Same as for Form 990	Yes	Yes	Yes	No	Yes	No
990-T/**/	Same as for Form 990	Yes	Yes	Yes	No	Yes	No
990-T/**/	Same as for Form 990	Yes	Yes	Yes	No	Yes	No
990-T/**/	Same as for Form 990	Yes	Yes	Yes	No	Yes	No
990-PP/**/	Same as for Form 990	Yes	Yes	Yes	No	Yes	Yes
5227/**/	Same as for Form 990	No	No	No	No	No	No
1041-A	Same as for Form 990	No	No	No	No	No	Yes
4720	Same as for Form 990	Yes	Yes	No	No	Yes	No

/*/ Forms 990-T only, BMF programming uses the organization code

10	FOURTH MONTH	25	SIXTH MONTH	25	NINTH MONTH	25	TENTH MONTH	25
11	FOURTH MONTH	25	SIXTH MONTH	25	NINTH MONTH	25	ELEVENTH MONTH	25

Exhibit (20)300-16 Sample Form 2220

The following form is not included in this file
Form 2220 - Underpayment of Estimated Tax by Corporations

Exhibit (20)300-17 Computation of Required Payment--IMF

(1) The following information applies to Examples 1, 2 and 3.

- (a) The estimated total tax for the current year is \$1333;
- (b) The total tax for the preceding year was \$1600.
- (c) The taxpayer can use the preceding year tax as a Safe Harbor.

EXAMPLE 1: Regular Computation Method

Because the current year ES tax is less than the preceding year's tax, it is to the taxpayer's advantage to use the current year's ES tax to compute the ES installment payments.

$$\begin{aligned} & \$1333 \text{ (estimated current year tax)} \times 90\% = \$1200 \text{ total ES} \\ & \text{tax payment} \\ & \$1200 \div 4 \text{ (number of ES installments)} = \$300 \text{ for each ES} \\ & \text{payment} \end{aligned}$$

Using the regular method requires 4 payments at \$300 each.

EXAMPLE 2: Annualized Income Installment Method

If the taxpayer's income varies during the year, the annualized income installment method can be used. Assume the taxpayer completed a Form 2210 worksheet for annualized income. Based on that worksheet, the taxpayer's annualized ES installments are as follows:

4/15 installment due	\$100
6/15 installment due	\$200
9/16 installment due	\$200
1/15 installment due	\$700
Total annualized installment payments	

for the year	\$1200

When the taxpayer sees the \$700 installment due 1/15 and remembers that by the regular method the 1/15 installment was \$300, he may be tempted to make the \$300 payment. However, to avoid the ES penalty the taxpayer must make up any "shortfall" resulting from the use of

the annualized method versus the regular method for all previous annualized installments. The computation would be:

Installment Due Date	Regular Payment	Annualized Payment	Shortfall Amount
4/15	\$300	\$100	\$200
6/15	\$300	\$200	\$100
9/15	\$300	\$200	\$100
1/15	\$300	\$700	none
Total shortfall amount			\$400

Therefore, to avoid the penalty, the taxpayer would have to make the \$300 regular method payment PLUS pay the \$400 "shortfall" for a total payment of \$700 on the 1/15 due date.

Exhibit (20)300-17 Cont. Computation of Required Payment--IMF

EXAMPLE 3: Combination of Methods

If the taxpayer, after having used the annualized income installment method for the first estimated tax installment, decided to use the regular method for the rest of the installments, the installments would be computed as follows:

Installment Due Date	Regular Method	Annualized Method	Shortfall	Installment Amount Due
4/15	\$300	100	\$200	\$100
6/15	\$300 plus the	shortfall from 4/15 =		\$500
9/15	\$300			\$300
1/15	\$300			\$300

Total ES payments for the year				\$1200

In both Examples 2 and 3, the taxpayer would have to file Form 2210 and Schedule AI to support the annualized income installment method payments. The annualized income installment method worksheet (Schedule AI) included with Form 2210, computes the smaller of the annualized income installment or the regular installment (increased by any "shortfall" resulting from the annualized installment method versus the regular method, in figuring earlier installments).

(2) The following information applies to Example 4.

(a) The estimated total tax for the current year (9412) is \$202,000.)

(b) The total tax for the preceding year (9312) was \$155,000.

EXAMPLE 4: Regular Computation Method

Because the preceding year's tax is more than \$150,000, the required ES installments will be computed on the lesser of 110% of the prior year's tax or 90% of the current year's tax.

$$\frac{(110\% \times \$155,000)}{4} = \$42,625 \text{ or } \frac{(90\% \times \$202,000)}{4} = \$45,450$$

4

4

Using the regular method, 4 installment payments of \$42,625 will be required.

Exhibit (20)300-18 Computation of Required Payment--BMF

EXAMPLE 1:

Ash Corporation's total estimated tax for the tax year ending 9112 is \$94,000. The total tax for the prior year (9012) is \$90,000.

(a) Under the regular computation method, the corporation is required to deposit quarterly payments equal to the lesser of 90% of the current year's tax or 100% of the prior year's tax.

$$\frac{(90\% \times \$94,000)}{4} = \$21,150 \text{ or } \frac{(100\% \times \$90,000)}{4} = \$22,500$$

It is to the taxpayer's advantage to use the current year's tax to compute the ES installments. Using the regular method, 4 deposits of \$21,150 are required.

(b) Because the corporation's income varied during the year, the annualized income installment method could be used. After completing the Form 2220 worksheet, the corporation determined the first and second annualized installments to be \$15,000 and \$20,000 respectively.

However, the corporation decided to return to the regular installment method for the remaining two installments. To avoid a penalty, the corporation must recapture any shortfall in the first and second installments (resulting from use of the annualized installment method versus the regular method) by increasing the third installment by the amount of the shortfalls.

Installment Due Date	Regular Method	Annualized Method	Shortfall Amount	Installment Amount Due
4-15	\$21,150	\$15,000	\$6,150	\$15,000
6-15	\$21,150	\$20,000	\$1,150	\$20,000
9-15	\$21,150	plus the shortfall from 4/15 and 6/15		\$28,450
12-15	\$21,150			\$21,150

Exhibit (20)300-18 Cont. (1) Computation of Required Payment--BMF

EXAMPLE 2:

Birch Corporation's total tax for the tax year ending December 31, 1992 is \$136,000. The taxpayer is required to deposit 93% of the current year's tax in 4 equal payments.

$$\frac{(93\% \times \$136,000)}{4} = \$31,620$$

The corporation's total tax for the prior tax year (9112) was \$130,000. The corporation can deposit 100% of the prior year's tax in 4 equal payments if this would lower the estimated tax payments for the current year.

$$\frac{(100\% \times \$130,000)}{4} = \$32,500$$

In this case, the estimated payments based on 93% of the 9212 tax are lower.

EXAMPLE 3:

Chestnut Corporation's total tax for the tax year ending July 31, 1993 is \$98,000. The corporation's total tax for the prior year (9207) was \$90,000.

The corporation is required to deposit the lesser of 97% of the current year's tax or 100% of the prior year's tax in 4 equal payments.

$$\frac{(97\% \times \$98,000)}{4} = \$23,765 \text{ or } \frac{(100\% \times \$90,000)}{4} = \$22,500$$

In this case, 4 deposits of \$22,500 each based on the prior year's tax will provide a safe harbor.

Exhibit (20)300-18 Cont. (2) Computation of Required Payment--BMF

EXAMPLE 4:

Dogwood Corporation's total tax for the tax year ending December 31, 1994 is \$100,000. The corporation's total tax for the prior tax year (9312) was \$96,000.

The corporation is required to deposit the lesser of 100% of the current year's tax or 100% of the prior year's tax. In this case, \$96,000 is the lesser of the two. The corporation must have deposited 4 equal payments of \$24,000 each to meet the prior year's tax.

$$(100\% \times \$96,000) = \$24,000$$

4

Exhibit (20)300-19 Excessive Adjustment

Excessive Adjustment

(1) An example of an "Excessive Adjustment" would be:

(a) a corporation's tax year ends December 31, 1992, and it has made estimated tax deposits equalling \$10,000.

(b) The corporation determines their correct tax liability is \$8,000. It has made estimated tax deposits of \$2,000 in excess of their proposed tax liability.

(c) Before the corporation files its tax return, it files a Form 4466 requesting a refund of \$2,500.

(2) The \$ 2,500 is more than what will be available when the return is processed. The additional \$500 refund is considered an "Excessive Adjustment" and the estimated tax penalty will be assessed on the \$500 amount.

(3) Computation:

Total Deposits	\$ 10,000
Proposed Liability	8,000

Difference	\$ 2,000
Requested Refund	\$ 2,500
Available for Refund	2,000

Excessive Adjustment	\$ 500

Chapter (20)400 Failure to Deposit (FTD)

(20)410 (3-21-95) Description

(20)411 (3-21-95) General

(1) The Internal Revenue Code (IRC) section 6656 provides for a Failure To Deposit (FTD) Penalty if a taxpayer does not deposit tax in the correct amount, within the prescribed time period, and/or with an authorized depository. See Exhibit (20)400-1, for a list of related Employment and Excise Tax program forms.

(2) The penalty applies to tax deposits for the following forms:

(a) 720, Quarterly Federal Excise Tax Return,

(b) 940, Employer's Annual Federal Unemployment (FUTA) Tax Return,

(c) 941, Employer's Quarterly Federal Tax Return.

(d) 943, Employer's Annual Tax Return of Agricultural Employees,

(e) 945, Annual Return of Withheld Federal Income Tax,

(f) 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons, and

(g) CT-1, Employer's Annual Railroad Retirement and Unemployment Repayment Tax Return.

(3) The obligation to meet the requirements is ongoing and requires that the taxpayer continues to attempt to meet the requirements. Compliance is achieved when a taxpayer makes a diligent effort to meet the requirements of the law. The law states that the taxpayer must take the necessary action to meet these requirements. Sometimes, due to unforeseen events, the taxpayer is unable to meet the deposit requirements, even through ordinary business care and prudence is exercised.

(4) The Service does not apply the penalty when the failure to timely and properly deposit is due to reasonable cause and not willful neglect. See IRM (20)300 for general reasonable cause criteria and IRM (20)4(50)6 for specific reasonable cause criteria related to the FTD Penalty.

(20)412 (3-21-95) Reporting Criteria

(1) Generally, business taxpayers are required to complete the Record of Federal Tax Liability (ROFT) or provide a periodic breakdown of their tax liabilities and attach the information to the related return.

(2) The ROFT shows the date that the liability is incurred. For employment tax forms this will be the date that the employer issues paychecks to the employees.

(3) Deposit (TC 650) and payment (TC 610/670) information is compared to the liability information to determine if the FTD Penalty applies. All transaction codes (TCs) are defined in OFFICIAL USE ONLY Document 6209, ADP and IDRS Information.

(20)413 (3-21-95) Notice Information

(1) When a return is processed, various codes are written on the return by Code and Edit function or they are systemically generated by the computer program from the input of the tax data shown on the return. These codes (see IRM (20)4(20)2) determine whether the FTD Penalty issue will be:

(a) Manually reviewed, computed, and proposed,

- (b) systemically computed and proposed,
- (c) systemically assessed.

(2) Some of the notices related to the FTD program are:

(a) Internal notices which require a mandatory review of an account:

1 CP 194 -- Issued for manual review because Master File does not have enough information to determine if an FTD Penalty applies.

2 CP 294 -- Issued to determine if an additional 5 percent penalty (fourth tier) applies on a module where the tax liability remains unpaid and the FTD Penalty is restricted by TC 180 (Deposit Penalty).

(b) Notices issued directly to taxpayers which require a response:

1 CP 207 -- Issued to notify taxpayer of proposed FTD Penalty due to missing, incomplete or illegible tax liability information (i.e., ROFT).

2 CP 161 -- First notice issued to inform taxpayer of tax, penalty or interest due.

3 Other adjustment notices (e.g., math error, balance due or overpayment) issued to inform the taxpayer of a penalty assessment.

(c) Information notices issued to taxpayers which do not require a response:

1 CP 136 Form 941 -- Annual notification of deposit requirements for subsequent year.

2 CP 137 Form 943 -- Annual notification of deposit requirements for subsequent year.

3 CP 137A Form CT-1 -- Annual notification of deposit requirements for subsequent year.

4 CP 108 -- Notification that FTD coupon information is incomplete.

5 Notice 931 -- Form 941 Deposit requirements.

6 Notice 982 -- Form 943 Deposit requirements.

7 Notice 983 -- Form CT-1 Deposit requirements.

(20)414 (3-21-95) Federal Tax Deposit System

(20)414.1 (3-21-95) Authorized Depository

(1) Generally, taxpayers who file Forms 941, 943, 940, 945, 720, 1042, and CT-1 must deposit taxes with an authorized depository when the tax liability reaches certain dollar amounts. However, Form 720 filers are liable for deposits of only certain taxable excise taxes.

(2) An authorized depository is the Federal Reserve Bank (FRB) serving the taxpayer's geographic area. It may also be an approved commercial bank or other financial institution in the area. Taxpayers can contact their area FRB to get a listing of local authorized financial institutions. If the taxpayer cannot locate a FRB, refer the taxpayer to a number listed below.

(a) Taxpayer Service Toll-Free Number 1-800-829-1040.

(b) Telecommunications Device for the Deaf (TDD) 1-800-829-4059.

(3) Payments made directly to the IRS or to an unauthorized institution can result in a FTD Penalty. See IRM (20)4(40)2 for additional information.

(4) For information on service center pipeline processing of Federal Tax Deposit (FTD) payments, see IRM 35(17)0, Federal Tax Deposit System.

(20)414.2 (3-21-95) Making Deposits

(20)414.21 (3-21-95) Three Deposit Methods

(20)414.211 (3-21-95) Form 8109 Federal Tax Deposit Coupon

(1) Most taxpayers use this deposit method. If a taxpayer does not have a Form 8109, a blank over-the-counter coupon (Form 8109B) may be obtained from a district office or service center.

(a) When a Form 8109B is requested, the taxpayer's name and Taxpayer Identification Number (TIN) must be manually entered on the form by the dispensing IRS office.

(b) Beginning in January 1994, Form 8109 has a box for Form 945, Annual Return of Withheld Federal Income Tax.

(20)414.212 (3-21-95) Magnetic Tape (Mag Media)

(1) Some reporting agents may use this method to submit FTD payment information. Agents who wish to submit information on magnetic tape must file a "Letter of Application" with one of the Directors of the Internal Revenue Service Centers where the deposits will be processed.

(a) Approval is given to those agents who have a minimum of 200 clients and who satisfy all the requirements for the FTD Program. Although deposit information is provided on tape, the actual payment is forwarded to a depository with a completed Form 2284, Advice of Credit (AOC).

1 Part 1 is retained by the Federal Reserve Bank,

2 Part 2 is forward with the actual payment, and

3 Part 3 is retained by the depository.

(b) Magnetic Media deposits are identified by:

1 An "8" as the third digit in the microfilm serial number (MSN) identifies a magnetic tape deposit.

2 The last four digits of the MSN are the reporting agent's (a commercial tax data processing business) assigned code (see Exhibit (02)400-2).

(c) The service center that processes the reporting agent's mag tapes can provide microfiche copies of the FTD record.

(20)414.213 (3-21-95) Electronic Funds Transmission (EFT)

(1) For periods after December 31, 1994:

(a) The temporary regulations require that deposits be made by EFT based on the taxpayer's total deposits of taxes imposed by:

1 Chapter 21, Federal Insurance Contribution Act,

2 Chapter 22, Railroad Retirement Tax Act, and

3 Chapter 24, Collection of Income Tax at Source on Wages.

(b) The taxpayer must begin depositing by EFT on the applicable effective date if a taxpayer's total deposits of taxes, during the determination period, exceed a prescribed dollar threshold.

(c) See Exhibit (20)400 -- 3 for threshold amounts, determinations periods and applicable effective dates.

(2) Some taxpayers will be required by regulations to make FTD's using electronic funds transmission. Other taxpayers may choose to participate voluntarily in, for example, TAXLINK. A taxpayer that is required by regulations to use EFT cannot revert to the paper coupon system to make an FTD. If the taxpayer is unable to make the FTD using an Automated Clearing House (ACH) credit or debit payment option, they may request permission to use FEDWIRE. Note FEDWIRE discussion below.

(a) TAXLINK. This is an electronic remittance processing system that the Service uses to accept electronically transmitted federal tax deposits (FTD's). TAXLINK will accept payments for employment tax Forms 720, 940, 941, 943, 945, 1042, and CT-1.

1 Research on TAXLINK payment system may be obtained from the Atlanta Service Center (ATSC) TAXLINK Accounting Technical Unit. A TAXLINK Request for Research Form should be completed and sent to the TAXLINK Accounting Technical Unit.

a The top three sections of the form should be completed with as much information as possible.

b The TAXLINK Accounting Technical Unit will complete the research, return a copy of the form with the requested information to the initiator, and maintain a copy of the request.

2 The completed form may be sent via FAX to the TAXLINK Accounting

Technical Unit at 404-455-2512. Telephone calls for research requests may be placed through 404-455-2389.

3 Authorized Financial Agents (FA's) receive taxpayer information and transfer taxpayer funds to Treasury's general account.

4 These deposits are identified by an EFT number which is the unique identifier in the TAXLINK system for each EFT transaction. This 8 digit number is similar to the one used in our paper-based FTD system.

5 The first two digits represent the service center where the payment was made. The third digit represents a TAXLINK payment and will always be the number "6." The fourth through tenth digits represent the Financial Agent's numbers as follows:

- a FRB, Minneapolis (FA #1)/6000000-61999999,
- b First National Maryland (FA #2&3)/62000000 -- 63999999,
- c Mercantile, St. Louis (FA #4&5)/64000000-65999999, and
- d FRB, Minneapolis/69700000-69999999 (FEDWIRE only).

(b) FEDWIRE This funds-transfer system is owned and operated by the Federal Reserve Banks and is used primarily for the transmission and settlement of payment orders. Deposits submitted by FEDWIRE go directly into the Treasury's General Account.

1 FEDWIRE does not include a system for making ACH transfers.

a Taxpayers who are required to make FTD's by EFT, may use FEDWIRE as a routine payment option, and must use it as a backup payment method.

b FEDWIRE is not a routine payment option for taxpayers who voluntarily participate in TAXLINK, but may be used as a backup payment method.

2 The FEDWIRE TAXLINK Application is a system which will be operated by the Federal Reserve Bank of Minneapolis and is available only to authorized, enrolled taxpayers.

3 Payments received from taxpayers who are not authorized and enrolled will be returned.

4 All taxpayers required under Temporary Regulations 8553 to pay taxes by electronic fund transfers will be automatically enrolled to use FEDWIRE as a backup payment method.

(2) During the latter part of FY 1995 a new electronic system, Electronic Federal Tax Payment System (EFTPS), should be available to receive electronic FTD's. Also, in the future, financial institutions may be able to electronically deposit any type of federal tax liability.

(20)414.22 (3-21-95) Use of Federal Tax Deposit (FTD) Coupons

- (1) Taxpayers present their coupons and acceptable payment to an authorized depository.
- (2) Authorized depositories date stamp FTDs on the day received, if received before the depository's daily cutoff time. If the deposit is received after the cutoff time, the FTD is date stamped as received on the following business day.
- (3) Deposits made with the FRB or branch serving the taxpayer's geographic area, must be cash, postal money order, Treasury Bill, or a certified or Cashier's check that the FRB considers an immediate credit item. The FRB dates the FTD on the day of receipt.
- (4) Deposits made with other than immediate credit items referenced above are dated by the receiving FRB when the funds are collected.
- (5) When taxpayers deposit by mail, the Internal Revenue Code (IRC section 7502(e)) provides conditions for timely mailed/timely paid FTDs. Consider the deposit as timely, regardless of the "received date-stamp", if a taxpayer meets the following conditions:
 - (a) The taxpayer proves that the deposit was mailed in the U.S. at least two days before the due date,
 - (b) the depository or FRB which received the FTD is in the taxpayer's geographic location, and
 - (c) the deposit is under \$20,000, for taxpayers required to deposit more than once a month.
- (6) The timely mailed/timely paid provision does not apply when:
 - (a) the taxpayer mails the deposit to an incorrect FRB,
 - (b) the payment is not an immediate credit item, or
 - (c) the taxpayer is a foreign employer.
- (7) To meet timeliness requirements, foreign employers must:
 - (a) Make arrangements with a U.S. depository to accept the taxpayer's wire transfer of deposit and prepare an FTD coupon for the customer, or
 - (b) mail the FTD coupon and a payment instrument in U.S. dollars, to a FRB to arrive on or before the deposit due date.
- (8) See IRM (20)422 for information to resolve deposit date problems.

(20)414.23 (3-21-95) Automatic Generation of FTD Coupons (AUTOGEN)

- (1) The FTD Coupon Book contains, on the sixth and seventh coupon, Form ID Number "91 and 92". These special ID numbers systemically activate a reorder request of a FTD Coupon Book.
- (2) When the "91" and/or "92" has been input, Transaction Code 016 posts to the taxpayer's

account, and the computer does an analysis to determine whether or not to generate a FTD reorder request. The decision is based on the FTD posting activity on the most recent tax accounts.

(3) An "FTD ADDRESS CHANGE FORM" is included in the FTD Coupon Book. Taxpayers complete the form and submit it to the service center to request that FTD Coupon Books sent to a different mailing address.

(4) The FTD Coupon Book no longer contains a FTD "REMINDER" Form. In its place is an additional FTD Coupon which increased the number of FTD Coupons from 23 to 24 per book.

(5) The FTD Database has been expanded to include the "Date the FTD Coupon Book was generated".

(20)414.3 (3-21-95) Microfilm Serial Numbers

Each tax deposit is assigned a microfilm serial number (MSN) that can be used for research purposes.

(20)414.4 (3-21-95) Advice of Credit (AOC)/ADEPT

(20)414.41 (3-21-95) Advice of Credit (AOC)

(1) The microfilm serial number may be used to identify and obtain copies of advice of credit (AOC) and FTD coupons, Form 8109. The AOC document shows the total amount of deposits from a bank for that date. A paper document can be identified as follows:

(a) The first two digits represent the service center where the Federal Tax Deposit was processed,

(b) the third and fourth digits represent the OCR (Optional Character Recognition) processing cycle from 01 through 53,

(c) the fifth through the tenth digits are assigned in sequential order for that cycle.

(2) AOC information may be used to resolve deposit date discrepancies.

(3) To request AOC information, input Command Code (CC) ESTABM4.

(4) When requesting the AOC, include the following statement in the narrative, "ALL FTD and AOC for the date the deposit was received".

(20)414.42 (3-21-95) Automated Deposit of Electronic Payments for Taxes (ADEPT)

(1) ADEPT was a prototype system which electronically processed deposits through the FRB of Boston to the Andover Service Center. This prototype (test) was discontinued December 31, 1992. Any payments made to ADEPT after December 31, 1992, were rolled over into the TAXLINK system. See IRM (20)414.213:(2)(a) for a discussion of TAXLINK.

(a) ADEPT deposits (for prior years) can be identified by reviewing the microfilm serial number.

1 The first two digits represent the service center (08-Andover Service Center) where the deposit was processed.

2 The third and fourth digits (71) represent a payment made through the ADEPT System.

(b) Because no paper document exists, do not request a photocopy of the FTD coupon. Follow FTD payment tracer procedures (IRM 35(70), Payment Tracer) for tracing deposits made to another service center (Andover Service Center).

(20)415 (3-21-95) Who Asserts

- (1) Service Center Tax Examiners assert the penalty on returns received in the service centers.
- (2) Taxpayer Service Representatives (TSRs), Collection Tax Examiners, and Revenue Officers may recommend assertion or non-assertion of the penalty on secured returns. When there is indication that a taxpayer filed in a previous quarter but no current return is on file, the Service contacts the taxpayer and requests a return. A return obtained in this manner is a "secured" return.
- (3) Examination Tax Auditors and Revenue Agents, Collection, EP/EO, and Employment Tax Examiners make penalty assertion determinations on examined and/or secured returns.

(20)416 (3-21-95) Restrictions on Assertion

(20)416.1 (3-21-95) General

For information regarding restrictions on assertion see 416.1 of LEM XX-400.

(20)416.2 (3-21-95) Federal Agencies

According to Policy Statement P-2-4, the Service does not assert penalties against Federal Agencies.

(20)420 (3-21-95) Determination of the Penalty Amount

(20)421 (3-21-95) Failure to Deposit Penalty Rate

- (1) The FTD penalty rate changed several times in recent years. Therefore, the percentage rate charged depends on the following:
 - (a) The tax period involved,
 - (b) the number of days a deposit is late,
 - (c) when the Service assessed the tax, and
 - (d) whether it involves a direct payment.
- (2) For deposits required after December 31, 1989, there is a four tier penalty system (see Exhibit (20)400-4). The penalty rate assessed depends on the number of days a deposit is late, as shown

below:

- (a) 2 percent for deposits 1-5 days late,
- (b) 5 percent for deposits 6-15 days late,
- (c) 10 percent for all direct payments and those deposits made more than 15 days late, but paid on or before the 10th day following notice and demand.
- (d) 15 percent (actually, a 5 percent addition to the 10 percent for late payment in (c) above) for all undeposited taxes still unpaid after the 10th day following the first balance due notice or the day on which notice and demand for immediate payment is given.
- (e) Due to late enactment of the four tier penalty system, special penalty rates were in effect for the periods ending March 31, 1990 (9003) through March 31, 1991 (9103). See 421:(2)(e) of LEM XX-400.

(3) For returns assessed after October 25, 1986 (including cycle 8644) and before January 1, 1990, the penalty rate is 10 percent.

(4) For returns assessed prior to October 26, 1986 (prior to Cycle 8644) the penalty rate is 5 percent.

(5) See 421:(5) of LEM XX-400.

(20)422 (3-21-95) Deposit Due Dates

(1) The deposit due dates are determined by the deposit requirements, which vary according to the tax form involved and the amount of tax.

(2) Before determining the deposit due dates see Exhibits (20)400-5 and 422 of LEM XX-400.

(3) If the deposit due date is a Federal or State legal holiday, the due date is extended to the next day that is not a Saturday, Sunday, Federal or State legal holiday.

(20)423 (3-21-95) Application of Payments

(1) Payments are identified on Master File as follows:

(a) TC 610 -- Payment received with a return--depending on the amount of the liability, this payment may be liable for FTD Avoidance Penalty of 10 percent.

(b) TC 670 -- Subsequent payment -- See IRM (20)4(40)2 and 423 at LEM XX-400- for possible FTD avoidance penalty.

(c) TC 650 -- Federal Tax Deposit,

(d) TC 700 -- Credit Applied,

(e) TC 760 -- Substantiated Credit Payment Allowance,

(f) TC 710 -- Overpayment Credit Applied from Prior Tax Period,

(g) TC 716 -- Generated Overpayment Applied from Prior Tax Period,

(2) If the TC 716 Credit Availability Date is not present (e.g., on CP 194, BMFOL, etc.), TC 716 will apply the credit against the first liability for the period.

(3) On a credit transfer, the TC 710 will apply against the first liability for the period.

(4) For periods after March 31, 1991, apply deposits in date-made order against deposit liabilities in due-date order. This is referred to as the FIFO (first in, first out) method of assigning deposits to liabilities.

(a) Accordingly, apply deposits first to any remaining under-deposits within the same return period. Satisfy the oldest under-deposit first.

(b) Similarly, apply other taxpayer credits, such as an overpayment from a prior quarter to the first liability period in the next tax period. See 434.22:(1) of LEM XX-400.

(5) Exception: For tax periods beginning April 1, 1991 through December 31, 1991, (9106, 9109, 9112). Where a penalty was computed using the FIFO method and the taxpayer submitted documentation showing the intent (e.g. a missing deposit or correcting a liability period) that a specific deposit was for a specific liability period, recompute the penalty considering the taxpayer's intent. Taxpayer intent should be considered only for this period of time.

(6) For periods ending March 31, 1991, and prior, apply timely deposits to the liability for that deposit period. Apply any remaining credit to any earlier under-deposit within the same return period. Then, carry any remaining credit forward to apply to the next liability within the same return period. See 434.22:(2) of LEM XX-400.

(7) The amount required to be deposited is determined by the liability amount and not the undeposited amount.

(20)430 (3-21-95) Form 941 Series

(20)431 (3-21-95) General

(1) The Form 941, Employers Quarterly Federal Tax Return, is a quarterly tax return used to report employment taxes. If an employer accumulates less than a \$500 tax liability during a return period, no deposits are required. This amount may be paid with a timely filed tax return. Amounts of 500 or more must be deposited.

(2) Beginning January 1, 1993, taxpayers now follow a deposit schedule which will generally remain consistent throughout the year.

(3) Prior to January 1, 1993, the deposit due dates and amounts could fluctuate because they were both based on an accumulated dollar amount.

(4) Under either the old or new system, an employer will not be required to make a deposit more often than a payroll is made. However, 100 percent of the amount required to be deposited is due

on the deposit due date unless the employer meets one of the safe harbor exceptions.

(5) The regulations provide that if taxes are required to be deposited on any day that is not a banking day, the taxes will be treated as timely deposited if deposited on the first banking day thereafter.

(6) See Exhibit (20)400-6, Employment FTD Fast Facts for an overview of the general rules.

(20)432 (3-21-95) Lookback Periods

(1) One of the features of the new employment tax deposit system, effective January 1, 1993, for IRC section 6302 provides employers with up-front information in determining their deposit obligations and status.

(2) For tax periods beginning January 1, 1993 and later, an employer is either a "monthly depositor" or a "semi-weekly depositor" (See IRM (20)433) for a calendar year based on an annual determination of the aggregate amount of employment taxes reported during the employer's "lookback period."

(a) Forms 941 -- For quarterly return filers, the "lookback period" for each calendar year is the twelve month period ended the preceding June 30. For example, the lookback period for calendar year 1993 is the period July 1, 1991 to June 30, 1992 (which encompasses the quarters ended 9109, 9112, 9203, and 9206).

(b) Forms 943, CT-1 -- For annual return filers, the "lookback period" is defined as the second calendar year preceding the current calendar year. For example, the lookback period for calendar year 1994 is calendar year 1992.

(c) Form 945 -- The Form 945 is a new annual return that has been developed to report nonpayroll withholding separately from payroll withholding.

1 During calendar years 1994 and 1995 of annual nonpayroll return filers, the "lookback period" and deposit status is the same as the taxpayer's status on January 1, 1994 for taxes reported on Form 941. The taxpayer will generally retain that depositor status for all of calendar years 1994 and 1995.

2 After 1995, the "lookback period" for Form 945 filers will be the second calendar year preceding the current calendar year. For example, the lookback period for calendar year 1996, Form 945, (MFT 16) is calendar year 1994 (MFT 16).

(3) A new employer, who may be either a quarterly or annual filer, is treated as having employment tax liabilities of zero for any calendar quarter or year in which the employer did not exist.

(4) An annual notification is sent to the taxpayers/employers every November in the form of information notices (CP 136/137/137A) which advise taxpayers of their expected deposit requirements.

(5) The fact that the CP 136 notices were not issued to the service bureaus/reporting agents for the 1993 and 1994 filing years is not grounds for granting a FTD penalty abatement. The notice

was sent to the taxpayer and clearly states that it is the taxpayer's responsibility to verify the deposit requirement given on the notice.

(20)433 (3-21-95) January 1, 1993 and Later

(20)433.1 (3-21-95) Monthly Depositors

(1) If the employer reported Employment Taxes of \$50,000 or less during the one year lookback period, the employer is a monthly depositor and generally must deposit employment taxes on a monthly basis during the calendar year.

(a) Under the monthly rule, each month's taxes are required to be deposited on or before the 15th day of the following month.

(b) If the 15th of the following month falls on a Saturday, Sunday, Federal or State legal holiday, the employer will have until the next banking day to make a timely deposit.

(c) Monthly depositors must enter the Monthly Summary of Federal Tax Liability on the face of the tax return.

(20)433.2 (3-21-95) Semi-weekly Depositors

(1) If the employer reported Employment Taxes of more than \$50,000 during the one year lookback period, the employer must deposit using the semi-weekly rules. Under this rule, the day a deposit is due is determined by the day of their payroll.

(a) The deposit for a pay date of Wednesday, Thursday or Friday must be made on or before the following Wednesday.

(b) The deposit for a pay date of Saturday, Sunday, Monday or Tuesday must be made on or before the following Friday.

(c) The semi-weekly rule does not require an employer to make deposits twice a week (semi-weekly). Rather, the deposits are due based on a schedule which divides the calendar week into two (semi-weekly) sections.

(d) The semi-weekly depositor must submit a Schedule B, Employer's Record of Federal Tax Liability.

(e) Refer to exhibit IRM (20)400-5. FTD Due Date Chart.

(2) In the case of a return period that ends during a semi-weekly deposit period, the employer may be required to make two deposits, For example:

(a) The second quarter return period ends on Thursday and the third quarter return period begins on Friday.

(b) If the employer had a payroll on both Thursday and another on Friday, this employer must make two deposits.

- 1 One for the deposit from the Thursday payroll (second quarter), and
- 2 another for the Friday payroll (third quarter).

(20)433.3 (3-21-95) Rule for Semi-Weekly Non-Banking Days

(1) Treas. Reg. 31.6302-1(c)(2)3(i) provide that all semi-weekly depositors would have at least three banking days, following the close of the semi-weekly period, to deposit employment taxes accumulated during the semi-weekly period.

(a) For semi-weekly depositors, if one or more of the intervening days between the end of the semi-weekly period and the due date is a Federal or State legal holiday, the deposit due date will be extended by the same number of days.

(b) If the deposit due date for semi-weekly depositors is a Federal or State legal holiday, the due date will be extended to the next day that is not a Saturday, Sunday, Federal or State legal holiday.

(20)433.4 (3-21-95) The \$100,000/One Day Rule

(1) The regulations incorporate the statutory requirement that an accumulation of Employment Taxes of \$100,000 or more during a deposit period (either monthly or semi-weekly) must be deposited by the next banking day.

(a) A monthly depositor who must make a \$00,000 or more (daily) deposit immediately becomes a semi-weekly depositor for the remainder of the current year and for the following calendar year.

(b) Semi-weekly depositors who incur a \$100,000 or more (daily) deposit requirement return to a semi-weekly deposit schedule after the daily deposit is made.

(2) When the \$100,000 Rule applies, see IRM (20)4(40)1.

(20)433.5 (3-21-95) 1993 Transition Period Conversion Rules

(1) Employers were given a one-year transition period to complete their conversion to the 1993 rules. The transition period expired on December 31, 1993.

(2) During this period, a late or insufficient deposit(s) (according to the 1993 rules) will not create an assessable penalty if the account is compliant under the 1992 rules.

(3) Penalties will be assessed if the account is not compliant with either the 1992 or the 1993 rules.

(4) To compute any penalty using the 1993 deposit rules and due dates, analyze the account using the guidelines in the following example:

(a) A semi-weekly employer has pay days on Thursday (deposits are due the following Wednesday). The employer makes one of the deposits on the following Thursday.

(b) For purposes of this example, even after considering legal holidays and other exceptions, this deposit is late and creates the possibility of a penalty on this account.

(c) However, because of the one year transition period, before assessing the 1993 penalty, check to see if the account is compliant under the 1992 rules.

(d) Place the liabilities and deposits into the 8th monthly period schedule.

1 If the analysis of the deposits shows that all deposits were made correctly under the eighth-monthly period schedule, no further action is required.

2 If the analysis results in a penalty, use the procedures below to determine the appropriate penalty amount.

(5) Following the original regulations, the penalty assessed was computed strictly using the 1993 deposit schedule. However, late in 1994, Chief Counsel reviewed the regulations and issued a Technical Advice Letter to clarify the intent of the regulations.

(a) This clarification results in an administrative procedural change to the way the FTD penalty will be computed for the transition year.

(b) For purposes of this transition rule, the penalty is computed under the 1993 rules BEGINNING with the deposit that was not made timely.

(c) Adjust the FTD penalty only if the penalty computed, using the following procedures, is less than the original assessed penalty:

1 FTDPN "C" to identify where in the 1992 analysis the penalty occurred.

2 Enter FTDPN, using only the liabilities and deposits from the penalty occurrence to determine the 1993 portion of the penalty.

(d) Use the above guidelines to respond to formal or informal claims regarding the method of computing penalties under the 1993 transition rules.

(20)434 (3-21-95) December 31, 1992 and Prior

(20)434.1 (3-21-95) Eighth-Monthly Periods

(1) For deposit purposes, tax periods December 31, 1992 and before, each month of each quarter is divided into eight periods ending on the 3rd, 7th, 11th, 15th, 19th, 22nd, 25th and last day of the month. These are called eighth-monthly periods and are designated by alpha A through X on the return.

(2) If the quarterly tax liability is at least \$500, the taxpayer must list the tax liability in the ROFT section. Compare the information in the ROFT within the deposit information to determine if the taxpayer made timely and adequate deposits. (See IRM (20)441.3 if the ROFT is incomplete.)

(3) Deposit requirements may vary from month to month depending on the amount of taxes withheld each payday. For example, a taxpayer may be a monthly depositor for the first two

months of a quarter, and then become an eighth-monthly depositor in the third month.

(20)434.2 (3-21-95) Deposit Requirements Based on Tax Liability

(20)434.21 (3-21-95) April 1, 1991 and Later

(1) For periods beginning April 1, 1991 and later, the deposit requirements are not based on undeposited tax amounts. Instead, they are determined by the tax liability accumulated during the deposit period (monthly or eighth-monthly). See Exhibit 400-1 of LEM XX-400.

(a) When the tax liability is less than \$500 at the end of a month:

1 If the tax liability at the end of the first or second month is under \$500, there is no deposit required during the month the liability was incurred. The amount is carried over to the next month.

2 If the tax liability at the end of the quarter is under \$500, the tax can be paid with the timely filed Form 941, or deposited by return due date.

(b) When the tax liability is \$500 or more but less than \$3,000 at the end of any month:

1 If the tax liability at the end of a month is \$500 or more, but less than \$3,000, it must be deposited by the 15th day of the following month.

2 EXCEPTION: When an eighth-monthly deposit of \$3,000 or more is required in the first or second month of the quarter and the taxpayer incurs a subsequent liability of less than \$3,000 during the same month, the taxpayer must carry the tax liability under \$3,000 to the next month. If it is the last month of the quarter, the taxes under \$3,000 must be deposited by the return due date.

(c) When the tax liability is \$3,000 or more at the end of any eighth-monthly period, the taxes must be deposited within 3 banking days after the close of that eighth-monthly period.

(d) When the \$100,000 Rule applies, see IRM (20)4(40)1.

(20)434.22 (3-21-95) March 31, 1991 and Prior

(1) For periods ending March 31, 1991 and before, the deposit requirements are based on the amount of the liability (undeposited tax) at the end of the deposit period (monthly or eighth-monthly). See 434.22 of LEM XX-400.

(a) When UNDEPOSITED TAXES are less than \$500 at the end of a month:

1 If at the end of the first or second month the amount is under \$500, no deposit is required for this liability period. The amount is carried over into the next month.

2 If at the end of the quarter the amount is under \$500, the undeposited taxes may be paid with the timely filed Form 941, or deposited by the return due date.

(b) When UNDEPOSITED TAXES are \$500 or more but less than \$3,000 at the end of any month:

1 If at the end of a month the amount is \$500 or more, but less than \$3,000, the taxes must be deposited by the 15th day of the following month.

2 EXCEPTION: When an eighth-monthly deposit of \$3,000 or more is required in the first or second month of the quarter and the taxpayer incurs a subsequent liability of less than \$3,000 during the same month, the taxpayer must carry the tax liability under \$3,000 to the next month. If it is the last month of the quarter, the taxes (under \$3,000) must be deposited by the return due date.

(c) When UNDEPOSITED TAXES are \$3,000 or more at the end of any eighth-monthly period:

1 If at the end of an eighth-monthly period the amount is \$3,000 or more, deposit the taxes within 3 banking days after the close of that eighth-monthly period.

2 For First Time Exception to the eighth-monthly deposit requirements, see IRM (20)435.22.

3 When the \$100,000 Rule applies, see IRM (20)4(40)1.

(20)435 (3-21-95) Special Deposit Rules

(20)435.1 (3-21-95) Safe Harbor March 31, 1993 and Later

(1) Safe Harbor/98 Percent Rule -- For tax periods ending March 31, 1993 and subsequent.

(a) No penalty is assessed if at least 98 percent of the tax liability is timely deposited AND the remaining shortfall (the greater of 2 percent or \$100) is also timely deposited by the shortfall make-up date. For example: If the required deposit is \$1000:

1 a \$980 deposit (98%) will satisfy the safe harbor,

2 so long as the remaining \$20 is timely deposited.

(b) The shortfall make-up date for monthly depositors is the due date for the return period in which the underpayment occurs.

(c) The shortfall make-up date for semi-weekly/one day rule depositors is the first Wednesday or Friday (whichever is earlier),

1 falling on or after the 15th day of the month,

2 following the month in which the deposit was required to be made, or

3 if earlier, the due date for the return period.

(d) For example: for the liability period ending June 28, 1994, the deposit due date falls on July 6, 1994, and the safe harbor shortfall amount would be due August 1, 1994.

(e) Taxpayers do not have to apply Safe Harbor provisions to all deposits in a specific tax period. They may apply the provisions to certain deposits, while paying 100 percent of the others.

(20)435.2 (3-21-95) December 31, 1992 and Prior

(20)435.21 (3-21-95) Safe Harbor

(1) Safe Harbor/95 Percent Rule -- For tax periods ending December 31, 1992 and before. Under the 95 percent rule, a taxpayer required to make deposits under the \$3,000 or \$100,000 Rule can deposit less than the full deposit amount and not be subject to an FTD penalty.

(2) Taxpayers can indicate that they used the Safe Harbor provisions by checking the applicable box on the return or by attaching written correspondence to the return. The Safe Harbor provision may apply whether or not the box is checked if the taxpayer:

(a) Timely deposits at least 95 percent of the liability, and

(b) pays the remaining underpayment (5 percent) according to the following:

1 Deposits the underpayment from the first or second month of the quarter with or before the first deposit due after the 15th day of the following month. If the underpaid amount is \$500 or more and no other deposits are due after the 15th day of the following month, deposits the underpayment by the return due date. If the underpaid amount is less than \$500, it can be paid with a timely filed return.

2 Deposits the underpayment of \$500 or more from the last month of a quarter by the return due date or pays the underpayment of less than \$500 with the timely filed return.

3 For periods ending after March 31, 1991, see 435.21 of LEM XX-400.

(c) Taxpayers do not have to apply the Safe Harbor provisions to all deposits in a specific tax period. They may apply the provisions to certain deposits, while paying 100 percent of the others.

(3) Backup Withholding, Instructions for backup withholding deposits are found in IRM (20)441.1.

(20)435.22 (3-21-95) First Time Exception

(1) First Time Exception -- For tax periods ending December 31, 1992 and before. The first time a taxpayer has a tax liability of \$3,000 or more at the end of an eighth-monthly period, the taxpayer may deposit the taxes by the 15th day of the following month, instead of depositing them by the third banking day. See 435.22 of LEM XX-400.

(2) The taxpayer may claim the First Time Exception by marking the return ("If you are a First Time 3-banking-day depositor, check here"). The taxpayer may also claim the First Time Exception in correspondence.

(3) The first time exception applies only if the taxpayer meets the following conditions:

(a) The current undeposited taxes are under \$10,000. (The First Time Exception does not apply to amounts of \$10,000 or more).

(b) The taxpayer was not required to deposit \$3,000 or more in any earlier eighth-monthly period in the quarter.

(c) The taxpayer was not required to deposit \$3,000 or more in any eighth-monthly period during the four prior quarters. Research the 4 prior quarters only if the taxpayer meets the conditions in 1 and 2 above.

(4) When the First Time Exception applies:

(a) Exclude the first eighth-monthly liability (and its payment), if made by the 15th day of the following month).

(b) Compute FTD penalty on any other late or direct payments which may exist.

(5) If the taxpayer does not qualify for the First Time Exception, compute the penalty without regard to this provision.

(6) Beginning with period ending December 31, 1988, on IDRS the literal "3-DAY" appears in the account record.

(a) If Master File identifies a 3-banking-day requirement any-time during a quarter, a "1" displays for that module (tax period).

(b) When verifying the 4 prior quarters, if there is a "1" in the "3 DAY" field, where taxpayer was previously required to make a deposit of \$3,000 or more.

(c) Therefore, the taxpayer does not qualify for the First Time Exception in the current quarter.

(20)440 (3-21-95) Computation of the FTD Penalty

(20)441 (3-21-95) Form 941 Series

(20)441.1 (3-21-95) January 1, 1993 and Later

(1) For tax periods beginning January 1, 1993 and later, refer to Form 941 deposit requirements. See Exhibit (20)400-7.

(a) To determine if a deposit is timely, see Exhibit (20)400-5.

(b) Compare the taxpayer's liability, using the information from the ROFT, with the deposits made. If the ROFT information is unavailable or does not match the net tax, use the averaging method.

(c) If there is a discrepancy of the ROFT that is due to a line item adjustment (for 9312 and prior -- lines 4, 9, and 12, and for 9403 and subsequent -- lines 4 and 9), adjust

the last liability regardless of the dollar amount.

(d) When the \$100,000 Rule applies, see IRM (20)4(40)1.

(20)441.2 (3-21-95) December 31, 1992 and Prior

(1) For tax periods ending December 31, 1992 and prior, refer to Form 941 deposit requirements IRM (20)434. See Exhibit (20)400-8.

(a) Refer to 416.1, 422 and Exhibit 400-5 of LEM XX-400 to determine timely deposits.

(b) Compare the taxpayer's ROFT liability with the deposits made. If ROFT figures are unavailable, use the averaging method.

1 If there is an overstatement of the ROFT that is due to a line item adjustment (Lines 4, 9 and 12 on Form 941), adjust the last liability regardless of the dollar amount. Then compute the penalty.

2 If the taxpayer reports only monthly totals in the ROFT, and

a any monthly total is \$3,000 or more, consider the liability not furnished and average the entire tax liability.

b any monthly total is less than \$3,000, consider the monthly liabilities attributable to the last period of each month.

(c) When the \$100,000 Rule applies, see IRM (20)4(40)1.

(20)441.3 (3-21-95) Averaged Penalty

(20)441.31 (3-21-95) General

(1) Average the tax settlement amount when the Record of (Federal Tax (ROFT) is incomplete or blank. Apply deposit to the resulting averaged liabilities.

(2) The tax settlement amount equals the tax liability amount reduced by the amount of any refundable credit allowance (TC 150 less TC 766)

(20)441.32 (3-21-95) January 1, 1993 and Later

(1) For tax periods beginning January 1, 1993 and later the method of averaging will depend on the type of depositor and the information available.

(a) To compute an averaged liability for a monthly depositor who has not provided any liability breakdown, divide the net tax liability by 3 and assign that amount to each of the monthly totals.

(b) To compute an averaged liability for a semi-weekly depositor who has not provided any liability breakdown, divide the net tax liability by 12 and assign that amount to the first 12 Fridays of the quarter.

(c) To compute an averaged liability for a semi-weekly depositor who filled out the monthly ROFT (line 20), divide each month's tax liability by 4. Assign the resulting amount for each month to the first four Fridays of that month.

(20)441.33 (3-21-95) December 31, 1992 and Prior

(1) For tax periods ending December 31, 1992 and before, divide the tax settlement amount by 12.

(2) Consider the results as the tax liability amounts for the following eighth monthly periods B, D, F, H, J, L, N, P, R, T, V, and X.

(3) Apply deposits to the resulting averaged liabilities.

(20)441.34 (3-21-95) September 30, 1990 and Later

(1) For periods ending September 30, 1990 and later:

(a) If the averaged liability equals \$100,000 or more,

(b) assign the liability to the first day of the eighth-monthly periods B, D, F, H, J, L, N, P, R, T, V, and X.

(20)441.4 (3-21-95) Backup Withholding (BUWH) (December 31, 1993 and Prior)

(1) Taxpayers are required to backup withhold (BUWH) on non-payroll items. Tax period ending December 31, 1993 (9312), is the last quarter in which backup withholding is reported on Form 941/941E. All non-payroll items have been removed from Form 941, effective January 1, 1994.

(2) For tax periods ending December 31, 1993 and before, taxpayers reported BUWH amounts on Line 11, Form 941, or Line 9, Form 941E.

(3) Taxpayers who elected to report and deposit BUWH separately from other taxes, used Form 41, Schedule A to separately list the BUWH liabilities.

(4) If taxpayers choose the election, the separate BUWH deposits are identified by Tax Class 5.

(5) If it was the employer's practice to treat the two taxes separately (e.g., two separate deposits for the different types of taxes) the employer may follow separate deposit schedules. Thus, an employer with combined total liability of over \$50,000 could be required to deposit under the monthly rules, semi-weekly rules or a combination of both.

(6) If it was not the employer's practice to separate the two taxes for deposit and reporting purposes, the employer would have only one lookback period consisting of the combined employment and backup withholding liability.

(7) The regulations for REPORTING backup withholding (BUWH) have not changed for 1993. The regulations for DEPOSITING backup withholding (BUWH) did change. See Nonpayroll Taxes.

(8) Form 941, Schedule A (Record of Federal Backup Withholding Tax Liability) is obsolete for

tax periods after December 31, 1993.

(20)450 (3-21-95) Nonpayroll Taxes

(20)451 (3-21-95) Form 945 -- Deposit Requirements

(1) Effective with the first quarter of 1994:

(a) All non-payroll items have been removed from Form 941.

(b) New Form 945, Annual Return of Withheld Federal Income Tax, is used to report nonpayroll items. Nonpayroll items include pensions, annuities, and Individual Retirement Accounts (IRAs), military retirement pay, gambling winnings, deferred income, and backup withholding (BUWH).

(c) Beginning January 1, 1994, effective for payroll and nonpayroll items after December 31, 1993, the payroll items on Form 941 and the nonpayroll items on Form 945 must be deposited separately.

(d) As a general rule, all income tax withholding reported on Forms 1099 (e.g., Form 1099-R or Form 1099-MISC) or Form W-2G must be reported on Form 945.

(e) Form 941E (Quarterly Return of Withheld Federal Income Tax and Medicare Tax) is now obsolete. Form 941E filers will report Employment Taxes and withholding from wages on Form 941, and nonpayroll items on Form 945.

(2) The deposit requirements for Form 945 will parallel the Form 941 deposit requirements that became effective January 1, 1993. See IRM (20)433.

(3) The \$100,000 Rule for accumulated liabilities also applies to the Form 945. See IRM (20)4(40)1.

(4) For Calendar Years 1994 and 1995, the Form 945 deposit requirements (monthly or semi-weekly) are determined by the Form 941 depositor status, that applied for calendar year 1994.

(5) For Calendar Year 1996, the Form 945 deposit requirement will be determined by the Form 945 lookback period. The lookback period is the second year preceding the current calendar year. For example, for calendar year 1996, the Form 945 lookback year is 1994.

(20)452 (3-21-95) BUWH/FTD Penalty Computation

(20)452.1 (3-21-95) 9403 and Later

(1) The penalty computation for Form 945 will parallel the FTD penalty computation for Form 941.

(2) The Form 945-A, Record of Federal Tax Liability, provides the liability breakdown for the Form 945.

(20)452.2 (3-21-95) 9312 and Prior

(1) For tax periods ending December 31, 1993 and prior, backup withholding was reported on Form 941.

(2) Before computing an FTD penalty, determine whether the taxpayer intended to:

(a) Combine BUWH with social security and withheld income taxes (ROFT with no Schedule A), or

(b) treat it as a separate tax (ROFT and a Schedule A).

(c) If the taxpayer's intent is not clear, contact the taxpayer for clarification.

(3) If the return has a Schedule A, add the Schedule A total with the ROFT that is reporting income tax withholding and Social Security taxes (e.g., the monthly total from the face of the Form 941, or the Total from Schedule B, Employer's Record of Federal Tax Liability).

(a) If the combined total of the Form 941, Schedule A, and the ROFTs are within \$500 of the net taxes reported on Form 941, this is a good ROFT. Compute any applicable penalty.

(b) If the combined total of the ROFTs are not within \$500 of Form 941 net taxes, take the following actions:

1 If the taxpayer combined deposits:

a average the tax settlement amount (TC 150 less TC 766) and compute the penalty, or

b if the Schedule A includes credit (negative) amounts and the taxpayer did not make separate deposits, average the entire tax liability.

2 If the taxpayer made separate deposits, make separate computations as follows:

a Make one computation using the figures from the ROFT on Form 941 or Schedule B, and

b one computation using the figures on Schedule A.

c Combine penalty amounts. Input one TC 180 for the total amount. Attach both computation sheets to the return as part of the case file. See 416.1 of LEM XX-400.

(20)453 (3-21-95) Form 945 -- Administrative Error Adjustments

(1) A taxpayer will report an adjustment to Form 945 on Form 941c, Supporting Statement To Correct Information, or an equivalent statement and file it with Form 945 to provide the necessary background information on the adjustment(s).

(2) Adjustments cannot be made on Form 945 to correct income tax withholding or backup

withholding reported in a prior calendar year unless it is to correct an administrative error.

(a) An adjustment error is any error that does not change the amount of income tax that was certainly withheld or deducted from a payee.

(b) For example, if the total income tax actually withheld was incorrectly reported because of a mathematical or transposition error, this is an administrative error.

(c) Taxpayers must report an adjustment to correct an administrative error on Form 945 in the year in which the error was discovered.

(3) A taxpayer's adjustment(s) to correct a prior period administrative error must either increase or decrease the total taxes on Form 945, Line 1, by the amount of the net adjustment (including adjustments to income tax withholding and backup withholding). The taxpayer should identify the adjustment in Part V of Form 941c as correcting an administrative error and provide a description of the error(s).

(20)460 (3-21-95) Form 943 Series

(20)461 (3-21-95) General

(20)461.1 (3-21-95) Deposit Requirements

(1) Form 943, Employer's Annual Tax Return for Agricultural Employees, is an annual return used to report social security and income taxes withheld for agricultural employees.

(2) Although an annual return, Form 943 deposit requirements are generally the same as the Form 941 deposit requirements.

(20)461.2 (3-21-95) January 1, 1993 and Later

(1) If the employer accumulates less than \$500 tax liability during a year, no deposits are required.

(2) The deposit requirements depend on the tax liability incurred.

(3) To show the correct liability for the deposit periods beginning after January 1, 1993, the taxpayer must list the tax liability as follows:

(a) If the employer is classified as a monthly depositor (the lookback period is \$50,000 or less), the employer must list the tax liability in the Form 943 ROFT.

(b) If the employer is classified as a semi-weekly depositor (lookback period is \$50,000 or more), the taxpayer must list the tax liability on Form 943A.

(20)461.3 (3-21-95) December 31, 1992 and Prior

(1) If the employer accumulated less than \$100 tax liability during a year, no deposits were required.

(2) To show the correct liability for deposit periods ending December 31, 1992 and prior:

(a) If the annual tax liability is at least \$500, the taxpayer must list the tax liability in the Form 943 ROFT section.

(b) If any month's tax liability is \$3,000 or more, the taxpayer must complete Form 943A ROFT and attach it to the Form 943.

(c) When the \$100,000 Rule applies, see IRM (20)4(40)1. Since Schedule B covers only one quarter, an agricultural employer may need to attach four Schedule B's to Form 943.

(d) Deposit requirements may vary from month to month, depending on the amount of taxes withheld each payday. E.g., a taxpayer may be a monthly depositor for the first 11 months of the year and then become an eighth-monthly depositor in the last month.

(20)461.4 (3-21-95) Special Deposit Rules

(1) First Time Exception -- See IRM (20)435.22.

(2) Safe Harbor/98 percent/95 percent -- See IRM (20)435.21.

(20)461.5 (3-21-95) Computing the FTD Penalty

(1) For tax periods Beginning January 1, 1993, and subsequent, refer to Form 941 deposit requirements. See IRM (20)441.1.

(a) To determine if the deposit is timely, see exhibit IRM (20)400-5.

(b) Compare the taxpayer's liability, using the information from the ROFT, with the deposits made. If the ROFT information is unavailable, use the averaging method. See IRM (20)441.3.

(c) If there is an overstatement of the ROFT that is due to a line item adjustment, adjust the last liability regardless of the dollar amount.

(d) If the taxpayer shows a monthly or semi-weekly liability of \$100,000 or more, refer to IRM (20)4(40)1 for special deposit rules.

(2) For tax periods ENDING DECEMBER 31, 1992 AND PRIOR, refer to Computing the FTD Penalty -- Form 941. See IRM (20)441.2.

(a) Refer to Exhibit 400-2 of LEM XX-400 to determine if a taxpayer made timely and sufficient deposits.

(b) Compare the taxpayer's liability, using the information from the ROFT, with deposits made. If ROFT information is unavailable, use the averaging method.

(c) If there is an overstatement of the ROFT that is due to a line item adjustment, adjust the last liability regardless of the dollar amount.

(d) If the taxpayer reports only monthly totals in the ROFT, and:

1 Any monthly total is \$3,000 or more, consider the liability not furnished. Average the entire tax liability.

2 Any monthly total is less than \$3,000 each, consider the monthly liabilities attributable to the last period of each month. See IRM (20)441.3.

(e) If the taxpayer reports monthly or eighth-monthly liabilities of \$100,000 or more, refer to the special deposit rules. See IRM (20)4(40)1.

(3) For purposes of computing a penalty, compute each quarter separately. Then, combine the quarters into one penalty amount (TC 180).

(4) When computing Form 943 in quarterly portions, exceptions apply only to the last month of the reporting period (December). Exceptions do not apply to the last month of each quarter (March, June and September).

(20)461.6 (3-21-95) Averaged Penalty

(a) Average the tax settlement amount if the Record of Federal Tax (ROFT) Form 943 or 943A is incomplete or blank. The tax settlement amount equals the tax liability amount reduced by the amount of any refundable credit allowance (TC 150 less TC 766).

(2) For tax periods Beginning January 1, 1993 and later the method of averaging will depend on the type of depositor and the information available.

(a) To arrive at an averaged liability for a monthly depositor, who has not provided any liability breakdown, divide the net tax liability by 12 and assign this amount to each of the monthly totals.

(b) To compute an averaged liability for a semi-weekly depositor who has not provided any liability breakdown, divide the net tax liability by four to arrive at a quarterly amount. Divide the resulting amount by 12 and assign to the first 12 Fridays of each quarter.

(c) To compute an averaged liability for a semi-weekly depositor who provided a monthly ROFT, divide each month's liability by four and assign those four liabilities to the first four Fridays of that month.

(d) When the averaged liability is \$100,000 or more, assign the liability to the first day of the semi-weekly period ending Friday. This applies to both the monthly and semi-weekly depositor.

(3) For tax periods ending December 31, 1992 and before, to arrive at an averaged liability:

(a) Divide the yearly net tax liability by four to arrive at a quarterly amount. Divide the resulting amount by 12 and assign to eighth-monthly periods B, D, F, H, J, L, N, P, R, T, V and X.

(b) If the averaged liability equals \$100,000 or more, assign the liability to the first day of the eighth-monthly periods B, D, F, H, J, L, N, P, R, T, V and X.

(c) Compute the penalty using the averaged liability amount and combine the quarterly amounts into one total penalty amount (TC 180).

(20)470 (3-21-95) Form 940 Series

(20)471 (3-21-95) General

(1) Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return, is an annual return used to report Federal unemployment tax. For deposit purposes, divide each year into quarters.

(2) To show the correct liability for the deposit period, the taxpayer must list the tax liability in the ROFT, if the total tax is \$100 or more.

(3) Refer to Exhibit 400-3 of LEM XX-400 to determine if the taxpayer made timely deposits.

(4) For periods beginning April 1, 1991, and later, the deposit requirements are based on the amount of the tax liability incurred at the end of the deposit period. See Exhibit (20)400-9.

(a) If the tax liability at the end of the first, second or third quarter is \$100 or less, it is carried over to the next quarter.

(b) If the tax liability at the end of the fourth quarter is \$100 or less, there is no requirement to deposit. The taxpayer pays the tax with the return or deposits it by the return due date.

(c) If the tax liability at the end of a quarter is over \$100, the taxes must be deposited by the last day of the following month.

(5) For periods ending March 31, 1991 and before, the deposit requirements are based on the amount of undeposited taxes at the end of the deposit period.

(a) If undeposited tax at the end of the first, second or third quarter is \$100 or less, add that liability to the liability incurred in the following quarter.

(b) If undeposited tax at the end of the fourth quarter is \$100 or less, there is no requirement to deposit. The taxpayer pays the tax with the return or deposits it by the return due date (return due date).

(c) If undeposited tax at the end of a quarter is over \$100, the tax must be deposited by the last day of the following month.

(20)472 (3-21-95) Computing the FTD Penalty

(1) Refer to Form 940 deposit requirements discussed above to determine if the taxpayer made sufficient deposits.

(2) Refer to Exhibit 400-3 of LEM XX-400 to determine if the taxpayer made timely deposits.

(3) Compare the taxpayer's liability information from the ROFT with the deposits made. If these figures are not available, averaging is used. See IRM (20)441.3.

(4) If there is an overstatement in the ROFT, regardless of the dollar amount, adjust the LAST liability. Then, compute the penalty.

(20)473 (3-21-95) Averaged Penalty

(1) Average the total tax when the ROFT is incomplete or blank.

(a) Subtract the credit reduction amount from the total FUTA tax. Divide the difference by 4 to get a quarterly breakdown.

(b) Add the credit reduction amount back into the fourth quarter. (Taxpayers determine the credit reduction amount in the fourth quarter. There is no deposit requirement until that period. DO NOT include the credit reduction amount in the total being averaged.)

(c) Consider the posted deposits as payments against the resulting quarterly liabilities.

(2) Compute the penalty on under-deposits, late deposits, and direct payments. Assess the penalty, if appropriate.

(20)480 (3-21-95) Form 720

(20)481 (3-21-95) General

(20)481.1 (3-21-95) Reporting Requirements

(1) Form 720, Quarterly Federal Excise Tax Return, and any related attachments, is used to report certain excise taxes. The return is divided into three parts.

(a) Part I, reports taxes that ARE SUBJECT to deposit requirements,

(b) Part II, reports taxes that are NOT SUBJECT to deposit requirements, and

(c) Part III, provides a COMPUTATION of whether there is a balance due or an overpayment.

(2) The net tax liability for each class of tax is reported separately on Form 720, Schedule A, by semi-monthly periods:

(a) 9-Day Rule taxes are reported on line 1,

(b) 30-Day Rule taxes on line 2,

(c) Alternative Method taxes on line 3, and

(d) 14-Day Rule taxes on line 4.

(20)481.2 (3-21-95) Filing

(1) For filing purposes, the term "net tax liability" means the tax liability incurred during the semi-monthly period, PLUS OR MINUS any applicable adjustments and claims for that period.

(a) For communications and air transportation taxes, tax liability is treated as incurred in the semi-monthly period in which the tax is collected, or

(b) in the case of the Alternative Method, is considered as collected (see IRM (20)481.43).

(2) Each month of the quarter is divided into semi-monthly periods. The first semi-monthly period is the first 15 days of a month. The second semi-monthly period is the 16th through the last day of a month.

(3) The requirement for filing a return applies separately to each tax listed by IRS No. on Form 720. Thus, the filing of Form 720 for one IRS No. does not constitute the filing of a return for any other IRS No. See Exhibit (20)400-10.

(4) Only one Form 720 is filed for a calendar quarter, (the one-return rule). Under this rule, if a person is reporting two or more excise taxes and they are due on different dates, use the LATER filing date.

(a) For example: a Form 720 filer.

1 Reports IRS No. 60 for the third quarter, which is ordinarily due by OCTOBER 31, also

2 reports IRS No. 19, for which the due date is November 30.

(b) files only a single Form 720 which is due by November 30.

(5) Extension of the filing date under the one-return rule does not extend the date for making deposits or payments of tax.

(a) For example, although the filing of a Form 720 for the third quarter reporting both IRS Nos. 19 and 60 delays the filing of the return until November 30,

(b) any underpayment for IRS No. 60 must be deposited by October 31.

(6) For all taxes, except those listed below, the return must be filed by the last day of the month following the end of the calendar quarter.

(7) For the exceptions listed below, the return must be filed by the last day of the second month following the end of the calendar quarter.

(a) Ozone Depleting Chemicals (ODC) (IRS Nos. 19, 20 and 98),

(b) communications (IRS No. 22), and

(c) air transportation (IRS Nos. 26, 27, And 28).

(8) If any due date for filing a return falls on a Saturday, Sunday, or legal holiday, the taxpayer may file the return on the next business day.

(20)481.3 (3-21-95) Payment

(1) Payment must be made by the return due date without extension.

(2) There is a special rule for the payment of ODC floor stock tax (IRS No. 20), a Part II tax. The payment is due on June 30 of each year, two months before the return is due on August 31.

(20)481.4 (3-21-95) Deposits

(1) Taxes that are subject to deposit requirements are grouped together into classes as follows:

- (a) 9-Day Rule taxes,
- (b) 30-Day Rule taxes
- (c) Alternative Method taxes, and
- (d) 14-Day Rule taxes.

(2) If a person is depositing more than one tax in a class, all the taxes in the class are combined into one deposit for the semi-monthly period.

(3) A deposit is due for each semi-monthly period in which a liability is incurred.

(4) The amount of each deposit of tax for a semi-monthly period must be at least the amount of the net tax liability for that period unless a safe harbor rule applies.

(a) The net tax liability for the semi-monthly period for that class of tax is the amount entered in the appropriate box on Schedule A.

(b) If the deposit is timely made at an authorized Government depository, and equals or exceeds the amount entered in the Schedule A box for the semi-monthly period.

(c) then, the deposit requirement for that class of tax for the semi-monthly period has been met.

(5) On December 8, 1994, the President signed into law P.L. 103-465, implementing statutes related to the General Agreement on Tariffs and Trade (GATT). Although it is fundamentally a trade bill, it contains a number of revenue-raising amendments to the Internal Revenue Code.

(6) GATT will effect deposit due date requirements beginning in the third quarter of calendar year 1995.

(20)481.41 (3-21-95) 9-Day Rule; Line 1 of Schedule A

(1) The 9-Day Rule applies to all taxes in Part I of Form 720 except the ODC tax (IRS Nos. 98, 19), to which the 30-Day Rule applies. Except for ODC tax, the 9-Day Rule always applies unless the taxpayer chooses the Alternative Method by using line 3 of Schedule A and/or chooses the

14-Day Rule by using line 4 of Schedule A.

(2) The deposit of tax for a semi-monthly period is due by the ninth day following the end of the semi-monthly period. Generally, this is the 24th day of the month and the 9th day of the following month.

(3) The net tax liability for each semi-monthly period in the quarter is entered in line 1, boxes A-F, of Schedule A.

(4) For communications and air transportation taxes, a taxpayer can change to the Alternative Method of computing deposits only at the beginning of a calendar quarter. The taxpayer must notify the Service before a new choice is made so that proper adjustments may be made in order to properly reflect that person's collections of excise tax.

(5) An additional deposit of IRC section of 4081 taxes must be made in September. See IRM (20)484.

(20)481.42 (3-21-95) 30-Day Rule; Line 2 of Schedule A

(1) The 30-Day Rule applies only to ODC tax (IRS Nos. 98, 19).

(2) The deposit of tax for a semi-monthly period is due by the last day of the second following semi-monthly period. Generally, this is the 15th day of the following month and the last day of the following month.

(3) The net tax liability for each semi-monthly period in the quarter is entered in line 2, boxes G-L, of Schedule A.

(20)481.43 (3-21-95) Alternative Method; Line 3 of Schedule A

(20)481.43 (3-21-95) Alternative Method; Line 3 of Schedule A

(1) The Alternative Method applies only to communications (IRS No 22) and air transportation taxes (IRS Nos. 26, 28, 27). If a person is using the Alternative Method, amounts considered as collected are reported on line 3 of Schedule A. If line 3 is not used, the Alternative Method does not apply. For reporting information relating to tax under the alternative method, see Exhibit (20)400-11.

(2) Under the Alternative Method:

(a) The tax included in amounts billed or tickets sold during a semi-monthly period is considered as collected.

1 during the first seven days of the second semi-monthly period.

2 following the semi-monthly period in which the amounts were billed or tickets sold.

(b) For example, the tax included in amounts billed between January 1 and January 15, 1995, is considered as collected during the period February 1 through February 7, 1995.

(3) The amount reported on Schedule A for each semi-monthly period is the tax considered as collected during that period. For example, the tax considered as collected during the period February 1 through February 7, 1995, is the amount reported for the period February 1 through February 15, 1995.

(4) The net tax liability for each semi-monthly period in the quarter is entered in line 3, boxes M-R, of Schedule A. For example, the tax considered as collected during the period February 1 through February 7, 1995 is reported in box O of Schedule A.

(5) The deposit of tax considered as collected for the first semi-monthly period of the month is due:

(a) By the 3rd banking day after the 7th day of that month (generally, the 10th day of that month), and

(b) the deposit for the second semi-monthly period of the month is due by the 3rd banking day, after the 22nd day of that month (generally, the 25th day of that month).

(c) For example:

1 The deposit for the semi-monthly period beginning on February 1, 1995 is due by February 10, 1995 (this is a deposit of the tax included in amounts billed between January 1 and January 15, 1995, and

2 considered as collected between February 1 and February 7, 1995.

(6) A taxpayer can change to the 9-Day Rule of computing deposits only at the beginning of a calendar quarter. The taxpayer must notify the Service before a new choice is made so that proper

adjustments may be made in order to properly reflect that person's collections of excise tax.

(20)481.44 (3-21-95) 14-Day Rule; Line 4 of Schedule A

(1) The 14-Day Rule applies only to IRC section 4081 taxes (IRS Nos. 60, 62, 58, 73, 74, 59, 75, 76) and only if the deposit is an immediate credit item. See IRM (20)414.22:(3) for a definition of an immediate credit item.

(2) If a person is using the 14-Day Rule, net tax liability is reported on line 4 of Schedule A. If line 4 is not used, the 14-Day Rule does not apply.

(3) The application of the 14-Day Rule to:

(a) IRS Nos. 73, 74, 75, & 76 begins with the quarter ending 9303.

(b) IRS No. 60 begins with the quarter ending 9403.

(4) The deposit of tax for a semi-monthly period is due by the 14th day following the end of the semi-monthly period, Generally, this is the 29th day of the month and the 14th day of the following month.

(5) Under the 14-Day Rule, if the 14th day is a Saturday, Sunday, or legal holiday, the due date is the immediate preceding day that is not a Saturday, Sunday, or legal holiday. This is an exception to the normal treatment of deposit due dates falling on a Saturday, Sunday, or holiday.

(6) The net tax liability for each semi-monthly period in the quarter is entered in line 4, boxes S-X, of Schedule A.

(20)482 (3-21-95) De Minimis Exception to Deposit Requirements

(1) Form 720 deposits are not required if the net tax liability for the quarter does not exceed \$2,000. This is known as a "de minimis exception".

(2) The \$2,000 "de minimis exception" applies only to the taxes listed in Part I, Form 720. For example:

(a) A return is filed reporting \$1,950, Part I taxes, and \$4,000, Part II taxes,

(b) therefore, no deposits would be due against the total liability of \$5,950.

(c) The \$4,000 Part II taxes are not subject to deposit requirements, and the \$1,950 Part I taxes are below the \$2,000 "de minimis exception."

(3) To compute the \$2,000 threshold, exclude taxes reported on a one-time filing, which are not subject to deposit. For example. No deposits are required for a one-time filing of:

(a) Gas guzzler tax (IRS No. 40), or

(b) luxury tax (IRS No. 92).

(c) A person has made a one-time filing of Form 720 for IRS Nos 40 and/or 92, if:

2 the "final return block" on the front of Form 720 is marked, and

3 no other taxes are repealed.

(20)483 (3-21-95) Safe Harbor Rules for Deposits

(20)483.1 (3-21-95) General

(1) The safe harbor rules apply separately to deposits under the 9-Day Rule, 30-Day Rule, Alternative Method, and 14-Day Rule.

(2) If the conditions of the safe harbor rule are met, a person that has made timely deposits at an authorized Government depository of less than the full amount of net tax liability for each semi-monthly period in the quarter is considered to have satisfied the deposit requirement for the quarter.

(3) See IRM (20)484.2 for special safe harbor rules for deposits of IRC section 4081 taxes for the second semi-monthly period in September of 1993 and 1994.

(4) The lookback analysis under Form 720 Safe Harbor Rule is not the same as the lookback analysis for Form 941.

(20)483.2 (3-21-95) Lookback Quarter Safe Harbor (1/6 Rule)

(1) The lookback quarter liability safe harbor (1/6 Rule) applies to any person that filed Form 720 for the second preceding quarter (the lookback quarter). The 1/6 Rule applies without regard to the amount of the liability for the current quarter.

(2) To satisfy the deposit requirements under the 1/6 Rule, the taxpayer must meet the following conditions:

(a) The deposit for each semi-monthly period in the current quarter, must be at least 1/6 of the net tax liability of the lookback quarter, for the same class of tax. For example:

1 If we are discussing the 9-Day Rule in the current quarter.

2 then we must look at the net tax liability for the 9-Day Rule in the second preceding quarter (lookback quarter), therefore

3 the deposit for each semi-monthly period in the current quarter must equal 1/6 of lookback quarter net tax liability.

(b) Each deposit must be timely made at an authorized Government depository.

(c) Any underpayment of the liability for the current quarter must be paid by the return due date without extension.

(3) In general, the underpayment must be paid with the return. If the return due date is extended under the one-return rule, special rules apply to the underpayment.

(a) A deposit must be made by the last day of the month, following the end of the

quarter (the date the return would be due without extension).

(b) The deposit cannot be less than the lesser of:

1 The amount by which the net tax liability in that class (other than for ODCs (IRS Nos. 98, 19), communications (IRS No. 22), and air transportation taxes (IRS Nos. 26, 28, 27) for the current calendar quarter, exceeds:

a The net tax liability for the look-back quarter, or

b the amount of any underpayment of taxes in that Class for the current calendar quarter.

(4) If a tax rate increase goes into effect for a quarter, the following additional condition applies.

(a) The 1/6 Rule does not apply for the first and second calendar quarters.

1 beginning on or after the effective date of the increase, unless:

a The deposit of taxes for each semi-monthly period in the calendar quarter is not less than 1/6 of the liability the taxpayer would have had for the look-back quarter,

b if the increased tax rate had been in effect during the look-back quarter.

(b) Thus, if tax rates are increased.

1 taxpayers must deposit 1/6 of the amount that they would have been liable for in the look-back quarter,

2 had the higher rate applied at that time.

(20)483.3 (3-21-95) Current Liability Safe Harbor (95 Percent Rule)

(1) The current liability safe harbor (95 Percent Rule) may be used by any Form 720 filer.

(2) To satisfy the deposit requirements under the 95 Percent Rule, the taxpayer must meet the following conditions:

(a) The deposit for each semi-monthly period must be at least 95 percent of the net liability for the class of tax for the semi-monthly period. For example, 95 percent of the liability for 9-Day Rule taxes in that semi-monthly period.

(b) Each deposit must be timely made at an authorized government depository.

(c) Any underpayment of the liability for the current quarter must be paid by the return due date without extension.

(3) In general, the underpayment must be paid with the return. If the return due date is extended under the one-return rule, special rules apply to the underpayment.

(a) A deposit must be made by the last day of the month, following the last month of

the quarter (the date the return would be due without extension)

(b) of at least five percent of the net tax liability (other than for ODCs (IRS Nos. 98,19), communications (IRS No. 22), and air transportation taxes (IRS Nos. 26, 28, 27) for the current quarter, or

(c) the amount of the underpayment for the current quarter, whichever is less.

(20)484 (3-21-95) IRC Section 4081 Taxes (IRS Nos. 60, 62, 58, 73, 74, 59, 75, 76)

(20)484.1 (3-21-95) Special Rules for Deposits

(1) For the second semi-monthly period in September, separate deposits of section 4081 taxes are required for the period September 16 to 22 and the period September 23 to 30. Thus, an additional deposit is required during the third quarter of each year.

(2) For the period beginning September 16 and ending September 22, the taxes must be deposited by September 27. If September 27 falls on a Saturday, Sunday, or legal holiday, the due date is the immediately preceding day that is not Saturday, Sunday or legal holiday.

(3) The net tax liability for the period September 16 to 22 is entered in line 1, below box F, or in line 4, below box X. However, the 14-Day Rule does not apply to the deposit due September 27.

(4) For the period beginning September 23 and ending September 30, the deposit must be made by the due date under the 9-Day or 14-Day Rule, whichever applies.

(5) The net tax liability for the period September 23 to 30 is entered in line 1, box F, or line 4, box X, of Schedule A.

(6) The amount of each deposit for those periods must be at least the amount of net tax liability incurred under section 4081 during the period.

(20)484.2 (3-21-95) Special Safe Harbor Rules (1993 and 1994)

(1) The 1/6 Rule does not apply for the third calendar quarter unless each deposit of taxes for the periods September 16 to 22 and September 23 to 30 is not less than 1/12 (8.34 percent) of the net tax liability reported for the look-back quarter.

(2) The 95 Percent Rule does not apply for the third calendar quarter unless the deposit of taxes for the period September 16 to 22 is not less than 47.5 percent of the net Section 4081 tax liability for the second semi-monthly period in September and the total deposit for the semi-monthly period is not less than 95 percent of the net tax liability for the semi-monthly period.

(20)485 (3-21-95) Computing the FTD Penalty

(20)485.1 (3-21-95) General

(1) A deposit must be made for each semi-monthly period for which there is an entry in a box on Schedule A. The amount of each deposit for a semi-monthly period must be at least the amount of

the net tax liability entered in the appropriate box on Schedule A for that period unless a safe harbor rule applies.

(2) To determine whether a sufficient amount has been deposited, Schedule A must be completed. If Schedule A is complete, compare the amounts entered on Schedule A to the deposits and payments the person has made.

(3) If the deposit is timely made at an authorized Government depository and equals or exceeds the amount entered in the Schedule A box for the semi-monthly period, the deposit requirement for that class of tax for the semi-monthly period is satisfied.

(4) Each "Rule" stands alone when determining if a liability was satisfied A deposit made for one rule cannot be applied to another rule

(a) When deposits are considered between two "Rules", FIFO does not apply. For example, when it is determined that a deposit is intended for a liability under the 30-Day Rule, it cannot be applied to a liability under the 9-Day Rule. See IRM (20)423(4).

(b) When deposits are considered for only one "Rule", FIFO does apply.

(5) If Schedule A is not completed, penalties have to be proposed Proposing a penalty allows the taxpayer time to provide needed information. (See IRM (20)4852).

(a) Call (or write) the taxpayer to request a completed Schedule A.

(b) If a new Schedule A is received for the review quarter, determine whether a failure to deposit penalty applies.

(c) If a new Schedule A is not received, compute and assess an averaged penalty.

(6) A penalty may be imposed if the person has not made timely deposits in sufficient amounts at an authorized Government depository. Therefore, the taxpayer must meet the following three conditions:

(a) Timeliness.

(b) sufficient amount, and

(c) authorized depository.

(20)485.2 (3-21-95) Timeliness

(1) If the deposit is received by the deposit due date for each rule, the deposit is timely. See Exhibit 400-4 of LEM XX-400.

(2) Each "Rule" stands alone when determining if a liability was satisfied. A deposit made for one rule cannot be applied to another rule. For example:

(a) 9-Day taxes are due, generally, the 24th day and the 9th day of each month, and

(b) 30-Day taxes are due, generally, the 15th day and the last day of each month.

(3) For each semi-monthly period, the deposit due date for each class of tax (9-Day Rule, 14-Day Rule, 30-Day Rule, or Alternative Method) is the date from which penalty is computed.

(20)485.3 (3-21-95) Sufficient Amount

(1) If the deposit is timely made at an authorized Government depository, but is less than the amount entered in the Schedule A box for the semi-monthly period, determine the following:

(a) Check to see if the 1/6 Rule (see IRM (20)483.2) is satisfied.

1 The lookback quarter liability is the net tax liability amount entered on line 1b, 2b, 3b or 4b, whichever applies, of the Schedule A for the lookback quarter. Divide that amount by six to determine the amount required to be deposited in each semi-monthly period for the Current quarter under the 1/6 Rule.

2 Compare each deposit (including any credits from prior quarters or semi-monthly periods) with the amount required to be deposited in each semi-monthly period.

3 If the amounts deposited are sufficient and the amount of any underpayment is paid by the due date of the return, then the 1/6 Rule is satisfied and no penalty is appropriate. An underpayment is the difference between the amount entered on line 1b, 2b, 3b, or 4b, whichever applies, of the Current quarter Schedule A, and the same line of the Schedule A for the lookback quarter.

4 If the 1/6 Rule is not satisfied for any semi-monthly period within the quarter, the 1/6 Rule does not apply for that quarter. For example:

a Even if five of the six semi-monthly periods within the quarter are satisfied, and only one semi-monthly period is not satisfied, then the 1/6 Rule cannot be used for any of the liability periods during the quarter.

b However, no taxpayer has to pay more than they actually owe. For example: If the deposit for the sixth semi-monthly liability period is less than the 1/6 Rule amount, but the total deposits fully pay the liability for the entire quarter, no penalty applies.

(b) If the 1/6 Rule is not satisfied, check to see if the 95 percent Rule (see IRM (20)483.3) is satisfied.

1 Compare each deposit (including any credits from prior quarters or semi-monthly periods) with the amount reported in the Schedule A box for each semi-monthly period. The deposit must be at least 95 percent of the amount reported on Schedule A.

2 If the amounts deposited are sufficient and the amount of the underpayment is paid by the due date of the return, then the 95 Percent Rule is Satisfied and no penalty is appropriate. An UNDERPAYMENT is the difference between the amount entered on Schedule A and the amount deposited.

3 If the 95 Percent Rule is not satisfied for any semi-monthly period within the quarter, the 95 Percent Rule does not apply for that quarter. For example:

a Even if five of the six semi-monthly periods within the quarter are satisfied, and only one semi-monthly period is not satisfied, then the 95 Percent Rule cannot be used for any of the liability periods during the quarter.

b However, no taxpayer has to pay more than they actually owe. For example: If the deposit for the sixth semi-monthly liability period is less than the 95 Percent Rule safe harbor amount, but the total deposits fully pay the liability for the entire quarter, no penalty applies.

(c) If the 95 Percent Rule is also not satisfied, compute the penalty. For each semi-monthly period, subtract the amount deposited from the amount entered in the Schedule A box and compute the penalty based on the difference.

(d) If the underpayment, for either safe harbor (1/6 Rule or 95 Percent Rule), is not paid by the due date of the return:

1 The safe harbor does not apply for the entire quarter,

2 for each semi-monthly period, subtract the amount deposited from the amount entered in the Schedule A box and compute the penalty based on the difference.

(20)485.4 (3-21-95) Authorized Depository

If the deposit is timely and in the correct amount, but is not made at an authorized depository, the 10 percent penalty applies. If the taxpayer was using a safe harbor rule and failed to use an authorized depository, the safe harbor (1/6 Rule or 95 Percent Rule) does not apply for the entire quarter.

(20)485.5 (3-21-95) Averaged Penalty

(1) Whenever Schedule A is missing and a Schedule A is not received after contact with the taxpayer, determine whether a penalty applies by computing a separate averaged semi-monthly liability for 9-Day and 30-Day Rule taxes.

(2) Add the liabilities for all Part I taxes listed on the transcript except for IRS Nos. 98 and 19. Divide the total by six. Use the result as the net liability for 9-Day Rule taxes for each semi-monthly period.

(3) Add the liabilities listed on the transcript for IRS Nos. 98 and 19. Divide the total by six. Use the result as the net liability for 30-Day Rule taxes for each semi-monthly period.

(20)485.6 (3-21-95) Transitional Rule for the Alternative Method

(20)485.61 (3-21-95) General Transitional Rule

(1) The Alternative Method applies only, to communications (IRS No. 22) and air transportation taxes (IRS Nos. 26, 28, 27). If a person is using the Alternative Method, amounts considered as

collected are repealed on line 3 of Schedule A.

(2) There is a special Transitional Rule which applies and can be used by any person who has been making deposits under the Alternative Method, and appears to have reported tax too soon on Form 720 and Schedule A.

(a) This early reporting of tax makes otherwise timely deposits appear to be late.

(b) For detailed information, refer to Notice 1009, Information on the Alternative Method of Reporting on Form 720, Schedule A.

(3) If it appears the taxpayer repealed tax too soon, call or write (enclosing Notice 1009 and Schedule A) the taxpayer about the problem. Allow the taxpayer time to respond (30 days).

(20)485.62 (3-21-95) Quarter in Question

(1) If the taxpayer sends in a corrected Schedule A, with:

(a) The first two semi-monthly periods blank,

(b) any of the other four semi-monthly periods showing a liability amount, and

(c) the amounts in the boxes match the deposits timely received, then

(d) there is no penalty.

(e) Disregard the first two semi-monthly (blank) periods. These were reported on the previous Schedule A.

(2) The taxpayer has only one opportunity to "transition to the correct reporting period.

(20)485.7 (3-21-95) Repealed Luxury Taxes

(1) The Omnibus Budget Reconciliation Act (OBRA) of 1993 repealed the luxury taxes:

(a) On aircraft (IRS No. 90), boats (IRS No. 91), furs (IRS No. 93), and jewelry (IRS No. 94), for sales or uses after December 31, 1992, and

(b) on any part or accessory installed on a passenger vehicle after December 31, 1990, if the part or accessory is installed to enable or assist an individual with a disability to operate or to enter or exit the vehicle.

(2) With the repeal of these luxury taxes, there are no filing or deposit requirements after December 31, 1992.

(3) FTD or avoidance penalties may have been asserted due to untimely/insufficient/late deposits for one or more of those IRS nos.

(4) Any penalty adjustment based on abatement of tax (due to OBRA) will be processed using current abatement procedures.

(5) If a deposit was made for these IRS nos. for a tax period beginning after December 31, 1992,

Form 8849. Claim for Refund on Excise Taxes, may be submitted by a taxpayer to request deposit refunds.

(20)485.8 (3-21-95) Special Rule for 8912

Special Rules apply for computation of the penalty during 8912 only, See 485.8 of LEM XX-400.

(20)486 (3-21-95) Deposit Requirements For Prior Periods

(20)486.1 (3-21-95) Periods 9106 through 9212

(1) Taxes reported in Part 1 of Form 720 were subject to deposit requirements regardless of the dollar amount (no de minimis exception).

(2) There was a general safe harbor rule. This rule applied to persons who filed a Form 720 for the second calendar quarter preceding the current quarter (the look-back quarter).

(a) Persons who filed for the look-back quarter were considered to have met the deposit requirements if the following three Conditions were met:

- 1 The deposit for each semi-monthly period in the current quarter was not less than 1/6 (16.67 percent) of the net tax liability reported for the look-back quarter, and
- 2 each deposit was timely made at an authorized Government depository, and
- 3 any underpayment for the current quarter was paid by the due date of the return.

(b) However, if the due date of the return was extended because a taxpayer reported taxes with a different return due date, the taxpayer was required to deposit on the earlier due date, any underpayment for taxes ordinarily reported on the earlier date.

(3) Also, there was a special safe harbor rule. This special rule applied to new filers of Form 720. New filers were considered to have met the deposit requirements for the current quarter if:

- (a) The deposit for each semi-monthly period in the current quarter was not less than 90 percent of the net tax liability reported for that semi-monthly period, and
- (b) each deposit was timely made at an authorized Government depository, and
- (c) any underpayment for the current quarter was paid by the due date of the return.

(4) Deposits of air transportation taxes (IRS Nos. 28, 27 only) based on amounts considered collected were due by the third banking day after the end of the semi-monthly period.

(5) For communications and air transportation taxes, the following deposit exceptions applied to line 3, Schedule A, provided that any underpayment for any of the first four semi-monthly periods in the quarter was paid by the last day of the following month:

- (a) At least 90 percent of the liability for the semi-monthly period.
- (b) at least 45 percent of the liability for the month that included the semi-monthly

period, or

(c) at least 50 percent of the liability for the month that preceded the semi-monthly period.

(d) Exceptions (b) and (c) did not apply if more than 75 percent of the liability was incurred in the first semi-monthly period of the month.

(6) There was no special safe harbor rules for the deposit of section 4081 taxes for September 1991 and 1992.

(20)486.2 (3-21-95) Periods Ending 9103 and Prior

(20)486.21 (3-21-95) Manufacturers, Retailers, Environmental and Miscellaneous Taxes (IRS

(1) Requirements were as follows:

(a) Undeposited taxes \$100 or less at the end of a month:

1 If total undeposited taxes at the end of the first or second month were \$100 or less, the taxpayer carries them over to the next month.

2 If total undeposited taxes at the end of the last month were \$100 or less, the taxpayer may pay them with the return or they may deposit them by the return due date.

(b) If total undeposited taxes were over \$100 at the end of any month, the taxpayer must deposit them by the last day of the following month.

(c) Undeposited taxes over \$2,000 at the end of a month:

1 If taxes at the end of any month were over \$2,000, the taxpayer must make semi-monthly deposits in the following quarter, regardless of the tax amounts in that subsequent quarter.

2 The taxpayer must deposit the taxes by the ninth day following the semi-monthly period.

3 For exceptions to the semi-monthly deposit requirements, see IRM (20)486.24.

(2) There was no requirement for an additional deposit of IRC section 4081 taxes prior to September 1991.

(20)486.22 (3-21-95) Communications and Air Transportation Taxes (IRS Nos. 22, 26, 27, 28)

(1) Requirements were as follows:

(a) Undeposited taxes \$100 or less at the end of a month:

1 If the taxes at the end of the first or second month were \$100 or less, the

taxpayer carries these amounts over to the next month.

2 If the taxes at the end of the third month were \$100 or less, the taxpayer may pay them with the return or deposit them by the return due date.

(b) Undeposited taxes over \$100 at the end of a month:

1 If the taxes were more than \$100 at the end of the first or second month of a quarter, deposit them by the last day of the following month.

2 If the taxes at the end of the third month were over \$100, deposit them by the last day of the second month following the end of the quarter

(c) Undeposited taxes over \$2,000 at the end of a month.

1 If taxes at the end of any month were more than \$2,000. the taxpayer must make semi-monthly deposits in the following quarter, regardless of the tax amounts in that quarter.

2 A semi-monthly deposit is due within 3 banking days after the close of the Semi-monthly period in which the taxes were reported as collected or considered as collected by the taxpayer.

3 For exceptions to the semi-monthly deposit requirements, see IRM (20)486.24.

(2) Taxes that were considered as collected were repealed as follows:

(a) For monthly requirements, consider taxes as collected in the month after the month the taxpayer bills for services or sells the tickets.

(b) for semi-monthly requirements, consider taxes as collected in the second semi-monthly period after the period the taxpayer bills for services or sells the tickets.

(3) Beginning July 1, 1990, deposits for air transportation tax (IRS No. 26 only) were due within 3 banking days after the first week of the second full semi-monthly period.

(4) Beginning January 1, 1991, deposits for communication taxes (IRS No. 22) were due within 3 banking days after the first week of the second following semi-monthly period.

(20)486.23 (3-21-95) Policies Issued by Foreign Insurers (IRS No. 30)

(1) Requirements were as follows:

(a) Undeposited taxes \$100 or less at the end of a month:

1 If total undeposited taxes at the end of the first or second month were \$100 or less, the taxpayer carries them over to the next month.

2 If total undeposited taxes at the end of the third month of the quarter were \$100 or less, the taxpayer may pay them with the return or deposit them by the return due date.

(b) If total undeposited taxes were over \$100 at the end of any month, the taxpayer must deposit them by the last day of the following month.

(c) Undeposited taxes over \$2,000 at the end of a month:

1 If taxes at the end of any month were over \$2,000, the taxpayer must make semi-monthly deposits in the following quarter, regardless of the tax amounts due in that subsequent quarter.

2 The taxpayer must deposit taxes for the first semi-monthly period by the first day of the following month.

3 The taxpayer must deposit taxes for the second semi-monthly period by the 15th day of the following month.

4 For exceptions to the semi-monthly deposit requirements. see IRM (20)486.24.

(20)486.24 (3-21-95) Exception to Semi-Monthly Deposit Rules

(1) Exception 1 (90 percent Rule) -- This applies to ALL excise taxes.

(a) The taxpayer pays at least 90 percent of the total tax reported for the semi-monthly period timely.

(b) The taxpayer must deposit the unpaid 10 percent tax from the first or second month, as follows.

1 For manufacturers, retailers and environmental taxes, they must deposit the unpaid 10 percent tax by the 9th day of the second month after the month it was reported.

2 For air transportation and communications, they must deposit the unpaid 10 percent tax by the last day of the month after it was reported.

3 For all other excise taxes, they must deposit the unpaid 10 percent tax by the first day of the second month after the month it was reported.

(c) The taxpayer must deposit the unpaid 10 percent tax from the last month, if it is over \$100, by the return due date. If the unpaid tax is under \$100, the taxpayer can pay it with the return.

(2) Exception 2 (45 Percent Rule) -- This applies to ALL excise taxes.

(a) The taxpayer makes timely semi-monthly deposits of at least 45 percent of The reported taxes for that month.

(b) The taxpayer must deposit the underpayment from the first or second month, as follows.

1 For manufacturers, retailers and environmental taxes, they must deposit the underpayment by the 9th day of the second month after the month it was reported.

2 For air transportation and Communications, they must deposit the underpayment by the last day of the month after the month it was reported.

3 For all other excise taxes, they must deposit the un-derpayment by the first day of the second month following the month in which it was reported.

(c) The taxpayer must deposit the unpaid 10 percent tax from the last month, if it is over \$100, by the return due date. If the unpaid tax is under \$100, the taxpayer can pay it with the return.

(d) This exception is not valid if _____

1 The taxpayer collects more than 75 percent of air transportation or communications tax in the first semi-monthly period of the month, OR

2 the taxpayer incurs more than 75 percent of the monthly liability for other taxes in the first semi-monthly period of the month.

(e) If the exception applies, as above, the taxpayer does not have to record taxes on a semi-monthly basis.

(3) Exception 3 (50 Percent Rule) -- This applies to ALL excise taxes.

(a) The taxpayer makes timely semi -- monthly deposits of at least 50 percent of the total reported taxes for the preceding month. For manufacturer and retailer taxes, the timely semi-monthly deposit must be 50 percent of the taxes reported in the second preceding month.

(b) The taxpayer must deposit the underpayment from the first or second month, as follows.

1 For manufacturers, retailers and environmental taxes. deposit the unpaid tax by the 9th day of the second month after the month reported.

2 For air transportation and communications, deposit the unpaid tax by the last day of the month after it was reported.

3 For all other excise taxes, deposit the underpayment by the first day of the second month following the month reported.

(c) The taxpayer must deposit the unpaid tax from the last month, if it is \$100 or more, by the return due date. If the unpaid tax is under \$100, the taxpayer can pay it with the return.

(d) This exception was not valid if:

1 The taxpayer collects more than 75 percent of air transportation or communications tax in the first semi-monthly period of the month, or

2 the taxpayer incurs more than 75 percent of the monthly liability in the first

semi-monthly period of the month.

(e) If the exception applies, as above, the taxpayer does not have to record taxes on a semi-monthly basis.

(4) Exception 4 (90 Percent Rules) -- This applies to manufacturers, retailers and environmental taxes.

(a) The taxpayer timely deposits an amount for the second semi-monthly period in a month that when added to the deposit for the first semi-monthly period equals 90 percent of the total tax for the month.

(b) The taxpayer must deposit unpaid tax from the first or second month, as follows. They must deposit the unpaid 10 percent tax by the 9th day of the second month after the month the tax was reported.

(c) The taxpayer must deposit the unpaid 10 percent tax from the last month, if it is \$100 or more, by the return due date. If the unpaid tax is under \$100, the taxpayer can pay it with the return.

(d) If the exception applies, the taxpayer does not have to record taxes on a semi-monthly basis.

(20)490 (3-21-95) Form 1042

(20)491 (3-21-95) General

(1) Taxpayers file Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons, to report and pay tax due on income derived from sources in the United States. Currently, Form 1042 is processed only at the Philadelphia Service Center.

(2) Taxpayers may file Form 2758, Application for Extension to File Certain Excise, Income, Information, and Other Returns. Approval of the extension allows additional time to file the return.

(3) Form 2758 DOES NOT provide additional time to pay the taxes.

(20)492 (3-21-95) Deposit Requirements

(1) FTD deposit requirements for Form 1042 were not affected by the revised regulations effective for periods after December 31, 1992. The quarter-monthly periods still apply.

(2) For deposit purposes, divide each month into four periods ending on the 7th, 15th, 22nd and last date of the month. These periods are called quarter-monthly periods. The tax return labels them 1 through 60.

(3) The taxpayer must list the tax liability in the ROFT section, if the yearly tax is at least \$200.

(4) Deposit requirements are based on the amount of undeposited taxes at the end of the deposit period. Exceptions may apply due to Foreign Tax Treaties, See Exhibit (20)400-12.

(a) If the taxes at the end of a month (other than December) are under \$200, they are carried to the next month.

(b) If taxes at the end of December are under \$200, they may be paid with the return or deposited by the return due date.

(c) If the taxes at the end of a month are \$200 or more, but less than \$2,000, the deposits must be made by the 15th of the following month.

(d) If an earlier quarter-monthly deposit was made and taxes are \$200 or more but less than \$2,000 in a month other than December, the taxes are carried to the next month. For December, the deposits must be made by the return due date.

(e) If undeposited taxes at the end of a quarter-monthly period are \$2,000 or more, the deposits must be made within 3 banking days after the quarterly-monthly period.

(20)493 (3-21-95) Special Deposit Requirements

(1) 90 Percent/Safe Harbor Rule -- Taxpayers are considered to have met the \$2,000 deposit requirement in IRM (20)492 above, if they comply with all of the following:

(a) At least 90 percent of the liability is paid timely.

(b) The remaining balance for each month is paid as follows:

1 The taxpayer deposits underpayments from a month (other than December) with or before the first deposit due after the 15th day of the following month.

a If there are no deposits due after that date, the taxpayer deposits underpayments of \$200 or more by January 31.

b The taxpayer pays underpayment amounts under \$200 with the return or deposits them by the return due date.

2 The taxpayer deposits December underpayments of \$200 or more by January 31.

3 The taxpayer pays December underpayment amounts under \$200 with the return or deposits them by the return due date

4 For periods ending after March 31, 1991, see 434.22 of LEM XX-400.

(c) Apply deposits made after the 15th day of the following month as follows:

1 Satisfy any Safe Harbor underpayment from the prior month.

2 If the deposit does not satisfy the full amount, apply in the order in which they accrued.

(2) See Exhibit 400 -- 6 of LEM XX -- 400 to determine if the taxpayer made timely deposits.

(3) Taxpayers do not have to apply the Safe Harbor provisions to all deposits in a specific tax

period. They may apply the provisions to certain deposits, while paying 100 percent of the others.

(20)494 (3-21-95) Computing the FTD Penalty

(1) Refer to Form 1042 deposit requirements (See Exhibit (20)400-12) to determine if sufficient deposits were made).

(2) Compare the tax liability:

(a) on the Record of Federal Tax (ROFT) with the deposits made.

(b) If the ROFT is incomplete or blank, average the total tax. See IRM (20)441.3..

(3) For deposits required after December 31, 1989, there is a four tier penalty system. The penalty rate assessed depends on the number of days a deposit is late, See Exhibit (20)400-4.

(4) Remember that exceptions apply only to the last month of the repeating period (December). They do not apply to the last month of each quarter (March, June and September).

(20)495 (3-21-95) Average Penalty

(1) If the ROFT is incomplete or blank, average the total tax as shown below:

(a) Divide the tax liability:

1 by four to get a quarterly amount, then

2 divide each quarterly amount by 12.

(b) Consider the results as the tax liability for periods B, D, F, H, J, L, P, R, T, V and X.

(c) compute the penalty.

(d) total the quarterly penalty amounts for one penalty assessment amount. See 416.1 of LEM XX-400.

(20)496 (3-21-95) Deficiency Procedures

(1) The determination of whether a penalty will be subject to a statutory notice of deficiency procedure usually depends on whether the underlying tax is subject to the deficiency procedure.

(2) IRC section 1441, Withholding of Income Tax on Nonresident Aliens, is subject to deficiency procedures. IRC section 6665, Applicable Rules, does not exclude IRC section 6656, Federal Tax Deposit penalties.

(3) The statutory notice of deficiency procedures will apply to a Federal Tax Deposit penalty as well as any underpayment of tax. Even if there is not an underpayment of tax, statutory notice of deficiency procedures apply to the Federal Tax Deposit penalty as it relates to the Form 1042.

(20)4(10)0 (3-21-95) Form CT-1

(20)4(10)1 (3-21-95) General

(1) The railroad retirement system is the only "private" pension system administered by a federal board. It is similar to Social Security, but covers only railroad workers and includes benefits other than retirement.

(2) A second tier of benefits also pays unemployment compensation and retiree medical benefits.

(3) The system is fully funded by a payroll tax of 16.1 percent on railroad companies and 4.9 percent on employees.

(4) For additional information on Form CT-1, see IRM 3(15)(148)(10), BMF and Non-Master File (NMF) DP Tax Adjustment.

(5) The Kansas City Service Center processes Forms CT-1. Penalty adjustments on Forms CT-1 should be made only after contacting KCSC.

(20)4(10)2 (3-21-95) Filing Requirements

(1) Form CT-1 (Employer's Annual Railroad and Unemployment Repayment Tax Return) is an annual return used to report and pay Railroad Retirement Tax (RRTA) (including Supplemental tax and Special Supplemental tax, and Railroad Unemployment Repayment Tax (RURT)). RURT is not applicable after July 1, 1993. See Exhibit 400-5 of LEM XX-400.

(2) The Railroad Retirement Tax (RRTA) and Railroad Unemployment Repayment Tax (RURT) each have a separate ROFT.

(20)4(10)3 (3-21-95) Deposit Requirements

(20)4(10)3.1 (3-21-95) RRTA (Part II) Beginning January 1, 1995

(1) For periods after December 31, 1994:

(a) The taxpayer must begin depositing by EFT if a taxpayer's total deposits of taxes, during the determination period, exceed a prescribed dollar threshold.

(b) See Exhibit (20)400-3 for threshold amounts, determinations periods and applicable effective dates.

(c) See IRM (20)414.213.

(20)4(10)3.2 (3-21-95) RRTA (Part II) Beginning January 1, 1993

(1) New rules determine when a taxpayer deposits the RRTA (other than Supplemental Taxes and RURT).

(a) The taxpayer will be either a monthly or semi-weekly depositor based on the lookback period.

(b) Taxpayers must complete Part II (Record of Railroad Retirement Tax Liability), if

they are a monthly depositor and the tax liability is \$500 or more.

(c) Since Schedule B (Supplemental Record of Tax Liability) covers only one quarter, the employer may need to attach four Schedule B's to the Form CT-1. Schedule B is completed, if a taxpayer:

1 is a semi-weekly depositor,

2 accumulates \$100,000 or more on any day during a liability period, or

3 deposits under the Transition Year rules (old deposit rules) for 1993 only.

(d) Beginning in 1994, Form 945-A, Annual Record of Federal Tax Liability, should be used to report tax liabilities reported on Form CT-1. This should be a summary of tax liability, NOT a summary of deposits.

(2) The deposit requirements for Form CT-1 are generally the same as the deposit requirements for Form 941, with the following exceptions:

(a) Supplemental Annuity Work Hour Tax reported on Form CT-1, is based on work hours. The tax deposit is due once a month with the due date being the first deposit of RRTA due after the 15th day of the following month.

(b) Special Supplemental Annuity Tax reported on Form CT-1, is for employers who are exempt from the Supplemental Annuity Work Hour Tax. The tax deposit is due quarterly, the last day of the second month following the end of the quarter.

(c) December 31, 1992 and prior: If the tax liability at the end of December is at least \$100 but less than \$500, the taxpayer deposits the tax by the return due date. If the tax is under \$100, the taxpayer may submit the payment with the return.

(3) Currently, Form CT-1 consists of two major parts (Part I and II). A Part III was used only for periods beginning October 1985 through June 1993.

(a) Part I -- Railroad Retirement Taxes. The adjusted total of supplemental tax, and the adjusted total of employer and employee railroad retirement taxes based on compensation, are combined and should equal the total for year of Part II.

(b) Part II -- Record of Railroad Retirement Tax Liability. For deposit purposes, deposits are made quarterly even though the return is an annual return.

1 Compute the penalty for each quarter separately and combine the quarterly penalty amounts.

2 When computing the quarterly portions, exceptions apply only to the last month of the reporting period (December). Exceptions do not apply to the first three quarters (March, June and September).

(c) Part III -- Railroad Unemployment Repayment Tax (RURT). CAUTION: RURT is not required to be paid after July 1, 1993. The loans and interest were fully repaid as of

June 1993. For deposit purposes (prior to July 1, 1993), divide each year into quarters. If RURT taxes for the year are more than \$100, the tax liability must be listed in the ROFT section of Part III.

1 If the accumulated tax liability at the end of the first, second, or third quarter is \$100 or less, the taxpayer carries it to the next quarter.

2 If the accumulated tax liability is more than \$100 at the end of any quarter, the taxpayer must deposit it by the last day of the following month.

3 If the accumulated tax liability at the end of the last quarter of the year is \$100 or less, the taxpayer may submit the payment with the return or deposit it by the return due date.

4 Special rule for 1989 returns: Due to changes resulting from the Technical and Miscellaneous Revenue Act (TAMRA), deposits of RURT are not required. These taxes must have been paid by the deposit due date. The FTD penalty does not apply to RURT taxes for 1989.

5 For rail wages paid after July 1, 1993 (third and fourth quarters), no RURT is due or payable.

(4) Form CT-1 filers, whose tax liability was \$1 million or more in the second preceding taxable year, must deposit via electronic funds transfer (FEDWIRE) payments. For example, for tax year 1995, the second preceding taxable year would be 1993.

(20)4(10)3.3 (3-21-95) RRTA (Part II) Periods Beginning April 1, 1991 thru December 31, 1992

(1) Tax liability is less than \$500 at the end of a month:

(a) If the tax liability for a month other than December is under \$500, the taxpayer carries the taxes to the next month.

(b) If the tax liability at the end of December is at least \$100 but less than \$500, the taxpayer deposits the taxes by the return due date. The taxpayer may pay those taxes under \$100 with the return.

(2) Tax liability is \$500 or more but less than \$3,000 at the end of any month:

(a) If the tax liability at the end of any month is at least \$500 but less than \$3,000, the taxpayer deposits them by the 15th of the next month. If there was a \$3,000 deposit requirement earlier in the same month, other than December, carry the taxes to the next month.

(b) For December, the taxpayer deposits taxes of at least \$100 but less than \$3,000 by the return due date.

(3) Tax liability is \$3,000 or more at the end of any eighth-monthly period.

(a) If the tax liability at the end of any eighth-monthly period is \$3,000 or more, the taxpayer deposits it within 3 banking days after the eighth-monthly period.

(b) A first-time exception to this deposit requirement applies.

(4) Tax liability is \$100,000 or more on any day.

(a) Beginning August 1, 1990, the taxpayer must make a deposit within one banking day when the taxes reach \$100,000 on any day.

(b) The taxpayer must report the tax liability on Schedule B, Supplemental Record of Federal Tax Liability. Since Schedule B covers only one quarter, CT-1 filers may need to attach up to four schedules.

(20)4(10)3.4 (3-21-95) RRTA (Part II) Periods Ending March 31, 1991 and Prior

(1) Undeposited taxes are less than \$500 at the end of a month:

(a) If total undeposited taxes for a month other than December are under \$500, the taxpayer carries them to the next month.

(b) If undeposited taxes at the end of December are at least \$100 but less than \$500, the taxpayer deposits them by the return due date. The taxpayer may pay taxes under \$100 with the return.

(2) Undeposited taxes \$500 or more but less than \$3,000 at the end of any month:

(a) If total undeposited taxes at the end of any month are at least \$500 but less than \$3,000, the taxpayer deposits them by the 15th of the next month. However, if there was a \$3,000 deposit requirement earlier in a month other than December, carry the taxes to the next month.

(b) For December, the taxpayer deposits taxes of at least \$100 but less than \$3,000 by the return due date.

(3) Undeposited taxes are \$3,000 or more at the end of any eighth-monthly period.

(a) If total undeposited taxes at the end of any eighth-monthly period are \$3,000 or more, the taxpayer must deposit them within 3 banking days after the eighth-monthly period.

(b) See (20)435.22, the "First-Time Exception" rule.

(4) Undeposited taxes are \$100,000 or more on any day:

(a) Beginning August 1, 1990, the taxpayer must make a deposit within one banking day when the taxes reach \$100,000 on any day.

(b) The taxpayer must report the tax liability on Schedule B (Supplemental Record of Federal Tax Liability). Since Schedule B covers only one quarter, CT-1 filers may need to attach up to four schedules.

(5) CT-1 Supplemental Annuity Tax is based on work hours. It is due once a month. It is due with the first eighth-monthly deposit of RRTA due after the 15th of the month, following the month in which the Supplemental Annuity Tax arises.

(20)4(10)3.5 (3-21-95) RURT (Part III) Periods Beginning April 1, 1991 and Later

(1) Tax liability is \$100 or less at the end of a quarter.

(a) If the tax liability at the end of the first, second or third quarter is \$100 or less, the taxpayer carries it to the next quarter.

(b) If the tax liability at the end of the last quarter of the year is \$100 or less, the taxpayer pays it with the return or deposits it by the return due date.

(2) If the tax liability at the end of ANY quarter is over \$100, the taxpayer deposits it by the last day of the next month.

(3) Form CT-1 filers, whose tax liability was \$1 million or more in the second preceding taxable year, must deposit via electronic funds transfer (FEDWIRE) payments. For example, for tax year 1995, the second preceding taxable year would be 1993.

(20)4(10)3.6 (3-21-95) RURT (Part III) Periods Ending March 31, 1991 and Prior

(1) Undeposited taxes are \$100 or less at the end of a quarter.

(a) If total undeposited taxes at the end of the first, second or third quarter are \$100 or less, the taxpayer carries them to the next quarter.

(b) If total undeposited taxes at the end of the last quarter of the year are \$100 or less, the taxpayer pays them with the return or deposits them by the return due date.

(2) If undeposited taxes at the end of any quarter are over \$100, the taxpayer deposits them by the last day of the next month.

(3) Special rule for 1989 returns:

(a) Due to changes resulting from the Technical and Miscellaneous Revenue Act (TAMARA), deposits of Railroad Unemployment Repayment Tax (RURT) are not required.

(b) These taxes must have been paid by the deposit due dates.

(c) The FTD penalty does not apply to RURT taxes for 1989.

(20)4(10)3.7 (3-21-95) Special Deposit Rules

(1) First Time Exception -- See IRM (20)435.22.

(2) Safe Harbor/95 Percent/98 Percent -- See IRM (20)435.21.

(20)4(10)4 (3-21-95) Computing the FTD Penalty

(20)4(10)4.1 (3-21-95) Periods Beginning January 1, 1993 and Later

(1) Refer to Form CT-1 deposit requirements. See IRM (20)4(10)3.

(a) To determine timely deposits, see Exhibit (20)400-13.

(b) Compare the taxpayer's liability, using the information from the Record of Railroad Retirement Tax Liability (RRTA) and Record of Railroad Unemployment Repayment Tax Liability (RURT), with the deposits made. If the information is unavailable, use the averaging method.

(c) If there is an overstatement on the RRTA tax liability, due to a line adjustment, adjust the last liability regardless of the dollar amount.

(d) If the return indicates a monthly or semi-weekly liability of \$100,000 or more, refer to IRM (20)4(40)1.

(20)4(10)4.2 (3-21-95) Periods Ending December 31, 1992 and Prior

(1) Refer to Exhibit (20)400-14 to determine if deposits are timely and sufficient.

(2) See Exhibit 400-5 of LEM XX-400.

(3) For tax period ending December 31, 1989, ONLY, see 4(10)4 2 of LEM XX-400.

(4) Certain TC 670 payments do not require a FTD avoidance penalty. Master File is programmed to forego assessing FTD avoidance penalty on the payments which are uniquely identified as shown in (a) and (b) below. Do not manually compute the FTD avoidance penalty for the payments identified as follows:

(a) TC 670. Blocking Series 700 (for taxpayers required to make wire transfers), and

(b) TC 670. RURT (line 14) amounts only, for tax year ending December 31, 1989.

(5) Combine RRTA and RURT (for periods ending 9306 and prior) penalty amounts and assess only one TC 180.

(20)4(10)4.3 (3-21-95) Average Penalty

(20)4(10)4.31 (3-21-95) General

Average the tax settlement amount when the Record of Railroad Retirement Tax Liability (RRTA-Part II) and/or Record of Railroad Unemployment Repayment Tax Liability (RURT-Part III) is incomplete or blank.

(20)4(10)4.32 (3-21-95) For Periods Beginning January 1, 1993 and Later

(1) The method of averaging Part II will depend on the type of depositor and the information available. To compute an averaged liability:

(a) for a monthly depositor who has not provided any liability breakdown,

1 divide the tax liability by 12, and

2 assign that amount to each of the monthly totals.

(b) for a semi-weekly depositor who has not provided any liability breakdown:

1 divide the tax liability by four to arrive at a quarterly amount, then

2 divide the resulting amount by 12, and

3 assign to the first 12 Fridays of each quarter.

(c) for a semi-weekly depositor who provided the monthly RRTA:

1 divide each month's tax liability by four, and

2 assign the four liabilities to the first four Fridays in that month.

(2) When the averaged liability equals \$100,000 or more, assign the liability to the first day of the first semi-weekly period ending Friday. This applies to both the monthly and semi-weekly depositor.

(3) CAUTION: No RURT (Part III) is required to be paid after July 1, 1993. To average for 1993, use only the first and second quarter, and divide by two.

(20)4(10)4.33 (3-21-95) For Periods Ending December 31, 1992 and Prior

(1) To average RRTA (Part I for tax year 1991 and later) and (Part I for tax year 1990 and before):

(a) Divide the liability by four to arrive at a quarterly amount; then divide the resulting amount by 12, and assign to eighth-monthly periods B,D,F,H,J,L,N,P,R,T,V and X.

(b) If the averaged liability equals \$100,000 or more, assign the liability to the first day of the eighth-monthly periods B,D,F,H,J,L,N,P,R,T,V and X.

(c) Combine the averaged liability amount and the quarterly penalty amounts into one total RRTA penalty amount. Combine this RRTA penalty amount with the RURT penalty amount, if applicable, and assess only one penalty amount (TC 180).

(2) If the Part III RURT liability is incomplete or blank, divide RURT. (Part I, for tax year 1991 and later) and (Part I for tax year 1990 and before) by 4 to arrive at a quarterly breakdown. Compute the penalty using the averaged liability amount.

(20)4(20)0 (3-21-95) Assessment Procedures

(20)4(20)1 (3-21-95) Making Assessments

(1) The following transactions codes (TC) identify assessment or abatement of the FTD Penalty:

(a) TC 186 -- computer generated assessment.

- (b) TC 187 -- computer generated abatement.
- (c) TC 180 -- manual assessment.
- (d) TC 181 -- manual abatement.

(2) Computer generated assessments result from a Master File analysis of the account information.

(3) Manual assessments are input through IDRS. Employees who can not directly input the penalty assessment to IDRS need to prepare an appropriate document to request input of the assessment. Various documents are available for this purpose, such as:

- (a) The preprinted penalty and interest block found on some tax forms.
- (b) Form 4844. Request for Terminal Action.
- (c) Form 4364. Delinquency Computations.
- (d) Form 4907. TDA Posting Voucher.
- (e) Form 3870. Request for Adjustment, and
- (f) Form 8485. Assessment Adjustment Case Record.

(4) Various codes are used to identify conditions regarding the penalty assessment, e.g., penalty computation codes, condition codes, and schedule indicator codes.

(20)4(20)2 (3-21-95) Computer Codes

(20)4(20)2.1 (3-21-95) Identifying Base Period and State Codes

(20)4(20)2.11 (3-21-95) General

(1) Effective January 1, 1993, two new codes were created to display processing information unique to 1993 and subsequent deposit requirements. They are the Base Period Code -- (BASE-PD) and State Code Indicator (STATE).

(2) The Base Period Code (BASE-PD) was created to indicate which deposit schedule was used for FTD Penalty Analysis. The State Code Indicator (STATE) was created to indicate the state in which the taxpayer made FTD deposits.

(20)4(20)2.12 (3-21-95) Base Period Code

(1) The BASE-PD codes are:

- (a) 0=FTD Penalty Bypassed

1 A base period code of zero (even though a penalty might otherwise be due) indicates that the FTD Penalty computation was bypassed at the time the return posted, based on the presence of certain exception criteria.

2 CAUTION: DO NOT ADJUST THE BASE PERIOD CODE OR ASSESS AN FTD PENALTY.

3 Examples of exception criteria are:

a The input return record contains Computer Condition Code J.

b The Entity Employment Code is S (Foreign Subsidiary) -- Forms 940/941/943/945.

c Refer 4(20)2.11 of LEM XX-400.

(b) 1=Monthly Depositor

(c) 2=Semi-weekly Depositor

(d) 3=Monthly/Daily/Semi-weekly Depositor A monthly depositor who must make a \$100,000 or more (daily) deposit immediately becomes a semi-weekly depositor for the remainder of the current year and for the following calendar year.

(e) 4=Semi-weekly/Daily/Semi-weekly Depositor Semi-weekly depositors who incur a \$100,000 or more (daily) deposit requirement return to a semi-weekly deposit schedule after the daily deposit is made.

(2) to annually change the base Period Code (BASE-PD) use CC REQ77, TC 971 and action code, for the quarter affected.

(a) Use action code 40 to change Base Period Code (BASE-PD) to 1. [TC971/151-CD] Overlay CD with 40.

(b) Use action code 41 to change Base Period Code (BASE-PD) to 2. [TC971/151-CD] Overlay CD with 41.

(c) The TC 971 with action code 40 or 41 is displayed on TXMOD and all transcripts.

(3) The purpose of allowing a change to the BASE-PD is to establish an audit trail on a particular account. The BASE-PD should be changed only in limited situations. For example:

(a) The Service may determine that the employer should not be allowed to continue as a monthly depositor.

(b) The employer may submit information that would warrant a change to the account (e.g., a semi-weekly depositor elects to report and deposit back-up withholding separately from the other taxes reported on Form 941 [tax years 1993 and prior]).

(c) The TC 150 belongs on another TIN or tax period.

(20)4(20)2.13 (3-21-95) State Code Indicator (State)

(1) The STATE Code Indicator is entered on Form 941 to show the state in which the taxpayer makes FTD deposits. If the taxpayer deposits in more than one state, the multiple state depositor

(MU) code is entered. The State Code Indicator is displayed on TXMOD and transcripts.

(a) State legal holidays are non-banking days in the determination of deposit due dates.

(b) If the state code is MU, an account will require manual determination of deposit due dates because there is no way to systemically determine in which states an employer has paid wages.

(c) See IRM 3(25)(77)0. IDRS Terminal Responses, for CC FTDPN guidelines and a list of state holidays.

(2) To determine which wages were paid in which state, contact the taxpayer.

(20)4(20)2.2 (3-21-95) Penalty Computation Codes (PCC)

(1) Penalty Computation Codes (PCC) identify conditions which affect the penalty computation. This information is useful when responding to taxpayer inquiries or when making subsequent adjustments.

(2) Computer assessed FTD penalties generate the applicable PCC's

(3) Manually assessed FTD penalties require manual input of the applicable PCC. The PCC should be entered on the FTD penalty assessment or adjustment document.

(4) The PCC is listed with the literal FTD PEN below the penalty amount on IDRS (TXMOD and ACTRA). Master File transcripts (MFTRA) and balance due notices also display a PCC.

(5) Definitions for the various PCCs are as follows:

(a) PCC 03 applies when assessing the FTD penalty with specific liability and payment information. (e.g., computing with a complete ROFT).

(b) PCC 11 applies when assessing the FTD penalty on averaged tax liability information.

(c) PCC 41 applies when assessing the FTD penalty for avoiding the deposit system and the following conditions exist:

1 No FTD's were made, and

2 the taxpayer provided good liability information.

(d) PCC 42 applies when assessing the FTD penalty for avoiding the deposit system and the following conditions exist:

1 The taxpayer made both deposits (TC 650) and unauthorized payments (TC 670/610), and

2 the taxpayer provided good liability information.

(e) PCC 43 applies when assessing the FTD penalty for avoiding the deposit system

and the following conditions exist:

- 1 No FTD's were made, and
- 2 the tax liability is averaged.

(f) PCC 44 applies when assessing the FTD penalty for avoiding the deposit system and the following conditions exist:

- 1 The taxpayer made both deposits (TC 650) and unauthorized payments (TC 670/610), and
- 2 the tax liability is averaged.

(g) PCC 54 applies when assessing the FTD penalty on averaged tax liability information and the following conditions exist:

- 1 A semi-weekly depositor, and
- 2 the taxpayer made insufficient or late deposits (TC 650)

(h) PCC 55 applies when assessing the FTD penalty on averaged tax liability information and the following conditions exist:

- 1 A semi-weekly depositor, and
- 2 the taxpayer made unauthorized payments (TC 670/610).

(i) PCC 56 applies when assessing the FTD penalty on averaged tax liability information and the following conditions exist:

- 1 A semi-weekly depositor, and
- 2 the taxpayer made insufficient or late deposits (TC 650) and unauthorized payments (TC 670/610).

(j) PCC 57 applies when assessing the FTD penalty on averaged tax liability information and the following conditions exist:

- 1 An averaged monthly tax liability of \$100,000 or more and
- 2 the taxpayer made insufficient or late deposits for tax periods beginning January 1, 1993, and later (Forms 941, 943, and CT-1)

(k) PCC 58 applies when assessing the FTD penalty on averaged tax

liability information and the following conditions exist

1 An averaged monthly tax liability of \$100,000 or more, and

2 the taxpayer made insufficient or late deposits for tax periods beginning January 1, 1991 through December 31, 1992 (Forms 941, 943 and CT-1).

(6) Beginning January 1, 1993, PCC's 54, 55, 56, 57, and 58 are available for use to address penalty assessments based on averaged computations related to 1993 and later deposit rules and \$100,000 or more liabilities. Although Cedes 54, 55, and 56 appear on Master File records, they default to PCC 11 on notices. See Exhibit (20)400 -- 15

(7) Before March 31, 1991, PCC's 42, 43, and 44 were not available. When the conditions represented by these PCC's were present, PCC 41 was used with either PCC 03 or PCC 11, as applicable. These multiple PCC's display only on Master File records (MFTRA, ACTRA, and MCC transcripts). IDRS records (TXMOD) display only one PCC. When the account involves multiple PCC's, PCC 41 takes precedence and is displayed on TXMOD.

(20)4(20)2.3 (3-21-95) Penalty Indicator Codes (PIC)

(1) Penalty indicator cedes identify the status of the penalty assessment related to the 15 percent rate. The penalty indicator code is listed below the penalty computation code.

(2) Valid penalty indicator cedes are as follows:

(a) 00 applies when the 15 percent penalty rate is not applicable.

(b) 01 applies when the account is a potential 15 percent penalty, and

(c) 02 applies when the 15 percent rate is assessed.

(20)4(20)2.4 (3-21-95) Computer Condition Codes (CCC)

(1) Computer condition codes are assigned by tax examiners or are computer generated during the processing of the return. They identify a special condition or computation for the computer. Computer condition codes post to the master file.

(2) Condition code "J" is used when information from the return indicates the FTD penalty is to be waived. It prevents the computer from generating an FTD penalty.

(20)4(20)2.5 (3-21-95) Schedule Indicator codes (SIC)

(20)4(20)2.51 (3-21-95) General

(1) Schedule indicator codes (SIC) identify conditions that may affect FTD penalty computations.

(2) SIC's have the following priority order; 5, 6, 3, 4, 2, 1, 0. A return with a SIC other than 1 or 0 could have more than one applicable condition.

(3) The presence of some SIC's prevent the Computer from determining a penalty amount. Instead, Master File generates a CP-194, Possible FTD Penalty Notice. The Service Center

manually reviews all CP 194 accounts.

(4) The literal "SIC" displays numeric 0 through 6 in the return record and on all transcripts for returns posting in cycle 8903 or later. The number indicates which condition applies.

(5) For application of SIC's beginning January 1, 1993, and later, refer to Exhibit (20)400-16. Periods addressed 9312, 9412, 9512, refer to the entire calendar year beginning January 1, through December 31.

(20)4(20)2.52 (3-21-95) Periods Beginning January 1, 1993 and Later

(1) SIC 0 -- Master File generates SIC 0 when the ROFT is complete. The computer uses the liability breakdown, scanned or transcribed from the return to make a penalty determination.

(2) SIC 1 -- This applies when the ROFT is incomplete or illegible. When used on Forms 941, 945, 943, 941PR, 941SS, 940, 940PR, or 1042, SIC 1 alerts the computer to average the liability.

(3) SIC 2 -- Applies when a reasonable cause statement is attached to the return.

(4) SIC 3 -- Applies to Form 941 series when:

(a) The return has Schedule A attached showing Backup withholding liabilities and Line 11 shows a Backup Withholding amount, or

(b) the form is marked "Fringe Benefits", or

(c) "Child S.S. issue".

(5) SIC 4 -- is not applicable for 1993 and later returns.

(6) SIC 5 -- is not applicable for 1993 and later returns.

(7) SIC 6 -- (effective for periods ending September 30, 1990 (9009) and later) -- For the Form 941 series, Master File generates SIC 6 when the accumulated liability equals \$100,000 or more.

(8) SIC 7 -- (effective for 9503 and later returns) indicates that the penalty was computed by averaging on a \$100,000 account.

(20)4(20)2.53 (3-21-95) Periods Ending December 31, 1992 and Prior

(1) SIC 0 -- Master File generates SIC 0 when the ROFT is complete. The computer uses the liability breakdown, scanned or transcribed from the return to make a penalty determination.

(2) SIC 1 -- This applies when the ROFT is incomplete or illegible. When used on Forms 941, 941E, 941PR, 941SS, 940, 940PR, and 1042. SIC 1 alerts the computer to average the liability.

(a) When Master File averages the liability, a CP 207 notice is generated to propose an averaged FTD penalty.

(b) For Form 941, periods ending September 30, 1990 (9009) and later, Master File generates a CP 194, SIC-6 (rather than CP 207) if the averaging total is \$100,000 or

more.

(c) For Forms 941 and 940, period ending December 31, 1989 (8912), Master File generates a CP 194 with a 1 indicator, when the following conditions exist:

1 The 5 percent tier results in an assessable amount, and

2 the 2 percent penalty may be applicable. See 4(20)3.33 of LEM XX-400.

(3) SIC 2 -- Applies when

(a) A Reasonable Cause Statement is attached to the return, or

(b) when the taxpayer checks the box for the "95 Percent Rule" on Form 941 and Form 943 series.

(4) SIC 3 -- Applies to Form 941 series when

(a) The return has Schedule A attached showing Backup Withholding liabilities and Line 11 shows a Backup Withholding amount, or

(b) the form is marked "Fringe Benefits", or

(c) "Child S.S. issue".

(5) SIC 4 -- Applies to the Form 941 series when the taxpayer Checks the "First-Time 3-banking-day depositor" box.

(6) SIC 5 -- (effective for periods ending September 30, 1990 (9009) and later) -- Applies to the Form 941 series when:

(a) The return has a Schedule B. Supplemental Record of Federal Tax Liability attached, or

(b) any eighth-monthly period lists a liability of \$100,000 or more, whether or not the return has a Schedule B attached.

(7) SIC 6 -- (effective for periods ending September 30, 1990 (9009) and later) -- For the Form 941 series, Master File generates SIC 5 when SIC 1 is input and the averaged liability amount equals \$100,000 or more.

(20)4(20)3 (3-21-95) CP 194 Notices

(20)4(20)3.1 (3-21-95) Possible FTD Penalty Notice

(1) For application of SIC's beginning January 1, 1993, and later, refer to Exhibit (20)400-16 Periods addressed 9312, 9412, 9512, refer to the entire calendar year beginning January 1, through December 31.

(2) Master File generates a Possible FTD Penalty Notice, CP 194, for the following:

(a) Returns with Schedule Indicator Codes (SIC) input during the code and edit phase

of return processing.

(b) Certain 941, 943, 945, 940, 720 and 1042 filers

(c) Form CT-1

(d) Form 941M, if the filing requirement is 10.

(e) Forms 941E, 941PR, 941SS, 943PR, and 940PR for the Philadelphia Service Center (PSC) only, when they meet the conditions in (a) and (b) above.

(3) Issuance of the CP 194 means the service center must review the account and manually calculate the penalty. Whenever possible, telephone contact with the taxpayer should be used to resolve the CP 194 issue.

(4) The service center must process CP 194 notices within 45 calendar days of the IRS Received Date. This includes issuing Letter 313C to the taxpayer.

(5) Master file generates 2 copies of the CP 194 notice. The Service Center Files area receives the notices and secures the original related return. One copy of the notice is attached to the tax return and the other is used as the return charge out. If the Files area does not send the original return, proceed as follows:

(a) If Files attaches an incorrect tax return, send the return (with the CP 194) back to Files and request the correct return,

(b) If Files did not attach a return, review the charge out information or IDRS to determine if the tax return is in another function. If so, contact that area to secure a Copy of the return.

(c) If neither the original return nor a copy is available, follow instructions for averaging the tax liability. (Refer to computation procedures for the applicable return.)

(6) If the case has other freeze conditions, coordinate with the appropriate area for resolution.

(20)4(20)3.2 (3-21-95) Computing the FTD Penalty

(1) On CP 194 notice accounts that show a balance due, conduct the following IDRS research. This helps ensure that credit posting problems are identified and corrected before computing the penalty.

(a) Review the account transcript (TXMOD) to see if any timely deposits posted after the generation of CP 194 notice.

(b) Review TXMOD for other tax periods to see if there is a misapplied deposit intended for the period in question.

(c) Review CFOL, IDRS, etc. for the FTD Credit Module (01 0000), to see if it has a deposit intended for the current period.

(d) Review UPTIN for the EIN to see if any deposits are unpostable.

(e) Review URINQ/XSINQ for the name control to see if any credits are in the Unidentified or Excess Collections accounts.

(f) Review EINAD for any other TINS assigned to this employer.

(2) On CP 194 notice accounts with a credit balance, conduct the following IDRS research.

(a) Check for any pending assessments. If a TC 976 is present, a duplicate return (or amended return) has posted. Hold the CP 194 notice until the CP 193 notice generates. (Master File generates a CP 193 when a duplicate or amended return posts to an account) Follow local procedures for associating multiple cases.

(b) Check for other control bases. If one is present, coordinate with the other area.

(c) Check for debt balances on other account periods to see if the credit posted in error. If so, transfer the payment(s).

(3) See 4161 of LEM XX-400

(20)4(20)3.3 (3-21-95) Working CP 194 Notices

(20)4(20)3.31 (3-21-95) General

For application of SIC's beginning January 1, 1993, and later, refer to Exhibit (20)400-16. Periods addressed 9312, 9412, 9512, refer to the entire calendar year beginning January 1, through December 31.

(20)4(20)3.32 (3-21-95) SIC Indicator 0

(1) SIC 0 -- Master File may generate a CP 194 notice on an account with a 0 indicator. This means conditions exist, other than those identified by SIC's 1 through 6, that require manual review of the account.

(2) The reason Master File generates a CP 194 with a 0 indicator may not be clearly evident, since SIC 0 means the return has a valid ROFT for computing the penalty.

(a) If the tax return shows valid ROFT information, use the ROFT figures to compute and assess the penalty.

(b) If the tax return shows invalid ROFT information, compute the averaged liability and assess the penalty.

(c) If the return is not available:

1 use the ROFT figures from the account transcript (TXMOD), if those figures are valid.

2 If the figures are not valid or if the ROFT information is not available, average the liability.

3 Send Letter 313C, and the appropriate form or schedule to the taxpayer.

(20)4(20)3.33 (3-21-95) SIC Indicator 1

(1) SIC 1 -- The original tax return is not required, because SIC "1" indicates that the return does not have a complete and accurate ROFT. See 4(20)3.33 of LEM XX-300.

(2) Use the ROFT figures from the account transcript. If those figures are not valid or if the ROFT information is not available, average the liability. Send Letter 313C, FTD Penalty Proposal letter and appropriate ROFT form to the taxpayer. See Exhibit (20)400 -- 16

(3) In most instances, when a SIC 1 is input to a return, Master File averages the penalty. Then, Master File generates a CP 207 notice (Proposed Averaged Penalty) to the taxpayer.

(20)4(20)3.34 (3-21-95) SIC Indicator 2

(1) SIC 2 -- If Master File generated the CP 194 because a reasonable cause statement is attached to the return, follow procedures for processing reasonable cause requests. See IRM (20)4(70)1. If the taxpayer does not meet reasonable cause criteria, assess the penalty.

(2) For periods ended December 31, 1992 and prior, if Master File generated the CP 194 because the taxpayer checked the 95 percent Rule box on the return, refer to the Safe Harbor provisions when computing the penalty and assess the penalty, as applicable.

(3) If the return is not available and, the tax liability (TC 150) is \$10,000 or greater, assume the 2 indicator is present because Safe Harbor provisions apply.

(4) If the return is not available, use ROFT figures from the account transcript. If those figures are not valid or if the ROFT information is not available, average the liability. Send Letter 313C, and the appropriate form or schedule to the taxpayer.

(20)4(20)3.35 (3-21-95) SIC Indicator 3

(1) SIC 3 -- Refer to procedures for computing a penalty which involves backup withholding.

(2) Use ROFT information on the return and/or Schedule A or Form 945 and/or 945-A, as appropriate. Assess the penalty, as applicable.

(3) If the return and/or Schedule A is not available or is inaccurate, average the liability. Send Letter 313C and appropriate form or schedule to the taxpayer. See Exhibit (20)400 -- 17.

(20)4(20)3.36 (3-21-95) SIC Indicator 4

(1) SIC -- This SIC is not applicable after December 31, 1992. Refer to Exhibit 400 -- 16.

(2) Refer to the "First-Time Exception" procedures under the special deposit rules for the applicable tax form.

(3) If the taxpayer does not qualify for the "First-Time Exception", compute the penalty without regard to the exception and send Letter 1447C.

(4) If the taxpayer qualifies, follow procedures for computing the penalty when the "First-Time Exception" applies.

(5) If the return is not available, use ROFT figures from the account transcript. If those figures are not valid or if the ROFT information is not available, average the liability. Send Letter 313C, and the appropriate form or schedule to the taxpayer.

(20)4(20)3.37 (3-21-95) SIC Indicator 5

(1) SIC 5 -- This SIC is not applicable after December 31, 1992. Refer to Exhibit (20)400 -- 16.

(2) If assessing the penalty (TC 180), a letter of explanation must be sent.

(3) If the return is not available, use ROFT figures from the account transcript. If those figures are not valid or if the ROFT information is not available, average the liability. Send Letter 313C, and the appropriate form or schedule to the taxpayer.

(20)4(20)3.38 (3-21-95) SIC Indicator 6

SIC 6 -- This is generated when the average liability amount is \$100,000 or more. Follow procedures for working CP 194 Notices with SIC indicator 5.

(20)4(20)3.39 (3-21-95) SIC Indicator 7

SIC 7 -- (effective for 9503 and later returns) indicates that the penalty was computed by averaging on a \$100,000 account.

(20)4(20)3.4 (3-21-95) Proposing the FTD Penalty

(1) Propose the FTD Penalty on CP 194 accounts when computing the penalty based on ROFT or Record of Net Tax (RONT) information that is or may be inaccurate. For example, propose the penalty:

(a) When averaging the liability, or

(b) when ROFT figures from the return are inaccurate or unavailable, and figures from the account transcript are used.

(c) EXCEPTION: When the entire tax is paid with the return, the FTD avoidance penalty may apply. A proposed penalty does not apply since accurate ROFT information would not affect the penalty. If the avoidance penalty is appropriate, assess the penalty.

(2) To propose the penalty, correspond with the taxpayer using Letter 313 C and:

(a) For tax periods ending 9303 and later, enclose Schedule B. or the appropriate form (see Exhibit (20)400-17).

(b) For tax periods ending 9212 and prior, enclose Form 4977.

(20)4(20)4 (3-21-95) 313C Letters

(20)4(20)4.1 (3-21-95) Issuing Letters

(1) Send Letter 313C when the taxpayer's liability information is not available. For example:

- (a) When averaging the liability results in a penalty, or
 - (b) when ROFT figures from the return are inaccurate or unavailable, and figures from the account transcript are used.
- (2) Letter 313C is printed in triplicate.
- (a) Enclose the appropriate form (see Exhibit (20)400-17) with two copies mailed to the taxpayer.
 - 1 Include the appropriate Supplemental Record Federal Tax Liability, instead of Form 4977, when the \$100,000 rule (SIC 5 or 6) is the issue.
 - 2 Notice 1009 and Schedule A are automatic enclosures with Letter 313C for Form 720 filers.
 - (b) Suspend the third copy with the CP 194 notice.
- (3) DO NOT send Letter 313C in the following circumstances:
- (a) If the penalty is entirely due to direct payments, the 10 percent penalty applies. Send the Letter 1447C (for periods 9212 and prior) or Letter 2782 (for periods beginning after 9212). Close the case.
 - (b) For Forms 720, periods ending March 31, 1991 and prior: if Form 4977 information would not affect the penalty, do not send any letter. Assess and close the case.
- (4) When assessing an FTD Penalty as a result of a Letter 313C and the 15 percent tier penalty may be applicable:
- (a) Use blocking series 000-099 to indicate a refile DLN (original return or mag tape facsimile is available), or
 - (b) use blocking series 150-159 to indicate a non-refile DLN.
- (5) When assessing an FTD Penalty as a result of a Letter 313C and the 15 percent tier penalty is not applicable, (e.g., when the account is full paid):
- (a) Use blocking series 130-139 to indicate a refile DLN (original return or mag tape facsimile is available), or
 - (b) use blocking series 140-149 to indicate a non-refile DLN.
 - (c) Use of blocking series 130/149 will prevent the issuance of CP 294 which indicates that the 15 percent rate may be applicable.
- (20)4(20)4.2 (3-21-95) Replies to Letters**
- (1) Associate the taxpayer's reply with the suspense copy.
 - (a) If located, assess a penalty as appropriate.

(b) If not located, check IDRS to see if the suspended case was processed as a "No Reply". If so, recompute the penalty based on the taxpayer's reply. If a penalty was previously assessed, make any necessary adjustments.

(c) Inform the taxpayer of the correct penalty amount, the reason for the adjustment, and the correct balance due.

(20)4(20)4.3 (3-21-95) No Response Cases

(1) If the taxpayer does not reply within the suspense period, research IDRS to see if a duplicate/amended (TC 976) filing condition is present. (TC 976 usually generates CP93/193/293).

(a) A taxpayer may re-submit a tax return with a completed ROFT rather than complete Form 4977 or Schedule B. See Exhibit (20)400-17.

(b) If a duplicate filing condition is present, refer to adjustment guidelines (IRM 3(15)60, General DP Adjustments) for procedures for working multiple issues.

(2) For no response cases, assess the averaged penalty.

(20)4(20)5 (3-21-95) CP 207 Notices

(20)4(20)5.1 (3-21-95) Master File Proposes the FTD Penalty

(1) Master File generates CP 207 notices to propose an averaged FTD Penalty for certain 941, 940, 945, and 1042 filers when:

(a) The ROFT section of the return was incomplete/illegible, or

(b) the total tax liability did not equal the net taxes. See 4(20)5.1 of LEM XX-400.

(2) If the account has a balance due, credit balance, or math error, Master File assesses the FTD Penalty, with penalty Computation Code 11 (TC 186, PCC 11), with the first notice.

(3) If the account shows that the tax is paid, Master File "holds" the FTD Penalty assessment action for 15 cycles (weeks), and then generates the proposed penalty taxpayer notice.

(4) If there is no reply to a CP 207 or if the reply is not resolved and posted to Master File within 15 cycles (weeks) (after issuance of the CP 207). Master File will systemically assess an averaged penalty (TC186).

(5) If possible, contact the taxpayer by telephone to resolve an issue before the penalty is automatically/systemically assessed.

(20)4(20)5.2 (3-21-95) Replies to Notices

(1) Replies to CP 207 notices must be resolved by the 11th cycle after generation of the notice to allow time for posting and correction of unpostables before the automatic 15 cycle (week) hold expires. If possible, contact the taxpayer by telephone to resolve an issue before the penalty is

automatically/systemically assessed.

(2) If no penalty applies, input a TC 180 for zero amount to prevent systemic assessment of the deposit penalty.

(20)4(20)5.3 (3-21-95) Late Replies to Notices

(1) If the taxpayer provides the corrected ROFT information after the 11th cycle (week) but before automatic assessment (15th cycle), compute the correct penalty. If the correct penalty differs from the proposed penalty, see 4(20)5.3 of LEM XX-400.

(2) Inform the taxpayer that we did not receive the reply in time to prevent the penalty from being automatically assessed and that we will adjust the account and issue a corrected notice.

(3) Suspend the case until the TC 186 posts and then input the appropriate TC 18X, or

(4) If the reply is received after Master File automatically assesses the penalty (TC186), adjust the penalty as appropriate.

(20)4(20)6 (3-21-95) Replies to CP 207 and Letter 313C

(1) Taxpayer provides a complete Record of Federal Tax (ROFT) liability schedule.

(a) Compute the penalty based on the taxpayer's figures.

(b) For CP 207 notices, if there is not change to the proposed penalty amount, allow the computer to assess the penalty. Associate the reply with the return.

(2) Taxpayer provides an unacceptable ROFT or other correspondence.

(a) Contact the taxpayer (For CP 207 cases, issue the second letter only if there is enough time to receive the taxpayer's reply and input the penalty amount by the 11th week after generation of CP 207. See (c) below.

1 Explain why the information provided by the taxpayer is unacceptable.

2 Include a new Form 4977 or Schedule B Highlight pertinent areas if it would help the taxpayer.

3 Advise the taxpayer that if we do not receive acceptable ROFT information within 20 days, the averaged penalty amount will be assessed.

4 Suspend the case for 30 days.

(b) If the taxpayer does not respond or sends an unsatisfactory response to our second request, assess the averaged penalty amount (TC 180). Inform the taxpayer.

(c) For CP 207 notices, if time does not permit a second letter inform the taxpayer that the information provided was incomplete. Advise the taxpayer to submit the necessary information after receipt of the penalty assessment notice. Include Form 4977 [for period 9212 and prior] or Schedule B [for periods beginning after 9212].

(3) Taxpayer claims first-time exception (prior to December 31, 1992) or reasonable cause with or without providing a liability schedule.

(a) If the taxpayer claims the "first-time exception," refer to computation procedures for first-time exception.

(b) If the taxpayer claims reasonable cause, follow procedures for processing reasonable cause requests.

(c) If we need additional information for a reasonable cause determination, proceed as follows:

1 Send Letter 1382C for additional information, if there is enough time to receive the reply and input the resulting adjustment by the 11th week after generation of CP 207.

2 If there is not enough time to prevent systemic assessment of the penalty, advise the taxpayer to submit the information after receipt of the penalty assessment notice.

(d) If the taxpayer does not qualify for the "first-time exception" or does not establish reasonable cause, compute the penalty using the figures the taxpayer provide. If the taxpayer did not provide an acceptable ROFT, follow procedures in (2) above.

(4) Taxpayer submits an amended Form 720, see IRM (20)480.

(5) Taxpayer submits form 941c or other adjustment information. If an averaged penalty resulted because the ROFT did not agree with the TC 150, the taxpayer may reply with an amended return.

(a) For Form 941C procedures, refer to BMF Adjustment procedures in IRM 3(15)(148)0, BMF DP Adjustments.

(b) A valid ROFT is required before adjustments to the penalty can be considered. If an adjustment is disallowed, advise the taxpayer by correspondence.

(c) If it is a valid ROFT, compute the FTD penalty with the new information.

1 If the new tax and ROFT figures agree, assess the penalty.

2 If the new tax and ROFT figures do not agree, follow procedures in (2) above.

(20)4(20)7 (3-21-95) CP 294 Notices

(20)4(20)7.1 (3-21-95) Potential 15 Percent Penalty

(1) Under the four tier penalty system, the 15 percent penalty rate is applied to the balance due (tax only) that remains unpaid after notice and demand for the FTD penalty (e.g. 23-C date plus 10 days). The fourth tier is not assessed, if the FTD Penalty (TC 186) was not previously assessed. See 4(20)7.1 of LEM XX-400.

- (2) For systematic FTD penalty assessments, Master File (e.g., TC 186):
 - (a) Identifies modules with tax owing.
 - (b) marks the FTD penalty (TC186) as a potential 15 percent penalty (PCC 01), and
 - (c) sets a deferred action code (DA) that expires in five cycles
- (3) After expiration of the DA, Master File:
 - (a) Re-analyzes the account, generates the TC 18X, and
 - (b) generates the appropriate taxpayer notice
- (4) For manual FTD penalty assessments, Master File (e.g., TC 180):
 - (a) identifies modules with tax owing, and
 - (b) marks the FTD Penalty (TC 180) as a potential 15 percent penalty (PCC 01), ONLY if the TC 180 is in a Blocking Series other than 130/140
 - (c) Sets a DA that expires in five cycles, and
 - (d) after expiration of the DA, generates a CP 294 (internal notice) to force manual review of the account.

(20)4(20)7.2 (3-21-95) Processing Notices

- (1) Upon receipt of CP 294, the service centers take the following actions.
 - (a) Review available account information. Determine net unpaid tax as of the 23-C date plus 10 days:
 - 1 Consider only posted credits to determine net unpaid tax.
 - 2 Suspend an account until any pending or unpostable credits are resolved.
 - (b) See 422 of LEM XX-400.
- (2) When the net unpaid tax is determined:
 - (a) Multiply this amount by 5 percent (total penalty is limited to 15 percent, of which 10 percent has already been assessed),
 - (b) input TC 180 for the result of (2)(a) above,
 - (c) use the same PCC as in the original assessment/adjustment,
 - (d) use BS 130/139 when adjusting CP 294 with original return or mag tape facsimile,
or,
 - (e) use BS 140/149 when adjusting CP 294 without original return.

(f) See 4(20)7.1 of LEM XX-400.

(3) Master File generates the appropriate taxpayer notice.

(20)4(20)8 (3-21-95) Taxpayer Responds to Notice of Penalty Assessment

(20)4(20)8.1 (3-21-95) General

(1) For a computer generated penalty (186), or for a manually assessed penalty (TC 180), reconstruct the penalty using CC FTDPN for Form 941 accounts, if IDRS is available. Use Form 6844, FTD Computation Worksheet for all other MFTs. If needed, request the original penalty assessment document to determine the previous computation procedure.

(2) Review account transcripts (CFOL, IDRS, etc.) and check the penalty computation codes (PCC) and schedule indicator codes (SIC) for information on how the penalty was computed.

(3) If unable to reconstruct the penalty computation, manually recompute the penalty.

(4) Provide the taxpayer with a copy of your computation of the penalty.

(20)4(20)8.2 (3-21-95) "First-Time"/Reasonable Cause Claim Submitted

(1) Taxpayer claims the "First-Time Exception", valid for periods ending December 31, 1992 and prior.

(a) Refer to the "First-Time Exception" procedures under special deposit rules for the applicable return.

(b) If the taxpayer does not qualify for the "First-Time Exception," advise the taxpayer of this determination and that the penalty amount is valid.

(c) If the taxpayer qualifies, follow procedures for re-computing the penalty when the "First-Time Exception" applies. Adjust the penalty amount. Notify the taxpayer of the correct account balance.

(2) Taxpayer submits a reasonable cause statement.

(a) Refer to the criteria in IRM (20)4(70)1 and/or (20)300.

(b) If the taxpayer does not meet reasonable cause criteria, follow procedures for denying reasonable cause requests.

(c) If reasonable cause is established, adjust the penalty amount. Notify the taxpayer of the new balance due, if any.

(20)4(20)8.3 (3-21-95) Payment Information Submitted

(1) If the taxpayer claims the Service did not properly credit the account.

(a) review the cancelled check, bank data, or other information the taxpayer provided about the payment.

(b) Determine if the payment posted correctly to the account.

(2) If the deposit is not on the account, follow the functional procedures for tracing the payments

(3) If the payment has posted to the correct account after Master File generated the original penalty (TC 186), an automatic recomputation of the penalty occurs. Notify the taxpayer that the payment has been properly applied or that the payment was properly credited.

(4) If the payment posted to the correct account, after a manually assessed penalty (TC 180), recompute the penalty using the latest payment information.

(5) If a payment posted after the 15 percent rate is in effect, it may not be necessary to recompute the penalty.

(6) If the payment posted, but the transaction date does not agree with the information provided, refer to IRM (20)4(50)0.

(7) For information regarding the application of payments see IRM (20)423.

(20)4(20)8.4 (3-21-95) Additional ROFT Information Submitted

(1) Taxpayers may submit revised ROFT liability breakdown information.

(2) A revised ROFT received may be a reply to CP 207 or Letter 313.

(a) Check TXMOD to determine if Master File issued a CP 207.

(b) Check ENMOD/TXMOD to see if a service center issued Letter 313C.

(c) If either was issued and the penalty has not been assessed, coordinate with the FTD Penalty Function.

(d) If neither CP 207 nor Letter 313C was issued, follow instructions in (3) and (4) below.

(3) Since taxpayers file their returns under "penalty of perjury", taxpayer requests to revise or add return information must be resolved appropriately. See 4(20)8.4 OF LEM XX-400.

(4) Upon receipt of a properly signed request, recompute the penalty using the new ROFT information.

(5) See 4(20)8.4 of LEM XX-400 for information on employment tax deposits of \$100,000 or more.

(20)4(20)8.5 (3-21-95) Amended or Supplemental Return

(1) When the taxpayer files an amended or supplemental return that results in a tax adjustment, recompute the penalty using the net tax information.

(2) If a FTD Penalty is not on the tax account, compute the penalty on the new total tax amount and assess the penalty, as applicable. DO NOT assess the FTD Penalty if there is a reasonable

cause indicator on the account, as follows:

(a) Computer Condition Code (CCC) "J" in the return record or

(b) Transaction Code (TC) 181/180 with RC 62 or a Penalty Reason Code (PRC).

(3) If the taxpayer files an amended return and does not provide a revised ROFT and

(a) the tax is being increased, use averaging and assess the penalty using the appropriate penalty computation code. DO NOT correspond for a revised ROFT. The Service includes a blank ROFT form with Notice 746.

(b) If the tax is being partially decreased, inform the taxpayer to submit a revised ROFT. Advise the taxpayer that a revised ROFT may provide information to reduce the FTD Penalty.

(c) Since we cannot accurately determine the penalty amount without ROFT information, adjust the penalty amount so that the total assessed FTD Penalty is not higher than 10 percent of the tax liability, 5 percent for periods 8912 through 9103.

(4) The above instructions apply also to amended returns received from IRC section 6020(b) or jeopardy assessment (Doc. Code 51).

(20)4(20)9 (3-21-95) CAWR and FUTA

(20)4(20)9.1 (3-21-95) General

(1) Combined Annual Wage Repealing (CAWR) and Federal Unemployment Tax Adjustment (FUTA) cases are internally initiated adjustment cases. These Form 941 and 940 subsequent adjustment cases are worked similarly to amended returns for the respective forms.

(2) Because the assessments result from reconciliations with the Social Security Administration (CAWR) or the individual states (FUTA) a revised ROFT is not available and should not be requested before working the case.

(3) See IRM (20)(10)00, Information Returns, for CAWR Information Return Penalties.

(20)4(20)9.2 (3-21-95) Computation of the FTD Penalty

(1) Assess the FTD penalty at 10 percent of the TC 290 amount using PCC 03, and normal penalty considerations and adjustment procedures.

(2) If the adjustment is for a tax decrease, check the account for a prior TC 186 assessment. If the account has a prior TC 186 or TC 180, input the TC 181 for 10 percent of the TC 291. The TC 181 cannot exceed the amount of previously assessed TC 18X.

(3) The account will then be subject to normal procedures for monitoring for the possible assessment of the additional 5 percent fourth tier amount.

(20)4(30)0 (3-21-95) Computation of All FTD Penalties

(20)4(30)1 (3-21-95) Master File Adjustments

- (1) Master file computes the FTD penalty on original liability information only.
- (2) When credits are transferred in or out or when a partial tax decrease is entered. Master File will continue to compute the FTD penalty based on the original liability information. This can occur even if no penalty was charged on the original TC 150.
- (3) To prevent an erroneous systemically generated TC 186, recompute the correct FTD penalty manually if:
 - (a) the TC 291 is for a partial tax decrease, and
 - (b) the total of the credit transfers (TC 612, 652, 672, 702, 712, 762, 820, and/or 830) does not equal the TC 291 amount.

(20)4(30)2 (3-21-95) Manual Adjustments

- (1) CP 194 cases should be pre-screened prior to assignment to tax examiners. Refer to the PIN 80 report that is generated at the same time the CP 194 transcripts are printed. Reviewing the CP 194 along with this report will significantly decrease the unnecessary expenditure of staff resources for non-penalty cases.
- (2) Although computer software is available for calculating penalties, you must still know how the penalty is computed.
- (3) Effective January 1, 1993, command code BMFOL (Business Master Files On-Line) can be used to research FTD liability data before manual computation of FTD penalties. The BMFOL command code provides additional on-line IDRS research of master file tax account data. Several screens will be displayed based on the input definer code. See 3(25)(77)(65), IDRS Terminal Responses, for a listing of screen displays.
- (4) Review account transcripts (CFOL and IDRS. etc.) along with any documentation submitted by the taxpayer (appropriate liability breakdown form, copy of tax return, etc). If the information shows periodic liabilities were incorrectly entered on the account, recompute the penalty with the correct liability information.
- (5) Check the Penalty Computation Codes (PCC) and Schedule Indicator Codes (SIC) on the taxpayer's account. This may provide information on how the penalty was previously computed.
- (6) When necessary, reconstruct how a manually assessed penalty was computed. CC FTDPN may only be used for Form 941. Form 6844, however, may be used for Form 941 as well as other forms. If needed, request the penalty assessment document to determine the previous computation procedure.
- (7) An PIFTD/FTDPN print or other documentation (e.g. a notation on the history sheet that the penalty was computed using FTDPN, when applicable) should be attached, with the other source documents, to each IDRS adjustment. Form 6844, FTD Computation Worksheet, may be used to compute penalty on Form 941 only if IDRS is down or not available.

(8) To adjust the penalty, input TC 18X See 416.1 and 4(30)2 of LEM XX-400.

(9) Notify the taxpayer of the action taken and the correct account balance.

(10) Whenever adjusting the tax amount, input a corresponding FTD penalty transaction (TC 18X). A tax adjustment does not cause Master File to recompute the FTD penalty, even if it is a computer generated penalty, except when a complete tax decrease is input to a module which has no FTD restriction.

(a) As of July 1, 1990 (MCC cycle 9027), a TOTAL tax decrease input to a restricted module (TC 180/181 present) will not post if we do not address the FTD penalty. Unpostable Code 336. Reason Code 2 (UPC 336, RC 2) identifies these situations. These unpostables will be returned to the originator for reinput of the adjustment with the corresponding FTD penalty decrease (TC 181).

(b) It is important to reconsider the FTD penalty when a partial tax increase/decrease is made. The adjustment will post without a related TC 18X. However, when increasing or decreasing tax, consumer the ROFT. Has it been corrected as well?

(c) Master File systemically inputs a TC 187, when a complete tax decrease is input to a module which has no FTD restriction (TC 180/181).

(20)4(30)3 (3-21-95) Command Code FTDPN

(1) Use IDRS CC FTDPN to compute the FTD penalty on quarterly returns (Form 941).

(a) For tax periods 9303 and subsequent, there are ninety three (93) possible liability amounts.

(b) For tax periods 9212 and prior, FTD penalty is computed using the 24 eighth monthly liability amounts (A-X).

(2) CC FTDPN (with no definer) will allow the user to use the liabilities on the TIF data base, or

(3) CC FDTPN (with definer "A") will allow the user to enter the liability information furnished by the taxpayer

(a) CC FTDPN with Definer A displays the FTDPNB input screen format. When using the FTDPNB screen, the user may add, delete or change any liability an infinite number of times to obtain a now FTD computation.

1 If averaging the total liability, enter the total tax less any refundable credit amounts.

2 For tax period 9303 and subsequent, enter the liability next to the numbered day of the month in the quarter.

3 For tax periods prior to 9303, enter the letter code for the deposit period and the liability amounts (dollars and cents) from the Record of Federal Tax (ROFT) section of the return.

(4) CC FTDPN with definer "C" is used for the transition tax periods of 1993 (9303-9312). If definer "C" is used for a tax period in 1993, the penalty will be computed using the old 24 liability format (9212 and earlier).

(5) For tax periods 9303 and subsequent, CC FTDPN will display a credits screen. To compute the FTD penalty on new credits the user may.

(a) add to the current credits, or

(b) alter or delete the TRANS-DATE or TRANS CODE

(c) Also, the BASE-PERIOD-CODE and STATE-CODE may be altered on the FTDPNB Screen to achieve a new computation.

(6) For tax periods ending 9312 and prior -- if the taxpayer treats backup withholding (BUWH) as a separate tax. DO NOT use FTDPN. These cases must be manually verified/computed.

(7) See IRM 3(25)(77)0, IDRS Terminal Inquiries for complete information on IDRS command codes.

(20)4(30)4 (3-21-95) Form 6844 -- FTD Computation Worksheet

The Form 6844, FTD Computation Worksheet, may be used as an aid to manually compute FTD penalty

(20)4(30)5 (3-21-95) Master File Penalty Computations

(1) Master File systemically computes a generated FTD Penalty (TC 186) when credits are transferred in or out of the tax module.

(a) The transactions codes that cause systemic recomputation of the penalty are: 61X, 65X, 70X, 71X, 76X

(b) Since Master File computes the penalty based on the date received and the amount of the deposit, special care is needed to ensure that correct dates are used for making credit transfer.

(c) Credit transfers made to a tax module containing a manually assessed penalty (TC 180/181), require manual recomputation of the penalty.

(2) Master File computes the FTD Penalty on the original liability information only.

(a) A tax adjustment does not cause Master File to recompute the FTD Penalty, even if it is a computer generated penalty.

(b) EXCEPTION: When a complete tax decrease is input to a module which has no FTD restriction, Master File generates a TC 187.

(20)4(30)6 (3-21-95) Master File Differs from Manual Computation

(1) Master File computations may differ from the manual computations, since the computer

program considers deposits only at the time they are due. As a result, it may improperly compute a penalty when uncommon deposit situations arise.

(2) When there is a difference between computer generated and manual computations, manual computations take precedence.

(20)4(40)0 (3-21-95) Special Deposit Rules

(20)4(40)1 (3-21-95) \$100,000 Rule/Accelerated Deposit Rule

(1) For deposit periods beginning January 1, 1993, taxes on Forms 941, 943, 945, and CT-1 that reach \$100,000, or more, must be deposited within 1 banking day for either the monthly or semi-weekly depositor. See Exhibit (20)400-18.

(a) A monthly depositor who incurs a \$100,000 or more tax liability immediately becomes a semi-weekly depositor for the remainder of the current calendar year and the following calendar year (For example, a \$100,000 tax liability incurred on Wednesday becomes a semi-weekly depositor on Thursday).

(b) A semi-weekly depositor who incurs a \$100,000 or greater tax liability, will return to the semi-weekly deposit schedule the following day (For example, a \$100,000 tax liability incurred on Wednesday returns to a semi-weekly depositor on Thursday).

(2) For deposit periods beginning on or after August 1, 1990 through December 31, 1992, taxes on Forms 941, 943 and CT-1 that reach \$100,000 or more must be deposited within one banking day after the liability date (usually a pay day). If \$100,000 is reached before the end of an eighth-monthly period, the additional taxes incurred from that day through the end of that eighth-monthly period follow special deposit rules below.

(a) Additional accumulated taxes of less than \$3,000 are carried to the next eighth-monthly period.

(b) Additional accumulated taxes of \$3,000 or more but less than \$100,000 are due within three banking days after the close of the eighth-monthly period.

(c) Amounts of \$100,000 or more are due within one banking day after the day on which the \$100,000 or more is accumulated.

(3) Beginning with the September 30, 1990 (9009) through December 31, 1992 (9212) tax periods, Form 941, Schedule B (Supplemental Record of Federal Tax Liability), is required if any eighth-monthly period in the Record of Federal Tax (ROFT) equals \$100,000 or more.

(4) The accelerated deposit rule went into effect in the middle of the third calendar quarter of 1990. As a result, the Service waived the first FTD Penalty assessments resulting from noncompliance with the new deposit rules. Compute the penalty using the normal \$3,000/3-banking-day rule for Form 941 tax period ending September 30, 1990 (9009) and Form 943 and CT-1 tax period ending December 31, 1990 (9012).

(5) If the \$100,000 rule is applicable, see 4(40)1 of LEM XX -400 to determine deposit due

deposit due dates. This applies to each periodic liability within the quarter/year, whether it reaches \$100,000 or not.

(6) Since taxes of \$100,000 or more have accelerated deposit dates, periodic liabilities may not be due in the order incurred. List the liabilities in due date order when computing the penalty. See 4(20)8.4 of LEM XX-400.

(7) If a three-banking day and a one-banking day deposit are both due at the same time, satisfy the liabilities in the order in which they were incurred.

(8) Safe harbor (95 percent Rule) privileges are allowed. Note the following:

(a) The \$100,000 threshold applies to the liability amount, not to the deposit amount. Therefore, 95 percent of the total liability must be deposited in one-banking day, even if the 95 percent is less than \$100,000.

(b) The safe harbor underpayment of any amount is NOT subject to the one-banking-day rule. This applies even when the underpayment amount equals \$100,000 or more.

(20)4(40)2 (3-21-95) FTD Avoidance (TC 670/610)

(1) Taxpayers are required to deposit their taxes with an authorized depository. Taxpayers avoid the FTD system when they make payments to other than an authorized depository. This type of noncompliance is called FTD avoidance and is subject to an FTD penalty.

(2) Refer to 421:(2)(e) and 4(10)4.2 of LEM XX-400, to determine the appropriate deposit penalty rate for periods ending after December 31, 1989 (8912) through March 31, 1991 (9103).

(3) Payments made to an unauthorized depository include those made directly to IRS. Transaction code (TC) 670 identifies direct payments and generally indicate that an FTD avoidance penalty applies. There are exceptions.

(a) FEDWIRE payments, made by CT-1 filers, are listed as TC 670 with blocking series 700.

(b) Taxpayers in bankruptcy may be ordered by the court to make payments directly to the IRS. In such cases, the FTD avoidance penalty would not apply. If the account has a bankruptcy indicator, TC 520, closing code (CC) 85-89 with freeze code-V or TC 520, CC 81 with freeze code -W, contact the appropriate Special Procedures function to determine if the taxpayer is under court order to make direct payments.

(4) Regulations require certain taxes to be paid using deposits. Payments made in a manner other than a deposit may be subject to the penalty. An FTD avoidance penalty applies in the situations listed below.

(a) De minimis:

1 Form 941, 943, 945 -- If the TC 150 is more than \$500, any amount paid with

the return is subject to the avoidance penalty.

a A safe harbor shortfall (of any amount) originating from a monthly depositor may be paid with the return without an avoidance penalty.

b A safe harbor shortfall (of any amount) originating from a semi-weekly depositor must be deposited.

(2) Refer to 421:(2)(e) and 4(10)4.2 of LEM XX-400.

(20)4(50)0 (3-21-95) Misdated Deposits

(20)4(50)1 (3-21-95) Discrepancies

(20)4(50)1.1 (3-21-95) General

(1) A discrepancy may exist between the IRS transaction date of deposit, (TC 650 date) and the taxpayer's claimed deposit date. This occurs when:

- (a) The service center makes an error during FTD processing.
- (b) the authorized depository (bank) mishandles or misdates the deposit.
- (c) the reporting agent mishandles or misdates the deposit, or
- (d) the taxpayer uses an unauthorized depository.

(2) To resolve the discrepancy, determine how it was caused. If necessary, secure and review the following items:

- (a) IRS microfilm/microfiche copy of the FTD.
- (b) IRS microfilm/microfiche copy of the Advice of Credit (AOC), and
- (c) front and back of taxpayer's canceled check, bank statement or bank letter.

(3) IMPORTANT -- DO NOT change a TC 650 date or abate an FTD Penalty for date discrepancies without securing the necessary documentation, such as legible IRS copies of FTDs and AOCs showing microfilm serial numbers. This information must remain with the case file as part of the audit trail.

(20)4(50)1.2 (3-21-95) Service Centers

(1) If the taxpayer's receipt, bank letter, or canceled check agrees with the FTD date stamp (or encoded date), the AOC deposit date, and with the TC 650 transaction date, inform the taxpayer the transaction date is correct. Send a photocopy of the FTD coupon with your response.

(2) If it does not agree, input a credit transfer to correct the transaction date.

(a) No further action is required if Master File generated the FTD Penalty (TC 186). Master File will recompute the penalty amount.

(b) For manually assessed penalties (TC 180/181), recompute the penalty using the

new TC 650 transaction date. Make any necessary adjustments to the penalty amount.

(20)4(50)1.3 (3-21-95) Authorized Depositories

(1) To avoid deposit penalties employers must have made their required deposits through a Federal Reserve Bank (FRB) or an authorized depository. To determine if the taxpayer used an authorized depository, check the following:

(a) compare the check payee's name (or issuer of the receipt).

(b) date stamp name (on the FTD coupon), and

(c) the Advice of Credit (AOC) name.

(d) If they differ, the taxpayer may have used an unauthorized depository. See IRM (20)4(50)1.5.

(e) To determine if the check payee, (in (1)(a) above) is an authorized depository, contact:

1 The Interagency Coordinator (IAC) in the service center Accounting Branch or,

2 consult the latest Commercial Bank Address File (CBAF).

(2) A taxpayer will receive a FTD penalty even though they timely deposited to an authorized depository if the depository delays in forwarding the deposit to the Treasury. When this occurs:

(a) Prepare and process Form 8646 to the Financial Management Service (FMS). Upon receipt of the Form 8646, FMS will initiate penalty action against the bank (authorized financial institutions).

1 The contact point for misdated payments and the location of the Forms 8646 Centralized File are determined by the service center. The Inter-Agency Coordinator (IAC) in Accounting Branch, the FTD Coordinator in Management Staff, the FTD Penalty Unit, or other service center location may be responsible for maintaining the centralized file and/or coordinating with Financial Management Service (FMS).

2 The Form 8646, Checklist to Identify Delays in Processing Federal Tax Deposits, is a multi-use form used to document examples of cases concerning misdated FTD's. When preparing Form 8646:

a List the TIN and name control in the Transmittal Locator Number (TLN) box.

b provide the employee number, date, and appropriate remarks, such as "authorized depository-delay in forwarding of funds" in the remarks section.

c route one copy with attachments to the FTD coordinator in Management Staff.

(3) When Forms 8646 are received from the operational areas by an Inter-Agency Coordinator

(IAC) in Accounting Branch, the FTD Coordinator in Management Staff, or the FTD Penalty Unit, the following items (at a minimum) must be reviewed:

(a) Timeliness of the Form 8646's submission.

(b) appropriateness of referral FMS can only take action against banks (authorized financial institutions). Therefore, reject any cases resulting from service center processing errors or from mishandling by reporting agents. Instructions for handling these situations are contained in following sections.

(c) Clarity of the attachments. FMS supplies the photocopies to the depository as "proof" of the infraction and as documentation for the penalty charge. Therefore, it is critical that the dates, etc., are legible. If the copies cannot be read, they cannot be used by FMS.

(4) Once a month, cases will be forwarded to FMS by the Service Center contact. A transmittal memorandum should be used to identify the number of cases being forwarded.

(a) Route the cases to: Financial Management Service, Financial Services Division, 401 14th Street, SW-Room 318-C, Washington, DC 20227.

(b) At the same time, forward a copy of the transmittal memo and a statement of the total amount of penalties abated to the Office of Penalty Administration, CP:EX:ST:P, Room 2029-IR.

(5) In addition, prepare a credit transfer to correct the deposit (TC 650) transaction date to give the taxpayer credit for the deposit as of the date on the receipt or the date on the back of the cancelled check. (If both a bank receipt and cancelled check are provided, use the earlier date.)

(20)4(50)1.4 (3-21-95) Third Party

(20)4(50)1.41 (3-21-95) General

(1) Third parties are those individuals or companies who make deposits and/or file returns for clients electronically or by paper This includes reporting agents, payroll processors or bulk processors. They receive approval to work with the Service by filing a Reporting Agents Authorization, Form 8655.

However, this does not allow the third party to act as an "authorized depository" for the Treasury. Currently the majority of the third party's are depositing via magnetic tape. See Exhibit (20)400-2.

(3) Depending on the agreement the taxpayer/client has with the third party, taxpayers may not have copies of canceled checks. However, their bank statements will show the date the third party withdrew funds from the taxpayer's account.

(20)4(50)1.42 (3-21-95) Third Party Mishandling

(1) When third parties submit FTDs, they are depositing funds withdrawn from the taxpayer's account. These funds should then pass through the third party's account to an authorized

depository. Therefore, the removal of funds from a taxpayer's account:

(a) Does not in and of itself constitute a tax deposit, and

(b) the taxpayer remains liable for a deposit until funds have been placed in the control of either Treasury or its authorized depository. This applies to both the paper and Electronic Funds Transfer (EFT) deposit systems.

(2) To determine whether or not a penalty is appropriate, the following comparisons are necessary:

(a) If the date on the bank statement differs from:

1 the Advice of Credit (AOC) and FTD dates (TC 650) on the IRS microfiche copies, then

2 the third party timely transferred the funds from the taxpayer's account, but did not timely transmit them to the authorized depository as required.

(b) Consequently, the third party, not Treasury, had use of the taxpayer's funds.

(3) In this instance:

(a) the penalty is correct and should remain on the taxpayer's account.

(b) DO NOT CHANGE the TC 650 date or abate the FTD penalty

(4) In addition

(a) if the date on the bank statement and the date of the AOC differ, and

(b) the TC 650 and the date on the AOC also differ, then

(c) the bank has further delayed the submission of this money.

(5) Follow instructions above for resolving Misdated Deposits; Authorized Depositories.

(6) Correct the TC 650 to the date on the AOC (not to the date the funds were withdrawn from the bank).

(7) Any remaining penalty would be based on the length of time the agent held the funds.

(8) Requests for abatement should be closed on the appropriate adjustment document, using a TC 180 for zero, BS 98 or 99, with RC 62 and PRC 23 in the fourth reason code position.

(9) This transaction will indicate the denial of "a request for abatement of the FTD penalty because of a third party's error or delay".

(20)4(50)1.43 (3-21-95) Unauthorized Depositories

(1) When the taxpayer uses an unauthorized depository, there may be a difference between the taxpayer's payment date and the FTD transaction date. This is because the unauthorized depository cashed the taxpayer's check and then submitted its own payment to an authorized

depository.

(2) When this occurs, advise the taxpayer that they used an unauthorized depository.

(a) Explain the penalty for using an unauthorized depository and avoiding the FTD system.

(b) Advise the taxpayer to contact their area Federal Reserve Bank (FRB) to get a listing of local authorized financial institutions. If the taxpayer cannot locate a FRB, refer the taxpayer to the number listed

1 Taxpayer Service Toll-Free Number 1-800-829-1040.

2 Telecommunications Device for the Deaf (TDD) 1-800-829-4059

(3) The penalty may be waived if this is the first time the taxpayer used an unauthorized depository.

(a) Review the taxpayer's two prior tax modules and check the centralized file of Forms 8646 to determine if IRS previously contacted the taxpayer about the use of unauthorized depositories

(b) If this is the first time the taxpayer has used an unauthorized depository, give the taxpayer credit for the deposit as of the date on the receipt or the date on the back of the cancelled check.

1 If both a bank receipt and cancelled check are provided, use the earlier date.

2 Prepare a credit transfer to correct the transaction codes from the subsequent payment (TC 670) to a deposit (TC 650).

(4) If we previously contacted the taxpayer about the use of unauthorized depositories, DO NOT abate the FTD Penalty. Follow procedures in (2) above.

(5) Whether or not this is the first time the taxpayer used an unauthorized depository, prepare Form 8646. This form provides documentation that a particular taxpayer has used unauthorized depositories. Because taxpayers may use different banks to make their FTD's. Forms 8646 are to be filed in TIN order.

(a) Prepare the Form 8646 and be sure to include the following: TIN and name control in the TLN box, "unauthorized depository -- taxpayer informed", employee number and date in the remarks section.

(b) Route one copy of the completed Form 8646 to the centralized file area.

(c) Once a month, these forms should be summarized and the total number of abated penalties and the related dollar amount should be sent to the Office of Penalty Administration, CP EX ST P. room 2029-IR

(20)4(50)2 (3-21-95) FTD Processed As Subsequent Payment

- (1) Occasionally, financial institutions forward one check with the FTD coupons to cover the checks received from the taxpayers. When this occurs the credit will show as a TC 670 on the taxpayer's account
- (2) If there is a discrepancy between the IRS transaction date (TC 670) and the taxpayer's claimed deposit date, review the canceled check and any other information the taxpayer provides.
- (3) Determine if the check payee (or issuer of the receipt) is an authorized depository.
- (4) If the check was made to an authorized depository, follow procedures in IRM (20)4(50)1.21, and
 - (a) Compare the cancellation date on the back of the check with the IRS transaction date
 - (b) If both agree, inform the taxpayer that the IRS received date is correct Change the transaction code to TC 650
 - (c) If the dates differ, input a credit transfer to change the transaction code to TC 650 and to change the transaction date to the cancellation date on the back of the check
Manually adjust the penalty only when there is a restriction (TC 180/181) on the account

(20)4(60)0 (3-21-95) Taxpayer Contact

(20)4(60)1 (3-21-95) Correspondence

- (1) IRM 1(15)29, Correspondence Handbook is the central authority on guidelines for handling taxpayer correspondence. A copy of this IRM should be available to all employees.
- (2) The IDRS Correspondex Letter System provides several letters that Service Center employees may use to respond to taxpayers regarding FTD penalty issues. They include Letters 1206(C), 1446(C), 1447(C), and 2782(C)
- (3) An FTDPN print may be sent as a Correspondex Letter attachment when the taxpayer requests an explanation of a penalty.

(20)4(60)2 (3-21-95) Telephone Contact

- (1) Whenever possible, resolve issues by telephone contact with the taxpayer or authorized representative.
 - (a) Verify that the person to whom you are speaking is authorized to discuss the return and tax period involved. Check Centralized Authorization File (CAF).
 - (b) Document the case history sheet with the date and time of conversation and the name of the person contacted.
 - (c) For more specific information on oral testimony, see IRM 3(15)61.(11)(5) through (7), General Data Processing Adjustments.

(20)4(70)0 (3-21-95) Waivers

(20)4(70)1 (3-21-95) General

- (1) Waiver determinations must be made on a case by case basis.**
- (2) The Service will not impose, or will abate a FTD penalty when the taxpayer establishes that due to specific waiver provisions, the penalty should not be imposed.**

(a) Before assessment, recommend non-assertion of the penalty for deposit amounts when taxpayers provide documentation supporting their position. Reference the appropriate penalty reason code on the closing documentation.

(b) After assessment, abate the portion of the penalty related to the deposit amounts when taxpayers provide documentation supporting their position. Reference the appropriate penalty reason code on the adjustment document.

(3) A taxpayer's statement, regarding the waiver criteria, must be about the specific payment or deposit on which the Service proposes or computes a penalty. If the dates or explanations do not correspond with the penalized deposit, the taxpayer has not established a valid reason to waive the penalty.

(4) Contact personnel should address the reason for the failure to deposit timely when securing or examining returns on which the penalty applies. Making this initial determination will prevent the need for subsequent abatements.

(5) Requests for non-assertion or abatement of FTD penalties may require approval by the manager.

(6) See text 324 of LEM XX for acceptance of oral testimony relating to reasonable cause and (20)435.22 for First Time Exception Criteria.

(20)4(70)2 (3-21-95) Reasonable Cause

(1) For general reasonable cause guidelines see IRM (20)300, Reasonable Cause and Exhibit 100-3. Penalty Abatement/Assertion Reason Code Chart.

(2) In the interest of effective tax administration and equity, the non-assertion or abatement of civil penalties based on reasonable cause must be made in a consistent manner and should conform to reasonable cause considerations specified in the Internal Revenue Code, Treasury Regulations, Policy Statements (P-2-7 and P-1-18), and IRM Part XX.

(20)4(70)3 (3-21-95) Administrative Waivers

(1) In addition to those waivers identified in IRM (20)100, the Service also recognizes the impact of specific operational changes which may justify either not assessing or abating a penalty for a limited length of time.

(2) For tax periods ending 9106 and 9109, allow abatement of the penalty due if the taxpayer determined his/her deposit requirements based on the "undeclared taxes at the end of an

eight-monthly period", as stated in tax form instructions and circulates, rather than the accumulated liability during an eighth-monthly period.

(3) For the 9106 tax period, allow abatement of the penalty based on references made to the change in the method of applying credits (e.g., deposits in date made order against deposit liabilities in due date order).

(4) Abate Form 941, 941PR, and 941SS FTD Penalties when the taxpayer is referencing tax law changes:

(a) Regarding withholding of medicare taxes;

1 Allow 9103 claims,

2 consider 9106 and subsequent if at least 6.2 percent was withheld.

(b) Regarding employer FICA on tips:

1 Allow 8803 claims,

2 consider 8806. Remember that only the employer's share of FICA on tips is involved.

(c) Regarding deposits of \$100,000 or more for 1990:

1 allow claims for 9009, and

2 9012 provided the amounts were deposited timely under the three banking day rule,

(d) Regarding deposits of \$100,000 or more for 1991:

1 Allow claims for 9103 providing the amounts were deposited timely under the two banking day rule,

2 consider claims for 9106, 9109, and 9112,

3 allow claims for 9103, 9106, 9109 and 9112 if the taxpayer refers to TELE-TAX number 607.

(e) Regarding claims referencing the misprint in Publication 15. (Circular E) Employers Tax Guide, on page 9, under Rule 5 (\$100,000):

1 Allow claims for 9106 and prior.

2 consider claims for 9109 and subsequent, if the deposits would have been timely under the three day banking rule.

(5) Abate Form 943 and 943PR FTD penalties when the taxpayer is referencing tax law changes:

(a) Regarding 8812 tax law changes, abate late or insufficient deposits through June 30, 1989.

(b) regarding 1989 tax law changes requiring the withholding of income taxes:

1 Allow claims through June 30, 1990.

2 consider claims after June 30, 1990, realizing that only income tax is involved.

(c) Tax law changes referring to deposits of \$100,000:

1 Allow claims for 9012,

2 consider claims for 9112,

(d) For deposits of \$100,000 with regard to changing the number of days allowed to make a deposit from two banking days to one banking day:

1 Allow claims for 9112 when the taxpayer refers to TELE-TAX number 607,

2 Consider other claims based on the information provided,

3 Claims referencing the misprint in Publication 15 (Circular E), Employers Tax Guide, on page 9, Rule 5, (\$100,000); consider 9112 claims if deposits would have been timely under the three day banking rule.

(e) Abate Form 940 and 940PR FTD penalties when the taxpayer is referencing tax law changes:

1 References to Circular E misprint quoting 1988 rates (6.0 percent rather than 6.2 percent),

2 abate only the penalty amount that is directly related to the 2 percent tax underpayment; do not consider this difference for any other year.

(f) Abate Form CT-1 FTD penalties when references are made to:

1 Tax law changes for deposits over \$100,000:

a Allow claims for 9012,

b consider claims for 9112 only when the deposit would have been timely under the three day banking rule.

2 Tax law change from two to one banking day for deposits over \$100,000:

a Allow claims for 9112 if the taxpayer refers to message number 607 on the TELE-TAX system.

b consider claims for 9112 based on the information provided, only if the deposit would have been timely under the two day banking rule.

3 The misprint in Publication 15 (Circular E), Employers Tax Guide on page 9, Rule 5, (\$100,000); consider 9112 claims if deposits would have been timely under the three day banking rule.

(g) Abate Form 1042, periods 9112 and prior FTD penalties when the taxpayer references instructions provided in Publication 515. Withholding of Tax on Nonresident Aliens and Foreign Corporations. These instructions erroneously state that deposit rules do not apply to Canadian nominees and fiduciaries.

(h) If the taxpayer states they did not have the FTD coupon (Form 8109):

1 Consider when they requested Forms 8109 (5 to 6 weeks in advance).

2 Consider if over the counter coupons (Form 8109-B) were used.

(2) Another example of an administrative waiver is a circumstance described in an internal communication. These communications provide guidelines authorizing the waiver of the FTD penalty due to some administrative/operations problem.

(20)4(80)0 (3-21-95) Penalty Appeals

(1) Refer to IRM (20)400 for methods of appealing penalties.

(2) Managers may review employee penalty determinations and are considered the first line of appeal, whenever an appeal is requested by a taxpayer.

Exhibit (20)400-1 Employment and Excise Tax Program Forms B

Reference: (20)410

EMPLOYMENT AND EXCISE TAX PROGRAM FORMS

Employment Related Forms

Treasury Form 2284. Advice of Credit (AOC), Transmittal of Federal taxes paid to a depository bank

CT-1. Employer's Annual Railroad Retirement and Unemployment Repayment Tax Return

940. Employer's Annual Federal Unemployment (FUTA) Tax Return (and Instructions)

940EZ. Employer's Annual Federal Unemployment (FUTA) Tax Return

940PR. Employer's Annual Federal Employment (FUTA) Tax Return (Puerto Rico Version)

941. Employer's Quarterly Federal Tax Return (and Instructions)

Schedule B (Form 941). Supplemental Record of Federal Tax Liability

941C. Supporting Statement to Correct Information

941E. Quarterly Return of Withheld Income Tax (prior to 01/01/94)

941PR. Employer's Quarterly Federal Tax Return (Puerto Rico Version)

941SS. Employer's Quarterly Federal Tax Return (Under FICA)

- 943. Employer's Annual Tax Return of Agricultural Employees
- 943A. Agricultural Employer's Record of Federal Tax Liability
- 943A-PR. Agricultural Employer's Record of Federal Tax Liability
(Puerto Rico Version)
- 945. Annual Return of Withheld Federal Income Tax (after 12/31/93)
- 1042. Annual Withholding Tax Return for U.S. Source Income of Foreign
Persons
- 637. Application for Registration, (and Instructions)
- 720. Quarterly Federal Excise Tax Return (and Instructions)
- Form 6197. Gas Guzzler Tax
- 6627. Environmental Taxes (and Instructions)
- 8807. Certain Manufacturers and Retailers Excise Taxes
- 8849. Claim for Refund of Excise Taxes (mandatory after 06/30/94)

Exhibit (20)400-2 Reporting Agents

Reference: 413:212

	Agent Code	Reporting Agent	Responsible Service Center
1	0054	Automatic Data Processing	FSC
2	0055	Bank of America (North)	FSC
3	0056	Bank of New England	ANSC
4	0057	Wells Fargo	FSC
5	0058	Advantage Business Service	ANSC
6	0059	City Bank	BSC
7	0060	Control Data	PSC
8	0061	Payroll Tax Management	PSC
9	0062	Security Pacific	FSC
10	0063	California 1st Bank	FSC
11	0064	Bank of Hawaii	FSC
12	0065	Systems Tax Service	FSC
13	0066	Payroll People	FSC
14	0067	Bank of America (South)	FSC
15	0068	YMS Management Associates	BSC
16	0069	Paychex, Inc	BSC
17	0070	Wells Fargo Global Fund Transfer	FSC
18	0071	Bank of America Corporate Division	FSC
19	0072	City National Bank	FSC
20	0073	Compupay	ATSC
21	0074	Chick-Filet	ATSC
22	0075	Seattle-First National Bank	OSC
23	0076	Meldisco	BSC
24	0077	Bank of Boston	ANSC
25	0078	1st Interstate of CA	FSC
26	0079	Northwest Minnesota, NA	KCSC
27	0080	South Carolina National Bank	ATSC
28	0081	US Bank of Oregon	OSC
29	0082	Tax-Tel	ATSC
30	0083	Tax-Tel	FSC

31	0084	First Bank	KCSC
32	0085	Union Bank-TeleServices	FSC
33	0086	Bank of California	FSC
34	0087	Northern Trust Co.	KCSC
35	0088	Harbinger Computer Services	MSC
36	0089	National State Bank	BSC
37	0090	Harbinger Computer Services	CSC
38	0091	Continental Bank	KCSC
39	0092	Baybank Systems, Inc.	ANSC
40	0093	U S Bank of Washington, N/A	OSC
41	0094	1st Interstate Bank of Oregon	OSC
42	0095	Electronic Customer Services, Inc.	BSC
43	0096	Business Data Management, Inc.	ANSC
44	0097	DATON Payroll Services	FSC
45	0098	U.S Bank of California	OSC
46	0099	Pittsburgh Nat'l Bank	PSC
47	0100	Fleet National Bank	ANSC
48	0101	West One Bank of Wash	OSC
49	0102	Key Bank of Wash	OSC
50	0103	Pay America	PSC
51	0104	Chemical Bank-ETDS	BSC
52	0105	Norwest Bank-Denver NA	OSC
53	0106	M&I Bank	KCSC
54	0107	Southland Corp	AUSC
55	0108	1st Hawaiian Bank	FSC
56	0109	Northern Trust Bank-O'Hare	KCSC
57	0110	Northern Trust Bank-Dupage	KCSC
58	0111	Northern Trust Bank-Lake Forest	KCSC
59	0112	Wilmington Trust Co.	PSC
60	0113	Huntington Nat'l Bank	CSC
61	0114	Fleet Bank	BSC
62	0115	First of America-Southeast Michigan	CSC
63	0116	Hibernia Bank-New Orleans	MSC
64	0117	Shawmut Bank Connecticut, NA	ANSC
65	0118	Chase Manhattan Bank	BSC

Exhibit (20)400-3 Electronic Funds Transfer Threshold Amounts

Reference: 614.213

EFT Threshold Determination Periods/Effective Dates The taxpayer must begin depositing by EFT on or after the effective date, when the taxpayer's total deposits of taxes exceed the dollar threshold amounts referenced below.

THRESHOLD AMOUNT	DETERMINATION PERIOD	EFFECTIVE DATE
\$78 Million	1-1-93 to 12-31-93	January 1, 1995
\$47 Million	1-1-93 to 12-31-93 or 1-1-94 to 12-31-94	January 1, 1996
\$50 Thousand	1-1-95 to 12-31-95 or 1-1-96 to 12-31-96	January 1, 1997 January 1, 1998
\$20 Thousand	1-1-97 to 12-31-97	January 1, 1999

Exhibit (20)400-4 Four Tiered Penalty Rates

Reference: (20)421

FOUR TIERED PENALTY RATES

For Deposits Required Beginning January 1, 1990
(After December 31, 1989)

Penalty is:	When:
2%	deposit is 1-5 days late.
5%	deposit is 6-15 days late.
10%	Federal tax payment is made directly to the Service; or the deposit is more than 15 days late, BUT paid by the 10th day following notice and demand for payment.
15%	all undeposited taxes still unpaid after the 10th day following the 1st balance due notice, or the day on which notice and demand for immediate payment (i.e. jeopardy assessment) is given.

For Returns Assessed After October 25, 1986 (cycle 8644) and Before January 1, 1990, the penalty is: 10%

For Returns Assessed Before October 26, 1986 (prior to cycle 8644), the penalty is: 5%

See LEM XX for special penalty rate provisions in effect for tax periods 9003-9103.

Exhibit (20)400-5 FTD Due Date Chart

Reference: (20)422

1995 FTD Due Dates
for Employers following a Semi-weekly
Deposit Schedule
(including Federal holidays)

Payroll Date	Due Date	Payroll Date	Due Date
Jan 1 - 3	Jan 6	Jul 1 - 4	Jul 7
Jan 4 - 6	Jan 11	Jul 5 - 7	Jul 12
Jan 7 - 10	Jan 13	Jul 8 - 11	Jul 14
Dec safe harbor	Jan 18	Jun safe harbor	Jul 19
Jan 11 - 13	Jan 19	Jul 12 - 14	Jul 19
Jan 14 - 18	Jan 20	Jul 15 - 18	Jul 21

Jan 19 - 20	Jan 25	Jul 19 - 21 /#/	Jul 26
Jan 21 - 24	Jan 27	Jul 22 - 25	Jul 28
Jan 25 - 27	Feb 1	Jul 26 - 28	Aug 2
Jan 28 - 31	Feb 3	Jul 29 - Aug 1 /#/	Aug 4
Feb 1 - 3	Feb 8	Aug 2 - 4 /#/	Aug 9
Feb 4 - 7	Feb 10	Aug 5 - 8	Aug 11
Jan safe harbor	Feb 15	Jul safe harbor	Aug 16
Feb 8 - 10 /#/	Feb 15	Aug 9 - 11 /#/	Aug 16
Feb 11 - 14	Feb 17	Aug 12 - 15 /#/	Aug 18
Feb 15 - 17	Feb 23	Aug 16 - 18	Aug 23
Feb 18 - 21	Feb 24	Aug 19 - 22	Aug 25
Feb 22 - 24	Mar 1	Aug 23 - 25	Aug 30
Feb 25 - 28	Mar 3	Aug 26 - 29	Sep 1
Mar 1 - 3 /#/	Mar 8	Aug 30 - Sep 1	Sep 7
Mar 4 - 7	Mar 10	Sep 2 - 5 /#/	Sep 8
Feb safe harbor	Mar 15	Sep 6 - 8 /#/	Sep 13
Mar 8 - 10	Mar 15	Aug safe harbor	Sep 15
Mar 11 - 14	Mar 17	Sep 9 - 12	Sep 15
Mar 15 - 17	Mar 22	Sep 13 - 15	Sep 20
Mar 18 - 21 /#/	Mar 24	Sep 16 - 19	Sep 22
Mar 22 - 24 /#/	Mar 29	Sep 20 - 22	Sep 27
Mar 25 - 28	Mar 31	Sep 23 - 26	Sep 29
Mar 29 - 31 /*/	Apr 5	Sep 27 - 29 /*/	Oct 4
Apr 1 - 4	Apr 1	Sep 30 /*/	Oct 6
Apr 5 - 7	Apr 12	Oct 1 - 3	Oct 6
Apr 8 - 11 /#/	Apr 14	Oct 4 - 6	Oct 12
Mar safe harbor	Apr 19	Oct 7 - 10	Oct 13
Apr 12 - 14 /#/	Apr 19	Sep safe harbor	Oct 18
Apr 15 - 18	Apr 21	Oct 11 - 13 /#/	Oct 18
Apr 19 - 21 /#/	Apr 26	Oct 14 - 17	Oct 20
Apr 22 - 25	Apr 28	Oct 18 - 20	Oct 25
Apr 26 - 28	May 3	Oct 21 - 24	Oct 27
Apr 29 - May 2 /#/	May 5	Oct 25 - 27 /#/	Nov 1
May 3 - 5 /#/	May 10	Oct 28 - 31	Nov 3
May 6 - 9	May 12	Nov 1 - 3 /#/	Nov 8
Apr safe harbor	May 17	Nov 4 - 7	Nov 13
May 10 - 12	May 17	Oct safe harbor	Nov 15
May 13 - 16	May 19	Nov 8 - 10	Nov 15
May 17 - 19	May 24	Nov 11 - 14	Nov 17
May 20 - 23	May 26	Nov 15 - 17	Nov 22
May 24 - 26	Jun 1	Nov 18 - 21 /#/	Nov 27
May 27 - 30	Jun 2	Nov 22 - 24	Nov 29
May 31 - Jun 2 /#/	Jun 7	Nov 25 - 28	Dec 1
Jun 3 - 6	Jun 9	Nov 29 - Dec 1	Dec 6
Jun 7 - 9 /#/	Jun 14	Dec 2 - 5	Dec 8
May Safe Harbor	Jun 16	Dec 6 - 8	Dec 13
Jun 10 - 13 /#/	Jun 16	Nov safe harbor	Dec 13
Jun 14 - 16 /#/	Jun 21	Dec 9 - 12	Dec 15
Jun 17 - 20	Jun 23	Dec 13 - 15	Dec 20
Jun 21 - 23	Jun 28	Dec 16 - 19	Dec 22
Jun 24 - 27	Jun 30	Dec 20 - 22	Dec 28
Jun 28 - 30 /*/	Jul 6	Dec 23 - 26	Dec 29
		Dec 27 - 29 /*/	Jan 4
		Dec 30 - 31 /*/	Jan 5

/*/ The due date for any Safe Harbor shortfall arising out of these deposits is the return due date.

/#/ Check to see if the deposit due date for these liability periods is affected by a non banking day in your state.

A MONTHLY DEPOSIT SCHEDULE

Payroll period	Due date	Payroll period	Due date
January	Feb 15	July	Aug 15
February	Mar 15	August	Sep 15
March	Apr 17	September	Oct 16
April	May 15	October	Nov 15
May	June 15	November	Dec 15
June	Jul 17	December	Jan 18, 1996

For the quarter ending

March 31

September 30

The monthly safe harbor is due

May 1

October 31
/ # /

For the quarter ending

June 30

December 31

The monthly safe harbor is due

July 31

Jan 31, 1996

/ # / Check to see if the deposit due date for these liability periods is affected by a non banking day in your state.

1995 DUE DATES
FOR LIABILITIES OF \$100,000 OR MORE,
NEXT DAY DEPOSIT REQUIRED

DAY	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
1	1-3	2-2	3-2	4-3	5-2	6-2	7-3	8-2	9-5	10-2	11-2	12-4
2	1-3	2-3	3-3	4-3	5-3	6-5	7-3	8-3	9-5	10-3	11-3	12-4
3	1-4	2-6	3-6	4-4	5-4	6-5	7-4	8-4	9-5	10-4	11-6	12-4
4	1-5	2-6	3-6	4-5	5-5	6-6	7-5	8-7	9-5	10-5	11-6	12-5
5	1-4	2-6	3-6	4-6	5-6	6-6	7-6	8-7	9-5	10-8	11-6	12-6
6	1-6	2-7	3-7	4-7	5-6	6-7	7-7	8-7	9-7	10-10	11-7	12-7
7	1-8	2-8	3-8	4-10	5-8	6-8	7-10	8-8	9-8	10-10	11-8	12-8
8	1-9	2-9	3-9	4-10	5-9	6-9	7-10	8-9	9-11	10-10	11-9	12-11
9	1-10	2-10	3-10	4-10	5-10	6-12	7-10	8-10	9-11	10-10	11-13	12-11
10	1-11	2-13	3-13	4-11	5-11	6-12	7-11	8-11	9-11	10-11	11-13	12-11
11	1-12	2-13	3-13	4-12	5-12	6-12	7-12	8-14	9-12	10-12	11-13	12-12
12	1-13	2-13	3-13	4-13	5-15	6-13	7-13	8-14	9-13	10-13	11-13	12-13
13	1-17	2-14	3-14	4-14	5-15	6-14	7-14	8-14	9-14	10-16	11-14	12-14
14	1-17	2-15	3-15	4-17	5-15	6-15	7-17	8-15	9-15	10-16	11-15	12-15
15	1-17	2-16	3-16	4-17	5-16	6-16	7-17	8-16	9-18	10-16	11-16	12-18
16	1-17	2-17	3-17	4-17	5-17	6-19	7-17	8-17	9-18	10-17	11-17	12-18
17	1-18	2-21	3-20	4-18	5-18	6-19	7-18	8-18	9-18	10-18	11-20	12-18
18	1-19	2-21	3-20	4-19	5-19	6-19	7-19	8-21	9-19	10-19	11-20	12-19
19	1-20	2-21	3-20	4-20	5-22	6-20	7-20	8-21	9-20	10-20	11-20	12-20
20	1-23	2-21	3-21	4-21	5-22	6-21	7-21	8-21	9-21	10-23	11-21	12-21
21	1-23	2-22	3-22	4-24	5-22	6-22	7-24	8-22	9-22	10-23	11-22	12-22
22	1-23	2-23	3-23	4-24	5-23	6-23	7-24	8-23	9-25	10-23	11-24	12-26
23	1-24	2-24	3-24	4-24	5-24	6-26	7-24	8-24	9-25	10-24	11-24	12-26
24	1-25	2-27	3-27	4-25	5-25	6-26	7-25	8-25	9-25	10-25	11-27	12-26
25	1-26	2-27	3-27	4-26	5-28	6-26	7-26	8-28	9-26	10-26	11-27	12-26
26	1-27	2-27	3-27	4-27	5-30	6-27	7-27	8-28	9-27	10-27	11-27	12-27

27	1-30	2-28	3-28	4-28	5-30	6-28	7-28	8-28	9-28	10-30	11-28	12-28
28	1-30	3-1	3-29	5-1	5-30	6-29	7-31	8-29	9-29	10-30	11-29	12-29
29	1-30	--	3-30	5-1	5-30	6-30	7-31	8-30	10-2	10-30	11-30	1-2
30	1-31	--	3-31	5-1	5-31	7-3	7-31	8-31	10-2	10-31	12-1	1-2
31	2-1	--	4-3	--	6-1	--	8-1	9-1	--	11-1	--	1-2

Always check the State Code Indicator. You must adjust the above due dates by the state holidays listed in IRM 3(25)(77)0.

1994 FTD DUE DATES FOR EMPLOYERS FOLLOWING
A SEMI-WEEKLY DEPOSIT SCHEDULE

Payroll Date	Due Date	Payroll Date	Due Date
Jan 1 - 4	Jan 7	Jul 1	Jul 7
Jan 5 - 7	Jan 12	Jul 2 - 5	Jul 8
Jan 8 - 11	Jan 14	Jul 6 - 8	Jul 13
Dec Safe Harbor	Jan 19	Jun Safe Harbor	Jul 15
Jan 12 - 14	Jan 20	Jul 9 - 12	Jul 15
Jan 15 - 18	Jan 21	Jul 13 - 15	Jul 20
Jan 19 - 21	Jan 26	Jul 16 - 19	Jul 22
Jan 22 - 25	Jan 28	Jul 20 - 22	Jul 27
Jan 26 - 28	Feb 2	Jul 23 - 26	Jul 29
Jan 29 - Feb 1	Feb 4	Jul 27 - 29	Aug 3
Feb 2 - 4	Feb 9	Jul 30 - Aug 2	Aug 5
Feb 5 - 8	Feb 11	Aug 3 - 5	Aug 10
Jan Safe Harbor	Feb 16	Aug 6 - 9	Aug 12
Feb 9 - 11	Feb 16	Jul Safe Harbor	Aug 17
Feb 12 - 15	Feb 18	Aug 10 - 12	Aug 17
Feb 16 - 18	Feb 24	Aug 13 - 16	Aug 19
Feb 19 - 22	Feb 25	Aug 17 - 19	Aug 24
Feb 23 - 25	Mar 2	Aug 20 - 23	Aug 26
Feb 26 - Mar 1	Mar 4	Aug 24 - 26	Aug 31
Mar 2 - 4	Mar 9	Aug 27 - 30	Sep 2
Mar 5 - 8	Mar 11	Aug 31 - Sep 2	Sep 6
Feb Safe Harbor	Mar 16	Sep 3 - 6	Sep 9
Mar 9 - 11	Mar 16	Sep 7 - 9	Sep 14
Mar 12 - 15	Mar 18	Aug Safe Harbor	Sep 16
Mar 16 - 18	Mar 23	Sep 10 - 13	Sep 16
Mar 19 - 22	Mar 25	Sep 14 - 16	Sep 21
Mar 23 - 25	Mar 30	Sep 17 - 20	Sep 23
Mar 26 - 29 /*/	Apr 1	Sep 21 - 23	Sep 28
Mar 30 - 31 /*/	Apr 6	Sep 24 - 27	Sep 30
		Sep 28 - 30 /*/	Oct 5

/*/ The due date for any Safe Harbor shortfall arising out of these deposits is the return due date.

1994 FTD DUE DATES FOR EMPLOYERS FOLLOWING
A MONTHLY DEPOSIT SCHEDULE

Payroll Period	Due Date	Payroll Period	Due Date
January	Feb 15	July	Aug 15
February	Mar 15	August	Sep 15
March	Apr 15	September	Oct 17
April	May 16	October	Nov 15
May	Jun 15	November	Dec 15

June Jul 15 December Jan 17, 1995

For the quarter ending

March 31 September 30
 June 30 December 31

The Monthly Safe Harbor is due

May 2 October 31
 August 1 Jan 31, 1995

1993 FTD DUE DATES FOR EMPLOYERS
 FOLLOWING A SEMI-WEEKLY DEPOSIT SCHEDULE

Payroll Date	Due Date	Payroll Date	Due Date
Jan 1	Jan 6	Jul 1 - 2	Jul 8
Jan 2 - 5	Jan 8	Jul 3 - 6	Jul 9
Jan 6 - 8	Jan 13	Jul 7 - 9	Jul 14
Jan 9 - 12	Jan 15	Jul 10 - 13	Jul 16
Jan 13 - 15	Jan 22	Jul 14 - 16	Jul 21
Jan 16 - 19	Jan 25	Jul 17 - 20	Jul 23
Jan 20 - 22	Jan 27	Jul 21 - 23	Jul 28
Jan 23 - 26	Jan 29	Jul 24 - 27	Jul 30
Jan 27 - 29	Feb 3	Jul 28 - 30	Aug 4
Jan 30 - Feb 2	Feb 5	Jul 31 - Aug 3	Aug 6
Feb 3 - 4	Feb 10	Aug 4 - 6	Aug 11
Feb 5 - 9	Feb 12	Aug 7 - 10	Aug 13
Feb 10 - 12	Feb 18	Aug 11 - 13	Aug 18
Feb 13 - 16	Feb 19	Aug 14 - 17	Aug 20
Feb 17 - 19	Feb 24	Aug 18 - 20	Aug 25
Feb 20 - 23	Feb 26	Aug 21 - 24	Aug 27
Feb 24 - 26	Mar 3	Aug 25 - 27	Sep 1
Feb 27 - Mar 2	Mar 5	Aug 28 - 31	Sep 3
Mar 3 - Mar 5	Mar 10	Sep 1 - 3	Sep 9
Mar 6 - 9	Mar 12	Sep 4 - 7	Sep 10
Mar 10 - 12	Mar 17	Sep 8 - 10	Sep 15
Mar 13 - 16	Mar 19	Sep 11 - 14	Sep 17
Mar 17 - 19	Mar 24	Sep 15 - 17	Sep 22
Mar 20 - 23	Mar 26	Sep 18 - 21	Sep 24
Mar 24 - 26	Mar 31	Sep 22 - 24	Sep 29
Mar 27 - 30	Apr 2	Sep 25 - 28 /*/	Oct 1
Mar 31	Apr 7	Sep 29 - 30 /*/	Oct 6
Apr 1 - 2	Apr 7	Oct 1	Oct 6
Apr 3 - 6	Apr 9	Oct 2 - 5	Oct 8
Apr 7 - 9	Apr 14	Oct 6 - 8	Oct 14
Apr 10 - 13	Apr 16	Oct 9 - 12	Oct 15
Apr 14 - 16	Apr 21	Oct 13 - 15	Oct 20
Apr 17 - 20	Apr 23	Oct 16 - 19	Oct 22
Apr 21 - 23	Apr 28	Oct 20 - 22	Oct 27
Apr 24 - 27	Apr 30	Oct 23 - 26	Oct 29
Apr 28 - 30	May 5	Oct 27 - 29	Nov 3
May 1 - 4	May 7	Oct 30 - Nov 2	Nov 5
May 5 - 7	May 12	Nov 3 - 5	Nov 10
May 8 - 11	May 14	Nov 6 - 9	Nov 15
May 12 - 14	May 19	Nov 10 - 12	Nov 17
May 15 - 18	May 21	Nov 13 - 16	Nov 19
May 19 - 21	May 26	Nov 17 - 19	Nov 24
May 22 - 25	May 28	Nov 20 - 23	Nov 29
May 26 - 28	Jun 3	Nov 24 - 26	Dec 1
May 29 - Jun 1	Jun 4	Nov 27 - 30	Dec 3

Jun 2 - 4	Jun 9	Dec 1 - 3	Dec 8
Jun 5 - Jun 8	Jun 11	Dec 4 - 7	Dec 10
Jun 9 - 11	Jun 16	Dec 8 - 10	Dec 15
Jun 12 - 15	Jun 18	Dec 11 - 14	Dec 17
Jun 16 - 18	Jun 23	Dec 15 - 17	Dec 22
Jun 19 - 22	Jun 25	Dec 18 - 21	Dec 27
Jun 23 - 25	Jun 30	Dec 22 - 24	Dec 29
Jun 26 - 29 /*/	Jul 2	Dec 25 - 28 /*/	Jan 3
Jun 30 /*/	Jul 8	Dec 29 - 31 /*/	Jan 5

/*/ The due date for any Safe Harbor shortfall arising out of these deposits is the return due date.

1993 FTD DUE DATES FOR EMPLOYERS
FOLLOWING A MONTHLY DEPOSIT SCHEDULE

Payroll Period	Due Date	Payroll Period	Due Date
January	Feb 16	July	Aug 18
February	Mar 15	August	Sep 15
March	Apr 15	September	Oct 15
April	May 17	October	Nov 16
May	Jun 16	November	Dec 15
June	Jul 15	December	Jan 18, 1994

For the quarter ending

March 31	September 30
June 30	December 31

The Monthly Safe Harbor as due

Apr. 30	Nov. 1
Aug. 2	Jan 31, 1994

Exhibit (20)400-6 Employment FTD Fast Facts

Reference: (20)431

EMPLOYMENT FTD FAST FACTS

If the TOTAL Liability is	And	Then a deposit must be made
\$50,000 or less during the lookback period		On or before the 15th of the following month
More than \$50,000 during the lookback period	Payment date is	On or before the following
	- Saturday	
	- Sunday	Friday
	- Monday	
	- Tuesday	
	Payment date is	On or before the following
	- Wednesday	
	- Thursday	Wednesday
	- Friday	

Lookback period: A four quarter period. For 941 filers, July 1 through June 30

\$500 Rule: Taxes less than \$500 in a quarter do not have to be deposited, may be paid with a TIMELY filed return.

\$100,000 One-day Rule \$100,000 or more within a deposit period must be deposited on the NEXT BANKING DAY

Safe Harbor Rule. An employer who under deposits will not be penalized if the deposit shortfall is:

- \$100 or less, OR
- 2% or less of the amount which should have been deposited.
(Balance due must be deposited by the make up date for your depositor schedule)

FTD Penalty. The four per penalty rates are still in effect.

Description of Deposit	Rate
1-5 days late	2%
6-15 days late	5%
- More than 15 days late, but paid by the 10th day after notice and demand. Notice and demand date is the assessment date (23C date).	10%
- Amount paid directly to the Service when a deposit was required	
Taxes still unpaid after the 10th day following notice and demand for payment	15%

Exhibit (20)400-7 Deposit Requirements -- 1993 and later

Reference: (20)432 FORM 941 SERIES, AND FORMS 945 AND 943 DEPOSIT REQUIREMENTS FOR PERIODS BEGINNING JANUARY 1, 1993. (Based on the amount of employment taxes the employer reported in a one-year lookback period)

If liability during lookback /*/ period is	Employer is a	And deposits are due
\$50,000 or less	Monthly depositor	On/before 15th of the following month
\$50,000 or more	Semiweekly depositor	(a) On/before the following Wednesday, for pay dates running Wednesday thru Friday, or (b) On/before the following Friday, for pay dates running Saturday thru Tuesday
If during a deposit	And employer	Then, deposits must

period, the liability is	deposits.	be made
\$100,000 or more	Monthly	The next banking day, employer must deposit semiweekly for rest of current year and following year
\$100,000 or more	Semiweekly	The next banking day, employer continues as semiweekly depositor

/*/ Lookback Period A four quarter period. For 941 filers, July 1 through June 30, for Form 945 and 943 filers, January 1 through December 31.

\$500 Rule: Cumulative or total tax liability of less than \$500 in a quarter does not have to be deposited, but may be paid with a timely filed return.

Safe Harbor Rule: An employer who underdeposits will not be penalized, if the deposit shortfall is \$100 or less, OR no more than 2% of the amount which should have been deposited. (Balance due must be deposited by make-up date.)

FTD Penalty-The Four Tier Penalty rates remain unchanged

Exhibit (20)400-8 Deposit Requirements

Reference (20)441.2

FORM 941 SERIES AND FORM 943

DEPOSIT REQUIREMENTS FOR PERIODS BEGINNING APRIL 1, 1991 THROUGH DECEMBER 31, 1992 (Determined by the tax liability accumulated during the deposit period (monthly or eighth-monthly))

When tax liability at the end of a month is

And it's the . .	Then
less than \$500	first or second month no deposit is required for the month the liability is incurred Carry over into next month
less than \$500	end of the quarter pay tax with timely filed Form 941/943, or deposit by return due date (RDD)
\$500 or more, but less than \$3,000 /*/	end of any month in quarter make the deposit by the 15th day following month

When the tax liability is . .

Then . . .
\$3,000 or more at the end deposit taxes within 3 of

any eighth-monthly period,

banking days after the close of eighth-monthly period
/**/.

\$100,000 /**/ or more on any day,

taxpayer must deposit taxes within 1 banking day and report taxes on Sch. B (F 941) or F 943A.

/*/ EXCEPTION: When an eighth monthly deposit of \$3,000 or more is required in the first or second month of the quarter and the taxpayer incurs a subsequent liability of less than \$3,000 during the same month, the taxpayer must carry the tax liability under \$3,000 to the next month. If it is the last month of the quarter, the taxes under \$3,000 must be deposited by the RDD. /**/ FIRST TIME EXCEPTION: The first time a taxpayer has a tax liability of \$3,000 or more at the end of an eighth-monthly period and meets the three conditions [See IRM (20)434] the taxes may be deposited by the 15th day of the following month rather than on the 3rd banking day. /**/ Effective as of August 1, 1990. Deposit Requirements Reference: 434.22 FORM 941 SERIES AND FORM 943 DEPOSIT REQUIREMENTS FOR PERIODS ENDING MARCH 31, 1991, AND BEFORE. (Based on the amount of the liability [undeposited tax] at the end of the deposit period [monthly or eighth monthly])

When the undeposited tax is	And it's the end	Then,
less than \$500	of the first or second month	no deposit is required for this liability period amount is carried into the next month
less than \$500	of the quarter	undeposited taxes must be paid with a timely filed F 941/943, or deposited by the RDD
\$500 or more but less than \$3,000	of any month	taxes must be deposited by the 15th day of the following month.

When undeposited taxes reach	Then,
\$100,000 on any day	taxes are deposited within 1 banking day, also, taxpayer reports taxes on Sch B (FM 941) or on Form 943A as necessary
\$3,000 /*/ or more at the end of any eighth-monthly period	taxes are deposited within 3 banking days after the close of that eighth-monthly period

/*/ EXCEPTION: When an eighth-monthly deposit of \$3,000 or more is required in the first or second month of the quarter and the taxpayer incurs a subsequent liability of less than \$3,000 during the same month, the taxpayer must carry the tax liability under \$3,000 to the next month. If it is the last month of the quarter, the taxes (under \$3,000) must be deposited by the RDD. FIRST TIME EXCEPTION: The first time a taxpayer has a tax liability of \$3,000 or more at the end of an eight monthly period and meets the three conditions [See IRM (20)434] the taxes may be deposited by the 15th day of the following month rather than on the 3rd banking day.

Exhibit (20)400-9 FORM 940 DEPOSIT REQUIREMENTS -- APRIL 1, 1991

AND LATER

Reference: (20)471

DEPOSIT REQUIREMENTS FOR FORM 940, FOR PERIODS BEGINNING APRIL 1, 1991 AND LATER. (Based on the amount of the tax liability incurred at the end of the deposit period)

If the tax liability is . . .	And it is the end of . . .	Then,
\$100 or less	first, second, third quarter	tax is carried over to next quarter
\$100 or less	fourth quarter	tax is paid with return or by RDD
Over \$100	any quarter	tax must be deposited by the last day of the following month /*/.

FOR PERIODS ENDING MARCH 31, 1991 AND BEFORE (Based on the amount of undeposited taxes at the end of the deposit period).

If the undeposited tax is . . .	And it is the end of . . .	Then,
\$100 or less	first, second, or third quarter	tax liability added to the tax incurred in the following quarter
\$100 or less	fourth quarter	tax is paid with return, or by RDD.
Over \$100	any quarter	tax is deposited by last day of following month /*/.

/*/ IF THE EMPLOYER'S LIABILITY FOR ANY QUARTER IS OVER \$100:

Quarter	Ending	Due Date
Jan. - Feb. - Mar.	Mar. 31	April 30
Apr. - May - June	June 30	July 31
July - Aug. - Sept.	Sept. 30	Oct. 31
Oct. - Nov. - Dec.	Dec. 31	Jan. 31

Exhibit (20)400-10 Form 720 Return Due Dates

Reference: (20)481

RETURN DUE DATES FOR FORM 720

Quarter Covered	All excise taxes except ODCs communications, and air transportation	ODCs, communications, and air transportation (IRS) Nos. 98, 19, 22, 26, 28, 27, 20

FIRST	APRIL 30	MAY 31
SECOND	JULY 31	AUGUST 31
THIRD	OCTOBER 31	NOVEMBER 30
FOURTH	JANUARY 31	FEBRUARY 28

FILING AND PAYMENT DATES FOR FLOOR STOCK TAXES

Tax	Filing Date	Payment Date
ODCs	AUGUST 31	JUNE 30 (of each year)
FUEL	NOVEMBER 30	NOVEMBER 30 (1993 only)
DIESEL	JULY 31	JULY 31 (1994 only)
VACCINE	FEBRUARY 28	FEBRUARY 28 (1993 only)

Exhibit (20)400-11 FORM 720 ALTERNATIVE METHOD

Reference: (20)481.33

FORM 720 REPORTING OF TAX UNDER ALTERNATIVE METHOD

AMOUNTS BILLED/TICKETS SOLD
DURING SEMIMONTHLY
PERIOD LISTED BELOW:

ARE REPORTED ON LINE 3 OF
SCHEDULE A (FORM 720) FOR
QUARTER AND BOX INDICATED
BELOW:

12/1	through	12/15	1st	Q/box	M
12/16	through	12/31	1st	Q/box	N
1/1	through	1/15	1st	Q/box	O
1/16	through	1/31	1st	Q/box	P
2/1	through	2/15	1st	Q/box	Q
2/16	through	2/28 (2/29)	1st	Q/box	R
3/1	through	3/15	2nd	Q/box	M
3/16	through	3/31	2nd	Q/box	N
4/1	through	4/15	2nd	Q/box	O
4/16	through	4/30	2nd	Q/box	P
5/1	through	5/15	2nd	Q/box	Q
5/16	through	5/31	2nd	Q/box	R
6/1	through	6/15	3rd	Q/box	M
6/16	through	6/30	3rd	Q/box	N
7/1	through	7/15	3rd	Q/box	O
7/16	through	7/31	3rd	Q/box	P
8/1	through	8/15	3rd	Q/box	Q
8/16	through	8/31	3rd	Q/box	R
9/1	through	9/15	4th	Q/box	M
9/16	through	9/30	4th	Q/box	N
10/1	through	10/15	4th	Q/box	O
10/16	through	10/31	4th	Q/box	P
11/1	through	11/15	4th	Q/box	Q
11/16	through	11/30	4th	Q/box	R

Exhibit (20)400-12 Form 1042 Deposit Requirements For All Periods

Reference: (20)492 FORM 1042 DEPOSIT REQUIREMENTS FOR ALL PERIODS. (Based on the amount of undeposited taxes at the end of the deposit period called a quarter-monthly period. Exception may apply due to Foreign Tax Treaties).

If undeposited taxes are . .	And, it is the . .	Then. . .
under \$200	end of a month except December	taxes are carried to the next month.
under \$200	end of December	taxes may be paid with the return, or deposited by the RDD.
\$200 or more, but less than \$2,000 /*/	end of any month	deposits must be made by the 15th of the following month.
\$2,000 or more	end of a quarter-monthly period	deposits must be made within 3 banking days. The 90 Percent/Safe Harbor provisions apply. See text.

/*/ EXCEPTION: If an earlier quarter-monthly deposit was made and taxes are \$200 or more but less than \$2,000 in a month other than December, the taxes are carried to the next month. For December, the deposits must be made by the RDD.

Exhibit (20)400-13 Form CT -- 1, Part II -- Deposit Requirements 1/1/93 and later

Reference: (20)4(10)4.1 FORM CT-1, PART II RRTA DEPOSIT REQUIREMENTS FOR PERIODS BEGINNING JANUARY 1, 1993 AND LATER . . . (Based on the amount of Railroad Retirement Taxes (RRTA) the employer reported in a one-year lookback period.) The deposit requirements are the same as the Form 941 deposit requirements, with the following exceptions:

- (a) Form CT-1 Supplemental Annuity Work Hour Tax is based on work hours. The tax deposit is due once a month with the due date being the first deposit of RRTA due after the 15th day of the following month;
- (b) Form CT-1 Special Supplemental Annuity Tax is for employers who are exempt from the Supplemental Annuity Work Hour Tax [see IRC 3221(d)]. The tax deposit is due quarterly, the last day of the second month following the end of the quarter; and
- (c) December 31, 1992 and prior: If the tax liability at the

end of December is at least \$100 but less than \$500, the taxpayer deposits the tax by the return due date (RDD). If the tax is under \$100, the taxpayer may submit the payment with the return.

Form CT-1 filers, whose tax liability was \$1,000,000 or more in the second preceding taxable year, must deposit via wire transfer (FEDWIRE) payments.

Exhibit (20)400-14 CT -- 1, Part II -- Deposit Requirements -- 4/1/91 thru 12/31/92

Reference: (20)4(10)4.2

CT-1, Part II

RRTA DEPOSIT REQUIREMENTS FOR PERIODS BEGINNING APRIL 1, 1991 THROUGH DECEMBER 31, 1992

If tax liability is . . .	And it is the end of . . .	Then.
less than \$500	a month other than December	taxes are carried to the next month
at least \$100 but less than \$3,000	December	taxes are deposited by the RDD; taxes under \$100 may be paid with the return.
\$500 or more but less than \$3,000	any month	taxes are deposited by the 15th day of the next month. /*/
\$3,000 or more	any eighth-monthly period	taxpayer deposits taxes within 3 banking days after eighth-monthly period. /**/
\$100,000	any day	taxpayer must deposit tax within one banking day; tax liability must be reported on Sch. B. CT-1 filers may need to attach four separate Schedule B's.

/*/ (1) If there was a \$3,000 deposit requirement earlier in the same month, other than December, taxes are carried to the next month.

(2) For December, taxes of at least \$100 but less than \$3,000 are deposited by the RDD.

/**/ The first-time exception may also apply to this deposit requirement.

[See IRM (20)616.2(4)].

Exhibit (20)400-15 PCC Codes

TC CODES	PCC CODES		
	With ROFT	Without ROFT	Incorrect ROFT
All TC 650	03	11/58 /*/	54/57
All TC 670	41	43/58 /*/	55/57
MTX	42	44/58 /*/	56/57
\$100,000 /*/	03/41/42	58 /*/	57

/*/ If \$100,000 account use PCC 58

Exhibit (20)400-16 SIC Codes

Reference: (20)4(20)2.5

SIC Code	9212 & prior	9312	9412	9512
0 computer generated	return processed with good information	return processed with good information	return processed with good information	return processed with good information
1	missing information, penalty computed by averaging available information	missing information, penalty computed by averaging available information	missing information, penalty computed by averaging available information	missing information, penalty computed by averaging available information
2	Safe Harbor check- off/reasonable cause claimed	reasonable cause claimed	reasonable cause claimed	reasonable cause claimed
3	Backup withholding (BWH)/Church Social Security issue	Schedule A attached (BWH)/Church Social Security issue	not applicable	not applicable
4	1st time, 3 banking day	not applicable	not applicable	not applicable
5	Schedule B attached	not applicable	not applicable	not applicable
6 computer	\$100,000 account	\$100,000 account	\$100,000 account	\$100,000 account

generated

7
computer
generated

not
applicable

not
applicable

not
applicable

incomplete
information,
causing
averaging
on a
\$100,000
account

Exhibit (20)400-17 Liability Breakdown Chart

Reference: (20)4(20)3.4, (20)4(20)4.1, and (20)4(20)4.3

LIABILITY BREAKDOWN

January 1, 1993 and Later

Form	Liability Breakdown
Form 941 Form CT-1	941, Schedule B
Form 943	943-A
Form 720	720, Schedule A
Form 945	945-A
Form 940 Form 1042	4977
December 1992 and Prior	
All Forms 941, 643, CT-1, 940 and 1042	4977

Chapter (20)500 Return Related Penalties

(20)510 Overview

(20)511 Background

(1) This chapter covers the accuracy-related penalties under IRC section 6662 and the fraud penalty under IRC section 6663. Penalties applicable to returns due before January 1, 1990, were removed from this chapter.

(2) The Omnibus Budget Reconciliation Act of 1989 (OBRA 89) consolidated and renumbered the following penalty code sections:

(a) Negligence or disregard of the rules or regulations: from IRC section 6653(a) to

6662(b)(1) and 6662(c).

(b) Substantial understatement of income tax: from IRC section 6661 to 6662(b)(2) and 6662(d).

(c) Substantial valuation misstatement: from IRC section 6659 to 6662(b)(3) and 6662(e).

(d) Substantial overstatement of pension liability: from IRC section 6659A to 6662(b)(4) and 6662(f).

(e) Substantial estate or gift tax valuation understatement: from IRC section 6660 to 6662(b)(5) and 6662(g).

(3) The accuracy-related penalty rate is 20 percent of the underpayment attributable to any adjustments on the above.

(4) The penalty increases to 40 percent for above items (2)(c), (d) and (e) when there is a gross valuation misstatement as defined in IRC section 6662(h). (See IRM (20)542.3.)

(5) OBRA 89 changed the civil fraud penalty from IRC section 6653(b) to 6663. The penalty rate is 75 percent of the underpayment attributable to fraud.

(6) OBRA 89 added IRC section 6664 to provide definitions and special rules that apply to both the accuracy-related penalties and the civil fraud penalty.

(20)512 Common Features

Accuracy-Related and Civil Fraud Penalties

(20)512.1 Guidelines for Penalty Review,

Abatement, and Reconsideration

(1) All accuracy-related and civil fraud penalties are associated with the examination of a tax return. See Treas. Reg. 1.6662-2(a). Penalty review, abatement, and reconsideration follow guidelines established for the examination of the return.

(2) Special abatement procedures for EP/EO apply for those accuracy-related penalties assessed on NMF. These penalties relate to:

(a) Form 4720, Return of Certain Excise Taxes on Charities and Other Persons, under Chapters 41 and 24 of the Code, and

(b) Form 5330, Return of Initial Excise Taxes Related to Employee Benefit Plans.

(3) Claims for refund on assessed accuracy and civil fraud penalties are handled like other claims.

(20)512.2 Accuracy-Related and Civil Fraud Penalties

(1)Return Filing Requirement: The accuracy-related penalty and the civil fraud penalty apply when a return has been filed, either timely or late. The accuracy-related penalties under IRC section 6662 and the civil fraud penalty under IRC section 6663 cannot be asserted on a substitute-for-return filed under IRC section 6020(b). See IRC section 6664(b).

(2)Uniform Definition of Underpayment: IRC section 6664(a) provides a common definition of underpayment. The accuracy-related and civil fraud penalties are calculated only on the underpayment (or portion of the underpayment) of tax attributable to the misconduct or fraud, as applicable. See IRC sections 6662(a) and 6663(a). See IRM (20)512.5.

(3)Coordination of Accuracy-Related and Civil Fraud Penalties: The accuracy-related and civil fraud penalties cannot be asserted on the same portion of the same underpayment. However, the accuracy-related penalty and the civil fraud penalty may be asserted on the same return when civil fraud applies to one portion of the underpayment and the accuracy-related penalty applies to another portion of the underpayment. See IRC section 6662(b).

(4)Interest: Under IRC section 6601(e)(2)(B) interest on civil fraud and accuracy-related penalties accrues from the due date of the return, including extensions. See IRM 31(59)0 for additional information.

(5)Deficiency Procedures Apply: Both penalties follow the guidelines for 30-day letters and statutory notices of deficiency.

(20)512.3 Allocation

(1) An allocation is only necessary when both the accuracy-related and the civil fraud penalty apply.

(2)When there are three return adjustments, for example, and one penalty applies to just one of the three, the underpayment is derived as follows:

(a)Calculate the underpayment for all adjustments.

(b)Calculate the underpayment using only the two adjustments for which there is no penalty.

(c)Subtract (b) from (a).

(3)Apply the penalty rate times the amount derived in (c). This is the amount of the penalty.

(4)See Exhibit (20)500-1 for an example calculation of the underpayment on a return with three adjustments--the first with no penalty, the second with the accuracy-related penalty attributable to a substantial understatement, and the third with the civil fraud penalty.

(5)In allocating the portions of an underpayment for penalty assertion under IRC sections 6662 and 6663, follow the ordering rules of Treas. Reg. 1.6664-3:

(a)Those for which no penalties have been asserted.

(b) Those for which a penalty has been asserted at a 20 percent rate under IRC sections 6662(b)(1), (2), and (3).

(c) Those for which a penalty has been asserted at a 40 percent rate under IRC section 6662(h) for penalties defined in IRC section 6662(b)(3), (4), and (5).

(d) Those for which a penalty has been asserted at a 75 percent rate under IRC section 6663.

(5) Only one penalty rate applies to any portion of an underpayment. When two penalties could apply, the penalty at the higher rate is asserted. If two penalties at the same rate would apply, assert the penalty that is more comprehensively applicable and, in unagreed cases, include the other penalty in the report as an alternative position. (See IRM (20)513.1:(6).) The following illustrates the "no stacking" provision in Treas. Reg. 1.6662-2(c):

(a) If a portion of the underpayment of tax required to be shown on a return is attributable to both negligence and substantial understatement, the accuracy-related penalty would only apply once at the 20 percent rate to this portion of the underpayment. The examining agent should assert the penalty that is most strongly supported by the facts and circumstances and write up the other as an alternative position.

(b) The penalty is applied at the 40 percent rate on any portion of the underpayment attributable to a gross valuation misstatement. Any penalty at the 20 percent rate that could have applied to this portion is not asserted except as an alternative.

(c) A penalty is applied at the 75 percent rate on any portion of the underpayment attributable to civil fraud. Any penalty that could have applied to this portion at the 20 or 40 percent rate is not asserted.

(6) Any income tax withholding, estimated payments, or other payment made before a return was filed, that was not claimed on the return or previously allowed as a credit against the tax liability for the taxable year is allocated as follows:

(a) If the unclaimed prepayment credit is allocable to a particular adjustment, e.g., withholding on unreported W-2 income, the credit is used to reduce the amount of the underpayment resulting from such adjustment. (See Treas. Reg. 1.6664-3(c)(1).)

(b) If the unclaimed prepayment credit is not allocable to a particular adjustment, the credit is applied in accordance with the ordering rules set forth in Treas. Reg. 1.6664-3(c). (See Treas. Reg. 1.6664-3(d) for examples illustrating the manner in which unclaimed prepayment credits are to be allocated.)

(20)512.4 Carrybacks and Carryovers

(1) The amount of an underpayment subject to IRC sections 6662 or 6663 will not be reduced by any carryback or carryover of a net operating loss (NOL), deduction, or credit. See Treas. Reg. 1.6662-3(d), 1.6662-4(c) and 1.6664-2(f). For example:

(a) A 1991 examination adjustment results in an underpayment of \$3,000, which is

subject to the accuracy-related penalty attributable to negligence.

(b) A \$12,000 NOL carryback from 1992 to 1991 offsets the \$3,000 underpayment for income tax purposes, but the \$3,000 underpayment is still used in the calculation of the accuracy-related penalty for 1991: $20\% \times \$3,000 = \600 .

(2) The accuracy-related penalty applies to an underpayment for a year to which a loss, deduction or credit has been carried if the underpayment in the loss or credit year is penalized. For example:

(a) The taxpayer filed a 1993 return with an NOL of \$45,000, twenty thousand dollars of the \$45,000 for 1993 is carried forward to 1994.

(b) An examination of the 1993 return results in an adjustment of \$60,000 due to the negligent omission of income. The \$45,000 NOL is disallowed in full and there is an underpayment of \$3,000 for 1993.

(c) The \$20,000 amount carried over from 1993 to 1994 is disallowed. This produces a 1994 underpayment of \$2,000. Because this is the result of an adjustment for which negligence applied in 1993, the penalty also applies to the 1994 underpayment.

(d) Note: If the NOL disallowance for 1993 did not result in an underpayment, but did create an underpayment for 1994 (due to the disallowed carryover from 1993), then the penalty would apply to 1994.

(3) When the penalty assertion requires a dollar threshold,

(e.g., \$5,000 for substantial understatements and valuation misstatements) this threshold must be met for each year in which the penalty will be asserted (including a carryback or carryover year).

(4) For special rules regarding carrybacks and carryovers in the area of transfer pricing, see Treas. Reg. 1.6662-6(e).

(5) IRC sections 6662 and 6663 apply to post-OBRA 89 returns due after December 31, 1989, determined without regard to extensions. Pre-OBRA 89 returns are those due before January 1, 1990 determined without regard to extensions. Post-OBRA 89 penalty rates are different from pre-OBRA 89 rates. For example:

(a) Penalty rates applicable to carrybacks from a post-OBRA year (e.g., 1991) to a pre-OBRA year (e.g., 1988) will be calculated at the post-OBRA 89 rates under IRC section 6662 for both years. (See Treas. Reg. 1.6662-3(d)(2).) Any dollar thresholds required for penalty assertion will also be determined by IRC section 6662 for both years.

(b) The regulations are silent on penalty rates applicable to carryforwards from a pre-OBRA return to a post-OBRA return. Contact District Counsel on this issue before assertion.

(c) The transfer pricing penalty under IRC section 6662(e) applies to taxable years ending after November 5, 1990.

(20)512.5 Definitions

(1)Coordinated Examination Program: Rev. Proc. 94-69, 1994-2 C.B. 804, provides special rules for CEP taxpayers to meet the disclosure exception after receipt of audit notification.

(2)Carrybacks and carryovers: In the case of carrybacks and carryovers, disclosure is only made with the return for the taxable year in which the carryback or carryover originates.

(3)Corrected tax: The term corrected tax includes any statutory adjustments based on AGI. For example:

(a)medical, casualty loss, and miscellaneous deductions,

(b)changes to the tax as a result of the examination, or

(c)changes to any credit, prepayment credit, or refundable credit as a result of the examination. (This includes any prepayment credits that were paid for the year under examination but were not credited.)

(4)Pass-through entities: Generally, disclosure for items attributable to a pass-through entity should be made on Form 8275 or 8275-R, as appropriate, attached to the return (or qualified amended return) of the entity. A taxpayer (i.e., partner, shareholder, beneficiary or holder of a residual interest in a REMIC) also may make adequate disclosure by filing Form 8275 or 8275-R in duplicate, one copy attached to the taxpayer's copy of the return and one attached to the return that is filed with the Service.(4)Qualified amended return: Treas. Reg. 1.6664-2(c)(3). The taxpayer may make adequate disclosure on a qualified amended return, i.e., an amended return filed after the return is filed but before:

(a)the receipt of an audit notification letter, or

(b)the receipt of a timely request for an administrative adjustment under IRC section 6227, or

(c)contact concerning an activity described in IRC section 6700.

(5)Recurring items: Disclosure with respect to a recurring item, such as the basis of recovery property, must be made with each return on which the item is taken into account.

(6)Rebate: A rebate is:

(a)the amount of an abatement credit, refund or other repayment, as was made on the basis that the tax imposed was less than the excess of the sum of:

1 the amount shown as a tax by the taxpayer on the return, plus

2 amounts not so shown previously assessed, or

3 collected without assessment, as a deficiency over certain rebates previously made.

(b) In calculating the amount of the understatement, adjustments to refundable credits or prepayment credits for withholding or estimated tax are not included. See Treas. Reg. 1.6664-2(e) and 1.6662-4(b)(5).

(7) Tax per return: Tax per the return includes:

1 service center math error corrections,

2 changes made by a qualified amended return posted to the account as a credit or debit (See Treas. Reg. 1.6664-2(c)(3) and IRM (20)512.5:(4)), and

3 any amounts not shown on the return but previously assessed or collected without assessment (e.g., in jeopardy assessments). See Treas Reg. 1.6664-2(a)(1)(ii).

(7) Underpayment: See Treas. Reg. 1.6664-2.

(a) An underpayment is defined as the amount by which any income tax imposed, exceeds the excess of:

1 the sum of the amount shown on the return, plus

2 amounts not so shown that were previously assessed (or collected without assessment), over

3 the amount of rebates made.

(b) In calculating the amount of the underpayment, adjustments to refundable credits or prepayment credits for withholding or estimated tax are included.

(8) Understatement: The amount of the understatement determines if the condition is met to assert the penalty.

(a) Understatement is the excess of the amount of:

1 tax required to be shown on the return,

2 over the amount of tax imposed which is shown on the return, reduced by any rebate.

(b) See Treas. Reg. 1.6662-4(b)(2).

(20)513 Assertion of the Accuracy-Related Penalty

(20)513.1 Examination

(1) The examiner is responsible for the assertion of the accuracy-related penalty. The term "examiner" includes revenue agents, auditors, examiners, and officers who are auditing income tax returns, employment tax returns, employee plans, exempt organizations and related tax returns.

(2) Penalty considerations are to be addressed in all examinations and workpapers should

be prepared under the following guidelines:

(a) For examination adjustments that clearly do not involve penalties, a brief comment to that effect is sufficient.

(b) When adjustments would appear to warrant the penalty, but it is not asserted, the applicable exceptions to the penalty will be elaborated in the workpapers.

(c) On agreed examinations, the assertion of the penalty is documented in the workpapers and fully explained in the report.

(d) When the penalty is asserted on unagreed cases, the Service position must be fully developed and documented, including the applicability of any exceptions.

(e) Note: The above guidelines do not apply to returns examined under the Coordinated Examination Program.

(3) Form 3198, Special Handling Notice, is attached to all cases when the accuracy-related penalty is asserted.

(4) Examiners will identify the adjustments related to each penalty in the report, and identify each one separately by Code section and amount.

(5) In proposing the penalty to the taxpayer or taxpayer's representative, the examiner will:

(a) elaborate all the reasons why the penalty assertion appears appropriate, and

(b) consider and document any possible exceptions to the penalty provided by the taxpayer or the taxpayer's representative whether or not they are accepted.

(6) When more than one component of the accuracy-related penalty may apply to the same portion of an underpayment (e.g., negligence and substantial understatement):

(a) On agreed cases: the Service will assert the penalty with the strongest position.

(b) On unagreed cases: the Service will assert the penalty with the strongest position, but also will calculate and explain any alternative position(s) on Form 886-A, Explanation of Items, attached to the report. Alternative positions will also be included in the statutory notice of deficiency.

(20) 513.2 Underreporter

(1) The accuracy-related penalty is considered on the CP-2501, initial query letter. The examining officer will make a penalty determination based on the taxpayer's response. In the absence of a response, the determination will be made on the basis of return information and the significance of the amounts omitted.

(2) Notices and reports will fully identify the Code sections and the amounts for penalties asserted.

(3) All penalty determinations involving a reasonable cause exception will be documented in the workpapers. This will be done by identification on the Underreporter case analysis screen and will remain with the case file.

(4) In unagreed cases, the Service will provide the taxpayer or representative with a complete explanation of the penalty.

(20)514 Assessment of the Accuracy-Related Penalty

(1) The examiner will compute the penalty for the processing function (e.g. ESP, CSU, or EP/EO-SP). Form 3198, Special Handling Notice, will be used to indicate the penalty assertion.

(2) Input the accuracy-related penalty using the following Reference Numbers:

(a) 680:

- 1 6662(e) Substantial Valuation Misstatement,
- 2 6662(f) Substantial Overstatement of Pension Liabilities, and
- 3 6662(h) Gross Valuation Misstatement.

(3) Input the accuracy-related penalty with Reference Number 680. Master File will compute interest on this penalty from the due date or extended due date of the return (whichever is later) to the earlier of:

- (a) the date of payment,
- (b) waiver date plus 30 days, or
- (c) 23C date of assessment.

(20)515 Penalty Relief

General penalty relief is discussed in IRM (20)130, Penalty Relief. Exceptions specific to each of the accuracy-related penalties and the civil fraud penalty are discussed in their respective chapters.

(20)515.1 Reasonable Cause

(1) No accuracy-related penalty is imposed if it is shown that the taxpayer had reasonable cause and that the taxpayer acted in good faith for the position taken. The reasonable cause provision in IRC section 6664(c) applies to all of the accuracy-related components.

(2) IRM (20)130 and Treas. Reg. 1.6664-4 contain additional information and examples. The reasonable cause exception will be determined on a case-by-case basis taking into account all the pertinent facts and circumstances. Generally, the most important factor is the taxpayer's effort to assess the proper tax liability. The credibility of the taxpayer's reasons for not determining the proper tax liability should be evaluated.

(3) Treas. Reg. 1.6664-4T(f) provides guidelines for applying the reasonable cause and

good faith exception to IRC section 6662(e) penalties for transactions between persons described in IRC section 482 and net IRC section 482 transfer pricing adjustments. For specific reasonable cause criteria relating transfer pricing adjustments, see IRM (20)545.1.

(20)515.2 Reliance on Advice

(1) Reliance on advice as defined by Treas. Reg. 1.6664-4(c) may satisfy the reasonable cause exception of IRC section 6664(c):

(a) "Advice" is defined as any communication, including the opinion of a professional tax advisor, setting forth an analysis or conclusion by a person other than the taxpayer and on which the taxpayer relied in preparing the return. Advice does not have to be in any particular form.

(b) Under Treas. Reg. 1.6664-4(c)(1), taxpayers may meet the reasonable cause exception if they reasonably relied on advice that was based upon:

- 1 reasonable factual or legal assumptions,
- 2 all pertinent facts and circumstances, and
- 3 the law as it relates to the facts and circumstances.

(c) Having met the above requirements, the exception will still not apply unless, with respect to all the pertinent facts and circumstances, there was reasonable reliance on the advice in good faith.

(2) Whenever the taxpayer has met the advice standard as an exception to the penalty, the preparer's conduct becomes an issue. The preparer should be contacted to determine the applicability of IRC section 6694.

(3) Treas. Reg. 1.6664-4T(f) provides guidelines for applying the reasonable cause and good faith exception to IRC section 6662(e) penalties for transactions between persons described in IRC section 482 and net IRC section 482 transfer pricing adjustments. For specific reasonable cause criteria relating transfer pricing adjustments, see IRM (20)545.1.

(20)520 IRC Section 6662(b)(1) Negligence or Disregard of Rules or Regulations

(20)521 General

(1) OBRA 89 redesignated the negligence penalty from IRC section 6653(a) to 6662(b)(1).

(a) For returns due after December 31, 1989 (without regard to extensions) the current IRC section 6662(b)(1) applies.

(b) The amount of the penalty is 20 percent of the underpayment attributable to negligence or disregard of rules or regulations.

(20)522 Penalty Assertion

(20)522.1 Negligence

(1) Negligence includes any failure to make a reasonable attempt to comply with the provisions of the tax law, exercise ordinary and reasonable care in tax return preparation, or keep adequate books and records. (See Treas. Reg. 1.6662-3(b).)

(2) The regulations also provide that negligence is strongly indicated when a taxpayer fails to report income shown on an information return, fails to make a reasonable inquiry into the correctness of a deduction, credit, or exclusion on a tax return that seems "too good to be true," or when the returns of partners or S corporation shareholders are clearly inconsistent with the tax returns of their respective entities.

(3) Some indications of negligence follow:

- (a) unreported or understated income,
- (b) deductions or credits significantly overstated,
- (c) careless, improper, or exaggerated deductions,
- (d) misrepresenting or miscategorizing deductions in such a manner as to conceal the true nature of the deduction,
- (e) unexplainable items,
- (f) inadequate books and records,
- (g) cooperative state programs and state reports showing a negligence penalty (taking into account other factors and not relying entirely on the findings of another taxing agency),
- (h) substantial errors on an issue that had been adjusted in a prior year, or
- (i) giving the preparer incorrect or incomplete information to prepare the return.

(20)522.2 Disregard of Rules or Regulations

(1) Disregard of rules or regulations relates to the taxpayer's failure to follow the appropriate law in completing the return, and reflects a disregard of the Code, temporary or final regulations, notices, or revenue rulings (other than notices of proposed rule making). The term "disregard" includes careless, reckless, or intentional disregard.

(a) Disregard is "careless" if the taxpayer does not exercise reasonable care to determine the correctness of a tax return.

(b) Disregard is "reckless" if the taxpayer makes little or no effort to determine if a rule or regulation exists, under circumstances demonstrating a substantial deviation from a reasonable standard of conduct.

(c) Disregard is "intentional" if the taxpayer knows of a rule or regulation and ignores that rule or regulation.

(2) A taxpayer who takes a position contrary to a revenue ruling or notice has not disregarded the ruling or notice if the position has a realistic possibility of being sustained on its merits.

(20)522.3 Coordination with Civil Fraud Penalty

For the assertion of the civil fraud penalty and how it relates to the assertion of the accuracy-related penalty attributable to negligence or intentional disregard of the rules or regulations see IRM (20)512.2.

(20)522.4 Substitute-for-Return, Delinquent Returns, and "No Show" Cases

(1) The accuracy-related and civil fraud penalties can only be applied to a return that has been filed by the taxpayer. See IRC section 6664(b).

(a) The accuracy-related and civil fraud penalties cannot be applied to a substitute-for-return under IRC section 6020(b). However, these penalties can be asserted on a secured delinquent return, i.e., a return obtained after the taxpayer has been contacted by the IRS. Examiners cannot apply the accuracy-related penalties to a delinquent return after an assessment (TC 290/300) is made under substitute-for-return procedures.

(b) The accuracy-related penalty attributable to negligence will not be asserted solely for filing a return late.

(c) The accuracy-related penalty attributable to negligence will not be asserted solely due to the taxpayer's failure to appear for an audit or respond to an inquiry or notice. However, the facts and circumstances from the return and the case file may warrant assertion of the accuracy-related penalty attributable to negligence.

(2) For example:

(a) An IRP document shows the taxpayer received \$5,000 of interest income. The tax return reflects AGI of \$40,000 but no interest income. The taxpayer does not appear for the examination. The accuracy-related penalty attributable to negligence should be asserted based on the information on the return and in the case file.

(b) The 1991 and 1992 examinations disallowed the auto expense deduction because the costs were commuting expenses. The 1993 return was filed and secured after these examinations and the taxpayer claimed the same deduction for commuting expenses. The taxpayer did not appear for the office appointment. Based on the prior year's disallowed deduction, and the taxpayer's knowledge of the nondeductible expense, the accuracy-related penalty attributable to negligence would be asserted on the 1993 return.

(20)523 Penalty Assessment

(1) The examining officer will compute the accuracy-related penalty attributable to

negligence for the processing function (ESP, CSU, or EP/EO-SP). Form 3198, Special Handling Notice, will be used to indicate the penalty assertion.

(2) The total penalty will be entered on:

(a) Form 5344, Examination Closing Record, or

(b) Form 5403, for Examination cases (Form 5599 or 5650 for EP/EO) using TC 350.

(20)524 Penalty Relief

(20)524.1 Reasonable Cause

The penalty does not apply if the taxpayer has reasonable cause and acted in good faith, i.e., if an error was due to an honest misunderstanding of the facts or the law and the taxpayer took reasonable steps to comply with the law. (See IRM (20)130.)

(20)524.2 Adequate Disclosure

(20)524.21 General

(1) Disclosure is adequate if:

(a) it is made with the return, or on a qualified amended return, and

(b) unless otherwise prescribed by the Commissioner, a completed Form 8275, Disclosure Statement, is filed with the original return or qualified amended return. Form 8275-R, Regulations Disclosure Statement, is necessary for disclosing a position contrary to a regulation.

(c) Treas. Regs. 1.6662-3(c), 1.6662-4(e) and (f) define adequate methods of disclosure for returns due after December 31, 1991, the effective date of the regulations.

(d) See IRM (20)512.5:(4) for the definition of a qualified amended return.

(2) The exception for adequate disclosure will not apply if:

(a) the item on the return is attributable to a tax shelter,

(b) the taxpayer has not kept adequate books and records, or fails to substantiate items on the return, or

(c) for returns due (without regard to extension):

1 before January 1, 1994, the item or position on the return is frivolous (i.e., patently improper)

2 after December 31, 1993, the item or position on the return does not have a

reasonable basis. (Applies to disregard of rules and regulations only.)

3 See IRM (20)524.22 and (20)524.23.

(3)The applicability of the disclosure exception is determined for each item or group of similar items separately. When the adequate disclosure exception is met (except in the case of a tax shelter), the tax attributable to the disclosed item is not included in the calculation of the underpayment for penalty purposes.

(4)For disclosure with respect to recurring items (e.g., basis in recovery property), carrybacks and carryovers, pass-through entities, and CEP examinations see IRM (20)512.5:(2).

(20)524.22 Negligence and Adequate Disclosure

(1)For returns due after December 31, 1989 and before January 1, 1994 the adequate disclosure exception does not apply if the item is frivolous. See Notice 90-20, 1990-1 C.B. 328.

(2)For returns due after December 31, 1993, adequate disclosure does not apply. Whenever the taxpayer has a reasonable basis for an item or position taken, negligence by definition does not apply. See IRM (20)535.1.

(20)524.23 Disregard of Rules or Regulations and Adequate Disclosure

(1)Adequate disclosure is an exception to the penalty attributable to disregard of rules or regulations. Since the penalty attributable to negligence (for returns due after December 31, 1993) is not subject to a disclosure exception, the distinction between negligence and disregard of rules and regulations will sometimes have to be made.

(a)The penalties attributable to negligence and disregard of rules or regulations often overlap, seem to apply equally to any given case, and are often difficult to distinguish.

(b)See Treas. Reg. 1.6662-3(b)(1) and (2) for the definitions of negligence and disregard.

(2)For returns due after December 31, 1991 (without regard to extensions) and before January 1, 1994, the disclosure exception is met for disregard of rules or regulations only when:

(a) the required form is filed by the taxpayer (Form 8275 or 8275-R), and

(b)the item or position on the return has a realistic possibility of being sustained on its merits. See IRM (20)535.2.

(3) For returns due after December 31, 1993 (without regard to extensions), the disclosure exception is available if the position taken on the return has a reasonable basis.

(4)The penalty for disregard usually applies if an item on the return is contrary to the

Internal Revenue Code, temporary or final regulations issued under the Internal Revenue Code, or a revenue ruling or notice (other than notices of proposed rule making) published in the Internal Revenue Bulletin. However, the penalty does not apply to a position contrary to a revenue ruling or notice if the item has a realistic possibility of being sustained on its merits.

(20)530 IRC Section 6662(d) Substantial Understatement

(20)531 General

(1)OBRA 89 repealed IRC section 6661, Substantial Understatement of Liability, and replaced it with the accuracy-related penalties in IRC section 6662(d).

(2)The penalty is 20 percent of the underpayment of income tax when there is a substantial understatement of income tax. An understatement is substantial when it exceeds the greater of 10 percent of the tax required to be shown on the return for a taxable year, or \$5,000 (\$10,000 for C-corporations).

(20)532 Penalty Assertion

(1)The penalty can only be asserted when the understatement is substantial, i.e., when it exceeds the greater of 10 percent of the tax required to be shown on the return, or \$5,000 (\$10,000 for C corporations).

(2)When the understatement is substantial but the penalty is not asserted, the examiner should explain the applicable exceptions in the case file.

(3)Preparer penalties under IRC section 6694 must be considered and documented for all substantial understatement penalty cases.

(4)Whenever the penalty is not asserted because the taxpayer has met the "advice" standard under the reasonable cause exception, contact with the preparer is mandatory before the case is closed from the group. Disclosure guidelines are not jeopardized in this context.

(5)Examiners will identify the penalty attributable to each adjustment in the report, and explain each penalty by Code section and amount.

(6)When the accuracy-related penalty attributable to a substantial understatement of income tax is not asserted due to the assertion of negligence or disregard of the rules or regulations, any unagreed report will include the substantial understatement as an alternative position.

(7)The penalty cannot be asserted on a substitute-for- return under IRC section 6020(b). A return must have been filed (timely or delinquent) for the examiner to assert the penalty.

(8)The penalty can be asserted on "no show" cases when:

- (a) the understatement is substantial,
- (b) the return on its face is patently suspect, and
- (c) the taxpayer would not appear to meet any exceptions.

(20)533 Penalty Calculation

(1) For the definition, allocation and calculation of the underpayment see IRM (20)512.5.

(2) To determine the correct penalty:

(a) Calculate the understatement.

(b) Establish that the understatement exceeds the greater of \$5,000 (\$10,000 for C corporations) or 10 percent of the tax required to be shown on the return.

(c) Consider exceptions to the penalty.

(d) If any exceptions apply, recalculate the understatement without including the tax on the adjustments not subject to the penalty. Determine if the requirements are still met for penalty assertion.

(e) Consider adjustments to prepayment and refundable credits and establish the underpayment.

(f) Apply the penalty rate to the underpayment.

(3) For example calculations see Exhibits (20)500-2 and 500-3.

(20)534 Penalty Assessment

(1) To assess or abate penalties imposed under this code section, complete code and edit Forms 5344, 5403, 5599 or 5650 in the normal manner with the following exceptions:

(a) do not enter either Transaction Codes (TC) 240/241 or the penalty amount;

(b) enter the reference number and the penalty amount (TC 240/241 will automatically be generated to the Master File).

(2) When a manual computation of interest on the penalty is required, see established procedures.

(20)535 Penalty Relief

(20)535.1 Substantial Authority Exception

(1) The penalty under IRC section 6662(d) will not be asserted if there is substantial

authority for the tax treatment of an item or return position. When the taxpayer's authority for the item or return position is substantial with respect to the authority against it, the penalty will not be asserted. Authorities relevant to both sides of the tax treatment of an item are taken into account.

(a) Substantial authority is an objective standard involving an analysis and application of the law to the relevant facts. It is not determined with reference to what the taxpayer actually believed to be the correct treatment of the item. Every item must be separately evaluated to determine whether there is substantial authority for the tax treatment of an item.

1 The substantial authority standard is less rigid than the "more likely than not" standard. The "more likely than not" standard is met when there is more than a 50 percent likelihood that the position would be sustained.

2 The substantial authority standard is more rigid than the reasonable basis standard. The reasonable basis standard has not been defined by regulation, but per the committee reports associated with section 13251 of the Uruguay Round Agreement Act, P.L. 103-465 dated December 8, 1994, is the same standard that precludes the assertion of the penalty for negligence and disregard of rules and regulations. A position having a reasonable basis is a position that is arguable but fairly unlikely to prevail in court.

(b) Therefore, the substantial authority exception can be met when the taxpayer has less than a 50 percent, but more than a one-in-three likelihood of being sustained on the issue.

(2) "Authority" under Treas. Reg. 1.6662-4(d)(3)(iii) is established by reference to:

- (a) the Internal Revenue Code and other statutory provisions;
- (b) proposed, temporary and final regulations;
- (c) revenue rulings and revenue procedures;
- (d) tax treaties, the regulations thereunder, and

Treasury Department and other official explanations of such treaties;

(e) court cases;

(f) congressional intent as reflected in committee

reports, joint explanatory statements of managers included in conference committee reports, and floor statement made prior to enactment by one of a bill's managers;

(g) General Explanations of tax legislation prepared by the Joint Committee on Taxation (the "Blue Book");

(h) private letter rulings and technical advice memoranda issued after October 31, 1976;

(i) actions on decisions and general counsel memoranda issued after March 12, 1981 (as well as general counsel memoranda published in pre-1955 volumes of the Cumulative Bulletin);

(j) IRS information releases and press releases;

(k) notices, announcements and other administrative pronouncements published by the Service in the Internal Revenue Bulletin.

(3) Taxpayers automatically meet the substantial authority standard if:

(a) they have been named in a technical advice memorandum,

(b) have been issued a district director's determination letter,

(c) have been issued a private letter ruling, or

(d) received a revenue agent's report for a prior taxable year with an affirmative statement on the same item.

(4) Taxpayers do not automatically meet the substantial authority standard if a private letter ruling is revoked or is inconsistent with:

(a) subsequent proposed regulations

(b) subsequent revenue rulings, or

(c) other administrative pronouncements published in the Internal Revenue Bulletin.

(d) See Treas. Reg. 1.6662-4(d)(3)(ii).

(5) The term "authority" does not include treatises, legal periodicals, legal opinions or opinions rendered by other tax professionals,

(6) An authority does not continue to be an authority if it is overruled or modified, implicitly or explicitly, by a body having the power to overrule or modify an earlier authority such as a U.S. Court of Appeals overruling a district court which originally issued the authority used by the taxpayer.

(7) A Tax Court opinion is not considered to be overruled or modified by a court of appeals to which a taxpayer does not have a right of appeal, unless the Tax Court adopts the holding of the court of appeals.

(8) Substantial authority is determined as of the date of filing or the last day of the taxable year. (See Treas. Reg. 1.6662-4(d)(3)(iv)(C).)

(9) For determining the weight of various "authorities" see Treas. Regs. 1.6662-4(d)(3)(ii).

(20)535.2 Adequate Disclosure Exception

(1) When the adequate disclosure exception is met, the tax attributable to the disclosed item or return position is not included in the calculation of the understatement for penalty purposes.

(2) Generally, the accuracy-related penalty attributable to substantial understatement will not be asserted on the underpayment attributable to an item that is adequately disclosed. However, even when the item is adequately disclosed the penalty will still be asserted if:

(a) for returns due after January 31, 1991, but before January 1, 1994--the disclosed item is frivolous, i.e., patently improper (see former Treas. Regs. 1.6662-3(b)(3)),

(b) for returns due after December 31, 1993--the disclosed item does not meet the reasonable basis standard,

(c) the taxpayer failed to keep adequate books and records or failed to substantiate the disclosed item. (IRM 4271, Inadequate Records Cases), or

(d) the item is attributable to a tax shelter as defined in IRC section 6662(d)(2)(C)(iii) and Treas. Reg. 1.6662-4(g)(2).

(3) Disclosure is adequate if it is made in a statement attached to a return, i.e., Form 8275, Disclosure Statement, or Form 8275-R, Regulation Disclosure Statement.

(a) Disclosure is considered adequate for tax return line item entries identified in and disclosed according to the annual revenue procedure that applies for the year of the return.

(b) If the revenue procedure does not expressly provide that disclosure of an item on the return is sufficient, disclosure should be made on Form 8275. The definition of adequate disclosure provided by the following revenue procedures only pertains to the accuracy-related penalty attributable to a substantial understatement.

1 For 1990 returns, see Rev. Proc. 91-19, 1991-1 C.B. 523,

2 For 1991 returns see Rev. Proc. 92-23, 1992-1 C.B. 737,

3 For 1992 returns see Rev. Proc. 93-33, 1993-2 C.B. 470.

4 For 1993 returns see Rev. Proc. 94-36, 1994-1 C.B. 682.

5 For 1994 returns see Rev. Proc. 94-74, 1994-2 C.B. 823.

6 For 1995 returns see Rev. Proc. 95-55, 1995-52 I.R.B. 34.

7 For CEP returns see Rev. Proc. 94-69, 1994-2 C.B. 804.

8 After 1995, it is necessary to review the annual revenue procedure published by

the Service for the applicable tax year.

(c) Courts have also held that a disclosure statement is adequate if it reasonably apprises the Service of the nature and amount of the potential controversy. This statement should include the following:

1 a caption identifying the statement as a disclosure under IRC section 6662,

2 an identification of the item with respect to which the disclosure is made,

3 the amount of the item, and

4 the facts affecting the tax treatment of the item sufficient to apprise the Service of the nature of the potential controversy.

5 Note: If the disclosure statement fails to

include all of the above, misrepresents the facts, or is too general to reasonably apprise the Service of the potential controversy, the disclosure exception does not apply.

6 See Schirmer v. Commissioner, 89 T.C. 277, 285-86 (1977); Dibsy v. Commissioner, T.C. Memo. 1995-477.

(d) Treas. Regs. 1.6662-3(c), 1.6662-4(e) and (f) define adequate methods of disclosure. These provisions are effective for returns due after December 31, 1991, the effective date of the regulations.

(e) For returns due after December 31, 1989, and before January 1, 1992, the provision for qualifying disclosures is found in Notice 90-20, 1990-1 C.B. 328, which allows the disclosure to be made on the return (in a special manner) or on Form 8275.

(20)535.3 Exceptions for Tax Shelter Items

(20)535.31 General

(1) The term "tax shelter" is defined in IRC section 6662(d)(2)(C) and Treas. Regs. 1.6662-4(g)(2) as an arrangement, plan, or other entity (such as a corporation, partnership or trust), that has as its principal purpose the avoidance or evasion of federal income tax.

(2) The term "tax shelter item" is defined in Treas. Reg. 1.6662-4(g)(3) as an item of income, gain, loss, deduction, or credit that is directly or indirectly attributable to the principal purpose of a tax shelter to avoid or evade federal income tax.

(20)535.32 Non-Corporate Tax Shelter Items

(1) The portion of an understatement attributable to a tax shelter item of a non-corporate taxpayer will not be considered for assertion of the penalty when:

(a) there is substantial authority for the treatment of the item, and

(b) the taxpayer reasonably believed that the tax treatment of the item was more likely than not the proper treatment. See IRC section 6662(d)(2)(C)(i)(i).

(2) The reasonable belief standard is met if:

(a) the taxpayer analyzed pertinent facts and relevant authorities to conclude in good faith that there would be a greater than 50 percent likelihood that the tax treatment of the item would be upheld if challenged by the IRS; or

(b) the taxpayer reasonably relied in good faith on the opinion of a professional tax advisor who analyzed all the pertinent facts and authorities, and who unambiguously states that there is a greater than 50 percent likelihood that the tax treatment of the item will be upheld if challenged by the IRS.

(3) Non-corporate pass-through entities: If the entity satisfies the reasonable belief requirement, the taxpayer is deemed to have also met the requirement.

(4) The general exception for reasonable cause and good faith in IRC section 6664(c) will also be considered, if, for example, there is an honest misunderstanding of fact or law that is reasonable in light of all facts and circumstances.

(20)535.33 Corporate Tax Shelter Items

(1) For tax shelter items of corporate taxpayers relating to transactions occurring on or before December 8, 1994, the exceptions for non-corporate taxpayers also apply. See IRM (20)535.32.

(2) To more effectively deter corporate tax shelter transactions, the Uruguay Round Agreements Act, P. L. No. 103-465, 1994 U.S.C.A.N. (108 Stat.) 4809, 5011 of December 9, 1994, eliminated the exception to the accuracy-related penalty attributable to a substantial understatement for which the taxpayer had substantial authority and a reasonable belief that its treatment was more likely than not the proper treatment as it applied to corporations.

(3) For corporate tax shelter items relating to transactions occurring after December 8, 1994, the taxpayer may meet the reasonable cause exception in IRC section 6664(c) by establishing legal justification. Legal justification, as defined in Treas. Reg. 1-6664-4(e), includes any justification under the federal tax law for the treatment or characterization of the tax shelter item or of the entity, plan, or arrangement that gave rise to the item. A corporation establishes legal justification with respect to a tax shelter item if:

(a) the corporation has first met the standard for substantial authority (see IRM (20)535.1) and reasonable belief (see IRM (20)535.1:(1)(d)), and

(b)all relevant facts and circumstances (in addition to the corporation's legal justification) are taken into account and indicate that the corporation acted with reasonable cause and in good faith.

(c)Note: If a corporate taxpayer has a substantial understatement that is attributable to a tax shelter item, the accuracy-related penalty attributable to a substantial understatement applies to the understatement unless the taxpayer has reasonable cause.

(d)The reasonable cause exception for corporate tax shelter items may also be met under general guidelines in IRM (20)515.1 and (20)130.

(20)535.34 Reasonable Cause

(1)The accuracy-related penalty attributable to a substantial understatement will not be applied if the taxpayer shows reasonable cause for the understatement and acted in a good faith effort to derive the correct tax liability. (See IRM (20)130 and (20)515 for a more detailed discussion of the reasonable cause exception and Treas. Reg. 1.6664-4 for examples.)

(2)See Treas. Reg. 1.6664-4(c) and IRM (20)515.2 for reliance on tax advice in meeting the reasonable cause exception.

(20)540 IRC Sections 6662(e) and 6662(h) Substantial and Gross Valuation Misstatement

(20)541 General

(1)OBRA 89 repealed IRC section 6659, Valuation Overstatements, and replaced it with the Accuracy-Related Penalty attributable to a Substantial Valuation Overstatement under IRC section 6662(e), effective for returns due after December 31, 1989 (without regard to extensions). OBRA 89 introduced the following provisions:

(a)under IRC section 6662(e), a 20 percent penalty is imposed on the portion of any underpayment of tax caused by a substantial valuation overstatement, and

(b)under IRC section 6662(h), the penalty is increased to 40 percent in the case of a gross valuation overstatement.

(2)OBRA 90 redesignated IRC section 6662(e) as "Substantial Valuation Misstatement under Chapter 1 and added a penalty for valuation misstatements under IRC section 482. IRC section 6662(h) also redefined gross valuation misstatements. These changes are effective for tax years ending after November 5, 1990.

(3)OBRA 93:

(a)amended IRC section 6662(e)(1)(B)(ii), so that the substantial valuation misstatement amount for an IRC section 482 transfer price adjustment, went from

\$10,000,000 to the lesser of \$5,000,000 or 10 percent of the taxpayer's gross receipts,

(b) amended IRC section 6662(h)(2)(A)(iii),

(c) added IRC section 6662(e)(3)(D), and

(d) substantially amended IRC section 6662(e)(3)(B), which now outlines circumstances when certain adjustments are excluded from a net transfer pricing adjustment.

(4) Valuation misstatements fall into two categories: substantial and gross. Each type of valuation misstatement has different criteria for the assertion of the accuracy-related penalty and different penalty rates.

(5) Final regulations under IRC section 6662(e) for net IRC section 482 transfer price adjustments were issued and are effective on February 9, 1996. However, taxpayers may elect to apply the regulations contained in Treas. Reg. 1.6662-6, to all open taxable years beginning after December 31, 1993.

(20)542 Penalty Assertion

(20)542.1 General

(1) The examining officer is responsible for the assertion of the accuracy-related penalty attributable to a valuation misstatement penalty.

(2) The substantial valuation misstatement penalty is 20 percent of the applicable underpayment.

(3) No penalty shall be imposed unless the underpayment attributable to the misstatement is greater than \$5,000 (\$10,000 for corporations, except S corporations and personal holding companies).

(4) In order to monitor and gather information relative to the transfer pricing penalty, the Service formed the IRC section 6662(e) Penalty Oversight Committee to review these cases. See Announcement 96-16, 1996-13, I.R.B. 22

(20)542.2 Substantial Valuation Misstatement

(20)542.21 (20)542.2" > IRC Section 6662(e)(1)(A) Valuation Misstatement

(1) A substantial valuation misstatement occurs when the value (or adjusted basis) of any

property claimed on any return is 200 percent or more of the corrected amount and there is an underpayment of tax. This applies for years beginning after December 31, 1989 (determined without regard to extensions).

(2) The penalty is 20 percent of the underpayment attributable to the adjusted property.

(20)542.22 IRC Section 6662(e)(1)(B)(i) & (ii) Valuation Misstatement Penalties for Transfer Pricing Transactions Under IRC section 482

(1) IRC section 6662(e) imposes two transfer pricing penalties applicable to transactions between or among two or more organizations, trades or business owned or controlled by the same interests. These valuation misstatement penalties are identified as:

(a) the Transactional Penalty. This penalty applies when the price reported for any property or services is 200 percent or more (or 50 percent or less) than the correct price under the arm's length standard of IRC section 482.

(b) the Net Adjustment Penalty. This penalty applies:

1 to returns the due date for which (determined without regard to extensions) is after November 5, 1990 and before January 1, 1994, when the IRC section 482 adjustment exceeds \$10 million.

2 to returns the due date for which (determined without regard to extensions) is after December 31, 1993, when the IRC section 482 adjustment exceeds the lesser of \$5 million or 10 percent of the taxpayer's gross receipts.

(3) The term "price for any property or services" encompasses all kinds of adjustments under IRC section 482, including purchase prices, fees, services, rents, interest, and advances.

(4) For the net IRC section 482 adjustments that are excluded from the penalty, see IRC section 6662(e)(3)(B) and Treas. Reg. 1.6662-6(d). For example calculations see Treas. Reg. 1.6662-6(c)(7).

(5) The penalty is 20 percent of the underpayment attributable to the adjusted property.

(6) Exhibit 500-4 contains a flow chart for the IRC section 6662(e) Transfer Pricing Penalty.

(20)542.3 IRC Section 6662(h) Gross Valuation Misstatement

(1) A gross valuation misstatement occurs:

(a) if the value (or adjusted basis) of any property on a return of tax under Chapter 1 is 400 percent or more of the adjusted amount, or

(b) if the price for any property or services (or for the use of property) claimed on any

(b)if the price for any property or services (or for the use of property) claimed on any return is 400 percent or more (or 25 percent or less) of the amount determined under IRC section to be the correct price, or

(c)if a net IRC section 482 transfer price adjustment-

1 exceeds \$20,000,000, for years beginning after November 5, 1990 and before January 1, 1994, or

2 exceeds the lesser of \$20,000,000 or 20 percent of the taxpayer's gross receipts for years beginning after December 31, 1993.

(2)The penalty is 40 percent of the portion of the underpayment to which this section applies.

(20)543 Penalty Calculation

(1)The substantial valuation penalty applies to the individual income tax return in the example below because both conditions for assertion are met (no exceptions to the penalty apply and the amount of the understatement and the underpayment are equal):

(a) Price of property (or adjusted basis) as reported on the return	\$46,000
(b) Price as adjusted by examination	20,000
(c) 200 percent times the amount in (b)	40,000
(d) Note: Condition #1 is met. The value reported on the return of \$46,000 is more than 200 percent of the adjusted amount of \$20,000 (\$46,000 divided by \$20,000 = 230 percent).	
(e) Amount adjusted (line (a) less line (b)).	\$26,000
(f) Underpayment on \$26,000	7,000
(g) Penalty (20 percent times \$7,000)	

1,400

(h) Note: Condition #2 is met. The underpayment of \$7,000 attributable to the misstatement of \$26,000 exceeds the required \$5,000.

(2)If the adjusted value in (b) above were \$10,000, the amount reported of \$46,000 would then exceed the adjusted amount (\$10,000) by more than 400 percent (\$46,000 divided by \$10,000 = 460 percent). The gross valuation misstatement penalty would then apply at 40 percent of the applicable underpayment.

(3)For example calculations involving carryovers and flow through entities, see IRM (20)512.4 and Treas. Regs. 1.6662-5(d) and (h).

(4)The penalty is considered separately for each property adjusted. To distinguish between a substantial and a gross valuation misstatement requires a property-by-property calculation. (See Treas. Reg. 1.6662-5(f).)

(5)For example calculations for the net IRC section 482 adjustment, see Treas. Reg. 1.6662-6(c)(7).

(6)With regard to the transfer pricing penalty under IRC section 6662(e); please refer to

the rules for coordinating between the transactional penalty and the net adjustment penalty illustrated by examples in Treas. Reg. 1.6662-6(f).

(20)544 Penalty Assessment

See IRM (20)514, Assessment of the Accuracy-Related Penalty.

(20)545 Penalty Relief

(20)545.1 Reasonable Cause

(1) IRC section 6664(c) provides an exception to the penalty if the taxpayer has reasonable cause and acted in good faith. (See IRM (20)130 for a more detailed discussion of general reasonable cause exceptions.)

(2) The reasonable cause exception applies to the transfer pricing penalties (IRC section 6662(e) and Treas. Reg. 1.6662-6) only under certain circumstances.

(a) For the transactional penalty (see (20)542.22:(1)(a)) of IRC section 6662(e)(1)(B)(i), a taxpayer must meet the reasonable cause requirements of Treas. Regs. 1.6664-4 to avoid the penalty.

(b) However, for the net adjustment penalty (see (20)542.22:(1)(b)), the reasonable cause and good faith requirements under IRC section 6664(c) are met only if the taxpayer fulfills either the specified or unspecified method and documentation requirements.

(c) Refer to IRC section 6662(e)(3)(B) and Treas. Regs. 1.6662-6(b)(3) and (c)(6) for further guidance.

(3) A different definition of "advice" applies in the case of the transfer pricing penalties under IRC section 6662(e) and Treas. Reg. 1.6662-6. Where a taxpayer has relied on professional analysis in determining its transfer pricing, whether the professional is an employee of, or related to, the taxpayer is not determinative in evaluating whether the taxpayer reasonably relied in good faith on advice.

(4) Refer to Rev. Proc. 94-33 (1994-1 C.B. 628) regarding reasonable cause for tax years beginning before December 31, 1993.

(20)545.2 Charitable Deduction Adjustment

(1) The taxpayer will not satisfy the good faith test by merely relying on an appraisal. The taxpayer will not be considered to have reasonably relied in good faith on advice unless the requirements of Treas. Reg. 1.6664-4(b) and (c) are met.

(2) In addition, the taxpayer must meet the requirements in Treas. Reg. 1.6664-4(g) specifically on charitable deduction property.

(3) When there is an underpayment due to overstated charitable deduction property, the

reasonable cause exception under IRC section 6664(c)(2) applies only if the following two conditions are first met:

(a) the claimed value of the property was based on a "qualified appraisal" made by a "qualified appraiser," and

(b) the taxpayer made a good faith investigation of the value of the contributed property. (See Treas. Reg. 1.6664-4(g).)

(20)550 IRC Section 6662(f) Substantial Overstatement of Pension Liabilities

(20)551 General

(1) OBRA 89 repealed IRC section 6659A and replaced it with IRC section 6662(f), Substantial Overstatement of Pension Liabilities, for returns due after December 31, 1989 without regard to extensions.

(2) An overstatement of pension liabilities occurs when the actuarial determination of the liabilities taken into account for purposes of computing the employer contribution deduction under IRC section 404 exceeds the correct amount.

(3) See IRM (20)512.4 for carrybacks and carryovers, and IRM (20)512.5 for the definition of an underpayment.

(20)552 Penalty Assertion

(20)552.1 IRC Section 6662(f) Overstatement

(1) The penalty for substantial overstatement of pension liabilities applies when:

(a) the amount deducted on the return as the actuarial determination of the liabilities taken into account to compute the deduction under IRC section 404(a) exceeds the correct amount by 200 percent, and

(b) the underpayment attributable to the substantial overstatement of pension liabilities exceeds \$1,000.

(2) The penalty is 20 percent of the underpayment attributable to the overstatement of pension liabilities.

(3) The gross valuation misstatement penalty applies to an overstated deduction for pension liabilities when:

(a) the amount deducted on the return is 400 percent or more of the correct amount, and

(b) the related underpayment is more than \$1,000.

(4)The penalty is 40 percent of the underpayment attributable to the overstatement of pension liabilities. (See IRC section 6662(h)(1).)

(20)552.2 Penalty Calculation

(1)The following example illustrates the penalty criteria and calculation:

(a)The taxpayer's 1990 return had taxable income of \$300,000 and tax of \$98,000.

(b)In determining the amount of taxable income, the taxpayer deducted \$80,000 for contributions to a defined benefit pension plan maintained for its employees.

(c)Upon examination of the taxpayer's return, the Service adjusted the interest assumption in valuing the pension liabilities for calculating the deduction.

(d)The taxpayer's maximum deduction for contributions to its plan was accordingly adjusted from \$80,000 to \$35,000.

(e)There were no other adjustments on the return.

(2) Note: The 200 percent requirement is met when the amount deducted on the return (\$80,000) exceeds the correct amount (\$35,000) by more than 200 percent (\$80,000 divided by \$35,000 = 229 percent). The penalty is calculated as follows:

(a) Taxable income as adjusted: (\$300,000 + \$45,000)	\$345,000
(b) Tax liability as adjusted	111,500
(c) Tax liability as filed	98,000
(d) Underpayment ((b) less (c))	13,500
(e) Penalty rate 20%	.20
(f) Penalty ((e) times (d))	2,700

(3) Note: since the deduction claimed exceeds the corrected amount by more than 200 percent, but is less than 400 percent, the penalty applies at the 20 percent rate. If the corrected deduction were \$18,000, the percentage of the overstatement would be 445 percent (\$80,000 divided by \$18,000) and the penalty would apply at the 40 percent rate.

(4) See Notice 89-47, 1989-1 C.B. 687, for guidance on the calculation of the penalty. While this notice applies to IRC section 6659A that has been repealed, the examples contained in the notice still provide guidance in the mechanics of calculating the penalty.

(20)553 Penalty Relief

The burden is on the taxpayer to establish the grounds for an exception.

(20)553.1 Reasonable Cause

(1)The penalty will not apply if the taxpayer shows that there was a reasonable cause for the valuation or assumptions used in deriving the deduction on the return and that the taxpayer acted in good faith.

(2)See IRM (20)515.2 and Treas. Reg. 1.6664-4(c) for reliance on advice of an actuary or other professional as it relates to the reasonable cause exception in IRC section 6664(c).

(20)560 IRC Section 6662(g) Substantial Estate or Gift Tax Valuation Understatement

(20)561 General

(1)OBRA 89 redesignated IRC section 6660 as IRC 6662(g), Substantial Estate or Gift Tax Valuation Understatement penalty.

(2)The penalty applies to any return of tax imposed under Subtitle B due after December 31, 1989, without regard to extensions.

(3)See IRM (20)512.4 for carrybacks and carryovers, and IRM (20)512.5 for the definition of an underpayment.

(20)562 Penalty Assertion

(20)562.1 Substantial and Gross valuation Understatement

(1)There is a substantial estate or gift tax valuation understatement if:

(a)the portion of the underpayment attributable to the valuation understatement exceeds \$5,000, and

(b)the value of any property claimed on a return is 50 percent or less of the corrected amount.

(c)The penalty is 20 percent of the underpayment attributable to the valuation understatement.

(2)There is a gross valuation misstatement under IRC section 6662(h)(2)(C) if:

(a)the portion of the underpayment attributable to the valuation understatement exceeds \$5,000, and

(b)the value of any property claimed on a return is 25 percent or less of the corrected amount.

(c)The penalty is 40 percent of the underpayment attributable to the valuation understatement.

(20)562.2 Penalty Calculation

(1)The determination of whether the percentage threshold for a substantial or gross valuation misstatement has been reached is made on a property-by-property basis.

(2)To calculate the valuation understatement percentage, divide the value of the property reported on the return by the corrected value of the property.

(3)The following example illustrates the calculation of the understatement percentage for three adjustments (assuming the \$5,000 requirement is met for each undervaluation adjustment and no exceptions to the penalty apply). The decedent's estate tax return included stock in three closely held corporations, A, B and C. On the return the stock in each corporation was valued at \$80,000. On examination the corrected stock values were determined to be \$150,000 for A, \$190,000 for B, and \$330,000 for C. The following determinations are made:

(a)Stock A: The amount on the return (\$80,000), divided by the corrected amount (\$150,000) is 53 percent. The penalty does not apply to this adjustment because the value of the stock is not 50 percent or less of the corrected amount.

(b)Stock B: The amount on the return (\$80,000), divided by the corrected amount (\$190,000) is 42 percent. The accuracy-related penalty attributable to a substantial valuation misstatement penalty applies to this adjustment because the value of Stock B is less than 50 percent (but more than 25 percent) of the corrected amount. The penalty amount is 20 percent of the underpayment attributable to the adjustment for Stock B.

(c)Stock C: The amount on the return (\$80,000), divided by the corrected amount (\$330,000) is 24 percent. The accuracy-related penalty attributable to a gross valuation misstatement penalty applies to this adjustment because the value of Stock C is 25 percent or less of the corrected amount. The penalty amount is 40 percent of the underpayment attributable to the adjustment for Stock C.

(4)For penalty calculations that relate to the above adjustments, see Exhibit (20)500-5.

(20)563 Penalty Assessment

See IRM (20)514 for assessment of the accuracy-related penalty attributable to a substantial estate or gift tax valuation understatement.

(20)564 Penalty Relief

(20)564.1 Reasonable Cause

IRC section 6664(c) provides an exception to the penalty if there is reasonable cause for the underpayment and the valuation was made in good faith. See IRM (20)515.1

(20)564.2 Reliance on Advice

See IRM (20)515 and Treas. Reg. 1.6664-4(c) for reliance on the advice of an appraiser or other professional as it relates to the reasonable cause exception in IRC section 6664(c).

(20)570 Civil Fraud Penalty IRC Section 6663

(20)571 General

(1)The fraud penalty under IRC section 6653(b) was redesignated by OBRA 89 as IRC section 6663. This change is effective for returns filed after December 31, 1989.

(2)OBRA 89 did not alter the definition of fraud or the penalty calculation. The penalty is asserted at the rate of 75 percent of the underpayment attributable to fraud.

(3) For coordination between the civil fraud penalty and the accuracy-related penalties see IRM (20)512.2.

(20)572 Penalty Assertion

(20)572.1 Indications of Fraud

(1)Civil fraud is defined as an intentional wrongdoing designed to evade a tax that the taxpayer believed to be owing. Thus, mere negligence or ignorance of the law does not constitute fraud.

(2)Since direct proof of a taxpayer's fraudulent intent is rarely available, fraud may be proven by circumstantial evidence and reasonable inferences. Fraud will generally involve one or more of the following elements:

- (a)deception,
- (b)misrepresentation of material facts,
- (c>false or altered documents,

(d) evasion, (i.e., diversion or omission), or

(e) conspiracy.

(3) Some common "badges of fraud" include:

(a) understatement of income, e.g., by omissions of specific items or entire sources of income, failure to report substantial amounts of income received;

(b) fictitious or improper deductions, e.g., overstatement of deductions, personal items deducted as business expenses;

(c) accounting irregularities, e.g., two sets of books, false entries on documents;

(d) acts of the taxpayer evidencing an intention to evade tax, e.g., false statements, destruction of records, transfer of assets;

(e) a consistent pattern over several years of underreporting taxable income;

(f) implausible or inconsistent explanations of behavior;

(g) failure to cooperate with the examining agent;

(h) concealment of assets;

(i) engaging in illegal activities (e.g., drug dealing) or attempting to conceal illegal activities;

(j) inadequate records, and

(k) dealing in cash.

(4) Recommendations for asserting the civil fraud penalty should be carefully reviewed to fully establish that the evidence supports the assertion.

(20)572.2 Assertion

(1) Civil fraud penalties will be asserted when there is clear and convincing evidence to prove that some part of the underpayment of tax was due to civil fraud. Such evidence must show the taxpayer's intent to evade the payment of tax which the taxpayer believed to be owing. Intent is distinguished from inadvertence, reliance on incorrect technical advice, honest difference of opinion, negligence, or carelessness.

(2) To assert the civil fraud penalty in a tax case, it is necessary to establish that a part of the deficiency is due to a knowingly false representation of facts by the taxpayer. The Service bears the burden of proving civil fraud by clear and convincing evidence in the Tax Court. See IRC section 7454. The Service must show that:

(a) the taxpayer knew the content of the return was false; and

(b)made the return with the intent to evade tax.

(3)The civil fraud penalty should be asserted on a case- by-case basis giving consideration to all factors which have a bearing on the taxpayer's fraudulent intent.

(4)The civil fraud penalty cannot be asserted on the same underpayment (or portion of an underpayment) on which the accuracy-related penalties are asserted under IRC section 6662.

Only one penalty can be applied to any portion of an underpayment of tax.

(5)The criteria for proving fraudulent failure to file under IRC section 6651(f) and civil fraud under IRC section 6663, are the same. Although there is no specific prohibition against asserting penalties under both IRC sections 6651(f) and 6663, caution should be used when considering this action. The court is not likely to sustain the assertion of both penalties unless when compelling facts support the Service's position. Accordingly, consult Chief Counsel before asserting both these penalties on the same return.

(a)The civil fraud penalty is not asserted for failure to file a return or for filing a return late. OBRA 89 added the fraudulent failure to file penalty under IRC section 6651(f) for this purpose

(b)Fraudulent failure to file is discussed in IRM (20)270.

(6) On a joint return, the civil fraud penalty does not apply to a spouse unless some part of the underpayment is due to civil fraud on the part of that spouse. IRC section 6663(c).

(a)For taxpayers filing a joint return after having filed separate returns, see IRC section 6013(b)(5).

(b)The civil fraud penalty follows the Code provision that allows a married couple to file a joint return after separate returns have been filed.

1 If the amount shown on two separate returns (\$150 plus \$100 = \$250) is less than the amount shown on the joint return (\$300), then for the purpose of computing the civil fraud penalty, the amount shown on the separate returns is treated as the amount shown on the joint return.

2 Any fraud on either separate return will be deemed to be fraud on the joint return.

(7)As a general rule, neither Collection nor Taxpayer Service is authorized to assess the civil fraud penalty. The only exception to this rule is the Collection function may assess civil fraud on employment tax examination cases. When fraud other than that related to employment tax is identified by one of these functions, the case must be referred to Examination or EP/EO for investigation.

(8)In cases closing unagreed with the civil fraud penalty, the report must include all the alternative penalty positions that are most applicable. Litigation (or settlement) of the case without an explanation of the alternative penalty positions in the report would hamper the government's litigating position because the basis for the alternative penalty position(s) would

be unclear to either Appeals or District Counsel.

(9)The examiner's report will reflect the civil fraud penalty by code section on a separate attachment, identifying the adjustment(s) attributable to the penalty. Form 3198, Special Handling Notice, will be attached to the case.

(10)For information regarding restrictions on the assertion of the civil fraud penalty with respect to the failure to file/fraudulent failure to file penalty, see IRM (20)216.

(20)572.3 Statute of Limitations

(1)Examiners are responsible for protecting the statute of limitations for assessment. Cover letter L-907 may be used for this purpose.

(2) IRC section 6501(c)(1) extends the statute of limitations for assessment on false or fraudulent returns indefinitely:

(a)When the three year statute of limitations under IRC section 6501(a) is in jeopardy, the examiner should try to secure an extension whenever possible. If in litigation it is determined that the taxpayer did not commit civil fraud, then the statute of limitations for the assessment of the underlying tax and penalties will have expired.

(b)The six year statute of limitations applies when the taxpayer omits more than 25 percent of the:

1 gross income reported on the return, (IRC section 6501(e)(1)),

2 gross estate or total amount of gifts stated on the return, (IRC section 6501(e)(2)), or

3 excise tax reported on the return, (IRC section 6501(e)(3)).

(3)Criminal Investigation (CI) must give approval to solicit a consent to extend the statute of limitations for assessment on joint return investigations. See IRM 9324.

(20)572.4 Penalty Referral

(1)When an examiner determines that only the civil fraud penalty would apply, a referral to Criminal Investigation (CI) is not required. Referral guidelines to CI are contained in functional manuals. See IRM 4231 (981), 9322, and 9311.

(20)572.5 Civil and Criminal Fraud

(1)The major difference between civil and criminal fraud is the degree of proof required to establish fraud on the part of the taxpayer.

(a)Criminal fraud requires sufficient evidence to prove guilt beyond a reasonable

doubt.

(b) Civil fraud requires clear and convincing evidence of tax evasion.

(2) The civil fraud penalty may be imposed upon a taxpayer whose criminal case verdict was not guilty. If the taxpayer has been convicted of criminal tax evasion under IRC section 7201, the civil fraud penalty should be asserted for the same tax year.

(3) However, the criminal case conviction does not mean the civil penalty will be automatically sustained.

(20)573 Penalty Calculation

(1) The civil fraud penalty is derived by multiplying the 75 percent penalty rate times the underpayment attributable to civil fraud. For the definition of underpayment see IRM (20)512.5 and Treas. Reg. 1-6664-2.

(2) For an example calculation involving the accuracy-related penalty and the civil fraud penalty see Exhibit (20)500- 2.

(3) If any part of the underpayment is due to civil fraud, then the entire underpayment shall be treated as attributable to civil fraud unless the taxpayer establishes otherwise. The examiner will make a good faith effort to objectively weigh the evidence provided and eliminate those items that are inaccurate, but not fraudulent. (See IRC section 6663(b).)

(20)574 Civil Fraud Penalty Monitoring and Procedures

(1) Form 6809, Civil Fraud Penalty Report, is used to record and monitor all cases in which the civil fraud penalty is an issue. This includes referrals initiated by Examination and requests by CI for Examination assistance not based on a referral.

(2) A separate Form 6809, Civil Fraud Penalty Report, must be prepared for each person or legal entity involved. However, only one Form 6809 is prepared for a joint return.

(3) Upon establishing a civil fraud penalty case, prepare Form 6809 in triplicate, completing items 1-11. Forward one copy to the Chief, Examination Division (or designee) to serve as a division control. Retain the original and one copy in the case file.

(20)575 Penalty Assessment

(1) The total civil fraud penalty will be assessed using:

(a) Form 5344, Examination Closing Record,

- (b) Form 5403, Appeals Closing Record,
 - (c) Form 5599, EO Examined Closing Record, or
 - (d) Form 5650, EP Examined Closing Record.
- (2) The penalty is assessed to the Master File using TC 320.
- (3) The penalty is assessed to the Non-Master File using:
- (a) Form 4720, Return of Certain Excise Taxes on Charities and Other Persons Under Chapters 41 and 42 of the IRC,
 - (b) Form 5330, Return of Initial Excise Taxes related to Employee Benefit Plans,
 - (c) Form 5434, Non-Master File Assessment Voucher.
- (4) The Form 5434 will be processed with the tax return using established functional guidelines.

Exhibit (20)500-1 Calculation of an Underpayment Reference: (20)512.5

The following example illustrates how an underpayment is computed:

(a) Corrected tax	\$10,000
(b) Less: Tax per return	\$7,000
(c) plus any amounts not previously assessed or collected without assessment	\$0
(c) plus any amount of rebates made	\$0
(d) Underpayment (\$10,000 less \$7,000)	\$3,000

Exhibit (20)500-1 (Con't 1) Calculation of the Underpayment with Multiple Adjustments

Reference: (20)512 and Treas. Reg. 1.6664-3(d)

Adjustment A (no penalty imposed)	\$ 1,000
Adjustment B (accuracy-related)	40,000
Adjustment C (Civil fraud penalty)	45,000
Total adjustments (A + B + C)	86,000
Plus: Taxable income shown on the return	15,800
Taxable income as corrected	101,800

Computation of underpayment:	
Corrected tax	\$ 25,828
Less: Tax shown on return	-2,374
Previous assessments	0
Rebates	0
Underpayment	23,454

Computation of the portion of the underpayment on which the accuracy penalty under IRC section 6662(b) (2) and the fraud penalty under IRC section 6663 are imposed:

STEP I:

Determine the portion of the underpayment on which no accuracy- related or civil fraud penalty is imposed:

Taxable income shown on return	\$ 15,800
Plus: Adjustment A	1,000
Adjusted taxable income	16,800
Tax on adjusted taxable income	2,524
Less: Tax shown on return	2,374
Portion of underpayment on which no penalty is imposed	150

STEP II:

Determine the portion of the underpayment on which the accuracy- related penalty attributable to a substantial underpayment penalty of 20 percent is imposed:

Adjusted taxable income from Step I	\$16,800
Plus: Adjustment B	40,000
Adjusted taxable income	56,800
Tax on adjusted taxable income	11,880
Less: Tax on adjusted taxable income from Step I	2,524
Portion of underpayment on which the 20% penalty is imposed	9,356

Exhibit (20)500-1 (Con't 2) Calculation of the Underpayment with Multiple Adjustments

Reference: (20)512.32 and Treas. Reg. 1.6664-(3)(d)

STEP III:

Determine the portion of the underpayment on which a civil fraud penalty rate of 75 percent is imposed:

Total underpayment	\$ 23,454
Less: The underpayment determined in Step I	- 150
Less: The underpayment determined in Step II	-9,356
Portion of underpayment on which the 75 percent penalty is imposed	13,948

Exhibit (20)500-2 Calculation of the Accuracy-Related Penalty Attributable to

a Substantial Understatement

Reference: (20)530

(1) The amount of the understatement is derived as follows:

(a) Corrected tax	\$8,500
(b) Less: tax on return	2,000
(c) Less: rebates	100
(d) Less: tax on adjustments with no penalty	600
(e) Understatement	5,800

(2) For the penalty to apply in the above example, the understatement of \$5,800 must be more than the greater of \$5,000 or \$850 (i.e., 10 percent of the \$8,500 corrected tax required to be shown on the return). The understatement of \$5,800 meets the requirement for penalty assertion.

(3) In calculating the understatement in (2) above the following definitions apply:

(a) Rebates: An amount not showing on the return which has been assessed or collected as a deficiency prior to the filing of the return.

(b) Exceptions: Substantial authority, adequate disclosure, and reasonable cause are exceptions to the penalty. See IRM (20)535.1 for discussion of substantial authority. Each return adjustment is reviewed separately to determine if any exceptions apply. When an exception applies to any adjustment, the tax on that adjustment is not used in determining the amount of the understatement or the amount of the underpayment to which the penalty applies.

(4) To establish the amount of the penalty when not all adjustments are subject to the penalty:

- (a) calculate the total underpayment,
- (b) calculate the underpayment subject to an exception,
- (c) subtract (b) from (a), and
- (d) multiply the applicable penalty rate times (c).

Exhibit (20)500-2 Con't Computation of the Accuracy-Related Penalty Attributable to a Substantial Understatement

(5) The following calculations establish if an understatement is substantial (no rebates or exceptions to the penalty apply):

(a) The taxpayer failed to report income of \$25,000 on his tax return:

1 Corrected tax	\$20,000
2 Less: tax as reported on return	12,000
3 Understatement	8,000
4 Ten percent of corrected tax (10% of \$20,000 = \$2,000)	2,000
5 The greater of \$5,000 or \$2,000	5,000
6 Since the \$8,000 understatement exceeds \$5,000, the understatement is substantial	

and meets the requirement for assertion.

(b) The taxpayer failed to report \$247,000 of Schedule C income:

1 Corrected tax:	\$67,000
(Note: this includes any adjustment to self-employment tax.)	
2 Less: tax as reported on return	61,000
3 Understatement	6,000
4 The greater of \$5,000 or \$6,700	6,700
(Note: \$6,700 is 10 percent of corrected tax of \$67,000.)	

5 The understatement of \$6,000 does not exceed the greater of \$5,000 or 10 percent of the corrected tax, i.e., \$6,700. The underpayment is therefore not substantial and the penalty cannot be asserted.

(6) The accuracy-related penalty attributable to a substantial understatement will not be asserted on the same portion of the underpayment attributable to adjustments for which another accuracy-related penalty under IRC section 6662 or the civil fraud penalty under IRC section 6663 has been asserted.

Exhibit (20)500-3 Calculation of the Accuracy-Related Penalty Attributable to a Substantial Understatement with Multiple Adjustments

Reference: (20)530

The taxpayer has substantial authority for adjustment A. The accuracy-related penalty attributable to a substantial understatement under IRC section 6662(d) applies to adjustments B and C. The taxpayer has uncredited withholding of \$1,500.

Taxable income per return	\$18,200
Adjustments per examination:	
Adjustment A (non-tax shelter item)	5,300
Adjustment B	10,000
Adjustment C	18,000
Total (A + B + C)	+33,300
Corrected taxable income	51,500
Corrected tax	17,000
Less: Tax on return	- 2,500
Understatement	14,500
Taxable income per return	18,200
Plus: Adjustment A (no penalty)	+ 5,300
Corrected taxable income (Adjustment A)	23,500
Corrected tax on \$23,500	3,300
Less: Tax per return	- 2,500
Tax on Adjustment A	800
Corrected tax liability	\$17,000
Less: Tax on return	- 2,500
Less: Tax on Adjustment A (no penalty)	- 800
Understatement (for penalty purposes)	13,700
Less: Adjustment to increased withholding credits	- 1,500
Underpayment	\$12,200

Exhibit (20)500-4 Transfer Pricing Penalty

Reference: (20)540

Exhibit (20)500-5 Substantial and Gross Valuation Misstatement Penalties

Reference: (20)562.2

(1) The penalties are calculated on the amount of the underpayment attributable to each valuation understatement. The penalties are calculated as follows:

(a) The following adjustments and penalties apply:

1 Stock A adjustment (no penalty applies) \$150,000 less 80,000	\$70,000
2 Stock B adjustment (substantial valuation misstatement penalty applies) \$190,000 less 80,000	\$110,000
3 Stock C adjustment (gross valuation misstatement penalty applies) \$330,000 less 80,000)	\$250,000

(b) Calculation of the underpayment for adjustments on which no penalty is applicable:

1 Taxable income as filed	\$1,500,000
2 Adjustment without penalty	\$70,000
3 Adjusted taxable amount (line 1 plus 2)	\$1,570,000
4 Tax on line 3	\$707,000
5 Tax on return	\$675,000
6 Underpayment attributable to \$70,000 adjustment	\$32,000

Exhibit (20)500-5 (Con't) -- Substantial and Gross Valuation Misstatement Penalties

Reference: (20)562.2

(c) Calculation of the underpayment for a substantial valuation misstatement penalty:

1 Amount from line (a)3	\$1,570,000
2 Adjustment having substantial valuation misstatement penalty	\$110,000
3 Adjusted taxable amount (line 1 plus 2)	\$1,680,000
4 Tax on line 3	\$757,000
5 Amount from line (b)4	\$707,000
6 Underpayment attributable to \$110,000 (line 4 less 5)	\$50,000
7 Substantial valuation misstatement penalty (20% of line 6)	\$10,000

(d) Calculation of underpayment for a gross valuation misstatement penalty: 1 Amount from

(c) 3	\$1,680,000	
2 Adjustment having gross valuation misstatement penalty		\$250,000
3 Adjusted taxable amount (line 1 plus 2)		\$1,930,000
4 Tax on line 3		\$869,000
5 Amount from line (c) 4		\$757,000
6 Underpayment attributable to \$250,000 (line 4 less 5)		\$112,000
7 Gross Valuation Misstatement Penalty (40% x \$112,000)		\$44,800

Chapter (20)600 Preparer/Promoter/Protector Penalties

(20)610 General Information

(20)611 Overview of the Return Preparer Penalty Program

(1) The Tax Reform Act of 1976 provided the Service with penalty and enjoinder authority to more effectively monitor income tax return preparation. TEFRA 1982 added IRC sections 6700 and 6701 which are not limited solely to income tax return preparers. These provisions are designed to promote a high standard in the preparation of returns for compensation and also address the problem of fraudulent, unscrupulous, or incompetent preparers.

(2) Return preparer penalties relate to IRC sections 6694, 6695, 6700, 6701, 6713, 7407 and 7408. In the interest of overall sound tax administration, the Service focuses on preparer conduct and applies sanctions whenever warranted. Penalty assertion is the key enforcement vehicle for noncompliant preparers.

(3) Consistent with Policy Statement PU1U18, the Service will not automatically assert preparer penalties based solely on the determination of deficiencies proposed in related tax return examinations. Preparer penalties are not mechanical components of the examination process and are asserted only after due deliberation on all facts and circumstances.

(4) National office, region, district, and service center functions will designate a Return Preparer Coordinator (RPC), as appropriate, to administer and monitor tax return preparers activities.

(20)612 Program Coordination Responsibilities

(1) National office. The Assistant Commissioner (Examination), will designate a staff member to functionally supervise, on a nationwide basis, all Examination aspects of the program.

(2) Regional Office. Each Assistant Regional Commissioner (Examination) will designate an analyst to manage and monitor on a regional basis all Examination aspects of the program. The regional RPC will be responsible for:

(a) Planning and coordinating Examination activities related to return preparers' activity

with other functional areas, districts, and service centers;

(b) Orienting appropriate regional, district, and service center Examination personnel;

(c) Developing additional guidelines and procedures considered necessary;

(d) Maintaining quality of determinations and uniformity in the application of the return preparer provisions throughout the region; and,

(e) Monitoring program progress and the applications of civil return preparer penalties, identifying problem areas, and notifying district offices and National Office of appropriate solutions.

(3) Assistant Commissioner (International), Office of Taxpayer Service and Compliance (IN:C) will be subject to all applicable procedures and guidelines. IN:C:E returns will also include Form 1040NR, U.S. Nonresident Alien Income Tax Return.

(4) District Office. District Directors will establish a multifunctional Penalty Screening Committee (PSC), which includes the District Office Electronic Filing Coordinator (DOEFC), Examination Return Preparer (RPC) and a Criminal Investigation Division (CID) representative. Contact will be made with Service Center representatives from the Criminal Investigation Branch (CIB) and Examination as needed. The PSC will be responsible for:

(a) planning and coordinating the implementation of Regional and National office Return Preparer strategy;

(b) establishing viable communication lines between Planning and Special Programs (PSP), the District Electronic Filing (ELF) Coordinator, the CID Questionable Refund Program Coordinator (QRPC), the Service Center Examination RPC, and the CIB RPC. A major goal of the committee is to more effectively identify patterns of preparer abuse and prevent duplication of efforts within the Districts and Service Centers.

(c) holding monthly meetings during the filing season and then quarterly throughout the remainder of the year. The committee meetings will focus on monitoring program results, analyzing methods, and making recommendations to the District Director concerning changes to the program;

(d) reviewing all preparer case files from whatever source, including recommendations to initiate a project on an identified preparer and reports provided by site visitation teams;

(e) coordinating activities of site visitation teams. This responsibility includes:

1 determining the number of teams needed to conduct visitations;

2 selecting and determining the formation of teams;

3 conducting orientation for team members on ELF requirements, return preparer provisions, authority to conduct visits, penalty assertions and referrals to the PSC.

(f) Receiving information referred from district office functions, Electronic Return Originator (ERO) site visits, service center reports, including Service Center CI and Correspondence Examination should be used to identify potentially abusive preparers.

(g) Coordinating site visitation teams who will assert IRC section 6695 return preparer penalties, if warranted, recommend initiation of a Program Action case (PAC) or no action. Examiners charge time for site visits to activity code 522500.

(5) Each Chief, Examination Division (or as otherwise designated by the District Director in small districts), will designate an RPC who will be responsible for:

(a) accumulating all types of referrals including those forwarded by Service Center Examination, and Form 5808, Return Preparer Penalty Follow-up;

(b) preparing return preparers summarization of referrals to the district Penalty Screening Committee;

(c) accumulating, monitoring, and forwarding the Form 5808 to the appropriate Examination group for resolution;

(d) ordering return preparer information following the procedures in IRM (20)622;

(e) ordering and screening returns;

(f) coordinating all Examination activity of income tax returns prepared by return preparers approved for program action by the District Director;

(g) working closely with, and making recommendations to, the Penalty Screening Committee;

(h) communicating with the examiner when a fraud referral is pending on a particular preparer whose penalty case investigation has begun; and

(i) forwarding copies of completed Forms 5809, Preparer Penalty Case Control Card, to the district or service center Electronic Filing Coordinator. This information is needed for the suitability checks required in text 240 and 250 of IRM 12(14)0, Electronic Filing Systems District Office Coordinator's Handbook.

(j) working with the Disclosure Office and/or Fed/State Coordinator to obtain leads from the local state tax agency on abusive preparers;

(k) releasing freeze code 570 with TC 571 for those returns received from Service Center Classification, through the PSC, that will not be examined; and releasing frozen refunds, at the direction of the PSC, (either partially or in entirety) on cases being held for examination. (Note: in all situations in which refunds are held during an examination the District Director's approval is required).

(6) The Chief, Examination Division may assign one or more tax auditors or Compliance Officers to the position of Market Segment Specialization Program (MSSP) Return Preparer Specialist (optional at the discretion of district). The position can be assigned to office or

field groups. These assignments will be made in accordance with NTEU negotiated agreement on MSSP agreements. Responsibilities of the position will include:

(a) reviewing the case files upon completion by the examiner to ensure the facts and circumstances regarding the preparation of the return are fully developed; the preparer's position is fairly and carefully considered and clearly reflected in the penalty case workpapers; and the appropriate copies of the income tax examination workpapers, return and tax change reports (Form 4549) are included in the file;

(b) contacting the preparer for a closing conference. If the case is unagreed, the group manager or a manager in a local POD will be requested to attend the closing conference;

(7) Additional assignments for the specialist may include:

(a) conducting and documenting interviews with noncompliant preparers to discussed problem areas in an effort to curb future noncompliance by the return preparer;

(b) referring information on return preparers suspected of involvement in questionable practices to the RPC. This information will be obtained by working with tax auditors and revenue agents.

(20)613 Examination Guidelines

(20)613.1 Examination

(1)Examiners will determine if return preparer violations exist. This determination will be made for every examination and recorded on Form 4318 or 4700-A, Examination Workpapers. The examiner will only open a preparer penalty case when sanctions against the preparer are warranted. When facts and circumstances in the examination do not give rise to development of the preparer penalty issue, a simple statement to that effect in the workpapers is sufficient.

(2)During the income tax examination, all discussions relating to return preparer penalties with either the taxpayer or return preparer will be limited to the development of facts to determine the applicability of a penalty. Penalties under IRC sections 6694 and 6695 will not be proposed in the presence of the taxpayer.

(3)A determination on the preparer penalty case is conducted independently of, and without regard to, the determination on the income tax case. The tax case has bearing on the preparer penalty case only insofar as assertion of the penalty requires an understatement of tax.

(4)Generally, no return preparer penalty will be proposed until the income tax examination is completed at the group level. However, if the preparer case is inseparable from the income tax examination, both cases may be completed simultaneously. The examiner may pursue the preparer penalty after an unagreed income tax case is submitted at the group level.

(5)Examiners may initiate program action consideration by a referral through the group

manager to the RPC.

(6) Comments made by examiners proposing or discussing penalties against return preparers may not be appropriate when a related criminal case is under consideration against the taxpayer. These cases should be discussed with CID.

(20)614 Appeal Rights

(1) Relating to IRC sections 6700 and 6701:

(a) The person/preparer/promoter may appeal the district's or service center's denial of a claim for refund.

(b) Administrative appeal rights will be granted by the district or service center examiner when the basis for the claim does not conflict with section 601.106(b) of the Statement of Procedural Rules. An appeal should not be based on moral, political, constitutional, religious, or similar arguments.

(c) If the claim is denied on appeal and the Service assesses a penalty and issues a notice and demand:

1 The person may suspend collection activity by paying at least 15 percent of the penalty and filing a claim for refund within 30 days after the date of notice and demand.

2 However, the person must then bring suit in Federal District Court within 30 days of receiving a Notice of Claim Disallowance, or 30 days after the expiration of six months from the filing of the claim, whichever is earlier; or

3 the person may bring a refund suit in either the U.S. Court of Federal Claims or a district court within two years of the date of denial of the claim or upon the expiration of six months after the date of filing the claim, if the penalty has been paid in full.

(2) Relating to IRC sections 6694 and 6695:

(a) Unagreed Cases. Examination procedures provide that an unagreed income tax return preparer penalty case under IRC section 6694 or 6695 will not be sent to Appeals before the related unagreed income tax case is submitted to Appeals. If the two cases are submitted separately, Examination will include in the preparer case file information on the current status and location of the unagreed deficiency.

(b) Relationship to Deficiency Procedures.

1 IRC section 6696(b) indicates that deficiency procedures do not apply to IRC sections 6694 and 6695 penalties.

2 However, Treas. Reg. 1.6694-4(a)(1) allows a preassessment appeals procedure.

3 Examination sends the preparer a 30-day letter, L-1125(DO), providing information on appeal rights. If there is no timely response to the letter, the penalty is

assessed. (See Publication 5, Appeal Rights and Preparation of Protests for Unagreed Cases, for appeal procedures.)

4 If the preparer requests preassessment Appeals consideration, the request will be granted for penalties under IRC sections 6694 and 6695(b). Although the regulation only relates to the IRC section 6694 penalty, district and service center examiners will follow the same guidelines for IRC section 6695 penalties. With the exception of subsection 6695(f), all IRC section 6695 penalties will have post-assessment penalty appeal procedures only. Post-assessment appeal rights will also be given for penalties under IRC section 6713.

(c)Short Statute. If the statutory period for assessment of the IRC section 6694(a) penalty is about to expire and the preparer will not agree to an extension, the District Director will assess the penalty. The preparer, upon request, will be provided postassessment appeal rights in the same way preassessment appeal rights would have been provided.

(3)Short Statute.

(3) Short Statute.

(a) Examiners will not submit preparer penalty cases to Appeals if less than 120 days remain on the statute of limitations. In these instances examiners will first solicit an extension of the statutory period for assessment.

(b) Unagreed return preparer cases will not be submitted before the related unagreed income tax case is submitted, or the related agreed income tax case is closed from the examination group.

(20) 615 Claims

(1) IRC sections 6700 and 6701.

(a) IRC section 6703 provides special claim procedures for persons assessed penalties under the above IRC sections. Within 30 days from the date the penalty is assessed, the preparer may pay 15 percent of the penalty and file Form 843, Claim.

(b) If both conditions specified in (a) above are met, collection action and the running of the statute of limitation on collection are suspended until the claim is finally resolved administratively or judicially, i.e., by Appeals or by the Federal District Court. The term "final resolution" generally refers to the decision of the district court.

(c) If the preparer does not meet the conditions in (a) above, he can make a claim by paying the penalty in full and filing a Form 6118, Claim of Income Tax Return Preparers. The preparer has three years from the date of payment to file a claim under this procedure. Treas. Reg. 1.6696-1(g).

(d) IRC section 6703 claims must be processed on an expedite basis, especially when Appeals consideration is warranted and will be granted.

(e) In any proceeding involving the issue of the liability for the penalty under IRC sections 6700 and 6701, the burden of proof is on the government and deficiency procedures do not apply. IRC section 6703.

(f) The U.S. may counterclaim for the balance of the penalty under IRC sections 6700 or 6701 when the taxpayer has utilized the 15 percent rule in accordance with IRC section 6703.

(2) IRC sections 6694 and 6695.

(a) IRC section 6696(c) and Treas. Reg. 1.6696-1(b) authorize the filing of claims for credit or refund on any penalties paid under IRC sections 6694 and 6695.

(b) Form 6118, Claim of Income Tax Return Preparers, is used by preparers to submit claims under IRC section 6696(c).

(c) The statute of limitations for filing a claim for refund of penalties under IRC sections 6694 or 6695 is three years from the date of full payment unless there is a final

administrative or judicial action that there was no understatement.

(d) IRC section 6694(a) and (b) claims (penalty assessed and paid in full) and requests for abatement (penalty assessed but not paid in full) will be sent to and controlled by the service center RPC.

(e) Collection function is restricted to abatements on IRC section 6695 (a) (b) and (c). Abatements will be subject to routine managerial review.

(3) Special rule for IRC section 6694.

(a) A claim for refund of penalties under IRC section 6694 may follow IRC section 6694(c) and Treas. Regs. 1.6694-4. Within 30 days after the date of notice and demand for payment, the preparer may pay 15 percent of the penalty and timely file a claim for refund (Form-6118).

(b) Using the procedure described in subparagraph IRC section 6694(c)(1), collection of the remaining portion of the penalty will be suspended until the earlier of:

1 30 days after the refund claim is denied, or

2 30 days from the period ending six months after the preparer files the claim.

(c) If the preparer begins a proceeding in a United States District Court for the determination of the penalty during either of these 30 day periods, collection of the penalty will continue to be suspended until the final resolution of the proceeding.

(4) Claims filed on the district level should be forwarded to the service center for processing.

(20)616 Service Center Claim Processing

Claims filed at the service center will be identified and forwarded to the appropriate function. The Chief, Compliance Division (CCD) will determine which service center function within the division screens and evaluates claims.

(20)617 Program Action Cases

(1) A Program Action Case is the examination of returns prepared by one preparer when information indicates a pattern of noncompliance with the preparer provisions of the Internal Revenue Code. Only the District Director or Assistant District Director has the authority to approve program action.

(2) The Return Preparer Coordinator (RPC) in each district will maintain files containing information on return preparer activity and related Service actions. The RPC will review these files monthly. Those which contain information indicating a pattern of noncompliance will be considered for program action. These files will contain:

- (a) copies of Form 5808, Return Preparer Penalty Follow-Up;
- (b) various information received from the Service Center, Examination Division, Collection Division, and other sources;
- (c) copies of Form 5809, Preparer Penalty Case Control Card, reflecting penalties previously asserted against preparers and penalties pending assertion;
- (d) information on representative by-pass actions taken under IRM 12(16)0; and
- (e) information forwarded through the group manager on examiners' recommendations for program action or no program action.

(3) The RPC completes Form 5029, Return Preparer's Inventory List Order, and forwards it to the designated service center contact for processing. The Preparer's Inventory Listing (PIL) identifies all the individual returns prepared by the subject preparer, giving the taxpayer name code, SSN, Document Locator Number, and partial return data (e.g., adjusted gross income, taxable income, tax per return, Schedule C/F net income/loss, contributions, and refund amount).

(4) The Preparer Volume Listing (PVL) is a list of the total number of individual returns prepared by a given preparer and is generated automatically on a monthly basis. The RPC will also review this data as part of program action considerations.

(5) From this listing, the RPC will requisition an appropriate sample of returns prepared by the subject preparer. The RPC will screen these returns to determine if they appear to warrant examination.

(6) If, after these steps, the RPC determines that program action should be initiated, a summary of all facts indicating the advisability of such action will be prepared and presented to the Penalty Screening Committee (PSC). The PSC will carefully consider all relevant information to ensure that there is strong evidence of a preparer's alleged negligence, intentional disregard of rules or regulations, unrealistic position, or patterns of willful understatement, before seeking approval to initiate program action. Program action will be limited to abusive cases where information indicates that a return preparer has engaged in a widespread practice of making material errors which demonstrates intentional misconduct or clear incompetence in preparing income tax returns. If there is no PSC, the RPC will make the decision to initiate a request for program action.

(7) The PSC/RPC will forward a written request for approval to initiate program action through the Chief, Examination Division, to the District Director or Assistant District Director.

(a) The request will state the number of returns in the sample to be examined. The District Director or Assistant District Director will make the final determination, in writing, to approve or disapprove the request for program action.

(b) If approved, the sample returns will be secured and examined. Based on the results of these examinations, the District Director or Assistant District Director will determine

whether additional actions are warranted. Under no circumstance will a sample of returns be examined without the written approval of the District Director or Assistant District Director.

(8) Returns selected for examination under a program action will be clearly identified as "Return Preparer Program Action Cases" and the case file will include all information provided by the RPC. These cases will be assigned to the appropriate examination group by the RPC.

(a) The RPC will establish AIMS controls on those cases selected for examination and will be responsible for the disposition of non-selected returns.

(b) All returns including related, prior and subsequent years, will be established using Source Code 49 and the appropriate local project code.

(c) Examiners should become familiar with the practitioner's method of operation so that they may use their time most effectively. Information provided by the RPC should be helpful preparation.

(d) Examiners should follow established procedures and standards in considering whether to assert the negligence penalty under IRC section 6653(a) or the accuracy penalties under IRC section 6662 in relation to program action returns.

(9) Program action is selectively designed to concentrate enforcement activity on preparers who represent habitual noncompliance and lack of competence. Projected audit results are part of, but not the sole deciding factor for, program action.

(10) Each district should develop a follow-up system on preparers where penalties, suspension of filing privileges, and/or injunctive actions were undertaken.

(a) Returns prepared in subsequent years by these preparers may be evaluated and selected for examination on a sample basis in order to determine the extent of continued compliance or noncompliance.

(b) Districts may find it beneficial to use multifunctional site visitation teams to determine compliance of return preparers identified as preparing abusive returns in prior years. Information obtained by the team may be used to initiate program action on the preparer.

(20) 618 Affidavits

(1) An affidavit is a person's written declaration or statement of facts voluntarily made and confirmed by oath or affirmation before a person with authority for administering it. It is taken from any person having knowledge of facts and circumstances relating to a violation of law in order to document and validate the position of the Service in applying sanctions. Affidavits relating to the return preparer program will usually be taken from the taxpayer.

(2) Affidavits are not used routinely in return preparer cases; however, affidavits should be completed in all cases for which the Service may ask the Justice Department to seek an

injunction. The affidavit will facilitate the filing of a suit, obtaining a preliminary injunction, and an early hearing.

(3) The following items should be identified and incorporated in the affidavit:

(a) The judicial district involved.

(b) The name, SSN, business and home address, and business and home telephone number of the witness.

(c) Persons present during the interview and their relation to the investigation.

(d) Date, time, and place of the interview.

(e) Tax years involved.

(f) Specific portions of the return that are false or fabricated, if any.

(g) Other relevant information pertaining to the preparer, such as:

1 Actions taken by the preparer when informed of the client's examination (e.g., preparer offered to supply false documents to support false deductions, the preparer told the client to ignore the IRS, etc.)

2 Experience of the preparer in preparing returns.

3 Education of the preparer.

4 Where the preparer is or was working.

5 How the preparer solicits clients and whether the preparer is soliciting clients now.

(4) The examiner should make the following determinations and also include them in the affidavit:

(a) How and when the taxpayer met the person under investigation.

(b) The specific information that the taxpayer provided to the person under investigation, and how and when that information was given.

(c) Whether the taxpayer signed the return, has seen the return, was provided a copy of the return and had the return explained to him or her.

(d) If the person under investigation was paid and how the amount of remuneration was determined (e.g., a set fee, percent of the refund, etc.).

(e) How the fee was paid (e.g., cash, check, money order, barter, etc.).

(f) When the fee was paid (e.g., when the information was provided, after the return was completed, after the refund was received, etc.)

(g) Whether the taxpayer asked the preparer to put false items on the return.

(5) Form 2311, Affidavit, can be used for this purpose.

(20)619 Statute of Limitations

(1) The statute of limitations on assessment for IRC sections 6694(a) and 6695, expires three years from the later of the due date of the related return or the date the return was filed. There is no statute of limitations on assessment for IRC sections 6694(b), 6700, and 6701 penalties. There is no statute of limitations on actions to enjoin preparers or promoters under IRC section 7407 or 7408.

(2) CAUTION: Extending the statute (Form 872) on a taxpayer's return does not extend the statute for the return preparer penalty case.

(3) The statute on a return preparer penalty case under IRC sections 6694(a) and 6695 can be extended using Form 872-D, Consent to Extend the Time on Assessment of a Tax Return Preparer Penalty. (See Rev. Rul. 78-245 and IRM 4541.1.)

(4) A transcript of the return on which the preparer penalty is based should be included in the preparer penalty case file for accurate monitoring of the expiration date.

(5) Consents should be obtained, except for 6694(b) cases, when the statute of limitations for assessing the preparer penalty will expire within 180 days and there is insufficient time to complete the examination. Also, the statute for assessment must be extended if the preparer requests to go to Appeals and there is less than 120 days remaining on the statute for assessment. Ample time for processing is important because statutory notice of deficiency procedures do not apply to preparer penalties.

(6) A separate consent should generally be obtained for each year under consideration, but related taxpayers' returns for which the penalties are applicable can be included on each consent.

(20)61(10) Definitions

(1) Adequate Disclosure. Disclosure made on a Form 8275 or 8275-R, as appropriate, or made in accordance with the annual revenue procedure issued for the purposes of the substantial understatement penalty. A preparer is not subject to a civil conduct penalty for an unrealistic position under IRC section 6694(a) if the position is not frivolous and is adequately disclosed. Different disclosure rules apply to signing and nonsigning preparers (see Treas. Regs. 1.6694-2(c)(3)(i) and (ii), and 1.6694-3(e)(1) and (2)). For further guidance, see (20)633:(2)(c).

(2) Frivolous position. A position that is patently improper. See Treas. Reg. 1.6694-2(c)(2).

(3) Gross Valuation Overstatement. A gross valuation overstatement is a statement of the value of any property or service that exceeds 200 percent of the amount determined to be the correct value, when the value of the property or services is directly related to the amount of

any allowable deduction or credit. (See *Mattingly v. United States*, 722 F. Supp. 568 (E.D. Mo. 1989).)

(a) If a promoter provides a gross valuation overstatement in connection with the organization or sale of an interest in the entity, the penalty applies regardless of whether the promoter knows or has reason to know of the overvaluation.

(b) The gross valuation overstatement must be directly related to a material matter.

(c) Reasonable Basis/Good Faith Exception. When a penalty under IRC section 6700 is based on the promoter's making or furnishing of a gross valuation overstatement, the Service may waive the penalty if the valuation had a reasonable basis and was made in good faith. This exception does not apply to penalties based on the making or furnishing of a false or fraudulent statement as to the tax benefits to be derived from participating in the arrangement.

(4) Income Tax Return Preparer. Any person (including a partnership or corporation) who prepares for compensation all or a substantial portion of a tax return or claim for refund under the income tax provisions of the Code. For a more complete discussion of the meaning of this term, see (20)632:(1)(a).

(a) The IRC section 7701(a)(36) definition of a tax return preparer has been interpreted by Treas. Reg. 301.7701-15 and various revenue rulings to include persons (including "nonsigning preparers") who:

1 furnish sufficient advice or information so that the completion of the return by another individual is a mechanical process.

2 supply computerized tax return preparation service to tax practitioners, or offers a service or program that makes substantive tax determinations.

3 software companies or other persons that prepare a computer program and sell it to taxpayers for use in preparing the taxpayer's return, may also be an income tax return preparer for purposes of the civil conduct penalties, if

(b) Excepted from this definition are persons who provide mere clerical services, employees who prepare returns for their employers, preparers of fiduciary returns, as well as those who prepare a claim for refund for a taxpayer in response to a deficiency notice or a consent to extend the period of assessment after the audit of a taxpayer has begun.

(c) For the purposes of the IRC section 6694(a) or (b) penalties, the "return preparer" definition was modified in 1991 so that only one individual associated with a firm (i.e., an employee or partner) is treated as a preparer ("one preparer-per-firm" rule). See Treas. Reg. 1.6694-1(b)(1).

(d) A nonsigning preparer who prepares a schedule or entry that constitutes a substantial portion of the return may be considered a tax return preparer. In making the decision as to what constitutes a "substantial portion," the examiner should consider the relation of the entry or schedule to the tax liability, the complexity of the return as a

whole, and the relative time involved in preparing it.

(e) An electronic return originator may be a return preparer under IRC section 7701(a)36 and Treas. Regs. 301.7701-15, who could be liable for these penalties. However, an electronic filer who is primarily a transmitter with services limited to "typing, reproduction or other mechanical assistance in the preparation of a return or claim for refund" is not an income tax preparer for purposes for these penalties. See Rev. Proc. 91-69, 1991-2 C.B. 893.

(5) Penalty Screening Committee. A multifunctional group that is established by the District Director. The committee members are the Electronic Filer Coordinator, Return Preparer Coordinator and a Criminal Investigations Division representative. This committee identifies patterns of preparer abuse, recommends the initiation of a project on potentially abusive return preparers, and reviews the appropriateness and accuracy of the return preparer penalty assertion.

(6) Promoter. A promoter is any person who organizes, assists in the organization of, or participates (directly or indirectly) in the sale of any interest in a partnership or other entity, investment plan or arrangement, or plan or other arrangement.

(a) The class of persons covered by the penalty includes not only sellers, but also individuals who:

- 1 aid or assist sellers,
- 2 cause other persons to make or furnish the proscribed statements, or
- 3 cause an appraiser to grossly overvalue property.

(b) IRC section 6700 applies broadly to:

- 1 promoters, organizers, sales persons, appraisers, engineers, accountants, attorneys, commodities future dealers of tax straddles, financial advisors, and any persons who actively participate in the promotion of a tax shelter;
- 2 promoters and sellers of mail order ministries, family trust arrangements, tax protector plans, offshore tax shelters, and tax havens;
- 3 investment bankers, bond counsel, feasibility consultants, engineers, etc., in relation to plans or arrangements that may include obligations issued by a state or local government but need not be investment oriented.

(7) Reason to Know Standard. The penalty for making a statement with respect to the allow ability of any deduction or credit, the excludability of any income, or the securing of any tax benefit only applies when the individual "knows or has reason to know" that the statement is false or fraudulent.

(a) Whether a person knows or has reason to know that a statement is false or fraudulent depends upon his role in the organization or sale.

1 An attorney would generally be entitled to rely on feasibility studies conducted by a reputable engineering firm, unless such attorney knew or had reason to know of information which would call that study into question. Absent that, the attorney would not normally be required to question the assumptions underlying, or results reached by the study.

2 Similarly, as to matters of fact or expectation, attorneys can rely on information provided by other parties, absent actual knowledge or reason to know of its inaccuracy. However, attorneys cannot rely on statements which are not credible or reasonable on their face.

(b)The "reason to know" standard does not carry with it a duty of inquiry, unless the person involved with the promotion has reason to know of the inaccuracy of facts provided by another person.

(c)Examiners may rely on objective evidence in determining whether a person involved with the promotion has "reason to know" that a statement is false or fraudulent. A promoter's ignorance of facts revealed in the materials provided to him is not a legitimate defense if the knowledge is required by his/her role in the transaction.

(8)Reasonable Cause/Good Faith. A common sense allowance under the circumstances for omissions or errors. The IRC section 6694(a) penalty will not be imposed if, considering all the facts and circumstances, it is determined that the preparer had reasonable cause and acted in good faith. Factors to consider in making this determination include the nature of the error, the materiality of the error, the frequency of the error, the preparer's normal office practice, and the preparer's reliance upon the advice of another preparer. (See IRM (20)330, Reasonable Cause Guidelines.)

(9)Reckless or Intentional Disregard. In general, a preparer is considered to have recklessly or intentionally disregarded a rule or regulation if the preparer takes a position on the return or claim that is contrary to a rule or regulation and the preparer knows of, or is reckless in not knowing of, the rule or regulation.

(a)A preparer who makes little or no effort to determine if a rule or regulation exists may be subject to the IRC section 6694(b) penalty if such conduct deviates from a "reasonable" preparer standard. Diligence is implicitly a part of the standard for a reasonable preparer.

(b)An IRC section 6694(b) penalty predicated on reckless or intentional disregard would not be imposed if there is adequate disclosure of a nonfrivolous position and, in the case of a regulation, the position represents a good faith challenge to the regulation's validity.

(c)Prior to January 1, 1990, reckless or intentional disregard of a rule or regulation was addressed by an IRC section 6694(a) penalty of \$100. OBRA '89 repositioned this conduct to IRC section 6694(b) and made it a \$1,000 penalty.

(10)Rules and Regulations. The provisions of the Internal Revenue Code, temporary or

final regulations, revenue rulings, or notices (other than notices of proposed rule making) that are published in the Internal Revenue Bulletin. Revenue procedures are not included in this definition.

(11) **Understatement of Liability.** Any understatement of the net amount payable with respect to any tax due under Subtitle A of the Code (income taxes) or any overstatement of the net amount creditable or refundable with respect to any such tax may subject a preparer to the IRC section 6694 penalty.

(a) A final administrative or judicial determination concerning the taxpayer's return is not required in order to assert the preparer conduct penalties. However, the conduct penalties should be abated if a subsequent judicial or administrative determination concludes that no understatement exists.

(b) For purposes of the civil preparer conduct penalties, the "net amount payable" is not reduced by any carryback.

(c) For further guidance on the meaning of this term, see (20)632:(1)(b) and (20)633:(1)(b).

(12) **Unrealistic Position.** A position for which there was not a realistic possibility of being sustained on its merits.

(a) A position has a realistic possibility of being sustained if a reasonable and well-informed analysis by a person knowledgeable in tax law would lead such a person to conclude that the position has approximately a one-in-three, or greater, likelihood of being sustained.

(b) In the case of signing preparers, the relevant date for determining realistic possibility is generally the date the preparer dates the return. The relevant date for nonsigning preparers is contained in Treas. Reg. 1.6694-2(b)(5)(ii).

(c) The analysis used for determining whether substantial authority is present for purposes of the accuracy-related penalty also applies in making a determination concerning the realistic possibility standard. Only the authorities specified in Treas. Reg. 1.6662-4(d)(3)(iii) are considered. Also, see Examples (1),(2),(3) and (5) in (20)638.

(13) **Willful Conduct.** Knowing and intentional conduct. A preparer is considered to have acted willfully if he disregards information provided (or adds information not provided) furnished by the taxpayer or other persons in an attempt to wrongfully reduce tax. It is not necessary to prove that the preparer acted with a bad purpose or evil motive in order to establish willfulness.

(20)61(11) Processing and Assessment Instructions

(20)61(11).1 General

(1) Return preparer penalties are assessed or abated on the Master File Civil Penalty Module using MFT 55.

(2) These procedures allow tracking of return preparer penalty assessments/abatements. The information must be input completely and correctly for data on the Return Preparer Penalty Program to be accurate.

(20)61(11).2 Responsibilities

(1) Examiners will attach Form 3198, Special Handling Notice, to each penalty case file, identifying it as a return preparer penalty case and referencing the applicable IRC section.

(2) The originator, in completing Form 8278, Computation and Assessment of Miscellaneous Penalties, will enter in red and initial:

(a) the applicable date of the expiration of the statute of limitations on assessment in Item 6 (or, if applicable, enter "No Statute" in Item 4), and

(b) the date Form 8278 was completed by the originator in Item 9 or 11.

(3) When the same penalties for the same period apply to a preparer in relation to more than one return, and the statute of limitations on the preparer penalty is determined by the statute of limitations for the return, complete Form 8278 using the earliest statute of limitations date. (See IRM (20)619, Statute of Limitations.)

(4) When more than one penalty under different IRC sections will be assessed against the same preparer for the same period, a separate Form 8278 has to be completed for each penalty.

(20)61(11).3 Processing Guidelines

(1) IRC sections and reference numbers for return preparer penalties on the Civil Penalty Module are contained in Exhibit (20)600-4.

(a) These penalties will be transmitted on Form 8278. The assessments and abatements will be input to Master File (MF) through IDRS using Command Code ADJ54, Transaction Code (TC) 290 with a zero amount, the appropriate three digit reference number, and the amount of the penalty. Reference numbers must be input correctly in all instances in order to track related data.

(b) An assessment generates a TC 240 and an abatement generates a TC 241 to the MF with the respective reference number of the penalty adjustment. TC 290 is only a carrier transaction and will not post to MF. The reference numbers generate a notice to the preparer which explains the assessment and appeal rights.

(2) NOTE: The return preparer penalty account is not established or controlled on AIMS.

(3) Imminent statute cases will be processed under quick assessment procedures.

(4) The following guidelines are used in establishing name lines:

(a) Establishment of a civil penalty name line (CVPN) only applies to MFT 55 assessments. Information to otherwise update the entity, such as an address change, must

be input prior to establishing the CVPN.

(b) A hard copy MFTRA will be requested for all preparer penalty cases (complete entity and all active modules).

(c) If the MF name line of the preparer being assessed is joint or ever has been, a CVPN must be established using Form 2363, TC 013, RF 55, (RF 55 informs the terminal operator that only a preparer penalty name line is being established or changed). DO NOT change the name line of the MFT 30 account.

(d) If the name line is single, the special action to establish the CVPN is not warranted. The preparer penalty may be assessed directly. MF will automatically extract and establish the penalty name line.

(e) If the MFTRA shows no record, then a MF entity must be established using Form 2363, TC 000 (with a "mail file requirement" of "1" for MFT 55), for the year of the penalty assessment. Input the preparer's complete name and address. This allows the penalty to be assessed. (Exhibits 500-9 and 500-10 in IRM 48(13)2, Aims - District Office and Service Center Processing Handbook, show the minimum data requirements for completing Form 2363.)

(f) If a penalty is to be asserted for a year prior to when the preparer has filed a return, a MF name line must be established for the year the penalty is to be assessed using Form 2363, TC 013. The penalty may then be assessed. MF will automatically extract and establish the penalty name line.

(5) Underline the following entries on Form 8278 in brown pencil to facilitate pick up by the remote terminal operators:

(a) Taxpayer's name control,

(b) Taxpayer Identification Number (TIN),

(c) MFT Code,

(d) Taxable Period,

(e) Transaction Code,

(f) Reference number,

(g) Complete the cents column with numbers only (no dash "--" mark is permitted,) and

(h) Statute date if notated.

(6) A separate Form 8278 has to be completed for each penalty asserted under different IRC sections if more than one applies to the same preparer for the same period. If this instruction in (20)61(11).2:(3) above has not been observed, return the case file to the originator for completion. When multiple penalties apply to the same preparer for the same period:

- (a) input the first penalty to be assessed using blocking series 52X,
- (b) input subsequent penalties using blocking series 53X,
- (c) annotate Form 8278 with correct blocking series opposite each penalty to facilitate terminal input, and
- (d) with blocking series 53X, CP Notice 55 will be generated to alert the service center to associate Forms 5147, IDRS Transaction Record, for subsequent penalty assessments with the penalty case file containing the input and source documents.

(7) After terminal input, all preparer penalty case files with Form 8278 will be forwarded to service center files function to be associated with Form 5147, IDRS Transaction Record.

(20)61(12) Electronic Filing Program

(1) Preparers in the Electronic Filing Program (EFP) must meet suitability standards reflected in Rev. Proc. 91-69, 1991-2 C.B. 893. Since penalties asserted against preparers are a factor in determining suitability for the EFP, Return Preparer Coordinators will notify Electronic Filing Coordinators (EFC) of all penalties asserted on return preparers. (See text 240 and 250 of IRM 12(14)0, Electronic Filing Systems District Office Coordinator's Handbook.)

(2) Section 6.03 of Rev. Proc. 91-69 broadly defines the applicability of return preparer penalties for those participating in the EFP: "...the Service reserves the right to assert all appropriate preparer, nonpreparer, and disclosure penalties against an Electronic Filer as warranted under the circumstances."

(3) District Offices are required to establish multifunctional teams to visit electronic filers to determine their compliance with the ELF revenue procedures. Examiners who participate on these teams charge their time to activity code 522500.

(20)620 Director of Practice

(20)621 General

(1) The Office of the Director of Practice is responsible for overseeing:

(a) the rules governing practitioners (i.e., attorneys, certified public accountants, enrolled agents, enrolled actuaries, and other persons representing clients before the Service), and

(b) the rules relating to authority to practice before the Service, and the duties, restrictions, and disciplinary action that pertain to such practice.

(2) The Director of Practice also helps ensure the cooperation and integrity of the practitioner community in the overall field of tax administration.

(20)622 Referral to the Director of Practice

(1) When the following penalties are asserted against a practitioner an information report to the Director of Practice is mandatory:

(a) IRC sections 6695(f), 6700, and 6701.

(b) IRC sections 6694(a) and (b) penalties when closed agreed by the examiner or sustained in Appeals, or closed unagreed without Appeal contact.

(c) IRC section 7407/7408 when action is taken to enjoin preparers or promoters

(d) IRC section 6701(a) asserted against appraisers.

(2) A referral is discretionary on penalties asserted under IRC section 6695(a) through (e)(2). Normally the referral will be made if there are a number of similar penalties asserted against the same practitioner, since this could indicate reckless conduct or lack of competence.

(3) Section 10.53 of Treasury Department Circular No. 230 requires Service employees make a written report to the Director of Practice when there is reason to believe that a tax practitioner has violated the rules set forth in the Circular. When disciplinary action is deemed appropriate, the report will include sufficient detail, documentation, and exhibits, to substantiate the character and extent of the violation.

(4) Examiners will send referrals for C-230 action to the Director of Practice on Form 8484, Penalty Information Report. It is routed through QMS to the RPC who forwards it to the District Director. The referral will be transmitted by memorandum explaining the preparer's conduct, whether an appeal will be made, and to what extent the preparer normally practices before the Service.

(5) If the referral is for information and not for C-230 action, examiners will route F-84 through QMS to the RPC who will send it directly to the Director of Practice.

(6) Referrals should be sent to:

Office of the Director of Practice

C:AP:P

1111 Constitution Avenue

Washington, D.C. 20224

(20)630 Preparer Conduct Penalties -- IRC Section 6694

(20)631

Legislative Overview

(1) The Tax Reform Act of 1976 (TRA 1976) enacted IRC section 6694 which gives the IRS the authority to assess civil penalties against income tax return preparers (preparer).

(a) As enacted by TRA 1976, IRC section 6694(a) provided a \$100 penalty for preparers who understated a taxpayer's income tax liability by the negligent or intentional disregard of rules or regulations.

(b) As enacted by TRA 1976, IRC section 6694(b) provided a \$500 penalty for preparers who willfully understated a taxpayer's income tax liability.

(2) The Omnibus Budget Reconciliation Act of 1989 (OBRA 1989) made the following changes to IRC section 6694(a):

(a) Increased the penalty amount from \$100 to \$250 per return or claim for refund.

(b) Changed the standard for imposing the penalty such that the penalty now applies if the understatement of liability is due to a position known or that was reasonably should have been known by the preparer and for which there was not a realistic possibility of being sustained on its merits:

1 The House Committee Report to OBRA 1989 states that the new realistic possibility standard was adopted because it generally reflects the professional conduct standards applicable to lawyers (American Bar Association Ethics Opinion) and to certified public accountants (AICPA's Statement on Responsibilities in Tax Practice - SRTP No. 1).

2 The Committee also believed that this standard of behavior was stricter than the prior negligence standard, so that negligent behavior subject to penalty under prior law would continue to be subject to penalty under this new standard.

(c) Added a disclosure exception for positions that are not frivolous.

(d) Added a reasonable cause and good faith exception.

(3) OBRA 1989 made the following changes to IRC section 6694(b):

(a) Increased the penalty amount from \$500 to \$1000 per return or claim for refund.

(b) Added reckless or intentional disregard of rules or regulations as a basis for imposing the IRC section 6694(b) penalty.

(c) Made intentional disregard of rules or regulations (formerly under IRC section 6694(a)) a basis for imposing the higher IRC section 6694(b) penalty.

(d) Indicated (in the legislative history to OBRA 1989) that the IRC section 6694(b) penalty for disregarding rules or regulations should not be imposed if proper disclosure is made.

(4) The OBRA 1989 amendments apply to documents prepared after 12/31/89.

(5) For guidance on the new IRC section 6694 provisions, see the regulations issued on December 31, 1991. For documents prepared and advice given after December 31, 1989 but on

or before December 31, 1991, also see Notice 90-20, 1990-1 C.B. 328.

(20)632 Returns and Claims for Refund Prepared Prior to 1/1/90

(1) Definitions.

(a) Income tax return preparer. IRC section 6694(f) cross references to IRC section 7701(a)(36) for the definition of an income tax return preparer. Under IRC section 7701(a)(36), an income tax return preparer means any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any income tax return or claim for refund of income taxes. For this purpose, the preparation of a substantial portion of a return or claim for refund is treated as if it were the preparation of such return or claim for refund.

1 Following are examples of persons who are income tax return preparers:

a A person who does not physically prepare an income tax return is nevertheless an income tax return preparer if that person furnishes to a taxpayer or other preparer sufficient information and advice so that completion of the return or claim for refund is largely a mechanical or clerical matter. (Treas. Reg. 301.7701-15(a)(1))

b A preparer of a partnership return or an S corporation return is an income tax return preparer with respect to a partner's or a shareholder's return if the entry or entries on the partnership or S corporation return reportable on the partner's or shareholder's return constitute a substantial portion of the partner's or shareholder's return. (Treas. Reg. 301.7701-15((b)(3))

c A firm that offers computerized tax preparation service to tax practitioners is an income tax return preparer if the program makes substantive tax determinations. (Rev. Rul. 85-187, 1985-2 C.B. 338, Rev. Rul. 85-188, 1985-2 C.B. 339; and Rev. Rul. 85-189, 1985-2 C.B. 339)

d A person who prepares a computer program and sells it to taxpayers to use in preparing the taxpayers' income tax returns is an income tax return preparer if the program provides substantive tax instructions. (Rev. Rul. 85-189)

e A general partner who prepares a partnership return can be an income tax return preparer with respect to a limited partner's return in certain situations. (Rev. Rul. 81-270, 1981-2 C.B. 250)

f A preparer (1st preparer) can be a preparer with respect to a return prepared by another preparer (2nd preparer) if the 2nd preparer relied on information contained on the return prepared by the 1st preparer. This occurs, for example, when the 1st preparer negligently overstates the expenses on a prior year's return, thus creating an NOL, and the 2nd preparer, in good faith, applies the NOL carryover in preparing the subsequent year's return. (Rev. Rul. 81-171, 1981-1 C.B. 581)

2 Following are examples of persons who are not income tax return preparers:

a A person who prepares a return or claim for refund with no explicit or implicit agreement for compensation even though the person receives a gift or return service or favor. (Treas. Reg. 301.7701-15(a)(4))

b A person who only provides mechanical assistance in the preparation of an income tax return or claim for refund (e.g., provides typing and/or reproducing services). (Treas. Reg. 301.7701-15(d)(1))

c A person who prepares an income tax return or claim for refund of a person, or an officer, general partner, or employee of a person, by whom the individual is regularly and continuously employed or in which the individual is a general partner. (Treas. Reg. 301.7701-15(d)(2))

d Just but only if such person is a fiduciary or is an officer, general partner, or employee of the fiduciary. (Treas. Reg. 301.7701-15(d)(3))

e A person who prepares a claim for refund for a taxpayer in response to a deficiency notice or a waiver of restriction after initiation of an audit of the taxpayer or another taxpayer (if the other taxpayer's audit affects the taxpayer in question). (Treas. Reg. 301.7701-15(d)(4))

f Any person who provides tax assistance under the VITA program. (Treas. Reg. 301.7701-15(a)(7))

(b) Understatement of liability. The term means any understatement of the net amount payable with respect to any income taxes or any overstatement of the net amount creditable or refundable with respect to any income taxes. The determination of whether there is any understatement of liability is made without regard to any administrative or judicial action involving the taxpayer. The exception to this rule is where there is a final administrative determination or a final judicial decision that there was no understatement of liability. In such cases, the assessed penalty must be abated. However, if the taxpayer's liability is eliminated by a NOL, the penalty should not be abated. (Rev. Rul. 82-25, 1982-1 C.B. 214)

(c) Rules or regulations. The term includes the provisions of the Internal Revenue Code, the Treasury regulations issued under the Code, and Internal Revenue Service revenue rulings published in the Cumulative Bulletin. (Treas. Reg. 1.6694-1(a)(3) -- Pre OBRA 1989 Treas. Regs.)

(2) IRC section 6694(a) Penalty:

(a) Criteria for imposition of the IRC section 6694 penalty:

1 An income tax return preparer, (See IRM (20)633:(1)(a))

2 An understatement of income tax liability, and (See IRM (20)633:(1)(b))

3 Understatement due to negligence or intentional disregard of rules or

regulations. (See IRM(20)633:(3)(c) & (d)).

(b) Standards under former IRC section 6653(a) applicable. In the Conference Report on the Revenue Act of 1978 relating to Technical Corrections to the Tax Reform Act of 1976, 1978-3 C.B. (Vol.1) 521, 618, the conferees specifically directed the Service to "reasonably interpret IRC section 6694(a) according to the standards of IRC section 6653(a) and in light of all the facts and circumstances of each case, taking into account any and all mitigating factors." Therefore, in determining whether a preparer has negligently or intentionally disregarded a rule or regulation, apply the same standards as applied in determining the application of the former IRC section 6653 penalty against taxpayers. The Conference Report also states that for purposes of IRC section 6694(a), "the view of the taxpayer concerning a rule or regulation is not material." Accordingly, it is not necessary for the IRC section 6653(a) penalty to be asserted against a taxpayer in order to justify the assertion of the IRC section 6694(a) penalty against the preparer of the taxpayer's return.

(c) Negligence is generally understood to mean a lack of due care or failure to do what a reasonable and ordinary prudent person would do under the circumstances. In determining whether the preparer negligently disregarded a rule or regulation, all the relevant facts and circumstances of the case should be taken into account, including the following factors:

- 1 Nature of the error causing the understatement;
- 2 Frequency of the error; and
- 3 Materiality of the error

4 Note: Even though consideration of the above factors still suggests negligence, the penalty is not warranted if the preparer's normal office practice, when considered together with other facts and circumstances (such as the knowledge of the preparer) indicates that the error in question would rarely occur and the normal office practice was followed in preparing the return/claim for refund.

5 In addition, the IRC section 6694(a) penalty generally should not be applied if a preparer, in good faith, relied without verification on information furnished by the taxpayer. However, reliance will not preclude the imposition of the penalty if the preparer should have made appropriate inquiries to determine the existence of facts and circumstances required by the Code or regulations. (Rev. Proc. 80-40, 1980-1 C.B. 774)

(d) A preparer will not be considered to have negligently or intentionally disregarded a rule or regulation if:

1 Due Diligence. A preparer exercised due diligence in an effort to apply the rule or regulation to the information given to the preparer to determine the taxpayer's correct tax liability. (Treas. Reg. 1.6694-1(a) -- Pre OBRA 1989 Treas. Regs.)

2 Good Faith & Reasonable Basis. A preparer in good faith and with reasonable

basis took the position that a rule or regulation did not accurately reflect the Code and did not follow it. (Treas. Reg. 1.6694-1(a)(4) -- Pre OBRA 1989 Treas. Regs.)

(e) Burden of Proof. The preparer bears the burden of proof on the issue of whether the preparer has negligently or intentionally disregarded a rule or regulation. The preparer will have satisfied this burden if:

1 The preparer presents evidence that his/her normal office practice concerning the treatment of the particular item was not negligent and that this normal practice was followed, and

2 The IRS does not have contrary evidence. (Treas. Reg. 1.6694-1(a)(5) -- Pre OBRA 1989 Treas. Regs.)

(3) IRC section 6694(b) Penalty

(a) Criteria for imposition of the IRC section 6694(b) penalty:

1 An income tax return preparer, (See IRM (20)633:(1)(a))

2 An understatement of income tax liability, and (See IRM (20)633:(1)(b))

3 Willful attempt to understate income tax liability. (See IRM (20)632:(3)(b))

(b) Willful understatement. A preparer has willfully attempted to understate the income tax liability of the taxpayer if the preparer disregards information furnished by the taxpayer or other persons in an attempt wrongfully to reduce the income tax liability of the taxpayer. In some cases, a penalty for willful understatement may be based on an intentional disregard of rules or regulations. In such cases, the preparer will be subject to both the IRC section 6694(a) and the IRC section 6694(b) penalties. (Treas. Reg. 1.6694-1(b)(2) -- Pre OBRA 1989 Treas. Regs.)

(c) Verification of information: As in the case of the IRC section 6694(a) penalty, independent verification of the information furnished by the taxpayer, generally, is not required. (Treas. Reg. 1.6694-1(b)(2) -- Pre OBRA 1989 Treas. Regs.)

(d) Where both IRC section 6694(a) and IRC section 6694(b) penalties apply. If both penalties apply to a preparer, the IRC section 6694(b) penalty amount must be reduced by the IRC section 6694(a) penalty amount. Therefore, examiners should ensure that the combined assessment of the IRC section 6694(a) and (b) penalties against a preparer do not exceed \$500 with respect to a return or claim for refund (\$100 for IRC section 6694(a) penalty and \$400 for IRC section 6694(b) penalty).

(e) Burden of Proof: The IRS bears the burden of proof on the issue of whether the preparer has willfully attempted to understate the income tax liability. (IRC section 7427 and Treas. Reg. 1.6694-1(b)(5) -- Pre OBRA 1989 Treas. Regs.)

(20)633 Returns and Claims for Refund Prepared After 12/31/89

(1) Definitions:

(a) Income tax return preparer. The definition of the term is the same as under prior law (see IRM (20)61(10):(1)) with one modification. For documents prepared and advice given after 12/31/91, and only for purposes of the IRC section 6694 penalties, the new regulations provide that no more than one individual associated with a firm will be treated as a preparer with respect to the same return or claim for refund (one-preparer-per-firm rule).

1 Signing preparer. If a signing preparer is associated with a firm, that individual, and no other individual in the firm, is treated as an income tax return preparer with respect to the return or claim for refund. (Treas. Reg. 1.6694-1(b)(1) -- Post OBRA 1989 Treas. Regs.)

2 Nonsigning preparer. If two or more individuals associated with a firm are income tax return preparers and none of them is the signing preparer, ordinarily, the one individual who will be treated as the preparer is the individual with overall supervisory responsibility for the advice given by the firm. For an example, see Treas. Reg. 1.6694-1(b)(3) -- Post OBRA 1989 Treas. Regs.

3 Note: The one preparer per firm rule does not mean that an IRC section 6694 penalty cannot also be asserted against the firm, as an employer. It also does not mean that there can never be more than one preparer per return. For example, if a CPA receives advice from an attorney (who is not associated with the same firm) and the advice constitutes a substantial portion of the return, both the CPA and the attorney are income tax return preparers with respect to that return.

(b) Understatement of Liability. The definition of the term is the same as under prior law. (See IRM (20)61(10):(2)). The new regulations now expressly provide that the net amount payable is not reduced by any carryback. Thus, it incorporates the position stated in Rev. Rul. 82-25. (Treas. Reg. 1.6694-1(c) -- Post OBRA 1989 Treas. Regs.)

(c) Rules or regulations. The definition of the term was expanded by the new regulations. This term now includes the provisions of the Internal Revenue Code, temporary or final Treasury regulations issued under the Code, and revenue rulings or notices (other than notices of proposed rule making) issued by the IRS and published in the Internal Revenue Bulletin. (Treas. Reg. 1.6694-3(f) -- Post OBRA 1989 Treas. Regs.)

(d) Frivolous position. A "frivolous position" is a position that is patently improper. (Treas. Reg. 1.6694-2(c)(2) -- Post OBRA 1989 Treas. Regs.)

(2) IRC section 6694(a) Penalty

(a) Criteria for imposition of the IRC section 6694(a) penalty:

1 An income tax return preparer, (See IRM (20)61(10):(1))

2 An understatement of income tax liability (See IRM (20)61(10):(2))

3 Understatement due to a position that has no realistic possibility of being sustained on the merits and the income tax return preparer knew or reasonably should have known of such position, (See IRM (20)61(10):(3))

4 No adequate disclosure, or a frivolous position, and (See IRM (20)61(10):(4))

5 No reasonable cause and good faith (See IRM (20)61(10):(5)).

(b) Unrealistic position. In order for the IRC section 6694(a) penalty to apply, the understatement of the income tax liability must be due to a position for which there was not a realistic possibility of being sustained on its merits (realistic possibility standard). Also, the preparer must have known or reasonably should have known of such position.

1 One-in-three rule. A position is considered to have satisfied the realistic possibility standard if a reasonable and well-informed analysis by a person knowledgeable in the tax law would lead such a person to conclude that the position has approximately a one in three, or greater, likelihood of being sustained on its merits. To make this determination, the analysis prescribed by Treas. Reg. 1.6662-4(d)(3)(ii) for making the substantial authority determination should be applied. Also, the same authorities should be considered. (Treas. Reg. 1.6694-2(b) -- Post OBRA 1989 Treas. Regs.)

2 Examples: See IRM (20)63(10):(1) below.

(c) Adequate disclosure exception. The IRC section 6694(a) penalty does not apply if the position taken is not frivolous and is adequately disclosed.

1 Signing preparers. The disclosure must be made on a properly completed and filed Form 8275 (Disclosure Statement) or 8275-R (Regulation Disclosure Statement), as appropriate, or on the return in accordance with an annual revenue procedure. (Treas. Reg. 1.6694-2(c)(3)(i) -- Post OBRA 1989 Treas. Regs.)

2 Nonsigning preparers. The disclosure may be made in the manner prescribed above for signing preparers or by including in the advice to the taxpayer (or to another preparer) a statement that contains the information required by Treas. Reg. 1.6694-2(c)(3)(ii).

(d) Reasonable cause and good faith exception. The IRC section 6694(a) penalty also does not apply if, considering all the facts and circumstances, it is determined that the understatement was due to reasonable cause and that the preparer acted in good faith. The factors to consider include:

- 1 Nature of the error causing the understatement,
- 2 Frequency of errors,
- 3 Materiality of errors,
- 4 Preparer's normal office practice, and

5 Reliance on the advice of another preparer. (Treas. Reg. 1.6694-2(d) -- Post OBRA 1989 Treas. Regs.)

(e) Verification of information. As under prior law, a preparer, generally, does not have to independently verify the information furnished by the taxpayer. (Treas. Reg. 1.6694-1(e) -- Post OBRA 1989 Treas. Regs.)

(f) When Both IRC section 6694(a) and IRC section 6694(b) Penalties Apply. As under prior law, if both penalties apply to a preparer, the IRC section 6694(b) penalty amount must be reduced by the IRC section 6694(a) penalty amount. Therefore, examiners should ensure that the combined assessment of the IRC section 6694(a) and (b) penalties against a preparer do not exceed \$1000 with respect to one return or claim for refund (\$250 for the IRC section 6694(a) penalty and \$750 for the IRC section 6694(b) penalty).

(g) Burden of Proof. The preparer bears the burden of proof with respect to:

1 Whether the preparer knew or reasonably should have known that the questioned position was taken on the return/claim for refund,

2 Whether there is reasonable cause and good faith, and

3 Whether the position was adequately disclosed. (Treas. Reg. 1.6694-2(e) -- Post OBRA 1989 Treas. Regs.)

(3) IRC section 6694(b) Penalty

(a) Criteria for imposition of the IRC section 6694(b) penalty:

1 An income tax return preparer, (See IRM (20)633:(1)(a))

2 An understatement of income tax liability, and (See IRM (20)633:(1)(b))

3 Understatement due to a willful attempt to understate the income tax liability or due to any reckless or intentional disregard of rules or regulations. (See IRM (20)634:(3)(b) and (c))

(b) Willful Understatement. Same definition as under prior law. (See IRM (20)633:(1)(b))

(c) Reckless or Intentional Disregard. In general, a preparer is considered to have recklessly or intentionally disregarded a rule or regulation if the preparer takes a position that is contrary to a rule or regulation and the preparer knows of, or is reckless in not knowing of, the rule or regulation in question. A preparer is reckless in not knowing of a rule or regulation if he/she makes little or no effort to determine whether a rule or regulation exists, under circumstances which demonstrate a substantial deviation from the standard of conduct that a reasonable preparer would observe in the situation.

1 Adequate disclosure. A preparer will not be considered to have recklessly or intentionally disregarded a rule or regulation if the position is not frivolous and is

adequately disclosed in accordance with Treas. Reg. 1.6694-3(e). If the position taken is contrary to a regulation, the position must also represent a good faith challenge to the validity of the regulation. As in the case of the IRC section 6694(a) penalty, the method of making adequate disclosure is different for signing and nonsigning preparers.

2 Positions contrary to a revenue ruling or a notice but which satisfy the realistic possibility standard: A preparer will not be considered to have recklessly or intentionally disregarded a revenue ruling or a notice if the position contrary to the revenue ruling or notice satisfies the realistic possibility standard. This rule does not also apply to a position contrary to a regulation. (Treas. Reg. 1.6694-3(c) -- Post OBRA 1989 Treas. Regs.)

(d) See IRC section 6694(b) examples under IRM (20)638.

(e) Verification of information. Same rule as under IRM (20)633:(2)(e).

(f) Where Both IRC section 6694(a) and IRC section 6694(b) Penalties Apply. If both penalties apply to a preparer, the IRC section 6694(b) penalty amount must be reduced by the IRC section 6694(a) penalty amount. See IRM (20)632:(3)(d).

(g) Burden of Proof. The IRS bears the burden of proof on the issue of whether the preparer willfully attempted to understate the income tax liability. The preparer bears the burden of proof on issues such as:

1 Whether the preparer recklessly or intentionally disregarded a rule or regulation,

2 Whether a position contrary to a regulation represents a good faith challenge to the validity of the regulation, and

3 Whether disclosure was adequately made. (Treas. Reg. 1.6694-3(h) -- Post OBRA 1989 Treas. Regs.)

(20)634 Coordination with Other Penalties

(1) Although IRC section 6694 and IRC section 6701 set different standards for imposition of each penalty, in some instances both penalties could apply. IRC section 6701(f) provides that a penalty under IRC section 6694 may not be assessed if a penalty has already been assessed under IRC section 6701. This provision allows the Service to choose which penalty to assert if both apply to a set of facts, but prohibits the Service from assessing penalties under both sections for the same act.

(2) The preparer penalties imposed by IRC section 6694(b) and 6701 require different activities as grounds for assertion. Thus, the penalty under IRC section 6701 may apply in cases in which the IRC section 6694(b) penalty would not apply and vice versa.

(3) As with all income tax examinations, the examiner should consider whether the negligence penalty under former IRC section 6653(a) or the IRC section 6662 accuracy-related penalties are applicable to the taxpayer. Assertion of the penalty under IRC

section 6694 against the income tax preparer does not preclude assertion of the penalty against the taxpayer under former IRC section 6653(a) or IRC section 6662.

(4) IRC section 6695 identification penalties can be asserted in conjunction with IRC section 6694 conduct penalties.

(20)635 Who Asserts the Penalty

District Examination Revenue Agents and Tax Auditors have responsibility for asserting the IRC section 6694 penalties.

(20)636 Asserting the IRC Section 6694 Penalties

(1) General Overview of the Penalty Procedures

(a) The income tax return preparer penalty cases are the key enforcement vehicle for identifying and penalizing noncompliant preparers. In preparer penalty cases, the Service focuses on the conduct of the preparer rather than the taxpayer and determines if that conduct warrants penalties. If preparer penalty cases are not opened, preparer misconduct may not be identified and penalized, and return preparer coordinators may not have the information necessary to identify patterns of noncompliance and initiate program action cases. However, in conformity with Policy Statement PU1U18, examiners will not automatically assess preparer penalties based solely on a determination of deficiency proposed in a related taxpayer's examination. Examiners will ensure that preparer penalties are used for their proper purpose and not as an automatic and mechanical component of the examination process.

(b) During every field and office examination, examiners will determine if an income tax return preparer conduct violation exists. If there are indications of misconduct, the examiner should open a preparer penalty case to determine if sanctions against the preparer are warranted. In this regard:

1 Each income tax examination is separate and distinct from the return preparer violation case relating to the income tax examination.

2 Examiners will not propose or discuss conduct penalties per se in the presence of the taxpayer.

3 During the income tax examination, examiners will inquire, as warranted, to develop facts and circumstances to determine whether or not a preparer penalty case should be opened.

4 Generally, no return preparer penalty will be proposed until the income tax examination is completed at the group level. Where practical, the preparer case may remain open after completing the income tax case. However, if the preparer case is inseparable from the income tax examination, both cases may be closed together. If the income tax case is unagreed, the examiner may pursue the preparer penalty after the unagreed income tax case is submitted at the group level.

(c) The determination on and settlement of the income tax examination will at all times proceed without regard to the return preparer penalty issue.

(d) CAUTION: On Forms 4813 and 4700-A, Examination workpapers, the examiner should only document the fact that the required inquiries on the return preparer issues were completed. The taxpayer's answers to these inquiries should not be written on Forms 4318 and 4700-A, nor should they be included in any other workpapers in the taxpayer's case file. All information on the return preparer's activities and the applicability of any penalties relating to the return preparer should be separated from the taxpayer's case file. If the information were included in the case file, it would be disclosed to the taxpayer if the taxpayer requested a copy of the case file. This would constitute an IRS disclosure violation, since information regarding the return preparer's liability for taxes is confidential.

(e) For returns prepared prior to January 1, 1990, Rev. Proc. 80-40, 1980-2 C.B. 774, sets forth guidelines for the application of the penalty under IRC section 6694(a) for the negligent disregard of rules and regulations by an income tax return preparer.

1 The revenue procedure indicates that the Service will consider the nature of the error causing the understatement, the frequency of the errors and the materiality of the errors.

2 Rev. Proc. 80-40 specifically provides that an isolated mathematical or clerical error ordinarily reflects no more than mere inadvertence and thus will not result in the assertion of the penalty unless the error is of such magnitude or so conspicuous that it should have been discovered after its commission.

3 The revenue procedure also provides that where all the relevant facts and circumstances suggest that the return was negligently prepared, the penalty will not be asserted if the preparer's normal office practice, when considered together with other facts and circumstances, indicates that the error in question would rarely occur, and the normal office practice was followed in preparing the return in question.

(2) Example applications of IRC section 6694(a) and (b) can be found in Treas. Regs. 1.6694-2 and 3.

(3) Revenue Ruling 81-171, 1981-1 C.B. 589, states that the IRC section 6694(a) penalty may be asserted for each taxable year return affected by a return preparer's negligent or intentional overstatement of expenses on a taxpayer's return that created a net operating loss that was carried back for 3 years and carried forward to the succeeding year's return. The IRC section 6694(a) penalty for the succeeding year will apply even though that year's return was prepared by a second preparer who used the information from the prior years' returns. No penalty may be imposed against the second preparer.

(4) Revenue Ruling 81-270, 1981-2 C.B. 250, states that if an understatement of liability on the individual income tax return of a limited partner is due to the negligent or intentional disregard of the rules and regulations by a general partner in preparing Schedule K-1 of a partnership return and the entries on that schedule constitute a substantial portion of the

limited partner's return, then the IRC section 6694(a) penalty may be imposed on the general partner.

(5) Treasury regulations provide that a 6694(b) penalty for willful understatement is warranted when a preparer disregards information furnished by the taxpayer. An example of this willful conduct would be the intentional overstatement of business expense deductions in spite of a detailed expense register provided to the preparer by the taxpayer.

(6) Case Development. Although the development of the penalty case will depend on specific facts and circumstances, the examiner should, at a minimum, observe the following:

(a) When the taxpayer is questioned in the course of the examination on items that relate to a potential preparer penalty, the questions will be phrased narrowly and directly without having to introduce or define a "preparer penalty" issue per se.

(b) The examiner should question the taxpayer concerning conversations with and information given to the preparer. If available, copies of the relevant documents, including the return containing the understatement, should be incorporated into the case file. Care should be taken in interpreting these conversations. For example, the statement, "mileage claimed was for commuting between home and the office" does not affix preparer culpability for the disallowed expense. However, if the preparer specifically questioned the taxpayer about business related travel and received the above response without qualifying or explaining the term "business-related" to the taxpayer and/or without further questioning the taxpayer concerning the nature of this travel, a penalty may be warranted.

(c) If, after evaluating the information gathered, the examiner determines that a penalty is warranted, the examiner should prepare Form 6459, Return Preparer's Check sheet (IRC section 6694 and IRC section 6695), and secure the group manager's approval.

(d) After securing approval, the examiner should contact the preparer to fully develop the facts regarding the preparation of the income tax return. The following areas should be developed:

- 1 The preparer's education, training, and experience;
- 2 the office procedures, if any, that were employed by the preparer to insure that a correct return was prepared; and
- 3 the preparer's explanation regarding the errors found by the examiner.

(7) Preparer Penalty Case File

(a) Once managerial approval is secured, the examiner should prepare the Form 5809, Preparer Penalty Case Control Card, and distribute it as follows:

- 1 Original - Remains in the penalty case file.
 - a Copy A - Retained in group for control purposes.

b Copy B - May be used as a Form 895 or not used.

c Copy C - Send to Return Preparer Coordinator.

d Copy D - Send to Return Preparer Coordinator when the penalty case file is closed. (If no penalty is recommended by the examiner, then this form is sent to the RPC to close internal controls.)

(b) The examiner charges time to the penalty case file using the following activity codes:

1 Activity Code 501500 for IRC section 6694(a) cases, and

2 Activity Code 502500 for IRC section 6694(b) cases.

(c) Workpapers. The following information should be included in the case file:

1 The first two pages of the related income tax return, and any schedules related to the understatement;

2 copy of the related income tax report; and

3 copies of relevant workpapers from the income tax case file and additional information sufficient to enable Quality Measurement Staff (QMS) or Appeals to determine:

a what information was provided to the preparer by the taxpayer,

b why the preparer's action or inaction warranted the application of the penalty, and

c the preparer's position regarding the penalty.

4 An affidavit secured from the taxpayer, whenever appropriate. This affidavit should clearly indicate exactly when and what information was provided to the preparer and the content of any pertinent conversations between the taxpayer and the preparer. (See IRM (20)618 regarding content of affidavits.)

(d) Assembly of Case File. The case file will include a copy of the report of proposed adjustments, the tax return, and relevant workpapers. The Form 5816, Report of Income Tax Return Preparer Penalty, is used for agreed and unagreed cases. See Exhibit (20)600-1 for a list of forms that should be included in the preparer penalty case file when appropriate.

(3) The increased rate does not change the monthly period for accruing the penalty. For example, a penalty which is accruing on the 16th day of the month at the one-half percent rate will first accrue at the 1 percent rate on the 16th day of the month following the trigger date, unless that date is the 16th. It will then continue to accrue at 1 percent until paid or until the 25 percent maximum penalty is reached.

(20)637 Quality Measurement Staff Function and Case File Assembly

(1)Preparer penalty cases are not subject to mandatory review. Groups will close cases to ESP for processing using Form 3198, following district guidelines.

(2)For unagreed cases, Form 5816, Report of Income Tax Return Preparer Penalty, and a statement of reasons for asserting the penalty will accompany Letter 1125(DO).

(3)Form 5816 will be forwarded to the Examination Return Preparer Coordinator (RPC) for the income tax return preparer's district. For all unagreed cases, Letter 1125(DO) will advise the preparer of his/her appeal rights. The preparer has 30 days to ask for Appeals consideration and to file any protest required.

(4)Upon receipt of a protest, the case will be reviewed for adequacy of the protest, development of the issue, and managerial involvement.

(5)If the related income tax case is unagreed, the unagreed preparer penalty case may not be submitted to Appeals before the income tax case is submitted to Appeals. An unagreed preparer penalty case may not be submitted to Appeals if there are less than 120 days remaining on the statute of limitations. In these instances, for IRC section 6694(a) and 6695 penalties, the examiner will first solicit an extension on Form 872-D, Consent to Extend the Time on Tax Return Preparer Penalty. NOTE: Where the statute of limitations for the assessment of penalties may expire without adequate opportunity for preassessment appeal rights, Quality Measurement Staff (QMS) will, before assessment of these penalties, send the preparer a copy of Form 5816, Report of Income Tax Return Preparer Penalty, along with an explanation of the reason for the quick assessment and the preparer's appeal rights.

(6)In agreed and unagreed cases, Form 5808, Return Preparer Penalty Follow-up, and Copy D of Form 5809, Preparer Penalty Case Control Card, will be forwarded by QMS to the RPC.

(7)If the examiner has determined that no penalty is warranted, the no-change Letter 1120 will be prepared at the group level and left undated in the file. QMS will date and issue the letter if the case is selected for sample review, otherwise the letter will be issued according to district policy.

(8)After mailing Letter 1120, no-change case files will be forwarded to the RPC. Pertinent information from the file will be recorded on Form 5808, and retained by the RPC for not less than one year. The balance of a no-change case file is not retained.

(20)638 Examples of IRC section 6694 Penalty Application

(1)IRC section 6694(a) examples from Treas. Regs. 1.6694-2(b)(3):

(a) **Example 1.** A new statute is unclear as to whether a certain transaction that a taxpayer has engaged in will result in favorable tax treatment. Prior law, however, supported the taxpayer's position. There are no regulations under the new statute and no

authority other than the statutory language and committee reports. The committee reports state that the intent was not to adversely affect transactions similar to the taxpayer's transaction. The taxpayer's position satisfies the realistic possibility standard.

(b) **Example 2.** A taxpayer has engaged in a transaction that is adversely affected by a new statutory provision. Prior law supported a position favorable to the taxpayer. The preparer believes that the new statute is inequitable as applied to the taxpayer's situation. The statutory language is unambiguous as it applies to the transaction (e.g., it applies to all manufacturers and the taxpayer is a manufacturer of widgets). The committee reports do not specifically address the taxpayer's situation. A position contrary to the statutes does not satisfy the realistic possibility standard.

(c) **Example 3.** The facts are the same as in Example 2, except the committee reports indicate that Congress did not intend to apply the new statutory provision to the taxpayer's transaction (e.g., to a manufacturer of widgets). Thus, there is a conflict between the general language of the statute, which adversely affects the taxpayer's transaction, and a specific statement in the committee reports that transactions such as the taxpayer's are not adversely affected. A position consistent with either the statute or the committee reports satisfies the realistic possibility standard. However, a position consistent with the committee reports constitutes a disregard of a rule or regulation and, therefore, must be adequately disclosed in order to avoid the IRC section 6694(b) penalty.

(d) **Example 4.** The instructions to an item on a tax form published by the Internal Revenue Service are incorrect and are clearly contrary to the regulations. Before the return is prepared, the Internal Revenue Service publishes an announcement acknowledging the error and providing the correct instruction. Under these facts, a position taken on a return which is consistent with the regulations satisfies the realistic possibility standard. On the other hand, a position taken on a return which is consistent with the incorrect instructions does not satisfy the realistic possibility standard. However, if the preparer relied on the incorrect instructions and was not aware of the announcement or the regulations, the reasonable cause and good faith exception may apply depending on all facts and circumstances. See 1.6694-2(d).

(e) **Example 5.** A statute is silent as to whether a taxpayer may take a certain position on the taxpayer's 1991 Federal income tax return. Three private letter rulings issued to other taxpayers in 1987 and 1988 support the taxpayer's position. However, proposed regulations issued in 1990 are clearly contrary to the taxpayer's position. After the issuance of the proposed regulations, the earlier private letter rulings cease to be authorities and are not taken into account in determining whether the taxpayer's position satisfies the realistic possibility standard. See Treas. Reg. 1.6694-2(b)(2) and 1.6662-4(d)(3)(iii). The taxpayer's position may or may not satisfy the realistic possibility standard, depending on an analysis of all the relevant authorities.

(f) **Example 6.** In the course of researching whether a particular position has a realistic possibility of being sustained on its merits, a preparer discovers that a taxpayer took the same position on a return several years ago and that the return was audited by the Service. The taxpayer tells the preparer that the revenue agent who conducted the audit

was aware of the position and decided that the treatment on the return was correct.

1 The determination by the revenue agent is not authority for purposes of the realistic possibility standard.

2 However, the preparer's reliance on the revenue agent's determination in the audit may qualify for the reasonable cause and good faith exception depending on all facts and circumstances.

3 See Treas. Reg. 1.6694-2(d). Also see Treas. Reg. 1.6694-2(b)(4) and 1.6662-4(d)(3)(iv)(A) regarding affirmative statements in a revenue agent's report.

(g) Example 7. In the course of researching whether an interpretation of a phrase incorporated in the Internal Revenue Code has a realistic possibility of being sustained on its merits, a preparer discovers that identical language in the taxing statute of another jurisdiction (e.g., a state or foreign country) has been authoritatively construed by a court of that jurisdiction in a manner which would be favorable to the taxpayer, if the same interpretation were applied to the phrase applicable to the taxpayer's situation.

1 The construction of the statute of the other jurisdiction is not authority for purposes of determining whether the position satisfies the realistic possibility standard. See Treas. Reg. 1.6694-2(b)(2) and Treas. Reg. 1.6662-4(d)(3)(iii).

2 However, as in the case of conclusions reached in treatises and legal periodicals, the authorities underlying the court's opinion, if relevant to the taxpayer's situation, may give a position favorable to the taxpayer a realistic possibility of being sustained on its merits. See Treas. Reg. 1.6694-2(b)(2) and Treas. Reg. 1.6662-4(d)(3)(iii).

(h) Example 8. In the course of researching whether an interpretation of a statutory phrase "has a realistic possibility of being sustained on its merits," a preparer discovers that identical language appearing in another place in the Internal Revenue Code has consistently been interpreted by the courts and by the Service in a manner which would be favorable to the taxpayer if the same interpretation were applied to the phrase applicable to the taxpayer's situation.

1 No authority has interpreted the phrase applicable to the taxpayer's situation.

2 The interpretations of the identical language are relevant in arriving at a well reasoned construction of the language at issue, but the context in which the language arises also must be taken into account in determining whether the realistic possibility standard is satisfied.

(i) Example 9. A new statutory provision is silent on the tax treatment of an item under the provision. However, the committee reports explaining the provision direct the Treasury to issue regulations interpreting the provision in a specified way. No regulations have been issued at the time the preparer must recommend a position on the tax treatment of the item, and no other authorities exist. The position supported by the committee reports satisfies the realistic possibility standard.

(2) IRC section 6694(b) examples from Treas. Regs. 1.6694-3(d):

(a) **Example 1.** A taxpayer provided a preparer with detailed check registers reflecting personal and business expenses. One of the expenses was for domestic help, and this expense was identified as personal on the check register. The preparer knowingly deducted the expenses of the taxpayer's domestic help as wages paid in the taxpayer's business. The preparer is subject to the penalty under IRC section 6694(b).

(b) **Example 2.** A taxpayer provided a preparer with detailed check registers to compute the taxpayer's expenses. However, the preparer knowingly overstated the expenses on the return. After adjustments by the examiner, the tax liability increased significantly. Because the preparer disregarded information provided in the check registers, the preparer is subject to the penalty under IRC section 6694(b).

(c) **Example 3.** A revenue ruling holds that certain expenses incurred in the purchase of a business must be capitalized. The Code is silent as to whether these expenses must be capitalized or may be deducted currently, but several cases from different courts hold that these particular expenses may be deducted currently. There is no other authority.

1 Under these facts, a position taken contrary to the revenue ruling on a return or claim for refund is not a reckless or intentional disregard of a rule, since the position contrary to the revenue ruling has a realistic possibility of being sustained on its merits.

2 Therefore, the preparer will not be subject to a penalty under IRC section 6694(b) even though the position is not adequately disclosed.

(d) **Example 4.** Final regulations provide that certain expenses incurred in the purchase of a business must be capitalized. One Tax Court case has expressly invalidated that portion of the regulations. Under these facts, a position contrary to the regulation will subject the preparer to the IRC section 6694(b) penalty even though the position may have a realistic possibility of being sustained on its merits. However, because the contrary position on these facts represents a good faith challenge to the validity of the regulations, the preparer will not be subject to the IRC section 6694(b) penalty if the position is adequately disclosed in the manner provided in Treas. Reg. 1.6694-3(e).

(20)639 Appeal Rights

See IRM (20)614.

(20)63(10) Statute of Limitations

(1) The statute of limitations on assessment for IRC section 6694(a) penalties expires three years from the due date of the related return or the date the return is filed whichever is later. (See IRM (20)619)

(2) There is no statute of limitations on assessment for IRC section 6694(b) penalties.

(20)63(11) Referral to Director of Practice

See IRM (20)620 and also IRM (20)617 which includes guidelines on program action cases.

(20)640 Other Assessable Penalties -- IRC Section 6695

(20)641 Background

(1)The IRC section 6695 penalties only apply to income tax return preparers. For the definition of "income tax return preparers," see IRM (20)633:(1)(a) and Rev. Rul. 86-55.

(2)For returns prepared before January 1, 1990, the maximum amount of these penalties are as follows:

(a)For IRC section 6695(a), (b) and (c) penalties, there is no maximum amount;

(b)For IRC section 6695(d) penalty, the maximum amount is \$25,000 per person for any return period;

(c)For IRC section 6695(e) penalty, the maximum amount is \$20,000 per person for any return period; and

(d)For IRC section 6695(f) penalty, there is no maximum amount.

(3)The Omnibus Budget Reconciliation Act of 1989 (OBRA 1989) changed the amounts of the penalties per each occurrence (listed above) and the maximum amounts which may be asserted. The OBRA 1989 changes apply to documents prepared after 12/31/89. The maximum amounts which may be asserted are:

(a) For IRC section 6695(a), (b) and (c) penalties, the maximum amount is \$25,000 per person per year;

(b)For IRC section 6695(d) penalty, the maximum amount remains \$25,000 per person for any return period;

(c)For IRC section 6695(e) penalty, the maximum amount is \$25,000 per person for any return period; and

(d)For IRC section 6695(f) penalty, there is still no maximum amount.

(20)642 IRC Section 6695(a) Penalty -- Failure to Furnish Copy to Taxpayer

(1)The IRC section 6695(a) penalty applies if the preparer fails to comply with IRC section 6107(a). Under IRC section 6107(a), a preparer is required to furnish a completed copy of the return or claim for refund to the taxpayer before (or at the same time) the return or claim for refund is presented to the taxpayer for signature.

(2)If there is an employment arrangement between two or more preparers, the requirement to furnish a copy only applies to the person who employs (or engages) one or more preparers. Similarly, if there is a partnership arrangement, the requirement to furnish a copy only applies to the partnership. Treas. Reg. 1.6107-1(c).

(3)The IRC section 6695(a) penalty does not apply if the failure is due to reasonable cause

and not due to willful neglect. Thus, the penalty for failure to furnish a copy to the taxpayer will not be imposed solely because:

(a) A person is a preparer under Treas. Reg. 301.7701-15(a)(2) and (b) on account of having given advice on specific issues of law; or

(b) A person is a preparer under Treas. Reg. 301.7701-15(b)(3) on account of having prepared another return (e.g., the partnership return) which affects the amounts reported on the return in question (e.g., the partner's return).

(4) The IRC section 6695(a) penalty will also not be imposed where a preparer deletes certain information from the copy furnished to the taxpayer if the taxpayer holds an elected or politically appointed position with the government of the United States or a State or political subdivision thereof and who in order to carry out their official duties, has arranged their affairs so that they have less than full knowledge of their property they hold or of the debts for which they are responsible. (See Treas. Reg. 1.6695-1(a)(2).)

(20) 643 IRC Section 6695(b) Penalty -- Failure to Sign Return/Claim for Refund

(1) The IRC section 6695(b) penalty applies if the preparer, who is required by regulations to sign the taxpayer's return or claim for refund, fails to sign the return or claim for refund. The preparer must manually sign the return/claim for refund after it is completed and before it is presented to the taxpayer for signature.

(2) The signature requirement is satisfied if the preparer manually signs a photocopy of a completed return/claim for refund. This requirement is also satisfied if the preparer signs the completed return, makes a photocopy of the return, and the taxpayer signs and files the photocopy. (Rev. Rul. 78-370, 1978- 2 C.B. 336)

(3) If a preparer is physically unable to manually sign a return because of a temporary or permanent disability, the IRC section 6695(b) penalty should not be imposed if the words "Unable to Sign" are printed, typed, or stamped on the preparer signature line. Also, the preparer's name should be printed, typed, or stamped under the signature line after the return is completed, and before it is presented to the taxpayer for signature. (Rev. Proc. 79-7, 1979-1 C.B. 486)

(4) In general, a facsimile signature stamp or signed gummed label will not do. The exceptions to this rule are:

(a) A preparer of a return or claim for refund for a nonresident alien may use a facsimile signature to sign as preparer if the preparer is authorized to sign for the taxpayer using a facsimile signature. However, the conditions prescribed in Treas. Reg. 1.6695-1(b)(4)(iii) must be met; and

(b) A preparer of Forms 1041 may use a facsimile signature to sign the Forms 1041 if the conditions in Notice 89-48, 1989-1 C.B. 688, are met. This exception only applies to Forms 1041 filed for taxable years ending after 12/31/87, and on or before further guidance is issued.

(5) If the preparer required to sign the return/claim for refund is unavailable to sign, another preparer must review the return/claim for refund and then manually sign the return/claim for refund.

(6) If more than one preparer is involved in the preparation of the return/claim for refund, the preparer with primary responsibility for the overall substantive accuracy of the return/claim for refund is the preparer who must sign the return/claim for refund. (Rev. Rul. 81-246 provides guidance on who is required to sign when a department store licenses a corporation to prepare returns in its stores.)

(7) If the mechanical preparation of the return/claim for refund is done by a computer not under the control of the individual preparer, the manual signature requirement may be satisfied by a manually signed attestation by the individual preparer that all the information in the return was obtained from the taxpayer and is true and correct to the best of the preparer's knowledge. The attestation must be attached to the return/claim for refund and the information contained in the return or claim for refund must not be altered by another person.

(8) A preparer is not required to sign and affix an identification number to the taxpayer's copy of the return. (Rev. Rul. 78-317)

(9) The IRC section 6695(b) penalty does not apply if the failure was due to reasonable cause and not due to willful neglect. If the preparer asserts reasonable cause, the preparer should provide a written statement in substantiation of the preparer's claim of reasonable cause. The penalty for failure to sign will not be imposed solely because:

(a) A person is a preparer under Treas. Reg. 301.7701-15(a)(2) and (b) on account of having given advice on specific issues of law;

(b) A person is a preparer under Treas. Reg. 301.7701-15(b)(3) on account of having prepared another return (e.g., the partnership return) which affects the amounts reported on the return in question (e.g., the partner's return); or

(c) A preparer claims that the taxpayer submitted the copy intended for his files which the preparer is not required to sign.

(20) 644 IRC Section 6695(c) Penalty -- Failure to Furnish Identifying Number

(1) The IRC section 6695(c) penalty applies if the preparer fails to comply with IRC section 6109(a)(4). Under IRC section 6109(a)(4) and the regulations thereunder, the return/claim for refund must contain:

(a) The identifying number of the preparer required to sign the return/claim for refund under IRC section 6695(b); and

(b) The identifying number of the partnership or the identifying number of the person who employs (or engages) one or more preparers (if there is a partnership or employment arrangement between two or more preparers).

(2) The IRC section 6695(c) penalty does not apply if the failure was due to reasonable

cause and not due to willful neglect. Thus, the penalty will not be imposed solely because:

(a) A person is a preparer under Treas. Reg. 301.7701-15(a)(2) and (b) on account of having given advice on specific issues of law;

(b) A person is a preparer under Treas. Reg. 301.7701-15(b)(3) on account of having prepared another return (e.g., the partnership return) which affects the amounts reported on the return in question (e.g., the partner's return);

(c) A preparer explains that the identifying number was partially or wholly omitted when the return was printed by a computer and that a machine malfunction caused the error; or

(d) The preparer's EIN or SSN is on the return but is missing one or more digits (examiners can assume, in most cases, that this is due to human error and reasonable cause exists).

(3) The IRC section 6695(c) penalty also will not be imposed against:

(a) A preparer who is employed or engaged by a person who is also a preparer of the return/claim for refund; or

(b) A preparer who is a partner in a partnership which is also a preparer of the return or claim for refund.

(4) Rev. Rul. 81-246, 1981-2 C.B. 249 provides guidance on whose identifying number is required to be provided where a department store licenses a corporation to prepare returns in its stores.

(5) No more than one penalty of \$25/\$50 may be imposed with respect to a single return/claim for refund.

(20) 645 IRC Section 6695(d) Penalty -- Failure to Retain Copy or List

(1) The IRC section 6695(d) penalty applies if the preparer fails to comply with IRC section 6107(b). Under IRC section 6107(b) and the regulations thereunder, a preparer must:

(a) Retain a completed copy of the return/claim for refund, or alternatively retain a record (by list, card file, or otherwise) of all the taxpayers, their taxpayer identification numbers, the taxable years, and the type of returns/claims for refund prepared;

(b) retain a record (by copy of the return/claim for refund or by a list, card file, or otherwise) of the name of the preparer required to sign the return/claim for refund under IRC section 6695(b) for each return/claim for refund presented to the taxpayer; and

(c) make such copy or list available for inspection upon request by the IRS for a 3-year period following the close of the return period (see IRC section 6060(c) for the definition of "return period").

(2) If there is an employment arrangement between two or more preparers, the requirement

to retain a copy or list only applies to the person who employs (or engages) one or more preparers. Similarly, if there is a partnership arrangement, the requirement to retain a copy or list only applies to the partnership. Treas. Reg. 1.6107-1(c).

(3)The IRC section 6695(d) penalty does not apply if the failure was due to reasonable cause and not due to willful neglect. Thus, the penalty for failure to retain a copy or list will not be imposed solely because:

(a)A person is a preparer under Treas. Reg. 301.7701-15(a)(2) and (b) on account of having given advice on specific issues of law; or

(b)a person is a preparer under Treas. Reg. 301.7701-15(b)(3) on account of having prepared another return (e.g., the partnership return) which affects the amounts reported on the return in question (e.g., the partner's return).

(20)646 IRC Section 6695(e) Penalty -- Failure of Preparer-Employer to File Correct Information Returns Identifying Preparer-Employee(s)

(1)The IRC section 6695(e) penalty applies if the preparer fails to comply with IRC section 6060. Under IRC section 6060(a) and the regulations thereunder, each person who employs (or engages) preparers must retain a record of the name, taxpayer identification number and place of work of each preparer employed (or engaged) by him. For purposes of IRC section 6060, a partnership is treated as the employer of the partners.

(2)The record may be in any form of documentation so long as it discloses on its face which individuals were employed (or engaged) as preparers during that period.

(3)The record must be retained and made available for inspection for a 3-year period following the close of the return period to which it relates. The term "return period" means the 12-month period beginning on July 1 of each year.

(4)If a preparer is not employed by another preparer, such preparer is treated as his own employer for purposes of this penalty. Therefore, if a preparer is a sole proprietor, he must retain and make available a record with respect to himself.

(5)The IRC section 6695(e) penalty does not apply if the failure was due to reasonable cause and not due to willful neglect.

(6)The IRC section 6695(e) penalty must be assessed within 3 years after the close of the return period to which the record relates.

(7)The penalty is \$50 for each failure to file a return as required by IRC section 6060 and \$50 for each failure to include a required item in the return. The maximum amount of the penalty imposed on any person for any return period is \$25,000.

(20)647 IRC Section 6695(f) Penalty -- Negotiation of a Taxpayer's Refund Check

(1)The IRC section 6695(f) penalty generally applies if the preparer endorses or otherwise negotiates (directly or through an agent) a refund check issued to a taxpayer other than if the

section 6695(f) penalties, and activity code 504500 for IRC section 6695(a) through (e).

(20)64(10) Collection Procedures

(1)When a Collection employee secures a delinquent return or claim, and determines that a preparer has not complied with the provisions of IRC section 6695 for signing a prepared income tax return or claim (in original handwriting), for placing his/her Taxpayer Identification Number (TIN) on the prepared return or claim, or for providing the taxpayer with a completed copy of the prepared return or claim, a penalty will be asserted. The Collection employee who secures the delinquent return or claim will be responsible for requesting the assertion of these penalties.

(2)The return preparer may be contacted if relevant information is needed.

(3)Form 8278, Computation and Assessment of Miscellaneous Penalties, is used to assert preparer penalties. Form 8278 will be forwarded to Collection Support function for input.

(20)64(11) Reasonable Cause Exception

(1)Except for the IRC section 6695(f) penalty, all of the IRC section 6695 penalties provide that the penalty will not be imposed if the failure is due to reasonable cause and not due to willful neglect.

(2)An Example of what constitutes reasonable cause is when the preparer claims substantial compliance, i.e., despite exercising reasonable precautions, certain required preparer data was omitted because of human error.

(3)For other examples, see the IRM section on the specific IRC section 6695 penalties (above).

(20)64(12) Coordination with Other Penalties

IRC section 6695 identification penalties may be asserted with any other penalties, including but not limited to IRC section 6694, IRC section 6701, and IRC section 6653/6662 asserted against the taxpayer.

(20)64(13) Claim Processing and Penalty Abatement

See IRM (20)615 and 616.

(20)64(14) Examination Case File Assembly

See IRM (20)636:(7) and (20)637

(20)64(15) Prompt Assessment

Prompt assessment procedures apply, when applicable, to IRC section 6695 penalties. The preparer will have post-assessment appeal rights. See IRM 20614.

preparer was a preparer of the return/claim for refund that gave rise to the refund check. For certain limited exceptions see (3) below.

(2) A person in a business other than tax return preparation who fills out or reviews returns for its customers may be a preparer and, thus, subject to the IRC section 6695(f) penalty if such person endorses or otherwise negotiates the customer's refund check. (Rev. Rul. 86-55 1986-1 C.B. 138).

(3) In certain circumstances, a preparer-bank may cash a refund check and remit the cash to the taxpayer or may accept a refund check for deposit to the taxpayer's account. A preparer-bank may:

(a) cash a refund check and remit all the cash to the taxpayer;

(b) accept a refund check for deposit in full to the taxpayer's account, provided the bank does not initially endorse or negotiate the check (unless the bank has made a loan to a taxpayer on the basis of an anticipated refund);

(c) endorse a refund check for deposit in full to the taxpayer's account pursuant to a written authorization of the taxpayer (unless the bank has made a loan to the taxpayer on the basis of the anticipated refund); or

(d) endorse or negotiate a refund check as part of the check clearing process after initial endorsement or negotiation. See Treas. Reg. 1.6695-2(f)(2).

(4) There is no reasonable cause exception to this penalty.

(20)648 Who Asserts the Penalties

(1) Examination. Revenue Agents and Tax Auditors in the district.

(2) Collection. Revenue Officers may assert only IRC section 6695(a), (b), and (c) penalties.

(20)649 Examination Procedures

(1) Of the seven identification penalties listed under IRC section 6695, (a), (b), (c), and (f) may be discovered by the examiner during an examination interview or site visitation. These Code sections all relate to questions examiners ask in initial interviews under package audit guidelines or during a site visit.

(2) The penalties under IRC section 6695(d), (e)(1), and (e)(2) would arise if a project were being done on a preparer. These penalties generally would not be discovered during an income tax examination of a taxpayer.

(3) To assert this penalty the examiner should prepare Form 6459, Return Preparer's Check sheet, and secure the group manager's approval. Once managerial approval is secured, the examiner should refer to the procedures in IRM (20)637.

(4) The examiner may charge time to the penalty case using activity code 503500 for IRC

(20)64(16) Appeal Rights

See IRM (20)614

(20)64(17) Statute of Limitations

The statute of limitations on assessment for IRC section 6695 penalties expires three years from the due date of the related return or the date filed, whichever is later. (See IRM (20)619)

(20)64(18) Referral to the Director of Practice

A referral to the Director of Practice must be made when an IRC section 6695(f) penalty is assessed against an attorney, certified public accountant, enrolled agent, or enrolled actuary. (See IRM (20)620.)

(20)64(19) Definitions

See IRM (20)61(10) for definition of terms.

(20)650 Penalty for Promoting Abusive Tax Shelters -- IRC Section 6700

(20)651 Legislative Overview

(1) Prior to enactment of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA 1982), investors in abusive tax shelters were penalized through the assertion of the negligence and valuation overstatement penalties. Similarly, promoters were subject to:

(a) civil penalties for the false or fraudulent preparation of a return or other document, or

(b) criminal penalties for aiding, assisting, or advising with the preparation or presentation of false or fraudulent returns or other documents.

(2) However, such investor-targeted penalties did little to discourage the continued conception and promotion of abusive shelters.

(3) TEFRA 1982 enacted IRC section 6700 to permit the IRS to assert penalties against promoters of abusive tax shelters.

(a) As enacted by TEFRA 1982, the IRC section 6700 penalty amount was the greater of \$1,000 or 10 percent of the gross income derived from the promotion of the abusive shelter.

(b) As originally enacted, the penalty applies to any person who organizes, assists in the organization of, or participates in the sale of any interest in any plan or arrangement, and who, in connection with such sale or organization, either:

1 makes or furnishes a false or fraudulent statement with respect to the allow ability of any deduction or credit, the excludability of any income, or the securing of

any tax benefit by reason of participating in the entity, plan or arrangement; or
2 makes or furnishes a gross valuation overstatement as to any material matter.

(c) The IRC section 6700 penalty applies to activities occurring after September 3, 1982.

(3) The Deficit Reduction Act of 1984 (DRA 1984) increased the IRC section 6700 penalty amount to the greater of \$1,000 or 20 percent of the gross income derived from the activity. This penalty rate applies to activities occurring after July 19, 1984.

(4) The Omnibus Budget Reconciliation Act of 1989 (OBRA 1989) made a number of changes to IRC section 6700. These changes apply to activities occurring after December 31, 1989.

(a) OBRA 1989 changed the penalty rate to the lesser of \$1,000 per activity or 100 percent of the gross income derived from the activity.

(b) OBRA 1989 clarified that those who indirectly participate in the sale of an interest in the shelter and those who cause another person to make false statements or gross overvaluation may be subject to the penalty.

(20)652 Administrative Guidelines

(1) Shortly after Congress enacted the promoter penalties, the Service issued Rev. Proc. 83-78 1978-2 C.B. 595, and Rev. Proc. 84-84 1984-2 C.B. 782, to announce and describe its program for identifying and investigating abusive tax shelters.

(a) In accordance with this program, understatements of tax resulting from abusive shelters are curbed through the assertion of penalties under IRC section 6700, the issuance of injunctions under IRC section 7408, and the issuance of pre-filing notices to investors. (Pre-filing notices are letters to investors advising them that the purported tax benefits are not allowable.)

(b) Rev. Proc. 84-84 provides guidelines for identifying returns that claim benefits from abusive tax shelter arrangements before those returns are processed and before refunds are issued.

(2) IRM 4236 contains the "Examination Tax Shelter Handbook." IRM 42(17)(11) explains the goals and objectives of the IRC section 6700 Program and the Tax Shelter Program.

(20)653 When the Penalty Applies

(1) There are two types of conduct subject to the IRC section 6700 penalty.

(a) The penalty may be asserted when the following conditions are present:

1 a promoter (see (2) below);

amakes, furnishes or causes another to make or furnish a statement in connection with the sale or organization of an entity, plan, or arrangement;

bthe statement relates to the allow ability of any deduction or credit, the excludability of any income, or the securing of any tax benefit by reason of participating in the entity, plan or arrangement; and

2 the person knows or has reason to know that the statement is false or fraudulent as to any material matter.

(b)The penalty may also be asserted under the following conditions:

1 a promoter;

a makes, furnishes or causes another to make or furnish a statement in connection with the sale or organization of an entity, plan, or arrangement;

b the statement contains a gross valuation overstatement as to any material matter; and

(20)654 Who Asserts the Penalty

Revenue agents assert the penalty.

(20)655 Computing the Penalty

(1)Effective September 4, 1982, the amount of the penalty for each year was the greater of \$1,000 or 10 percent of the gross income derived or to be derived by the promoter (or salesperson) from the promotional activity.

(2)The Tax Reform Act of 1984 raised the 10 percent penalty rate to 20 percent for offenses occurring after July 18, 1984.

(3)Section 7734 of OBRA 89 clarifies that each shelter activity is subject to a penalty, e.g. each sale of an interest in a shelter.

(a)Under OBRA 89, each sale of an interest constitutes a separate activity and is subject to a \$1,000 penalty, but the penalty cannot exceed the gross income derived or to be derived from an activity.

(b)The penalty is easily computed if the promoter is entitled to a flat fee or commission. However, if the gross income is contingent or speculative the Service may compute the penalty only on the present value.

(c) For the purpose of calculating the penalty on income "to be derived," a prospectus or other sources of projected income may be used, but only if it is reasonably likely that the income will be received. For example, amounts payable on sham notes should not be taken into account.

(4)A "person," for purposes of IRC section 6700 is defined in IRC section 7701 to include

an individual, a partnership, a corporation, a trust or an estate. However, if the promoter is a corporation, partnership, or other entity, the penalty may also be assessed against the entity's directors, officers, employees, and agents who assist in the tax shelter's promotion.

(20)656 Coordination with Other Penalties

(1) This penalty is in addition to all other penalties that may be imposed under the Code. However, after December 31, 1989, a penalty under IRC section 6701 may not be applied to the same activities which result in the application of a penalty under 6700. (See the discussion in IRM (20)664.5:(2).)

(2) IRC section 6694(b) imposes a penalty if a return preparer understates a taxpayer's liability as a result of willful or reckless conduct. In some instances, a person who is subject to the penalty under IRC section 6700 may also be subject to the penalty under IRC section 6694(b).

(3) IRC section 7206(2) relates to any person who willfully aids or assists etc., in making fraudulent and false statements. In some cases, the promoter might be prosecuted under IRC section 7206(2) for assisting, procuring, or advising the preparation or presentation of a return or other document which is fraudulent or false.

(4) IRC section 7408 authorizes the United States to commence a civil action at the request of the Secretary to enjoin any person from further engaging in conduct subject to the penalty under IRC section 6700. The promoter penalty under IRC section 6700 and the injunction actions under IRC section 7408 are more effective when applied prior to the time investors file their returns. Therefore, abusive tax shelters should be identified and penalty investigations initiated promptly.

(5) IRC section 6111 requires tax shelter organizers to register tax shelters with the IRS by the day on which interests in the tax shelter are first offered for sale. This rule applies to tax shelters first sold on or after September 1, 1984. See Treas. Reg. 301.6111-1T(b) (Q&A 58).

(a) Tax shelter organizers must use Form 8264, Application for Registration of a Tax Shelter.

(b) A penalty may be imposed under IRC section 6707 for failure to timely register a tax shelter.

(c) Criminal penalties may apply for willful noncompliance with the registration requirements. See IRC section 7203.

(6) IRC section 6112 requires organizers and sellers of potentially abusive tax shelters (for interests sold on or after September 1, 1984) to maintain a list identifying each person who purchases an interest in such tax shelter. See Treas. Reg. 301.6112-1T(D)(1) (Q&A 22). The list will contain any other information the IRS may require and will be available upon request for inspection. For failure to maintain the investors list, the penalty under IRC section 6708 may apply.

(20)657 How to Assert the Penalty

(20)657.1 Revenue Agent Responsibilities

- (1) After the Committee selects the promoter/scheme, the assigned revenue agent:
 - (a) develops facts and circumstances to determine the applicability of the penalty,
 - (b) decides when/if pre-filing notification letters are warranted by reviewing any false and fraudulent statements as to material matters and any assets overvalued within the meaning of IRC section 6700(b),
 - (c) completes a request to District Counsel for the assistance of a senior trial attorney, and
 - (d) periodically reviews the applicability of injunctive relief under IRC section 7408.
- (2) These penalty assertion procedures do not apply to grand jury investigations.

(20)657.2 Examination Guidelines

(1) Letter 1844(DO), Notice of Commencement of IRC section 6700 Examination, is sent to the promoter.

(2) The agent and the attorney prepare a document request in the format suitable for a summons. (See IRM 4233, Tax Audit Guidelines.) The promoter is required to make the requested documents available within 10 days. (See Rev. Proc. 83-78 1983-2 C.B.595.)

(a) Failing that, a summons should be issued expeditiously while the examination continues.

(b) If the summons must be enforced by court action, Revenue Agents cannot grant an extension of time to respond. Contempt charges may be filed by the Government for any failure to respond. (See IRC section 982 for guidance concerning the promoter's admittance of foreign-based documentation following the failure to respond.)

(3) Since the IRC section 6700 penalty is considered a tax, an examination can proceed on the preparer's individual return at the same time. This requires two separate and distinct document requests. The same agent should control both cases and maintain a carefully documented history of all actions and responses.

(4) The agent may open examinations on other abusive tax shelters/promotions with the group manager's approval, and follow up with notification to the assigned to the district counsel attorney and the Committee.

(5) Consideration of the IRC section 7408 injunction would only cause the IRC section 6700 case to be suspended if requested by the Department of Justice or there is criminal investigation.

(20)657.3 Conclusion of an IRC Section 6700 Examination

(1)The agent and the attorney will jointly determine if the following actions are appropriate:

- (a) assessment of the penalty,
- (b)issuance of pre-filing notification letters,
- (c)a request for injunctive relief should be sought, and
- (d)a referral to criminal investigation division should be made due to an indication of fraud.

(2)The promoter should be offered a closing conference and the opportunity to present any arguments or evidence. No communication regarding the determination of the case should be presented at the meeting. A copy of the letter offering the conference will be kept in the file.

(3)Written approval of the District Director is needed if the penalty will be asserted.

(4)When the penalty will be asserted, Form 4549, Revenue Agent Report, will be completed with Form 886A, Explanation of Items. F-886A will include the penalty calculation. The case file includes Form 8278, Computation and Assessment of Miscellaneous Penalties, and Form 4665, Report Transmittal. F-4665 will indicate whether or not:

- (a)the key case is subject to TEFRA,
- (b)the subsequent year will be examined, and
- (c)investors are required to file Form 8271, Investor Reporting of Tax Shelter Registration Number.

(5)Letter 1866, IRC section 6700 Discontinuance Letter, is sent to the promoter if the penalty will not be asserted.

(20)657.4 Investor Penalties

(1)The accuracy-related penalties under IRC section 6662 can be applied to the individual returns of the investors if the criteria apply. Once the penalty is assessed and Pre-filing Notification Letters have been sent to the investors, the penalty can only be abated with the concurrence of District Counsel.

(2)If the investor is a witness in either an IRS grand jury investigation or an administrative criminal investigation, advise Criminal Investigation before assessing the penalty.

(20)657.5 Pre-filing Notification Letters

(1)After District Director's approval, the letter shown in Exhibit (20)600-6 will be sent.

(2)PFN letters will not be sent to the investors when a determination is made after July 15 of the subsequent year. Instead, see procedures in Rev. Proc. 84-84, 1984-2 C.B.782.

(3)The district office forwards to the service center where the investor filed, the following items:

- (a) a list of all PFN letters,
- (b) each investor's PFN,
- (c)the District Director's letter of approval,
- (d)the pro forma RAR that relates to each of the investor's returns, and
- (e)any RARs for subsequent years.

(4)Taxpayers sent PFN letters will be identified and the portion of any credits relating to the abusive tax shelter will be disallowed. If this proportion cannot be determined, all credits will be disallowed. (Note: Non-TEFRA entities are all entities except those described in IRC section 6221 and 6241.)

(5)Service Center Pre-filing Coordinators are responsible for administering the PFN program and monitoring its effectiveness.

(20)658 Appeal Rights

See IRM (20)614.

(20)659 Statute of Limitations

There is no statute of limitations on assessment with respect to the promoter penalty imposed by IRC section 6700.

(20)65(10) Referral to the Director of Practice

See IRM (20)620.

(20)65(11) Definitions

See IRM (20)61(10) for definition of terms.

(20)660 Penalties for Aiding and Abetting -- IRC Section 6701

(20)661 Legislative Overview

(1)The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) added IRC section 6701 to the Code to penalize persons who knowingly aid and abet in the understatement of the tax liability of another person. See exhibit (20)600-7. The Tax Reform Act of 1984 included the IRC section 6701 penalty under the provisions of IRC section 7408 permitting the U.S. to seek injunctive relief barring a person aiding and abetting others in understating tax liabilities from further engaging in such activity.

(2)The Omnibus Budget and Reconciliation Act of 1989 (OBRA 89) expanded the scope of the penalty to individuals "who have reason to know" that they are aiding or abetting in the

understatement of a tax liability of another person.

(a) After December 31, 1989, the penalty has been broadened to cover the person who only has reason to believe that the document will be used in connection with a material matter arising under the tax laws.

(b) Prior to amendment, the penalty required that the person have actual knowledge that the document would be used in connection with a material matter arising under the tax laws. In addition, OBRA '89 coordinated this penalty with IRC sections 6694 and 6700. (See IRM (20)661:(5) below.)

(20)662 When the Penalty Applies

(1) IRC section 6701(a) imposes a \$1,000 penalty (\$10,000 if the prohibited conduct relates to a corporation's tax return) for aiding or assisting in the understatement of tax. The penalty is imposed on a person who:

(a) aids or assists in, procures or advises with respect to, the preparation or presentation of any portion of a return, affidavit, claim or other document (pre 89);

(b) knows (or has reason to know) that such portion will be used in connection with any material matter arising under the internal revenue laws; and

(c) knows that such portion (if used) would result in an understatement of another person's tax liability.

(2) Activities Subject to the Penalty. The key words in the penalty are "document," "knows," and "understatement." For the penalty to be imposed, the person penalized must be implicated in the preparation or presentation of a document some portion of which he or she knows or has reason to know will be used in connection with a material matter arising under the tax laws and knows that such position would result in an understatement of tax liability if so used.

(a) In general, targets of the penalty are tax counselors who advise clients to take unsupported filing positions or to file false or fraudulent returns.

(b) The authors of legal opinions made available to promoters of tax shelters are another target of the penalty. A carefully fabricated legal opinion may lend credence to an abusive tax shelter. The penalty may be imposed even if the opinion does not contain any false advice if the writer knows that the opinion is based on inaccurate assumptions and/or knows of other facts which render the legal advice false.

(c) The penalty can be imposed for gratuitous advice or assistance in preparing any document. Unlike the IRC section 6700 penalty, the person cannot lower the penalty by establishing the amount of gross income derived from the actions.

(d) In order to aid in the understatement of another's tax, it is not necessary to actually prepare the tax return or document that leads to the understatement. A person who controls the activities of subordinates and either orders the subordinate to act, or does not

prevent their participation in actions that person knows will produce an understatement is subject to the penalty under IRC section 6701.

(3) Aid, Assist, Procure, or Advise.

(a) The term "procures" in the statute includes ordering (or otherwise causing) a subordinate to do an act subject to the penalty. It also includes knowing of, and not attempting to prevent, participation by a subordinate in such an act. "Subordinate" means any other person (whether or not a director, officer, employee, or agent of the taxpayer involved) over whose activities the person has direction, supervision or control. The Senate Report adds that such direction, etc., must be "direct and immediate." Where a subordinate is directed or expected, as a condition of retaining his position, to participate in the prohibited activity by a person who directs, supervises, or controls such subordinate, the latter person is the one potentially subject to the penalty.

(b) The term "advises" includes actions of independent contractors such as lawyers and accountants who counsel a particular course of action.

(c) Mechanical Assistance. A person furnishing typing, reproduction, or other mechanical assistance with respect to a document is not to be considered as having aided or assisted in the preparation of the document for purposes of the statute solely by reason of such assistance.

(4) The Actor's Requisite Knowledge.

(a) For activities occurring before January 1, 1990, the actor must know that a document (the preparation or presentation of which he or she was in some way instrumental) will be used in connection with a material matter arising under the tax laws and will result in an understatement of tax liability. For example, if an individual assists another in procuring a forged birth certificate, he will not be liable for the penalty unless he knows that the birth certificate will be used for a tax matter, such as to obtain a benefit under the Code and that the use of such benefit will result in an understatement of tax.

(b) For activities occurring after December 31, 1989, the actor can be held liable for the penalty if he or she knows or has reason to believe that the document will be used in connection with any material matter arising under the tax laws. However, the statute still requires that the actor have actual knowledge that the document will result in an understatement of tax liability.

(5) Congressional Intent in Enacting the Provision.

(a) A tax advisor would not be subject to this penalty for suggesting to a client an aggressive but supportable filing position even though that position was later rejected by the courts and even though the client was subjected to the substantial understatement penalty. However, if the advisor suggested a position which he or she knew could not be supported on any reasonable basis under the law, the penalty would apply.

(b) The Senate Report also states that no person will be subject to the penalty unless they are "directly involved in aiding or assisting in the preparation of a false or fraudulent

document under the tax laws." Thus, the preparation of a correct schedule by a preparer to be incorporated in a return will not expose the preparer of the schedule to a penalty even though the preparer is aware other portions of the return may be fraudulent.

(6) Single Penalty per Taxpayer Per Period.

(a) If a penalty is imposed on a person with respect to a federal tax document, no penalty shall be imposed under IRC section 6701 on such person with respect to any other federal tax document relating solely to the same taxpayer and the same taxable period, or, if there is no taxable period, the same taxable event. If, however, such other federal tax document also related to another taxpayer or another taxable period or taxable event, a second penalty may be imposed under IRC section 6701 with respect to such other federal tax document.

(b) A husband and wife who make a joint return of income tax are considered to be the same taxpayer for the taxable year to which such return relates.

(c) For example: someone who assists two taxpayers in preparing false documents would be liable for a \$2,000 penalty whereas the penalty would be only \$1,000 if he had advised in the preparation of two false documents for the same taxpayer. Similarly, an advisor who prepares a false partnership return and then false K-1s for 10 individual partners would be subject to a \$10,000 penalty.

(20)663 Who Asserts the Penalty

Since the government has the burden of proof with respect to this penalty, it can be assessed only by employees who have the requisite knowledge of the facts giving rise to the penalty. Therefore, this penalty normally will be assessed by revenue agents and office auditors at an IRS district office as a result of an examination of a tax return or document or in connection with a tax shelter registration examination.

(20)664 How to Identify, Develop, and Assert the Penalty

(20)664.1 Investigation Responsibilities

(1) Persons subject to penalty under IRC section 6701 will usually be identified by examiners through the examination process or by service center correspondence examinations in which a pattern (or suspected pattern) was evident. If a penalty under IRC section 6701 might be appropriate, the examiner should provide relevant information to the District 6700/7408 Coordinator to determine if a project is warranted.

(2) When the District 6700/7408 Coordinator reviews a tax plan or arrangement which if used by a taxpayer could result in the understatement of tax liability an IRC section 6701 lead is established. There are two types of investigations:

(a) A limited investigation involving a small number of tax returns (Committee approval not required), or

(b) An extensive investigation involving a large number of tax returns, and

consideration of program action in IRM (20)617 or injunctive relief under IRC sections 7407 or 7408.

(3)The District 6700/7408 Coordinator will:

(a)ensure that each IRC section 6701 lead is assigned to a revenue agent for investigation,

(b)recommend IRC section 6701 investigations and injunction actions under IRC sections 7407 or 7408 for approval by the Committee, and

(c)approve and monitor limited investigations.

(4)The revenue agent assigned an IRC section 6701 lead will:

(a)estimate the number of taxpayers and years involved through coordination with the RPC who obtains a return preparer listing,

(b) determine the tax loss to the government,

(c) calculate the penalty amount, and

(d) recommend to the District 6700/7408 Coordinator whether an in-depth investigation is warranted.

(5)Form 2848, Power of Attorney (POA), may be used to authorize representation. (See IRM 4055.6 on POAs.) The POA will be reviewed for purposes of the investigation. A copy is maintained in the case file and is not submitted to the service center Centralized Authorization File.

(20)664.2 Investigation Procedures

(1)Procedures for extensive investigations after Committee approval and assignment to a revenue agent will parallel IRC section 6700 guidelines:

(a)The revenue agent meets with the coordinating attorney from District Counsel, maintains a summary document of agreed-upon actions, and records quarterly meetings that also include the respective managers from Examination and Counsel. (See Exhibit (20)600-2.) When Criminal Investigation Division is involved, the special agent and the related manager also attend quarterly meetings.

(b)The person under investigation will be notified in writing at a time determined by the revenue agent and the attorney. (See Exhibit (20)600-3) Information from third parties may be collected before notification.

(c)If the person is under a criminal investigation, the special agent assigned the case will issue the person a statement of rights before an interview with the revenue agent. In order to avoid adversely affecting the criminal investigation, all direct contact with the person will be coordinated with the special agent.

(d)The revenue agent will secure related tax returns and transcripts and obtain a

Treasury Enforcement Communications System (TECS) inquiry report. (See IRM 5186.63.)

(e) After obtaining relevant background information on the person under investigation (including any record of prior civil or criminal actions taken) the revenue agent will meet with the person and carefully develop and document all factors with respect to the person's position and the defense of it.

(f) The revenue agent prepares a report of proposed adjustments and, with the assigned attorney, conducts a final meeting with the person under investigation. After this meeting, based upon the recommendation of the attorney and the revenue agent, a decision will be made regarding whether the penalty should be assessed. A penalty assessment file is sent to the District Director for approval and/or to authorize an injunction under IRC section 7408.

(g) The revenue agent secures a copy of the assessment documentation from Quality Assurance Staff for the administrative file.

(2) Limited investigations not requiring Committee approval will be cleared through District Counsel before the penalty is assessed.

(20)664.3 Procedures for Developing IRC Section 6701 Cases

(1) The following factors, although not all inclusive, apply to the person under investigation in IRC section 6701 cases. These factors should be developed to the extent applicable:

(a) education level, degrees, certifications (CPA, LLM in taxation, MBA, etc.);

(b) expertise in accounting and tax law (evidence by seminars/courses taken or given);

(c) occupation and relevant work experience (as an accountant, bookkeeper, tax advisor, etc.);

(2) The following factors pertain to the evidence on facts and circumstances and must be fully developed. This is information that establishes:

(a) the assistance or advice upon which the penalty is based (who, when, where, how, and form of assistance or advice);

(b) any documents prepared by the person which reflect the advice given;

(c) how the advice or assistance affected the taxpayer's tax liability; (How was it reflected on the tax return? What actions did the taxpayer take to change the tax liability based on the advice?)

(d) how the advice or assistance would create an understatement of tax;

(e) the relationship between the person and the taxpayer; (Although not required to assess the IRC section 6701 penalty, was the person compensated for the advice given? Is

the person an employee of the taxpayer or an independent contractor?)

(f) how the person knew or should have known that the advice would be used in connection with a material matter arising under the tax laws; and

(g) how the person knew that the advice would cause an understatement of tax, e.g., what facts were considered by the person making the advice.

(3) The following factors relate to tax shelter advisors, brokers, dealers, organizers, promoters, and other personnel (referred to as promoters) involved in organizing or promoting a tax plan or arrangement which results in the understatement of the tax liability of another person. The revenue agent will:

(a) Complete a detailed overview of the financial structure and organization of the scheme, shelter, plan, or arrangement (referred to as plans). The details of the financial transactions and how tax liabilities would be reduced.

(b) Determine the promoter's relationship to the plan: Did the promoter participate in organizing the plan? How much control did the promoter have in the promotion and organization of the plan?

(c) Determine the relationship of the sales personnel to the promoter:

- 1 What instructions were given by the promoter?
- 2 How much control was exercised by the promoter?
- 3 Did sales personnel make independent representations?

(d) Determine how commissions were earned and paid:

- 1 Did the promoter receive a commission from each taxpayer/investor?
- 2 If so, how much?

(e) Investigate the details of the investor's acquisitions:

- 1 How was the transaction reported on the return?
- 2 Did the transaction result in an underpayment on each return?
- 3 If so, how much?

(f) Determine the tax benefits promised by the promoter:

- 1 How were the benefits presented?
- 2 Who received the tax reporting information?
- 3 Who determined how the transaction was reported?

(g) Review all documentation furnished to the investor:

1 Who furnished the information?

2 Did the promoter personally provide the information and instruct the preparers on its use?

(h) Determine the relationship between the promoter and each taxpayer:

1 If the promoter was not the actual preparer, how was the promoter liable for the penalty?

2 Was the promoter's activity sufficient to support the penalty?

(i) Obtain evidence to establish that the promoter knew the document would result in an understatement of each participant's tax liability.

(j) Gather information to establish consistent treatment of all promoters:

1 State the type of false documents prepared and how these documents affected tax returns.

2 Retain copies.

(k) Determine whether the promoter had a reasonable basis for the position taken: what authority, if any, supports the promoter's position?

(l) Reference federal court decisions at all levels, congressional records, Tax Court decisions, regulations, public and private rulings, notices, and other Service publications and written documentation to support the application of the penalty.

(4) The IRC section 6701 penalty should be imposed only after review of the person under investigation, the surrounding circumstances, and the reasons for the position taken. This position must be contrary to clear authority and without reasonable basis.

(20)664.4 Evidence Supporting the Government's Burden of Proof

(1) The penalty under IRC section 6701 may be imposed on a broad range of persons. When a tax return preparer is involved, either IRC section 6694(b) or 6701 could apply.

(a) The government's burden of proof under IRC section 6694(b) and 6701 is not sustained by the mere fact of unreported income or overstated credits and deductions.

(b) The focus is on the information that establishes the knowledge, willfulness, or recklessness of the preparer, i.e., information conveyed by the taxpayer to the preparer, information known or reasonably known by the preparer, the inquiries or statements directed by the preparer to the taxpayer.

(c) For example, if the preparer fabricates deductions (without the taxpayer's knowledge), the preparer could be liable for a penalty under IRC section 6694(b) or 6701 because of willfully attempting to understate the tax and because of preparing a return based on information which is known by the preparer to result in an understatement of the

taxpayer's tax liabilities.

(2) Even though a preparer may in good faith rely on the taxpayer to provide accurate information, the preparer may not ignore the implications of such information and must make reasonable inquiries when information furnished appears to be incorrect or incomplete. It must be shown that the preparer failed to make any reasonable inquiry under circumstances required by rule or regulation, and a deliberate act of omission prevails.

(3) The evidence must prove each of the three elements defined in (20)662.2:(1) above. In addition, the evidence should show the amount of understatement on each return related to IRC section 6701 activity. Examples of evidence to be collected include, but are not limited to:

(a) Tax returns or other documents which were prepared by the person under investigation. Although copies may be used during the investigation, originals or certified copies will be needed for introduction in court.

(b) Affidavits taken from taxpayers whose federal tax returns were prepared by the person under investigation. These affidavits should define the items falsely reported on the filed return as well as any other preparer violations. The affidavits are used for report purposes but the individuals must be available to testify if the case goes to court. (See IRM (20)618, Affidavits)

(c) Computation of loss to the government due to the understatement of tax attributable to the return preparer.

(d) False receipts or other documents to establish the involvement of the individual under investigation in aiding or assisting in the filing of false documents specified in IRC section 6701.

(e) Affidavits taken from third parties who can testify as to the preparer's tax knowledge and personal responsibility in the preparation of the tax returns or other factors bearing on the investigation.

(20)665 Coordination with Other Penalties

(1) The penalty under IRC section 6701 is not imposed on a person with respect to a federal tax document if a penalty with respect to such document has been assessed on such person under IRC section 6694, relating to income tax return preparers. The penalty may be imposed, however, with respect to any other federal tax document for which the penalty under IRC section 6694 has not been assessed, even though the document relates to the same taxpayer and taxable year as a document with respect to which the penalty under IRC section 6694 has been assessed. (See IRM (20)634.)

(2) After December 31, 1989, a penalty under IRC section 6701 may not be applied to the same activities which result in the application of a penalty under IRC section 6700. Therefore, if a promoter develops promotional materials such as a prospectus and other documents which explain the promotion and those documents are used as the evidence supporting a penalty under IRC section 6700 for organizing and promoting an abusive tax

shelter, a penalty under IRC section 6701 will not be assessed for those same documents. However, if the same promoter prepares a partnership tax return relating to the same tax plan or arrangement, a penalty can be assessed under IRC section 6701 for each schedule K-1 if an understatement of tax liability is reported on the investor's federal tax returns.

(20)666 Examples of IRC Section 6701 Activity

(1)**Example 1:** A tax advisor would not be subject to the penalty for suggesting an aggressive but supportable filing position to a client even though that position was later rejected by the courts and even though the client was subjected to the substantial understatement penalty.

(2) **Example 2:** However, if the tax advisor suggested a position which he or she knew could not be reasonably supported by statute or regulation, and the advisor prepared (or assisted in the preparation of) a document for the underlying tax return reflecting that insupportable position, the penalty could apply.

(a) Thus, if a person prepares a return (or a schedule or other portion of a return) for a client reflecting a deduction of an amount the preparer knows is not deductible, the preparer could be subject to the penalty.

(b) However, if a person prepares a schedule or other portion of a return which portion reflects positions which are reasonably supported by rules or regulations, the person will not be subject to an IRC section 6701 penalty even if other portions of the return are erroneous or fraudulent.

(3)**Example 3:** Taxpayer B was given a winning horse race ticket at a race course by taxpayer A, the ticket owner. The race course, using information supplied by Taxpayer B, prepared a Form 1099 in Taxpayer B's name. Taxpayer B received the proceeds from the winning ticket and returned the proceeds to Taxpayer A for a 6 percent fee.

(a) Taxpayer B is a person who has aided, assisted in the preparation of, or procured a document (the Form 1099) that Taxpayer B knows, or has reason to know, will be used in connection with material matters under the internal revenue laws.

(b) Taxpayer B knows that, if used, the document would result in an understatement of Taxpayer A's income tax liability. Thus, Taxpayer B is liable for the IRC section 6701 penalty.

(4)**Example 4:** Mr. C, an accountant, prepared a 1983 return for Taxpayer D, a client. Mr. C knowingly overstated D's expenses on the return, thereby creating a NOL for the year. Mr. C prepared amended returns for Taxpayer D for 1980, 1981, and 1982, claiming refunds for those years based on the 1983 NOL carryback. The carryback was not exhausted in 1982. Mr. E, another accountant, prepared Taxpayer D's 1984 return using the information presented to Mr. E by Taxpayer D, including copies of the document prepared by Mr. C. Mr. E is unaware of the overstatement of expenses by Mr. C and deducted the remaining unused NOL on Taxpayer D's 1984 return.

(a) Mr. C is liable for four separate IRC section 6701 penalties for his role in preparing Taxpayer D's 1980, 1981, 1982, and 1983 returns, which Mr. C knew, or had reason to know would result in understatements of Taxpayer D's 1980, 1981, 1982, and 1983 federal income tax liabilities.

(b) Mr. E, however, was unaware of the overstatement of expenses on the 1983 return and is unaware of the understatement of tax liability on the 1984 return. Thus, Mr. E is not liable for a section 6701 penalty.

(5) **Example 5:** On January 15, 1983, A, an individual, offers to donate a painting to museum X. B, the curator of the museum, agrees to accept the painting. B offers to backdate a receipt for the donation to December 30, 1982. B knows that the receipt will be used to substantiate A's charitable deduction. A uses the backdated receipt to claim a charitable deduction for 1982.

(a) B has aided in the preparation of a federal tax document knowing that it will be used in connection with a material tax matter and that it will result in an understatement of tax.

(b) Thus, B is liable for the IRC section 6701 penalty.

(6) **Example 6:** Taxpayer F retains Mr. G, an appraiser, to appraise rare books that she wishes to donate to a university. Mrs. F tells Mr. G that she needs the appraisal to substantiate a charitable contribution deduction for federal income tax purposes. Mr. G knows that the fair market value of the books may be any amount between \$50,000 and \$75,000. Mr. G offers to provide Mrs. F an appraisal, for a fee, indicating the books are worth \$100,000. Mr. G indicates to Mrs. F that if the IRS challenges the valuation, the appraisal of \$100,000 can be used to negotiate a fair market value of \$75,000.

(a) Mrs. F agrees to pay the fee for the appraisal indicating the books are worth \$100,000, and Mr. G prepares the appraisal.

(b) Mr. G has aided in the preparation of a document knowing that it will be used in connection with a material tax matter and that it will result in the understatement of tax liability. Thus, G is liable for the IRC section 6701 penalty.

(7) **Example 7:** Mrs. H, an accountant, overstates the value of depreciable property on an estate tax return. Mrs. H knows there is no reasonable basis for the valuation. Mrs. H also knows that the valuation claimed on the estate tax return will not understate the tax liability of the estate because of the application of the unified credit. Mrs. H, however, intends that the value claimed on the return will be used by the beneficiary of the estate in computing depreciation deductions. Mrs. H has aided in the preparation of a tax document and knows that the estate tax return will result in an understatement of the tax liability of the beneficiary. The IRC section 6701 penalty therefore applies.

(8) **Example 8:** Mr. A, an attorney, knowingly understates an item of partnership income in preparing a partnership return for calendar year 1983. Mr. A prepares and transmits to the partners Schedules K-1 for the 10 individual partners for the same calendar year reflecting the

understated income. Mr. A is subject to ten separate \$1,000 IRC section 6701 penalties for his preparation of ten Schedule K-1s which Mr. A knew would, if used, result in understatements of the federal tax liabilities of the ten partners on their federal income tax returns. Mr. A will not be subject to an eleventh penalty in connection with the partnership return itself, since the partnership itself is not liable for income tax and the only understatements of tax liability are the understatements of tax liability on the ten partners' individual returns.

(9) **Example 9:** Mrs. B, an officer of an S corporation under section 1361(a)(1), prepares the corporation's tax return for calendar year 1983. Mrs. B intentionally understates the corporation's net capital gain for the taxable year, resulting in an understatement of the corporation's tax liability under section 1374. Mrs. B also prepares Schedules K-1 for the individual shareholders for the same calendar year reflecting the understated capital gain. Mrs. B is subject to a \$10,000 penalty for her aid in the preparation of the small business corporation return and a \$1,000 penalty for each Schedule K-1 prepared. Note: If Mrs. B intentionally understated operating income rather than net capital gains, Mrs. B is subject to a \$1,000 penalty for each Schedule K-1 prepared, but is not subject to a penalty for the S corporation return since under these facts the S corporation is not subject to tax.

(10) **Example 10:** Mrs. C, an accountant, prepares false income and gift tax returns for client Mr. D. Each of the returns is prepared for calendar year 1983. The calendar year 1983, however, relates to a period for which different taxes are imposed. Thus, there are two taxable periods for purposes of application of the penalty under IRC section 6701: the calendar year 1983 which is the period for which the income tax is imposed, and the calendar year 1983 which is the period for which the gift tax is imposed. Mrs. C is subject to a penalty of \$2,000.

(20)667 Appeal Rights

See IRM (20)614.

(20)668 Statute of Limitations

There is no statute of limitation on assessment of penalties under IRC section 6701 because the penalty does not depend on the filing of a return.

(20)669 Director of Practice

See IRM (20)620, Director of Practice.

(20)66(10) Definitions

See IRM (20)61(10) for definition of terms used.

(20)670 Penalty for Unauthorized Preparer Disclosure or Use -- IRC Section 6713

(20)671 Legislative Overview

The penalty for unauthorized preparer disclosure or improper use was enacted as IRC section 6712 as part of the Technical and Miscellaneous Revenue Act of 1988 (P.L. 100-647). See exhibit (20)600-7. In 1989, this provision was renumbered IRC section 6713. It provides a penalty of \$250.00 for each unauthorized disclosure or use of information connected with a tax return or the preparation of a tax return. The penalty may be asserted against a tax return preparer or any person providing services in connection with the preparation of a return.

(20)672 Asserting the Penalty

(1) Revenue Agents and Tax Auditors in District Examination assert the penalty.

(2) If disclosure or use of return or return related information was made pursuant to court order or one of the provisions of the Code that permits disclosure, then the penalty will not be asserted.

(3) If any person prepares a return for compensation or provides services in connection with the preparation of the return, and knowingly or recklessly discloses or uses return information, the examiner should consider the criminal penalty under IRC section 7216.

(20)673 Computing the Penalty

For each unauthorized disclosure or use of return information a penalty of \$250.00 may be asserted. The total amount cannot exceed \$10,000 per person per calendar year.

(20)674 Coordination with Other Penalties

The IRC section 6713 penalty can be asserted in conjunction with any other preparer penalties.

(20)675 Appeal Rights

See IRM (20)614.

(20)676 Statute of Limitations

There is no statute of limitations for this penalty.

(20)677 Definitions

See IRM (20)61(10) for definition of terms.

(20)680 Action to Enjoin Preparers/Promoters -- IRC Sections 7407 and 7408

(20)681 Legislative Overview

(1) Under IRC section 7407 the Service has the power to seek an injunction prohibiting an income tax preparer from engaging in certain practices. See exhibit (20)600-7. The Service

may bring a civil action in the U.S. District Court for the district of

- (a) the return preparer's residence,
- (b) the return preparer's principal place of business, or
- (c) the residence of the taxpayer with respect to whose return the action arises.

(2) If the court finds that the income tax return preparer has engaged in one or more of the enumerated practices, it may enjoin him or her from further engaging in such conduct. If the court finds that the return preparer has continually or repeatedly engaged in those practices, it may enjoin him or her from acting as an income tax return preparer. (The court's jurisdiction in this case may be exercised separate and apart from any other action brought by the U.S. against the income tax return preparer or any taxpayer.)

(3) Income tax return preparer practices that may cause the Service to initiate injunctive action:

- (a) conduct subject to IRC sections 6694 and 6695 penalties;
- (b) conduct subject to criminal penalties;
- (c) misrepresentation of the return preparer's eligibility to practice before the Service, or his or her experience and education as an income tax return preparer;
- (d) guarantee of payment of a tax refund or of allowance of a tax credit; or
- (e) other fraudulent or deceptive conduct that substantially interferes with proper administration of the internal revenue laws.

(4) Bond to Stay Injunction (IRC section 7407). Prior to January 1, 1990, an income tax return preparer could prevent the Service from beginning or pursuing an injunctive action with respect to conduct subject to IRC sections 6694 and 6695 penalties by filing and maintaining with the district office of his residence or principal place of business, a bond of \$50,000 as surety for payment of the IRC sections 6694 and 6695 penalties that might be assessed. The return preparer did not need to continue the bond after paying the assessed penalties that gave rise to the injunctive action. In 1989, Congress repealed this provision because it believed that return preparers should not be able to prevent judicial resolution of the issue of whether the return preparer had engaged in prohibited conduct. This repeal is effective with respect to actions commenced after December 31, 1989.

(5) The Committee Reports for the Tax Reform Act of 1976 (which enacted IRC section 7407) indicate that injunctive relief sought by the Service must be commensurate with the conduct which led to the seeking of the injunction. For example, if an income tax return preparer, who is only experienced in preparing individual returns, overstates his qualifications as a preparer by claiming expertise in the preparation of corporate returns, it was anticipated that any injunction would be directed toward the misrepresentation itself or the preparation of corporate returns and not toward preventing the preparer from preparing any returns at all. Furthermore, if some of an employer's employee-preparers have engaged in conduct leading to

a request for an injunction against the further preparation of returns, any injunction is to be sought only against those preparers and not the employer (or other employees), unless the employer (or other employees) is actively involved in the improper conduct.

(6) Action to Enjoin Promoters of Abusive Tax Shelter, etc. A civil action may be brought under IRC section 7408 to enjoin further conduct subject to IRC section 6700 or 6701. The court action can be brought in the U.S. district court for the district in which the individual resides, has his principal business, or has engaged in prohibited conduct.

(7) The court may grant injunctive relief against any person if it finds:

(a) that the person has engaged in any conduct subject to the penalty for organizing or selling abusive tax shelters under IRC section 6700, or

(b) that the person has engaged in aiding and abetting tax understatements under IRC section 6701, and

(c) injunctive relief is appropriate to prevent recurrence of such conduct.

(20)682 Action on Injunctions

(20)682.1 Seeking the Injunction

Any examiner conducting an investigation under IRC sections 6694, 6695, 6700, or 6701 will consider whether an injunction should be sought under IRC sections 7407 or 7408. In addition, an injunction may be sought by an examiner to whom an investigation is assigned for activities specified in IRC section 7407.

(20)682.2 Identifying Persons Subject to an Injunction

All Service personnel who become aware of income tax return preparers engaged in activities identified in IRC section 7407(b)(1)(A) through (D) will notify the District 6700/7408 Coordinator in writing of the facts and circumstances.

(20)682.3 Initiating an Investigation under IRC Section 7407/7408

An investigation under IRC sections 7407 and 7408 will be conducted in the same fashion as an investigation under IRC sections 6700 and 6701.

(20)682.4 Approval to Seek an Injunction

(1) If the Revenue Agent and District Counsel Attorney conclude that an IRC section 7407/7408 referral is appropriate, a recommendation for injunction will be forwarded to the District 6700/7408 Committee for approval. If approved by the District 6700/7408 Committee, the recommendation will be submitted to the District Director for final approval. If approved by the District Director, the case file will be submitted to District Counsel for referral to the Department of Justice. The following procedures should be adopted with respect to submitting these cases:

(a) A copy of the Revenue Agent Report (RAR) will be submitted with the IRC section

7407/7408 administrative file.

(b)The RAR will be cross referenced to the exhibits and the exhibits numbered correspondingly.

(c)Revenue Agents should retain complete copies of the documents submitted in order to facilitate telephone discussions with the trial attorneys.

(d)When video or audio tapes are forwarded as evidence, a transcript should be forwarded with the tape.

(2)When an injunction is issued, copies of the court order and the asserted opinion will be sent to the district in which the subject promoters reside. District personnel will then take appropriate action on the IRC section 6700/6701 case.

(20)683 Coordination with Other Penalties

(1)The injunction authorized under IRC section 7407 is coordinated with civil penalties under IRC sections 6694 and 6695 and criminal tax provisions. In addition, IRC section 7407 can be used in conjunction with IRC section 7408, if appropriate.

(2)The injunction authorized under IRC section 7408 is coordinated with civil penalties under IRC section 6700 and 6701. In addition, IRC section 7408 can be used in conjunction with IRC section 7407, if appropriate.

(3)In addition, an injunction may be sought without regard to whether penalties have been or may be assessed against any income tax return preparer.

(20)684 Statute of Limitations

The Code does not explicitly provide any limitation period for seeking an injunction under IRC sections 7407 and 7408.

(20)685 Director of Practice

See IRM (20)620.

(20)686 Definitions

See IRM (20)61(10) for definition of terms.

Exhibit (20)600-1 Forms Used in the Preparer Penalty Case File

Form Description

886-A

872-D

2797
3198
3244-A
4318
4318-A
4665
4700
4700-A
5808
5809
5816
5838
6459
8278
8484

Explanation of Items - Unagreed Case

Consent to Extend Time on Assessment of Tax Return Preparer Penalty

Notice of Statute Expiration

Referral Report for Potential Fraud Case

Special Handling Notice - Annotate "Preparer Penalty Case" in the "Other" section

Payment Posting Voucher

Examination Workpapers

Continuation of Examination Workpapers

Report Transmittal - Unagreed Case

Examination Workpapers

Form 4700 Supplemental

Return Preparer Penalty Follow-up

Preparer Penalty Case Control Card

Report of Income Tax Return Preparer Penalty - A separate form is required for each year/return.

Waiver of Restrictions on Assessment and Collection of Tax Return Preparer Penalty - Unagreed Case

Return Preparers Checklist - Prepare in duplicate. Needs group manager approval.

Computation and Assessment of Miscellaneous Penalties - Instructions on back of form. A statute date must be inserted in box 6 in order for this penalty to be processed by ESP. This form is an assessment document, therefore a case with a short statute (as defined by the District) should follow district policy concerning short statute assessments. F-8278 is completed for each penalty.

Penalty Information Report (formerly: Referral to the Director of Practice)

Exhibit (20)600-2 Quarterly Joint Workplan and Conference Memorandum

Table omitted.

Exhibit (20)600-3 Section 6701 Pre-Assessment Letter

INTERNAL REVENUE SERVICE
DEPARTMENT OF THE TREASURY

(ADDRESS)

Person to Contact:

Date:

Telephone Number:

Mr. Red Oak

Appointment

624 Hackberry Lane

Date:

Frytown, Texas 77777

Time:

Place:

Dear Mr. Oak:

We have reviewed certain materials with respect to your preparation of tax returns. We are considering assessing penalties under section 6701 of the Internal Revenue Code. Enclosed is an exhibit which identifies the tax returns on which the penalty is based and calculated.

You may meet with the examiner at the date, time and place scheduled above to present any facts or legal arguments indicating such action should not be taken.

Sincerely yours,

District Director

Enclosure

Exhibit (20)600-3 Con't. Section 6701 Pre-Assessment Letter

Table omitted.

Exhibit (20)600-4 Penalty Reference Numbers

Reference: IRM (20)61(11).3

IRCTitle	Reference
Section	Number
6694Understatement of Taxpayer's Liability by Income Tax Return Preparer:	
6694(a)--Penalty assessed prior to 1/1/90	622
--Penalty assessed after 12/31/89	645
6694(b)--Penalty assessed prior to 1/1/90	646
--Penalty assessed after 12/31/89	650
6695Other Assessable Penalties with Respect to the Preparation of Income Tax Returns for Other Persons	
6695(a), (b), (c), (d), and (e)	624
6695(f)	626
6700Promoting Abusive Tax Shelters, Etc.	628
6701Penalties for Aiding and Abetting	

Understatement of Tax Liability

--Assessed against a promoter 630
 --Assessed against a preparer 631
 6713 Disclosure or Use of Information by 633

Preparers of Returns

Exhibit (20)600-5 Legislative Overview

Reference: (20)631

Code

Section	Description	Effective Date
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Pre-OBRA 1989:

6694(a)	Understatement due to negligent or intentional disregard of rules or regulations (\$100.00 per return or refund)	Documents prepared before 1-1-90
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6694(b)	Willful understatement of liability before 1-1-90 claim for refund)	Documents prepared income tax (\$500.00 per return or
---------	---	--

Post OBRA 1989:

6694(a)	Understatement due to unrealistic position (\$250.00 per return or claim for refund)	Documents prepared after 12-31-89
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6694(b)	Willful attempt to understate liability after 12-31-89 disregard of the rules or return or claim for refund)	Documents prepared an income tax or a reckless or intentional regulations (\$1,000.00 per
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Exhibit (20)600-5 Con't (1) Legislative Overview

Reference: (20) 632 and (20) 633

Pre-OBRA 1989:

Code	Amount of Penalty Per	Description
Section	Return/Claim for Refund	

6694(a)	\$100.00	Understatement due to negligent or intentional disregard of rules/regulations
6694(b)	\$500.00	Willful understatement

Post OBRA 1989:

Code	Amount of Penalty	Per Section	Description
6694(a)	\$250.00		Understatement due to an unrealistic position
6694(b)	\$1000.00		Willful, reckless, or intentional understatement

Exhibit (20)600-5 Con't (2) Legislative Overview

Reference: (20)641

Penalty Amount for

IRC Penalty Documents Prepared

Section	Description	Before	After
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1/01/90	12/31/89
---------	----------

6695(a)	Failure to furnish copy of income tax return or claim for refund to taxpayer	\$25.00	\$50.00
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6695(b)	Failure of preparer to sign income tax return or claim for refund	\$25.00	\$50.00
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6695(c)	Failure to furnish identifying number of the preparer	\$25.00	\$50.00
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6695(d)	Failure to retain copy	\$50.00	\$50.00
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or list of income tax
returns or claims for
refund

6695(e)(1) Failure to file an infor- mation return required under IRC section 6060	\$100.00	\$50.00
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6695(e)(2) Failure to set forth an item in the return as required by IRC section 6060	\$5.00	\$50.00
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6695(f) Endorsement or negotiation of a taxpayer's refund check	\$500.00	\$500.00
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Exhibit (20)600-6 Notification Letter

Reference: (20)657.5

LetterEntity

Letter 1842(DO), TEFRA Partner
Notification Letter

Sent to all individual partners

Letter 1843(DO), Investor Pre-filing
Notification Letter (PNL)

Sent to all non-TEFRA flow-
through entities

Letter 1845(DO), Partnership Pre-
filing Notification

Sent to Tax Matters Partner if
Partnership covered by TEFRA

Letter 1976(DO), S Corporation
entities

Sent to S Corporation TEFRA

Shareholder Pre-filing Notification
Letter--TEFRA

1977(DO), S Corporation Pre- Sent to S Corporation TEFRA
 entities filing Notification Letter (first tier entities only)
 --TEFRA

Exhibit (20)600-7 Legislative Overview

Reference: IRM (20)661, (20)671, (20)681

IRC Section	Penalty Amount Per Violation	Effective Date
6701	\$1,000 (non-corporate) \$10,000 (corporate)	September 4, 1982
6713	\$ 250	December 31, 1989
7407		December 31, 1976
7408		September 4, 1982
	For IRC section 6700 activities	
7408		July 19, 1984
	For IRC section 6701 activities	

Chapter (20)700 Information Return Penalties

(20)710 Introduction

(20)711 Reporting Requirements

(20)711.1 General

(1) This chapter covers the provisions of the Internal Revenue Code (IRC) that apply when a filer fails to meet information return reporting requirements. The term "information return" means any statement, form, or return as described in Treas. Reg. 301.6721-1(g). The provisions of IRC section 3406(a)(1)(B), which applies to filers who submit Forms 1099-B, INT, DIV, OID, PATR or MISC with missing or incorrect Taxpayer Identification Numbers (TINs) are also included.

(2) The provisions of IRC section 3406(a)(1)(B), which applies to filers who submit Forms 1099-B, -INT, -DIV, -OID, -PATR or -MISC with missing or incorrect Taxpayer

Identification Numbers (TINs) are also included.

(2)(3) Penalty proposal notices (500 Series Reference Numbers) are generated from the information return data that is processed to the Payer Master File (PMF). Penalty assessments are manually input to the Civil Penalty Module.

(3)(4) Generated penalty proposals/notices may include penalty infractions identified for late filing, failure to file on magnetic media, and/or missing and incorrect taxpayer identification numbers (TINs).

(4)(5) The penalties for unprocessable returns filed on either paper or magnetic media and the penalties for prior year returns are manually assessed by the service centers. (5)(6) Compliance Functions assess information returns penalties using 600 Series Reference Numbers.

(6)(7) Generated information return penalty notices (500 Series Reference Numbers) may include one, two, or any combination of the the penalties for late filing, failure to file on magnetic media, and/or missing and incorrect taxpayer identification numbers.

(a) Exhibit (20)700-1, 500 Series Reference Numbers - This exhibit shows the reference numbers applicable to returns due after December 31, 1989.

(b) Exhibit (20)700-2, 600 Series Reference Numbers - This exhibit shows the reference numbers applicable to information return penalties assessed by the Compliance functions.

(7)(8) Law Enforcement Manual (LEM XX-700) should be reviewed before any of the penalties mentioned in this chapter are considered.

(20)711.2 Chapter Outline

(1) The penalties discussed in this chapter are as follows:

(a) IRM (20)730: IRC section 6721 - Failure to File Correct Information Returns.

(b) IRM (20)740: IRC section 6722 - Failure To Furnish Correct Payee Statements.

(c) IRM (20)750: IRC section 6723 - Failure To Comply with Other Information Return Requirements.

(d) IRM (20)760: IRC section 6011(e) - Regulations Requiring Returns on Magnetic Media.

(e) IRM (20)770: IRC section 6652(e) - Failure to File Certain Information Returns, Registration Statements, Etc.

(f) IRM (20)780: IRC section 6693 - Failure To Provide Reports on Individual Retirement Accounts or Annuities; Penalties Relating to Designated Nondeductible Contributions.

(g) IRM (20)790: IRC section 6724 - Waiver: Definitions and Special Rules.

(2) In addition, the requirements under IRC section 3406(a)(1)(B), Backup Withholding Due to Notification of an Incorrect Name/TIN Combination, are included (see IRM (20)7(10)0).

(20)711.3 Forms 1096, Annual Summary

Form 1096, Annual Summary and Transmittal of U.S. Information Returns, is used to report the total number of paper information returns filed for Forms 1099, 1098, 5498, and W-2G. A separate Form 1096 must be filed with each type of information return filed. Each Form 1096 should include:

- (a) the filer's name and address,
- (b) filer's taxpayer identification number (TIN),
- (c) total number of information returns filed,
- (d) the total federal income tax withheld,
- (e) the total dollar amount reported, and
- (f) the box checked which represents the type of information return filed,
- (g) the filer's signature and the date signed.

(2) Form 4804, Transmittal of Information Returns Reported Magnetically/Electronically or Form 4802, Transmittal of Information Returns Reported Magnetically/Electronically (Continuation), are used to report the above information for returns filed on magnetic or electronic media.

(3) This information is posted to the Payer Master File (PMF).

(20)711.4 Forms

(1) The various penalties discussed in this chapter may apply to one or more of the following information reporting requirements. See Treas. Reg. 301.6721-1(g)(2) and 711.3 of LEM XX-700.

- (a) Form 1098, Mortgage Interest Statement,
- (b) Form 1099-A, Acquisition or Abandonment of Secured Property,
- (c) Form 1099-B, Proceeds From Broker and Barter Exchange Transactions,
- (d) Form 1099-C, Cancellation of Debt,
- (e) Form 1099-S, Proceeds From Real Estate Transactions,
- (f) Form 1099-INT, Interest Income,

- (g) Form 1099-DIV, Dividends and Distributions,
- (h) Form 1099-OID, Original Issue Discount,
- (I) Form 1099-PATR, Taxable Distributions Received From Cooperatives,
- (j) Form 1099-MISC, Miscellaneous Income,
- (k) Form 1099-R, Distribution From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.,
- (l) Form 5498, Individual Retirement Arrangement Information,
- (m) Form 1042-S, Foreign Persons' U.S. Source Income Subject to Withholding,
- (n) Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips,
- (o) Form 8282, Donee Information Return,
- (p) Form 8300, Report of Cash Payments Over \$10,000 Received in a Trade or Business,
- (q) Form 8308, Report of a Sale or Exchange of Certain Partnership Interests,
- (r) Form 8594, Asset Acquisition Statement,
- (s) W-2, Wage and Tax Statement,
- (t) W-2G, Certain Gambling Winnings,
- (u) K-1 (1065, 1120S and 1041).

(20)712 Common Features

(20)712.1 General

(1) The information contained in this section is common to all information return penalties discussed in this chapter, unless otherwise indicated. Exceptions and additional information are noted in the discussions of the specific penalties.

(2) For IRM (20)700, TIN refers to either an Employer Identification Number (EIN) or a Social Security Number (SSN).

(3) IRM (20)796 provides procedures for service center processing of backup withholding notices CP2100/2100A. Filers who file information returns with missing, incorrect, and/or not currently issued TINs may be liable for a penalty under IRC section 6721.

(20)712.2 Payer Master File

(1) The Internal Revenue Code provides civil penalties for persons who fail to file information returns as required. For tax years 1991 and prior tax years, penalties were

generated to the Civil Penalty Tax Module based on the information return data processed to the Payer Master File (PMF).

(a) Beginning with tax year 1992 returns, penalty proposal notices will be generated from the PMF. Assessments which result from the proposal will be manually input to the Civil Penalty Module.

(b) Penalties may also be proposed as the result of an examination of a filer's records. PMF data may be accessed by using CC PMFOL or PATRA as described below. See IRM 3(25)77 for information on the use of these command codes.

(2) The PMF is viewed using CC PMFOL which allows research of:

(a) The filer entity information,

(b) filing history - indicators to show whether returns were filed or a penalty was proposed for the five most recent tax years, and

(c) a record of each Form 1096 submitted by the filer, including:

1 Documents - the type and number of forms submitted, the media used (paper, magnetic/electronic), whether returns were original, amended or replacement.

2 payments - the total payment for all payees for each type of form,

3 withholding - the total amount withheld for all payees,

4 received date - for late filed returns,

5 penalties - the number of returns for which a penalty was proposed for late filing, magnetic media, and TINs,

(d) return due date for each form type,

(e) extension - if the filer received an extension of time to file which extended the due date of the return,

(f) waiver - if the filer received a waiver exempting the returns from the requirement to be filed on magnetic media, and

(g) totals - summary for each form type filed, amounts reported, and penalties proposed.

(3) See Exhibit (20)700-3 for an example of a PMF transcript.

(4) The PMF maintains data for the five most current tax years including generated penalty assessment or proposal amounts. However, penalty abatements are not posted on the PMF. This information must be obtained from TXMOD (MFT 13/55). In addition, no manual input assessments or abatements are shown. This information must be obtained from TXMOD (MFT 13/55) BMFOL, IMFOL or MFTRA.

(a) The penalty indicators show which types of PMF generated penalties were assessed

or proposed.

(b) The penalty indicators do not consider any manual assertions and should be used in conjunction with TXMOD, BMFOL, IMFOL or MFTRA information to determine previous compliance history.

(c) A blank for a tax year indicates that no computer generated penalty was issued (or proposed) for that period. See (4) above concerning manual assessments.

(5) Currently only Forms W-3, Transmittal of Income and Tax Statements that were penalized or that met penalty criteria (i.e., filer was granted a waiver or extension) appear on the PMF. Other forms Forms W-3 submitted by the filer for a particular tax year are not posted to the PMF. Additional Form W-3 and W-2 information is available on BMFOLU.

(6) CC PMFOL provides a summary of a filer's submissions by return type for all five years as well as a complete record of each Form 1096 filed for tax year 1989 and later tax years.

(7) CC PATRA provides complete transcript data for all five years on the PMF. Only paper (hard copy) transcripts are available and require three to four weeks for delivery. See IRM 3(25)(77)0 for a complete description of all PATRA requests.

(8) BMF/IMF linkage is identified by the literal "Linked" in the entity section of the PMF. In this situation, the PMF and the Master File share identical entity information.

(a) Linked PMF accounts are verified annually and receive entity updates from the Master File on a weekly basis.

(b) This is the only way the PMF entity can be changed. Individual 1096/1099 filings will not update the PMF entity.

(c) Approximately 95 percent of the PMF is linked.

(d) The remaining 5 percent, are non-linked which is not-linked accounts which represent represents new filers or filers without BMF/IMF filing requirements.

(9) The "Transmitted" volume is the count for the number of returns processed which should reflect the actual number of documents filed, minus voided or blank forms and forms reporting under one dollar.

(a) This count will sometimes differ from the count entered by the filer on the Form 1096.

(b) The "subj" (Subject to Penalty) volume further excludes returns which that are not required to be filed by law because of the amount being reported, e.g., Form 1099-INTs reporting less than \$10 dollars are systematically dropped from the number of returns subject to penalty. See Exhibit (20)700-4.

(10) The subject to Penalty ("Subj") count appears on each Form 1096 record and refers to the total number of returns in a submission that could be penalized. No penalty is

applicable to a particular Form 1096 submission unless separate counts are shown in the "Late", "MAG" or "TIN" fields of the Form 1096. See 712.2:(10) of LEM XX-700.

(11) The "Replacement" volume is for returns that replace the original return when a correction is submitted to change a TIN, name, or return type.

(12) When applicable, an entry for Form 8487, Payer Master File Entity Change Entry, will appear on the civil penalty transcripts directly below the document that was changed or deleted. The affected document will state: "NOTE: THIS DOCUMENT HAS BEEN REMOVED" directly above the entity information for the affected Form 1096 record. The Form 1096 will not be considered in penalty computations.

(13) Civil Penalty Summary (accruals) provides:

(a) The aggregate volume of original, amended, and replacement returns, by return type, that were transmitted and the number subject to penalty based on all Forms 1096 filed (see (11) above).

(b) The gross penalty amounts applicable to the returns that were penalized by return type and the type of penalty (late, magnetic media, missing and incorrect TINs). These figures include all potential penalties identified for the tax year.

(c) The "Civil Penalty Proposed" is the actual penalty amount assessed or proposed on the notice. This amount is limited by the penalty maximum of \$250,000 per year and the \$50 per return maximum.

(d) A waiver of magnetic media filing is indicated by a "yes" or "no" entry. The extended due date (if applicable) is shown by return type. If no extension was granted, the date shown is the required due date for the return. See 712.2:(13)(d) of LEM XX-700.

(20)712.3 Information Return Filing Requirements

(20)712.31 General

(1) The due dates for information returns are listed below. When any due date falls on a Saturday, Sunday or legal holiday, the due date becomes the next day which is not a Saturday, Sunday or legal holiday (IRC section 7503). The return must be postmarked by the stated due date.

(2) The filer is required to mail a correct statement (Forms 1099, 1098, W-2 and W-2G) to payees no later than January 31 of the year following the calendar year the funds were distributed.

(3) The filer is required to file Forms 1099, 1098 and W-2G with the Service no later than February 28th of the year following the calendar year the funds were distributed.

(4) A filer is required to file Forms W-2, (W-3 Transmittal of Income and Tax Statements), with the Social Security Administration no later than February 28 of the year following the calendar year the funds were distributed. In a leap year the due date is February

29.

(5) A filer is required to file Form 8027 with the Internal Revenue Service no later than February 28 of the year following the calendar year the funds were distributed.

(6) Form 5498 is required to be filed with the Service by May 31 of the year following the calendar year in which regular or rollover contributions are made to an Individual Retirement Account (IRA).

(7) Form 8300. The recipient of more than \$10,000 in cash received in trade or business is required to file Form 8300 with the Service within 15 days after the date the cash is received. The recipient is also required to provide a written statement to each person named on the form, showing the total amount of cash received and that the information was provided to the Service. This statement must be provided on or before January 31 of the year following the calendar year in which the cash was received.

(8) Form 8308. A Partnership must file a separate Form 8308 with their Form 1065, U.S. Partnership Return of Income, when money or property is received by a transferor partner in exchange for all or part of a partnership interest which is attributable to unrealized receivables or substantially appreciated inventory items (an IRC section 751(a) exchange).

(9) Form 8594. The buyer and the seller must each report on Form 8594, Asset Acquisition Statement:

(a) The transferee's basis in such assets, and

(b) the gain or loss of the transferor with respect to the transaction.

(c) The consideration received shall be allocated among the assets acquired.

(d) This statement is filed with the income tax return for the year that includes the date of the acquisition.

(10) Form 8282. When a donee disposes of certain charitable property within two years of its receipt, the donee shall provide an information return, Form 8282, to the Service on or before the 125th day after the disposition date of the property.

(11) Form 1042-S is required to be filed with the Service and furnished to the recipient by March 15th of the year following the calendar year the funds were distributed.

(20)712.32 Magnetic Media Filing Requirements

Information returns are filed either on paper or via magnetic or electronic media. Paper information returns are filed with the service centers. Magnetic media and/or electronic information returns are filed with the Martinsburg Computing Center (MCC). See IRM (20)760 for further information.

(2) The Omnibus Budget Reconciliation Action of 1989 (OBRA '89) P.L. 101-239, requires that uniform magnetic media requirements apply to all information returns filed during any calendar year. The bill provides that after December 31, 1989, information returns

must be filed either using magnetic or electronic media when 250 or more of the same documents are submitted. The penalty only applies to the returns that exceed this requirement. For example, if 300 Forms 1099-DIV are filed on paper, only 50 will be subject to the penalty.

(3) A filer may request a waiver of the magnetic media filing requirement by filing Form 8508, Request for Waiver From Filing Information Returns on Magnetic Media.

(a) The filer must show that it would cause an undue hardship if the filer were required to file either magnetic or electronic media.

(b) The request must be postmarked no later than due date of the return.

(4) See IRM (20)792:(10)(j) for explanation of the undue economic hardship criteria.

(20)712.33 Extension of Time to File

A filer can request an extension of time to file with the Service (MCC).

(2) The request for Forms 1099, 1098, 5498, W-2G and W-2 is made by filing Form 8809, Request for Extension of Time To File Information Returns. The extension request must be postmarked no later than the due date of the return.

(a) If the extension request is for multiple filers, a listing providing the TINs, names and addresses of the filers must also be attached.

(b) Extensions are initially granted for 30 days.

(c) A second 30 day extension may be granted. To obtain an additional extension the filer must file a second Form 8809 before the first 30 day extension expires.

(d) Both the first and second extensions must be approved by the Service (MCC).

(3) Filers may also request an extension of time to provide the statement to recipients (payees).

(a) The request is made by submitting a letter to the Service (MCC or the filer's local District Director). It must be postmarked no later than the due date of the recipient statement.

(b) The letter must contain:

1 The filer's name, TIN and address,

2 type(s) of information returns,

3 reason for delay,

4 signature of the filer or authorized agent,

(c) If approved, the extension is generally granted for 15 days.

(4) A withholding agent may request an extension of time to file Forms 1042-S.

(a) The request is made by submitting a letter or Form 2758, Application for Extension of Time To File Certain Excise, Income, Information, and Other Returns, to the Service. Requests for returns that will be filed magnetically or electronically must be sent to MCC. If the returns will be filed on paper, the request must be sent to the Philadelphia Service Center. The extension request must be postmarked by the due date of the return. If approved, the extension is granted for 90 days.

(b) The request must include:

- 1 the withholding agent's (or transmitter's) name, address and TIN,
- 2 the type of return (1042-S) and the tax year for which the extension is requested,
- 3 the Transmitter Control Code (TCC) of the organization or individual requesting the extension and the name of a contact person familiar with the request,
- 4 the reason for delay and the date the returns will be submitted, and
- 5 a list providing the withholding agents' names and TINs must be attached, if the extension request is for multiple withholding agents.

(c) If requested, an additional 90 day extension of time to file is granted. Any additional extension is only being granted in extreme circumstances.

(d) Requests for an extension of time to provide the recipient copy must be sent to the filer's local District Director.

(20)712.4 Exceptions and Special Rules

(1) Inconsequential Omission. The penalties discussed in this chapter will not be assessed for any failure to include correct information on an information return, tax return, or payee statement if the failure is considered inconsequential. An inconsequential omission or inaccuracy is defined as one that does not prevent or hinder the Service in the processing of the information, putting the return to its intended use, or the payee from timely and correctly reporting the information on their tax return.

(2) The Service may administratively specify other errors or omissions that are never considered inconsequential.

(3) See IRM (20)734:(2), (20)743, (20)753 for additional criteria for inconsequential errors and omissions under IRC sections 6721, 6722 and 6723.

(4) See IRM (20)790 for criteria relating to Waivers; Definitions and Special Rules.

(20)713 Penalty Assertion

(20)713.1 Assertion Criteria

(1) The consolidated information return penalties under IRC sections 6721, 6722, and

6723 apply to most of the information reporting requirements discussed in this chapter. The following is a general discussion of these IRC sections. Specific matters are discussed later in this chapter.

(a) IRC section 6721 provides for a penalty when an information return or statement is not correctly filed by the due date of the return.

1 Penalties assessed under IRC section 6721 for returns due after 1989 are based on a time sensitive penalty rate.

a \$15 per failure, not to exceed an annual maximum of \$75,000 for returns filed correctly within 30 days of the due date,

b \$30 per failure, not to exceed an annual maximum of \$150,000 for returns filed correctly after 30 days but on or before August 1, or

c \$50 per failure, not to exceed an annual maximum of \$250,000 for returns filed after August 1,

d The correction must be made in the year the information return was required to be filed.

2 A small business limitation is also a part of revised IRC section 6721. See IRM (20)732:(5).

3 A complete discussion of the related criteria is discussed in the IRM (20)730.

(b) IRC section 6722 provides for a penalty of \$50 when a payee statement is not timely and correctly furnished. See IRM (20)740.

(c) IRC section 6723 provides for a penalty of \$50 for a failure to comply with other specified information reporting requirements. See IRM (20)750.

(2) Waiver; Definitions and Special Rules are addressed under IRC section 6724. Reasonable cause replaced due diligence as the standard for abatement of a penalty. However, the due diligence criteria remains in effect for Forms 1099-INT, DIV, OID, and PATR for penalties assessed on tax year 1988 and prior year information returns. See IRM (20)790.

(20)713.2 Who Asserts/Assesses

A service center or compliance function may determine that a penalty should be imposed.

(a) At the service center the penalty proposal may generate automatically based on returns posted to the PMF, or

(b) compliance functions consider the penalty during an examination if it is found that the filer failed to file, filed late, or filed incorrectly.

(2) Service centers use penalty reference codes in the '500 series for assessing these

penalties.

(3) Compliance functions use penalty reference codes in the 600 series for assessing these penalties.

(20)714 Computation of the Penalty

(1) To compute the appropriate information return penalty as it relates to IRC section 6721, 6722, or 6723 multiply the number of violations in each penalty category by the dollar amount associated with the respective category:

- (a) Standard (\$50),
- (b) reduced (\$15 or \$30)(IRC section 6721 only), or
- (c) Intentional Disregard (see IRM (20)733, (20)742, or (20)752,

(2) Note: Assess only one penalty per return or payee statement. This penalty will be the largest penalty applicable to that return or statement. When appropriate, use the penalty reference number that identifies all violations that apply to the return.

(20)715 How to Assess/Abate

(20)715.1 Examination

(1) Secure and make two copies of the delinquent information returns.

(a) Send the original delinquent information returns to the appropriate service center, the Detroit Computer Center (DCC) or the Social Security Administration (SSA).

(b) Place one copy in the penalty case file.

(c) Attach the other copy to Form 5346, Examination Information Report (Form 5666, EP/EO Referral Information Report).

(2) Prepare Form 5346 (or Form 5666) for each recipient shown on the delinquent information returns.

(3) Prepare and make a copy of:

(a) Form 1096, Transmittal Document, for information returns filed with the service center,

(b) Form W-3 for W-2s filed with the SSA,

(c) Form 4804, Transmittal of Information Returns Reported Magnetically/Electronically, for information returns required to be filed at MCC, or

(d) any other specific information return not transmitted by a transmittal document (for example Form 8300).

- (4) Retain the appropriate copies in the penalty case file.
- (5) Across the bottom of Form 1096, W-3 or 4804 write in red "Delinquent Returns-Secured by Examination (or EP/EO) -Penalty Considered."
- (a) For Form(s) 1096, enter "E" (Exam) in the first box under "Official Use Only."
- (b) CAUTION: Do not make any markings in the top margin of Forms 1096. This will interfere with the processing of these documents.
- (6) If there is more than one type of information return, prepare separate transmittals for each type of information return.
- (7) Prepare Form 3198, Special Handling Notice, and under the "Other" section write "Assess Civil Penalty per Form 3645, Computation of Penalty for Failure to File Info Returns or Furnish Statements or Form 8278, Computation and Assessment of Miscellaneous Penalties."
- (8) Make a copy of the face of the income tax return for the tax year of the delinquent information returns. Retain the copy of the income tax return in the penalty case file.
- (9) Prepare Form 8278, Computation and Assessment of Miscellaneous Penalties, for each tax year. Retain Form 8278 in the penalty case file.
- (10) Prepare Form 3645, Computation of Penalty for Failure to File Information Returns or Furnish Statements, for each tax year. Form 3645 should stay in the penalty case file. Provide the following in the explanation section:
- (a) The reason for the penalty.
- (b) Did the filer agree or disagree with the penalty?
- (c) Was reasonable cause considered?
- (11) If the taxpayer agrees with the penalty, ask for the payment. For payments received, prepare Form 3244, Payment Posting Voucher. Note: Do not secure an agreement on Form 4549, Examination Income Tax Changes Report. The information return penalty case file is separate from an income tax, employment tax or other case file.
- (12) When asserting the penalty and the waiver provisions were considered, the following must be noted on the Form 8278.
- (a) When a waiver is denied:
- 1 assert the penalty;
 - 2 give the filer written appeal rights, and
 - 3 note on Form 8278 that the waiver provisions were considered, and
 - 4 identify the waiver requested using the penalty reason codes in Exhibit

(20)100-3.

(b) When a waiver is granted:

1 the penalty should not be assessed,

2 a notation made on Form 8278 that the waiver provision was granted, and

(c) After determining whether to grant or deny the waiver provision claimed, identify the waiver request using the penalty reason codes in Exhibit (20)100-3.

(20)715.2 Collection Procedures

Assessments

(a) Generally information return penalties are asserted by other than collection activities, however collection personnel are not prohibited from making these types of assessments.

1 During the course of an investigation or other contact with taxpayers it may be determined that required information returns have not been filed.

2 The information returns should be secured from the taxpayer, and if appropriate, the applicable penalty recommended for assessment.

(b) Across the bottom of Form 1096, W-3 or 4804 write in red "Delinquent Returns-Secured by Collection -Penalty Considered."

1 For Form(s) 1096, enter "C" (Collection) in the first box under "Official Use Only."

2 CAUTION: Do not make any markings in the top margin of Forms 1096. This will interfere with the processing of these documents.

(c) A Civil Penalties Master file has been developed to accommodate most penalties using MFT 55 (for IMF) and MFT 13 (BMF). Form 8278 (Computation and Assessment of Miscellaneous Penalties) is used to forward the assessment/abatement action for input.

(d) For penalties being recommended under IRC section 6721, 6722 or 6723, Form 3645 (Computation of Penalty for Failure to File Information Returns or Furnish Statements) should be prepared.

1 A determination as to reasonable cause should be entered under the caption "Recommendation of Examining Officer."

2 If reasonable cause does not exist, the penalty should be collected. The Form 3645 and information documents, should be attached to Form 8278 and submitted with the daily report for assessment.

(2) Abatements/Non-assessment

(a) Reference IRM (20)790 for waiver provisions due to reasonable cause for penalties

under IRC section 6721, 6722 and 6723.

(b) Penalties asserted by Examination will be identified by TC 240 with 600 series reference number.

1 Prior to abating these penalties, collection employees will obtain the examination assessment file for any information previously presented by the taxpayer.

2 This information should be reviewed and taken into consideration in making a reasonable cause determination.

(c) When taxpayers request non-assertion or abatement of penalties due to reasonable cause, the taxpayer must submit a signed statement explaining the basis for non-assertion/abatement or sign Form 3870 (Request for Adjustment).

1 The signature must be executed under the penalty of perjury. This requires insertion of "under penalty of perjury the above information is true, correct and complete," on Form 3870 prior to obtaining the taxpayer's signature. (See text 172:(10))-(21) of LEM V).

2 The penalty reason code (see exhibit (20)100-3) for abating the penalty will be clearly annotated in red on the face of the Form 3870 "RC-___" (fill in number corresponding to applicable reason code).

(d) Requests for non-assertion/abatement of penalties for reasonable cause will be approved by the requesting employee's manager. Approval will be denoted by the employees manager's signature next to the work approved on the form requesting non-assertion/abatement.

(e) Unassessed Liabilities: If after discussion of the causes for the failure, the employee determines that a taxpayer's failure was not due to reasonable cause, the employee will inform the taxpayer that the penalty will be asserted.

1 If the taxpayer disagrees with the employees determination and maintains that the penalty should not be asserted, the employee should provide written notification of the denial to the taxpayer.

2 Pattern Letter 2414(P) will be sent to the taxpayer advising them of their pre-assessment appeal rights, and claim procedures and post assessment appeal procedures.

3 When a collection employee decides to deny reasonable cause and proceeds with assertion of the penalty, it is imperative that the decision be recorded in such a manner that other Service employees will be aware that reasonable cause has already been addressed.

4 For that reason, when reasonable cause is denied at the time the information return penalty is recommended for assessment, the reason code (See exhibit (20)100-3) will be annotated on Form 8278 in column (e) opposite the penalty amount

assessed. The penalty reason code (PRC) shall be entered in red in the following format "PRC-__" (fill in number corresponding to applicable reason code).

(f) **Assessed Liabilities:** When the collection employee makes a determination not to abate a penalty for reasonable cause, the taxpayer will be informed of that decision.

1 If the taxpayer disagrees with the employee's determination and maintains that the penalty should be abated, written notification should be provided to the taxpayer using Pattern Letter 2413(P).

2 An appropriate input document will be used to request input of TC 290, Reason Code 92, blocking series 98. This is necessary to insure that, if subsequent claims of reasonable cause are received, the employee will be able to determine that the issue has been addressed before.

3 If the taxpayer submits a written appeal, the collection employee who rejected the abatement request will examine the appeal for additional information which may change the original determination not to abate the penalty.

4 Normally collection action will be suspended on the penalty portion of the assessment during the 15 day period granted to the taxpayer to file an appeal, or during the period the case is under consideration by Appeals. However, action need not be suspended if circumstances meriting continuation of collection action exist. The Collection function employee must obtain managerial approval not to suspend collection of the penalty portion of the assessment.

(20)715.3 Service Centers Procedures

(20)715.31 General

- (1) The penalties will be assessed on a Civil Penalty Module:
 - (a) MFT 13 (Business Master File), or
 - (b) MFT 55 (Individual Master File).
- (2) The penalty will be assessed/abated/sustained using command code ADJ54. Input:
 - (a) a TC 290,
 - (b) the appropriate reference number (see Exhibit (20)700-1),
 - (c) the dollar amount of the penalty:
 - 1 as a positive amount to assess,
 - 2 as a negative amount to abate, or
 - 3 as a zero amount to sustain (if no change), and
 - (d) blocking series:

- 1 52X for the first assessment on the account,
- 2 53X for any subsequent adjustments,
- 3 98X for any disallowance, or
- 4 15X to file attachments, correspondence, etc.,
- 5 59X for PMF generated assessments (tax year 1991 and prior tax years).

(e) Use Hold Codes, Priority Codes, Posting Delay Codes, and Penalty Reasons Codes as applicable. See IRM 3(15)60, Exhibit (20)100-3, and Document 6209 for additional information regarding these codes and indicators.

(f) Use Letter 1948C to answer questions from the filer, to request additional information, or to notify the filer that the explanation submitted establishes reasonable cause.

(g) Letter 854(c) is sent to the filer when a penalty waiver or abatement request is denied. This letter provides appeal rights and the procedures filers must follow if they wish to appeal the Service's decision.

1 Only use Letter 854C when the filer has submitted an explanation which can be fully evaluated to determine that the filer does not have reasonable cause to have the penalty abated or waived. Letter 854C should not be used to close a case which requires additional information to determine whether reasonable cause exists or for "no reply" cases.

2 Letter 854C should list the reason(s) the abatement request is being denied.

3 Replies to Letter 854C should be evaluated to determine if the information provided will allow the penalty unit to abate the penalty. If not, route the reply to Letter 854C to the Service Center Appeals Coordinator.

(h) When considering the assessment or abatement of a penalty and or a waiver request was made, the following information must be input to the appropriate Civil Penalty Module:

1 if reasonable cause was considered, enter RC 62 in the first reason code position, and

2 when waiving/abating a penalty due to reasonable cause, use the appropriate Penalty Reason Code (as shown in Exhibit (20)100-3) in the fourth reason code position.

3 Note: do not use Reason Code 62 if the penalty is waived/abated for other than reasonable cause, e.g., processing errors.

(3) If a credit balance remains on the account after an abatement due to a credit offset from another module, research to see if the offset module is still on the account. If present,

reverse the credit back to that account.

(4) When making an adjustment on a civil penalty module, the TC 290 acts as a carrier transaction. The TC 290 and the reference number will post to the civil penalty module as a TC 240/241 with the reference number used in the adjustment transaction.

(5) See IRM 3(15)60, General DP Adjustments, for complete service center processing instructions.

(6) Before making a manual assessment, you must use the research Command Codes BMFOL, IMFOL, INOLE, EINAD, or SSNAD to make sure that the penalty is being assessed on the correct filer's account. To avoid unpostable conditions, the following factors must be considered prior to making the manual assessment.

(a) It may be necessary to establish the filer's entity on the Master File if it has not been established.

(b) The Entity Control Unit must establish BMF entities.

(c) The penalty unit will establish entities and create Civil Penalty Name Lines for IMF accounts as required.

(d) See IRM (20)718 for these procedures.

(7) DO NOT manually assess information return penalties against any Federal agency. See IRM 3(13)20 for guidelines identifying Federal agencies.

(a) Forward a copy of the Form 1096, Form 4804 or Form W-3 to the Headquarters Office, CP:CO:SC:A. If unprocessable returns are involved, also forward Letter 1865C and a sample of the returns (3-5) with the unprocessable document.

(b) For magnetic media returns, forward the 4804/4802 and any other documentation provided by MCC.

(c) Mark the Form 1096, 4804, or W-3 "Penalty Not Assessed."

(8) All computer generated penalty proposal notices for Federal agencies are suppressed by the Payer Master File if the employment code "F" designation is present on the Master File. In addition, any IRP civil penalty assessed (in error) against Federal agencies will automatically unpost if the Employment Code "F" designation is on the Master File. These unpostables will be sent to the IRP Civil Penalty Unit on a Nullified Distribution List. Verify that the entity is a Federal agency and forward the list to the Headquarters Office, Project 102 CP:CO:SC:A. NOTE: Due to organizational changes, please verify the office symbols.

(9) If the Employment Code "F" designation is not present on the Master File, the penalty proposal notice or penalty assessment will generate. Centers should pull these notices during notice review per the instructions in IRM (20)715.32 and (20)715.33.

(20)715.32 Processing Notice 972CG

Beginning with the tax year 1992 IRP penalty program, Notice 972CG, Notice of Proposed Civil Penalty, will generate from the Payer Master File for filers who fail to comply with the information reporting requirements. See IRM (20)735.(12) for additional information on Notice 972CG.

- (2) Centers will receive separate tape files for:
 - (a) Notices 972CG (IMF) that require special handling,
 - (b) Notices 972CG with TIN listings,
 - (c) Notices 972CG without TIN listings containing up to 15 pages,
 - (d) Notices 972CG without TIN listings containing over 15 pages,
 - (e) PMF transcripts provided for each penalty case,
 - (f) TIN listings containing up to 250 payee records
 - (g) suspense copies of all notices, including those mailed by MCC (see (4) below), and
 - (h) CP 215A/15A, "Summary of Proposed Penalty"--to be mailed with Notices CP 215/15. See (16) below.
- (3) Each file will be sorted in TIN order.
- (4) For notices that include a proposed penalty for missing and/or incorrect TINs for 250 or less payee records, a paper listing of the payee records with missing, incorrect or not currently issued TINs will be provided for mail out with Notice 972CG.
- (5) MCC will mail Notice 972CG and a tape listing for filers with 251 or more payee records with missing or incorrect TINs.
- (6) Notices which include a penalty for TINs (penalty Reference Numbers 502, 505, 507, 510) must be associated with TIN listings and Publication 1586. These notices must be prepared manually for mail out.
- (7) Notices without TIN listings containing over 15 pages must also be folded and mailed manually.
- (8) IMF notices that require special handling must be reviewed to separate notices that can be mailed from those that may require a change in the name on the notice before mailing. See IRM (20)715.34.
- (9) The Notices referenced in (2)(c) above may be mailed by Machine Services after they are reviewed for garbled data and printing problems .
- (10) Centers must produce two copies of the TIN listings and retain the second copy for association with the suspense file. See IRM (20)715.36 regarding recreate requests.
- (11) The PMF transcript received for each notice should be retained with the suspense

copy of the notice.

(12) Centers must print and maintain the suspense copies of all notices.

(13) Tape reels for Notice 972CG and TIN listings must also be retained for 90 days.

(14) A control listing for Notices 972CG will be generated for each service center.

NOTE: This listing generates as the first item in the file which contains the PMF transcripts.

(15) In addition, a separate control listing will be generated for filers who receive TIN listings (paper and tape). This listing will include the filer's TIN (EIN or SSN), name, address, account access key number, tape (MCC) or paper (SC) sequential number, transmittal number, and the total volume of missing, incorrect, and/or not currently issued TINs.

(16) Mail labels (filer name and address) will be generated for each Notice 972CG that will be mailed with a TIN listing.

(17) Centers should produce one copy of the file containing CP 215A/15A, Summary of Proposed Penalty. This item is not to be mailed with Notice 972CG. It should be set aside for later use with notices CP 215/15. See IRM (20)715.335(4)(a).

(18) The Headquarters Office will notify the service centers and MCC of the actual dates that the tape files will arrive and the file-number of each tape.

(20)715.33 Mailing Notice 972CG

For notices with TIN listings:

(a) A complete package from the service center should contain:

- 1 the Notice 972CG
- 2 listing of missing, incorrect, and/or not currently issued TINs,
- 3 Publication 1586, and
- 4 a bar-coded return envelope (E-73).

(b) A complete package from MCC should contain:

- 1 Notice 972CG,
- 2 magnetic tape listing of missing, incorrect, and/or not currently issued TINs,
- 3 Publication 1586, and
- 4 a bar-coded return envelope (E-73).

(c) The service centers should mail the notice and listing(s) in the E-44A envelope, using the mail label (filer name and address) provided. MCC will use the appropriate magnetic tape coverage.

(d) Annually, each service center must supply MCC with an adequate number of

bar-coded return envelopes to mail with the notices generated for their center.

(2) For notices without TIN listings a complete package will include:

(a) Notice 972CG, and

(b) a bar-coded return envelope (E-73).

(c) Mailer envelope E-199 will be used to mail the notices.

(3) Review notices and TIN listings for garbled information.

(4) Do not mail to Federal agencies. See IRM 3(13)20 for guidelines on Federal agencies. Send any notices of this nature to the Headquarters Office, CP:CO:SC:A, for disposition.

(5) Service centers (and MCC) should contact the Headquarters Office for assistance if a TIN listing is received without a Notice 972CG.

(6) Any notice with Resolution Trust Corporation (RTC) or Federal Deposit Insurance Corporation (FDIC) in the entity should not be mailed. Refer the notice to the Examination Classification Specialist. See the procedures at IRM (20)796:(5) and (6).

(7) If a filer contacts the service center indicating that they have erroneously received a Notice 972CG and/or TIN listing for another filer, apologize and advise them to immediately return it to a designated contact person. NOTE: Service centers should establish a designated contact person to expedite the return of misrouted mail.

(a) Research to attempt to find the correct mailing address. If found, remail the notice to the correct filer and complete the required local disclosure procedures,

(b) stamp the current date on the notice prior to mailing.

(8) See IRM (20)716 for undeliverable mail procedures.

(20)715.34 Special Notice Review Procedures for Notices 972CG

These procedures are necessary to address a problem that occurs with IMF notices due to a condition which prevents the assessment of penalties (MFT 55) on joint accounts. See IRM (20)718. Other conditions exist (primarily with non-linked accounts) which that requires the manual review of the entity to ensure that the name on the notice is acceptable.

(2) IMF notices with joint names and other conditions will be sorted separately (except for those which already have a Civil Penalty Name line on the Master File) to identify the responsible spouse).

(3) Service Centers must review the entities on these notices prior to mail out.

(4) The name on Notice 972CG will be changed so that it agrees with the name of the responsible spouse who will be assessed the penalty if the Notice 972CG is not resolved. Pull notices if either of the following conditions are present:

- (a) A joint name line is present,
- (b) the only name is a business name, or
- (c) garbled information.

(5) NOTE: Any notices in this selection which have an individual name or a business name in addition to an individual name may be mailed without change.

(6) For joint name lines, research to verify to which spouse the SSN belongs. Prepare a new mail label including the name of the spouse associated with the SSN. Cover the old name and address with the label and mail the notice.

(7) If a business name is the only name present, research for the name of an individual associated with that SSN. If found, prepare a mail label with the individual name, including include the business name on the second name line. Cover the old name and address with the label and mail the notice.

(8) For business names, also consider the possibility that the TIN shown is an EIN instead of SSN (the TIN will appear in SSN format). Research to determine whether the name/TIN is a valid BMF entity. If so, the notice may be mailed.

(9) For garbled information, research to find or verify the correct individual name associated with the SSN.

(10) For (7), (8) and (9), if unable to find a valid name associated with the TIN, do not mail the notice.

(11) If the notice is mailed later than the date on the notice, stamp the current date on the notice. Also stamp the new date on the file copy. If an address change is identified during research, verify the name and correct the address.

(11)(12) If the notice is mailed later than the date on the notice, stamp the current date on the notice. Also stamp the new date on the file copy. (12) If a penalty must be assessed on these accounts, it will be necessary to establish the account or to create a Civil Penalty Name line following the procedures in IRM (20)718.

(13) If a penalty must be assessed on these accounts, it will be necessary to establish the account or to create a Civil Penalty Name line following the procedures in IRM (20)718.

(20)715.35 Special Notice Review Procedures for Notices CP 215/15

(1) These procedures must be followed for all IRP Civil Penalty notices, CP15/215 with reference numbers 5XX (excluding reference number 549 and 550):

(a) The following notices must be reviewed prior to mailing:

1 All notices assessing penalties of \$100,000 or more. The amount may be lowered at the discretion of the service center or region. Notices should be reviewed for accuracy and coordinated with any reviews conducted by the ARDI (Accounts

Receivable Dollar Inventory) function.

2 All notices assessing penalties against state or local agencies, charitable organizations, Large Complex Corporations and others determined to be sensitive by the service centers and/or regions. These notices will be reviewed to give the Service Center Director the opportunity to alert the appropriate District Director or Problem Resolution Officer, if desired.

3 For Large Complex Corporation cases, coordinate with the Technical Unit (or other designated function) per the instructions in IRM 35(44)0. Clearly notate the file as a Large Complex Corporation so that replies to correspondence received by the penalty unit can be coordinated with the Technical Unit.

(b) Any notices assessing penalties against Federal agencies must not be mailed. Abate these penalties, notate "Penalty Abated" and forward to Headquarters Office, CP:CO:SC:A.

(c) Penalties may be assessed against state or local governments with the exception of those identified as participants in the NASACT project (tax year 90 and prior tax years). See 796:(43) of LEM XX-700. Centers should make a copy of state and local notices prior to mailing and send them to the Headquarters Office analyst, CP:CO:SC:A.

(d) Any notice with Resolution Trust Corporation (RTC) or Federal Deposit Insurance Corporation (FDIC) in the entity should not be mailed. Refer the notice to the Examination Classification Specialist per the procedure at IRM (20)796:(5)(1)(d)3.

(2) Review notices for garbled information.

(3) Each notice mailed for tax year 1989 and later must include Notice 925, Penalty Code Explanations, (see Exhibit (20)700-5).

(4) Also, if notice 972CG was mailed prior to the CP 215/15, a penalty summary sheet, "Summary of Proposed Penalty" (CP215A/15A) will be provided for mailing with the CP notice.

(a) All CP 215A/15A will be generated at the same time as Notice 972CG (see IRM (20)715.32:(17)).

(b) the CP 215A/15A should only be mailed if the penalty amount on the CP notice is the same as on Notice 972CG. If the amount on the CP notice is different, do not include the summary sheet.

(c) date stamp the summary sheet with the same date as the CP notice.

(5) See IRM (20)716 for undeliverable mail procedures.

(20)715.36 Recreating Notice 972CG and TIN Listings

Filers may contact either service centers or the MCC IRP Call Site to request recreates (copies) of Notice 972CG and/or TIN listings. These requests may be received at any time after the initial

mailing of the notices.

(2) If a recreate request is received before the expiration of the 45 day response date for the Notice 972CG (see 735.(12)2:(5) of LEM XX-700), the service center should change the date on the notice to allow the filer 45 days to respond. MCC will also contact the center to change the notice date when they do a recreate for a tape listing. However, the notice date should not be changed again if a second or subsequent recreate request is received from the same payer.

(3) The procedure for filling the requests will differ for paper and tape and is based on when the request is received.

(a) For Notices 972CG mailed alone or with a paper listing of missing and incorrect TINs:

1 Service centers are required to retain a second printed "file" copy of the Notice 972CG (indefinitely) and the file copy of the TIN listings for at least 90 days.

2 Service centers will fill requests received within the 90 day period by photocopying the "file" copy of the notice and TIN listing and mailing it to the payer. These requests may be received directly at the service center or may be forwarded to the service center, through the Management Analyst, from the MCC IRP call site.

3 The Headquarters Office, Information Systems (IS) function will fill requests for copies of TIN listings received after the 90 day period. IS will retain this data for four years. Requests received by service centers must be routed through the IRP Centralized Call Site to the Headquarters Office IS function. A contact sheet will be provided for this purpose.

4 When IS has filled the request, Headquarters (CP:CO:SC:A) will coordinate the mailing to the center for association with Notice 972CG (if necessary) or will mail the listing directly to the filer. Note: Filers who did not respond to Notice 972CG will generally have received the penalty notice at this point. (b) For tape notices:

1 The MCC IRP Centralized call site will fill all requests received for tape listings of missing and incorrect TINs within the four year retention period, (i.e., four years from the date of Notice 972CG).

2 MCC will also retain hard copies of the original Notice 972CG.

3 Requests for recreates of tape listings of missing and/or incorrect TINs received by the service centers for recreates of tape listings of missing and/or incorrect TINs, must be routed through the Management Support Branch Analyst to the MCC IRP Centralized call site.

(20)715.37 Correcting Erroneous Entity Information on the PMF (Form 8487)

This procedure is used to delete and/or move a Form 1096 which has posted to the wrong filer's account, TIN or tax year on the PMF. Form 8487, Entity Change Entry, is used to make this

correction.

(2) The Unpostables area occasionally researches entity information on a PMF unpostable (for Form 1096) and finds both a valid IMF and BMF entity.

(a) Unpostable staff have been instructed to post the PMF source document using the BMF entity information when both are equally correct.

(b) The filer is informed of the action the Service has taken we have taken to post the Form 1096 source document.

(c) In the event the filer disagrees with this action, they will correspond to the unit responsible for working the IRP penalties. The penalty unit should request a PMF transcript to determine which transaction needs to be changed or deleted, then use Form 8487 to make the correction. See Exhibit (20)700-6.

(3) In addition, Forms 1096 may post to the wrong filer's account when there was an unsuccessful attempt to merge two accounts on the BMF or IMF resulting in a "no-merge" condition. A successful merger which was done in error may also result in Forms 1096 posting to the wrong filer's account. If either situation is identified based on correspondence received from the filer, centers should contact the Headquarter's Office for assistance before preparing Forms 8487.

(4) Route completed Forms 8487 to Numbering and Batching.

(20)715.38 PMF Uncorrectable Unpostables Meeting Penalty Criteria

PMF transactions (Forms 1096) that fail to post are sent to the Unpostables area for resolution. If the Unpostables area is not able to resolve the condition, they return the transaction to the PMF as uncorrectable.

(a) The uncorrectable transactions are then screened for potential penalty situations.

1 Any lateLate filed submission transaction which transmitted at least eleven (11) information returns, See LEM 715.38(1)(a)1. or

2 transactions submissions which met the magnetic media filing requirements will be regenerated to the service center's IRP Civil Penalty Unit.

(b) The IRP Civil Penalty Unit will make a final attempt at resolving the unpostable condition.

(2) The centers will receive the listing (P/R/F/ 102-95-11) of potential penalty cases titled "PMF Uncorrectable Unpostables Meeting Penalty Criteria." This listing will be generated annually and will contain the information necessary to research the Master File for a valid entity. Use the following instructions to resolve the potential penalty case:

(a) Obtain a microfilm copy of the Form 1096 source document to assist in researching for a valid entity on the Master File. See the instructions for microfilm research in IRM (20)717. Also, contact MCC to request copies of Forms 4804/4802 for magnetic media

filed returns.

(b) Research the TIN and name control using, PMFOL, IMFOL, BMFOL, EINAD, SSNAD, or ENMOD. See IRM (20)718 for specific instructions on creating entities.

(c) If a valid entity is found, check the TIN against the listings of extensions and waivers for the tax year in question.

1 If the TIN is on the extension listing, DO NOT assess the late filing penalty unless the received date is later than the extended due date (see 715.38:(2)(c)1 of LEM XX-700).

2 If the TIN is on the waiver listing DO NOT assess the penalty for failure to file on magnetic media.

3 CAUTION: If a TIN is changed as a result of the research, check both the old and the new TIN against the extension and waiver listings.

4 If the TIN is not on the extension or waiver listing, assess the penalty manually following the procedures in IRM (20)715.31. See 715.38:(2)(c)2 of LEM XX-700. See 715.38:(2)(c)4 of LEM XX-700.

(d) If a valid entity is found, also forward a copy of the Form 1096 to Receipt and Control for processing through DIS and posting to the PMF (whether or not a penalty is assessed).

1 First correct the name or TIN on the Form 1096 as appropriate.

2 Also annotate "Correction to PMF Unpostable Penalty Considered" on the 1096 and forward the copy to Receipt and Control.

3 On the routing slip notate "Process as original" to alert Receipt and Control that they should process the copy as an original document.

4 Keep a copy of the corrected Form 1096 in the case file.

5 DO NOT forward a copy of Forms 4804/4802 to Receipt and Control. Keep these documents in the case file.

(3) Monitor the assessment action to ensure the penalty posts to the taxpayer's account.

(4) Upon completion of this work, send a report to the Headquarters Office, CP:CO:SC:A, showing counts for paper and mag/electronic records separately the:

(a) total number of cases received,

(b) number of resolved and processed through DIS (Form 1096) cases (valid entity found, etc),

(c) number resolved and manually of penalties assessed, and

(d) number of cases which were not resolved Forms 1096 processed through DIS

(applies to paper only), and

(e) number of unresolved cases (no valid entity found or other reason).

(20)715.39 Form 3491-Consumer Cooperative Exemption Application

Filers are entitled to an exemption from filing Forms 1096 and 1099-PATR under Treas. Regs. 1.6044-4(a)(2) if they can establish that they meet the 85 percent rule as explained on page 2 of Form 3491, Consumer Cooperative Exemption Application (for Exemption from Filing Forms 1096 and 1099 PATR). The cooperative must be primarily engaged in selling retail goods or services of a type which are generally for personal, living, or family use.

(2) Stamp or obtain the Director's signature of approval and mail the original Form 3491 to the filer. File a photocopy of the document using CC ADJ54, TC 290.00, reference number 600, and "exemption from filing Form 1096" in the remarks area.

(20)716 Undeliverable Mail

(20)716.1 General

(1) Process undeliverable notices within 48 hours of receipt.

(2) Research for a better address using CC INOLE or IRPOL.

(a) INOLE will provide the most current entity information on the NAP.

(b) IRPOL will provide a current address for the filer from an information return filed for the most recent processing year.

(c) See IRM 3(25)(77)0 for additional information concerning the use of these command codes.

(3) Telephone directories may be used as a secondary source if IDRS research does not provide a better address. NOTE: New address information obtained from these sources may not be used to update the taxpayer's address on the Master File

(20)716.2 Undeliverable Notices 972CG

(1) If Notice 972CG is undeliverable, research for a different address.

(a) If one is found, stamp the current date on the notice and re-mail (include the original envelope),

(b) Also stamp the new date on the file copy of the notice. NOTE: It is important to stamp a new date on the file copy undeliverable notices to ensure that the filer is allowed 45 days to respond before the assessment of the penalty.

(2) If no other address is found for notices mailed by the centers, file the undeliverable notice, (including TIN listing and Pub. 1586, if applicable), and the original envelope with the file copy of Notice 972CG.

(3) MCC will search for a better address for undeliverable notices mailed by MCC. If found, MCC will stamp the new date on the notice and re-mail. MCC will also notify the service center to stamp a new date on the file copy.

(4) MCC may also send a listing to the appropriate center for any notices where MCC is unable to find a better address. The centers will do additional research to attempt to find a new address to allow MCC to mail the notice and tape.

(a) Centers will return the listing to MCC indicating new addresses,

(b) MCC will stamp a new date on the notice and notify the center of the new notice date,

(c) if centers are unable to find a new address for notices mailed by MCC, they should annotate the case history to show that the notice was undeliverable.

(d) centers should also attempt to maintain an accurate count of undeliverable notices mailed by MCC for reporting purposes (see IRM (20)735.(12)2:(8)).

(5) Research again for a new address when "no response" these notices are purged for assessment of the penalty (see 735.(12)2:(5) of LEM XX-700).

(a) If a new address is found, stamp a new date on Notice 972CG and re-mail (include the original envelope),

(b) if no new address is found, assess the penalty.

(c) follow the procedures in IRM (20)716.3 if the CP 215/15 is returned as undeliverable.

(20)716.3 Undeliverable Notices CP 215/15

(1) If Notice CP 215/CP15 is undeliverable, research undelivered letters with operational errors, incomplete or incorrect name, and or erroneous or extraneous data. Correct the error and mail the letter or notice.

(2) Place a label with the correct address over the incorrect address if the notice contains:

(a) a balance due and the date of the notice is no more than seven days prior to the current date (also see (3) below),

(b) an even balance notice, regardless of the date,

(c) a taxpayer inquiry, regardless of the date, or

(d) an overpayment notice.

(3) If the notice is a balance due notice and is dated more than seven days prior to the current date, recompute interest on reassessed penalties, correct the notice on IDRS, and retype the notice following procedures in IRM 37(60)0 and 37(163)0. See IRM 31(59)9 or (22)000 (to be issued) when recomputing interest.

(4) If no better address is found, file route the undeliverable letter or notice to the Files Unit for association/attachment to the assessment document under the Controlling DLN using blocking series 15X.

(20)717 Requesting Microfilm Source Documents

(1) These procedures may be used to request copies of Forms 1096 or W-2/W-3 for returns filed on paper only. The PMF shows whether returns were filed on paper or magnetic/electronic media.

(a) NOTE: To request Forms 4804/4802 for Forms 1099 filed on magnetic media/electronic media, see IRM (20)735.4:(4).

(b) DO NOT request Form 6559, Transmitter Report and Summary of Magnetic Media, and Form 6559-A, Continuation Sheet for Form 6559, Transmitter Report and Summary of Magnetic Media, for Forms W-2 filed on magnetic media (see 735.4:(8) of LEM XX-700).

(2) You may request copies of Forms 1096 (not 1099s) and W-2/W-3. Generally, centers should not do a follow-up request for Forms W-3. However, if Forms W-2 are needed to resolve a penalty case, request both Form W-3 and W-2s, unless Forms W-2 are also requested to assist in resolving an IRP penalty case. See IRM (20)735.4:(5) and(6) and 735.(6) of LEM XX-700.

(3) The DLN for a Form 1096 (Document Code 69) is the microfilm ID number. (a) The 14 digit DLN consists of: Forms 1096: When it is necessary to obtain a SCRIPS image or a microfilm print of the Form 1096, request it using the procedures in IRM 3(25)(77)0. The DLN of the 1096 is required to request the documents.

(a) The 14 digit DLN consists of:

1	DIGITS	DEFINITION	1,2	Service Center or	
	District Office	code	3	Tax Class "5" (5)	4,5
	Document Code	"69" (69)	6,7,8	Julian Date	
9,10,11	Block Number	12,13	Sequence Number	14	List
	year				

2 Check the PMF transcript to determine if the returns were processed on SCRIPS, OCR, or DIS. The first two digits of the DLN identify where and how the Form 1096 was processed. See Exhibit (20)700-11.

(b) The DLN is also referred to as the Page Sequence Number (PSN) for OCR purposes.

(b) SCRIPS Documents:

1 Use CC ESTAB with the definer "S" to request the image. See IRM 3(25)77(70), Terminal Response.

2 The entire DLN is required when requesting a SCRIPS document.

3 In some cases a Universal Access Routing (UAR) Code, must be entered as the last line of the data. This code includes the following: @, SC, EC (at, code of the service center that processed the SCRIPS documents, and the operator's entry code). Enter data with no spaces.

a Non-SCRIPS centers (ATSC, ANSC, BSC, FSC, and PSC) must use the UAR code in addition to the input currently requested in IRM 3(25)(77)(70).

b SCRIPS centers should only use the UAR code when they are requesting documents from another SCRIPS center.

c During the transition to SCRIPS, some documents may be microfilmed on the old system. If a SCRIPS image is not received after requesting through ESTAB "S", use ESTAB "M". See the procedures for OCR and DIS documents.

(c) OCR and DIS Documents:

1 Input requests using ESTAB with both definers "S" and "M". During the conversion to SCRIPS, OCR and DIS documents may have been either imaged or microfilmed.

2 Only ten digits of the DLN are required when requesting microfilmed documents (the DLN minus digits 3, 4, 5, and 14).

3 The procedures for ESTAB "M" are contained in IRM 3(25)(77)(18). The following exceptions apply for input of Form 1096 requests:

- a Use Micro Request CD"4";
- b MFT 01 (BMF) or MFT 30 (IMF);
- c Enter the modified DLN as the Micro Request number;
- d Enter Micro Code "R" after the tenth digit of the DLN.

4 In the remarks section, enter "1096 Request" and the list year of the DLN (digit 14).

(d) Form 3774, Request for Research, may be used as an alternate method for requesting copies of Form 1096.

1 Complete all applicable sections of Form 3774. The DLN of the Form 1096 must be entered in the remarks area followed by "1096 Request."

2 If the Form 1096 was processed in another center, complete Form 3774 and route it to the appropriate center.

(4) When it is necessary to obtain a microfilm print of the Form 1096, request the print using the 1096 DLN, using one of the following methods:

(a) ESTABM-Use request code "4" with CC ESTABM to generate an IDRS Microfilm request to be routed to the Research function.

1 See IRM 3(25)(77)0 Microfilm Requests.

2 The microfilm ID number is limited to 10 digits. You must eliminate digits 3, 4, 5 and 14 of the 1096 DLN requested to equal 10 digits. Enter the microfilm ID number followed by micro code "R" or "Z" on line 3 and enter "1096 Request" with the appropriate list year in the remarks section of the screen format (e.g., LY-1 for 1990 requests, LY-2 for 1991 request).

3 MFT

a BMF-01

b IMF-30

(b) Form 3774, Request for Research

1 The DLN of the 1096 source document should be entered in the remarks area followed by "1096 request."

2 Enter the additional information as necessary to ensure proper delivery of completed requests. Note: When it is necessary to obtain a microfilm copy of a Form 1096 which was processed in another service center, complete all applicable sections of Form 3774 and route to the appropriate center.

3 When it is necessary to obtain a microfilm print of a Form W-2/W-3, request the print using the filer's TIN.

a Enter "W-2 Penalty" in the category section (Box 2) on Form 3774 and complete all applicable sections to ensure the completed request can be returned to the requester.

b The Microfilm Sequence Number (MSN) of the W-3 source document(s) should be entered in the remarks. Convert the MSN back to the 11 digit number assigned by SSA by dropping the first two digits (SC code) and the last digit (list year) that were added for the Service processing.

c Also enter "W-3 and all W-2s" in the remarks for W-2/W-3 requests. NOTE: The MSNs must be highlighted to ensure proper handling at WIRS. Forward the request to the address in d below to obtain a print of the source document. Allow 4 weeks for receipt of the requested microfilm.

d Internal Revenue Service
Latham Circle Mall,
Suite 200
800 New Loudon Road
Latham, NY 12110

(4) Forms W-2/W-3: Use Form 3774 to request microfilm copies of Forms W-2/W-3.

(a) Complete all applicable sections of Form 3774 to ensure the complete request will be returned to the requester.

1 Enter "W-2 Penalty" in the category section (Box 2) on Form 3774.

2 Enter the Microfilm Sequence Number (MSN) of the Form W-3 in the remarks. To convert the MSN back to the 11 digit number assigned by SSA, drop the first two digits (SC code) and the fourteenth digit (list year). These digits were added to allow the service to process the information.

3 Also, enter "W-3 and all W-2s" in the remarks for W-2/W-3 requests. NOTE: The MSN(s) must be highlighted to ensure proper handling.

(b) Forward the request to the following address to obtain a print of the document. Allow 4 weeks for receipt of the requested microfilm.

Internal Revenue Service Latham Circle Mall, Suite 200 800 New Loudon Road Latham, NY
12110

(20)718 Instructions for Creating Entities or Name lines for Non-Return Civil Penalty Cases

(20)718.1 General

(1) These procedures are required to establish entities if there is no entity on the BMF or IMF or where a civil penalty name line (CVPN) must be established (the CVPN applies to IMF accounts only) to assess the penalty.

(2) An account will be created on the master file to manually assess the penalty on IDRS. See the separate procedures that apply to BMF (IRM (20)718.2) and IMF (IRM (20)718.3) accounts.

(3) Beginning with tax year 1992 penalties, service centers will manually assess all IRP penalties on IDRS. Research must be completed prior to making the assessment to ensure that the penalty is being assessed to the correct filer's account (see IRM (20)715.31:(6)). However, in the event one of these assessments goes unpostable, the case may be referred to the penalty unit to correct the entity problem.

(4) These procedures will also be used when no-merge transcripts are generated for penalties assessed to the wrong SSN.

(20)718.2 BMF Entities

(1) The Entity function is the only area authorized to establish BMF accounts. Hand carry or use Form 3210, Document Transmittal, to route all cases which require that an account be established on the BMF to the Entity Control Unit. Maintain controls for all cases routed to Entity and ensure they are returned for penalty assertion.

(2) Assess the appropriate penalty on IDRS following the instructions in this IRM. Verify that the penalty was not previously assessed on the Civil Penalty Module (CPM).

(20)718.3 IMF Entities

(1) All penalties must be assessed against the responsible individual. Assessments against joint accounts will not post to the Civil Penalty Module (CPM). After entity is established on the CPM or the civil penalty name line (CVPN) is created, the penalty should be manually assessed following the appropriate instructions in this IRM.

(a) After entity is established on the CPM or the civil penalty name line (CVPN) is created, the penalty should be manually assessed following the appropriate instructions in this IRM.

(b) In addition, correspondence should only be sent to the responsible individual.

(2) An unpostable condition will occur when the taxpayer does not have an account on the IMF under his or her own SSN. Using the valid individual SSN, establish the account using CC INCHG with TC 000.

(3) If the penalty is to be assessed against a spouse filing as the secondary taxpayer on a joint individual tax return and that spouse has no account on the IMF, establish an account using CC INCHG with TC 000.

(a) Assess the appropriate penalty following the instructions in this IRM. Verify the that this penalty has not already been assessed for this tax module on the CPM. is not a duplicate assessment.

(b) Once an account is established, Master File processing will establish a Civil Penalty Name Line (CVPN) on MFT 55 when the civil penalty assessment is input. Once created, the CVPN remains on the account and applies to all civil penalty periods.

(4) Special action to establish a CVPN for assessing civil penalties is required if all of the following conditions are met:

(a) the current account is, or has ever been joint,

(b) the assessment will be against the primary taxpayer whose SSN controls the account, and

(c) the account does not already have a CVPN. NOTE: If a CVPN already exists, MFTRA transcripts and CC INOLE or ENMOD will display it after the current name and address data.

(5) To establish a separate CVPN, use an IMF entity change (CC INCHG to generate a TC 013) with the special CVPN procedures described in IRM 3(25)(78)(12). When using this special procedure, only the CVPN change may be input. No other entity change information is permitted. Information to otherwise update the entity, such as an address change, should be input before establishing the CVPN. When using this procedure, both first and last names must match the Master File name. If the name does not show on IDRS, check MFTRA or

INOLE.

(6) If the correct account is on the Master File and has a CVPN, the name line may be updated (e.g., taxpayer's current account name is Mary Jones and the CVPN is Mary Smith) by input of CC INCHG with the special procedures described above.)

(a) EXAMPLE 1:

1 A joint account is on Master File for John and Mary Doe (John's is the controlling SSN). A penalty is to be assessed against John. The account has no existing CVPN.

2 Action: Input a CVPN for "John Doe" using the special procedures for establishing a CVPN shown in IRM Exhibit 3(25)(78)(12)-5. The penalty may be assessed immediately.

(b) EXAMPLE 2:

1 On the same joint account as above, the penalty is to be assessed against Mary Doe. Mary has an account on Master File under her own SSN with the name line of Mary Jones because she filed individually before filing jointly with John Doe. There is no CVPN on her account.

2 Action: Input a name change (and address change, if appropriate) to her existing Master File account, then assess the penalty. No CVPN needs to be input.

(c) EXAMPLE 3:

1 On a Joint account for John and Mary Doe, the penalty is to be assessed against Mary. However, Mary has no account under her SSN on the Master File.

2 Action: Establish an account for her on the Master File using her SSN with TC 000, as described in IRM Exhibit 3(25)(78)(12)-6, then assess the penalty. No CVPN needs to be input.

(d) EXAMPLE 4:

1 John Doe has a separate account without a CVPN on Master File and a penalty is to be assessed.

2 No special action is required, the penalty may be assessed and a CVPN will be generated by Master File.

(e) EXAMPLE 5:

1 John and Mary Doe do not have an account on the Master File since they are non-filers. A penalty is to be assessed against John. If a joint return is to be processed as a delinquent or substitute, a joint name line should be established before establishing a CVPN.

2 Once the joint entity is established, follow the special CVPN name line

procedures to establish CVPN for John.

(20)720 Powers of Attorney for Civil Penalties

(20)721 General

(1) Accountants, attorneys, enrolled agents or other representatives from whom a taxpayer has requested assistance on tax issues submit inquiries to the Service. The third party representative expects a reply to the inquiry so that the issue can be explained to the taxpayer.

(a) To authorize the third party reply, the representative may submit a Form 2848, Power of Attorney and Declaration of Representative, or

(b) Form 8821, Tax Information Authorization. We refer to the power of attorney requests as "POAs" and the tax information authorization requests as "TIAs".

(2) POA documentation may be received with a response to a civil penalty notice. The POAs or TIAs cannot be entered on the Centralized Authorization File (CAF) because civil penalties are asserted against non-return information documents. To ensure valid POA's/TIA's are recognized:

(a) The POA/TIA should be kept with the penalty case file and used for all subsequent correspondence.

(b) When the penalty case and the POA/TIA are not kept together, local procedures must be established to maintain a civil penalty data base or listing.

(3) Information supplied in correspondence received from a third party may be used per the instructions in 792:(1) of LEM XX-700.

(20)722 Authorized Third Party

(1) If a valid POA or TIA is received, copies of correspondence pertaining to the taxpayer should be sent to the authorized representative. NOTE: Refunds are not allowed to be sent to appointees named on Form 8821.

(2) A reply from a valid POA should be handled in the same manner as if the taxpayers themselves were responding.

(a) Original documents, photocopies or documents submitted by FAX transmission are acceptable for processing.

(b) If the POA or TIA is received with the response to the CP15/215, review them for the following information:

- 1 The name, TIN, and address of the taxpayer,
- 2 the name and address of the designated representative,
- 3 the specific acts to be performed,

4 the type of tax (individual or corporate, etc.) and tax form number,

5 the tax year(s) or period(s), and

6 the taxpayer's signature and date (if a joint return, both spouse's must sign only if the same representative is to represent both spouses).

(3) If the POA is granted to an attorney, CPA, enrolled agent or actuary, a declaration of good standing before the Service must be signed by the designated representative (Part II of Form 2848). NOTE: The signed declaration is not required for Form 8821.

(4) If the POA/TIA is granted to a person other than one of those listed above, it must include one of the following:

(a) the signature and date of two (2) disinterested witnesses, or

(b) the acknowledgement of a notary public.

(5) If any of the items listed above are missing, reject the request as invalid and return it to the taxpayer using Letter 861C/SC.

(6) If the POA/TIA is valid and it specifies it is for the CP15/215 only, file it in the penalty case file. NOTE: The form may also specify the 1099 (series), 1096 or Civil Penalty.

(a) If the POA/TIA does not specify CP15/215 only, make a copy of the document for the penalty case file to be used with any subsequent correspondence.

(b) Route the original POA/TIA to the CAF unit in the Taxpayer Relations Branch.

(20)723 Unauthorized Third Party

(1) No tax information can be sent to or discussed with an unauthorized third party.

(a) If the unauthorized third party is requesting authorization to act on behalf of the taxpayer or is requesting information concerning the penalty assessment, send Letter 135C to the third party.

(b) Any further correspondence required should be sent directly to the taxpayer. Include a paragraph in the taxpayer's letter requesting that the taxpayer notify the third party of our direct reply to the taxpayer.

(20)730 Failure to File Correct Information Returns Penalty IRC Section 6721

(20)731 General

(1) For information returns or statements due after December 31, 1989, a penalty may be imposed for filing returns:

(a) after the due date, (See 731:(1)(a) of LEM XX-700,

(b) without all required or correct information, (including missing, incorrect and/or not currently issued TINs),

(c) on paper when required to be filed on magnetic media, or

(d) in a manner which does not allow them to be processed or read by machine (not processable).

(2) The penalty for information returns required to be filed after December 31, 1989, is \$50 per return with a maximum of \$250,000 per calendar year. This amount is subject to the reductions and limitations discussed in IRM (20)732 and (20)733:(6).

(20)732 Reduction of the Penalty

(1) If a failure is corrected within 30 days, after the due date of the information return, the penalty will be decreased to \$15 per failure. The maximum annual penalty per filer shall not exceed \$75,000.

(2) If the failure is corrected more than 30 days after the due date of the return, but on or before August 1 of the filing year, the penalty will be decreased to \$30 per failure. The maximum annual penalty per filer shall not exceed \$150,000.

(3) See IRM (20)734 for an explanation of the de minimis exception. This exception applies only to a limited number of corrected returns filed by August 1 of the filing year.

(4) Form 8300. If a failure to file correct information returns Form 8300 is corrected within 30 days of the due date of the return, the penalty is decreased to \$15. If the failure is corrected after the 30 days, the penalty is \$50 per failure. The reduction applicable to the time frame of "after 30 days and on or before August 1st" is not applicable because the Form 8300 does not have a fixed due date.

(5) Small Business Limitation. If the filer's average annual gross receipts for the three most recent taxable years do not exceed \$5,000,000, the maximum penalty in each of the three penalty categories will be reduced. See IRC section 448C (2) and (3) when computing the average gross receipts test.

(a) ending before the calendar year in which the return was required to be filed

(b) (or if shorter, the period the business has been in existence) do not exceed \$5,000,000, the maximum penalty in each of the three penalty categories will be reduced.

(c) For example, if the filer uses a calendar year for tax purposes, and the calendar year the return is required to be filed is 1993, then, the most recent three taxable years would be 1990, 1991, and 1992.

(d) The total maximum information return penalty assessed against one filer, at \$50 per failure may not exceed \$100,000 for all failures during any calendar year.

(e) The total maximum, for information return penalties, that can be assessed against one filer, for all failures corrected within 30 days of the due date of the information return

(\$15 per failure), shall not exceed \$25,000, during any calendar year.

(f) The total maximum, for information return penalties, assessed against one filer, for all failures corrected more than 30 days after the due date of the return, but on or before August 1, of the year the return was required to be filed, (\$30 per failure) shall not exceed \$50,000.

(20)733 Intentional Disregard of the Rules and Regulations

(1) The Intentional Disregard of the Rules and Regulations Penalty applies when the facts and circumstances show that the filer knowingly or willfully failed to comply with the requirements of IRC sections 6721.

(2) Intentional disregard occurs when a filer who knows, or should know of a rule or regulation, chooses to ignore its requirements. The facts should show the filer:

- (a) was required to file,
- (b) knew or should have known of the requirement to file, and
- (c) consciously chose not to file or recklessly disregarded (i.e., ignored) the duty to file the information return.

1 Treas. Reg 301.6721-1(f)(3)(I) provides that a pattern of failures indicates intentional disregard. The greater the number of failures, the greater the likelihood some of those failures could be due to intentional disregard.

2 Additional indications of the existence of intentional disregard are:

- a did the filer correct the failure promptly after the discovery of the failure,
- b did the filer correct the failure within thirty days after notification of the failure by the Service, and
- c did the filer avoid an administrative inconvenience or was the cost of compliance greater than an IRC section 6721(a) penalty.

d For instance, intentional disregard may exist when it would be less expensive for the filer to pay the penalties under IRC section 6721(a) rather than to comply with the filing requirement. Treas. Reg. 301.6721-1(f)(3)(iv). See 792:(11)(f) of LEM XX-700.

(3) For information returns required to be filed after December 31, 1989, the Intentional Disregard of the Rules and Regulations Penalty amounts to:

- (a) \$100 for each information return required to be correctly filed, or if greater:
- (b) 10 percent of the total amount required to be reported on the information returns for dividends, patronage dividends, interest, fishing boat operators, royalties, and wage and tax statement, or

(c) 5 percent of the total amount required to be reported on the information returns for brokers, exchange of partnership interest, or disposition of donated property payments.

(4) Form 8300 Penalty. The Intentional Disregard penalty for failing to file a correct Form 8300 under IRC section 6050I(a) is the greater of:

(a) \$25,000, or

(b) the amount of cash required to be reported in the transaction up to \$100,000.

(c) The penalty applies to cash amounts exceeding \$10,000 received by a trade or business (as defined by IRC section 162) after November 5, 1990.

(d) The information required to be provided by the recipient of the cash includes:

1 the name, address, and TIN of the person providing the cash,

2 the amount of cash received, and

3 the date and nature of the transaction.

(e) The Form 8300 is required to be filed within 15 days of the receipt of the reportable amount.

(5) There is no dollar limitation for the Intentional Disregard of the Rules and Regulations Penalty.

(6) No more than one penalty per return can be imposed even if there is more than one failure on the same information return. However, where a return is filed with multiple failures, the higher penalty should be imposed.

(a) For example, only one penalty may be imposed on a return which is filed both late and incomplete.

(b) If the failure to provide the information is due to intentional disregard, but the late filing is not, the intentional disregard penalty should be imposed.

(c) The intentional disregard penalty on Form 8300 should only be determined by field Examination offices. Taxpayer assessed this penalty may be offered a preassessment administrative appeal.

(20)734 Exceptions and Special Rules

(1) The "de minimis" exception may apply to the number of incorrect information returns remaining after the reasonable cause waiver has been allowed (see 734:(1) of LEM XX-700). The de minimis exception may apply if the return:

(a) was filed, and

(b) had missing or incomplete information, and

(c) the filer supplied the missing or incomplete information on or before August 1st of

the filing year, and

(d) the maximum number of corrected information returns to which this exception applies cannot exceed the greater of:

1 10, or

2 one-half of one percent of the total number of returns required to be filed during that calendar year.

(e) This exception only applies to returns that were due on either the last day of February or March 15th.

(2) The penalty shall not be assessed for errors or omissions that are considered inconsequential.

(a) The term "inconsequential" means any failure that does not make it difficult for, or prevent the Service from:

1 processing the return,

2 matching the information return shown with the payee's tax return, or

3 otherwise putting the information return to its intended use.

(b) Errors or omissions are never considered inconsequential if they relate to:

1 a taxpayer identification number,

2 a surname of a payee, and/or

3 any monetary amount.

(3) If a return has more than one error or omission and the penalty amount for those failures differs, the penalty will be imposed at the higher amount.

(20)735 Failure to Timely File Information Returns Penalty

(20)735.1 Late Filing Penalty (Current Year Returns)

(1) These procedures are used to identify late filed paper returns received by the service centers during the current processing year:

(a) The delinquent Form 1096 is date stamped by Receipt and Control.

1 a delinquent indicator "X", and

2 the received date will be marked in the boxes under the title "For Official Use Only." A delinquent indicator "X", will be marked in the first box under the title "For Official Use Only."

(b) Tartan operators will key in the received date from the date stamp whenever the

"X" is present and the information will be processed to the PMF.

(c) When processing is complete for the year, a penalty proposal Notice 972CG will be generated by the PMF unless the filer was granted an extension of time to file. The penalty is applicable if the returns were filed after the extended due date.

(d) If the filer files current year information returns late with an explanation, Receipt and Control will request a tax examiner to review the explanation to determine if a penalty should be charged. See 711.3 of LEM XX-700.

1 If the submission is all original or mixed original and corrected returns, follow the procedures below as appropriate. See 735.1:(1)(d)1 of LEM XX-700.

2 If the filer's explanation meets reasonable cause and no penalty will be assessed, with managerial approval take the following actions:

a circle out or line through the date stamp,

b ensure that the first box on the Form 1096 under the title "For Official Use Only" is not marked with an "X",

c annotate on the Form 1096 "Reasonable cause established" (see "d" below) in an area that is not scanned,

d NOTE: Beginning with processing year 1995, no markings of any kind may be entered in the top margin of Form 1096. Markings in this area would interfere with processing these documents under the new SCRIPS processing system.

1 e Therefore, use care when circling out date stamps to avoid marking the top margin,

2 f "Reasonable cause established" must be written in either the bottom margin of Form 1096 or in the white space between the two columns of instructions at the bottom of the form.

eg using CC ADJ54, file the correspondence and a copy of the 1096 as source documents (see IRM (20)715.3),

fh send the filer Letter 1948C explaining our determination, and

gi forward the Form 1096 and associated returns for normal processing.

3 If the filer's explanation does not meet reasonable cause and the determination is to allow the PMF to generate a penalty proposal for late filing, follow the instructions below:

a Place delinquent indicator "X" in the first box on the Form 1096 under the title "For Official Use Only,"

b enter the received date in the remaining six boxes in the MMDDYY format,

cb create a case file containing a copy of the transmittal, postmarked material (if available), and the taxpayer's correspondence,

dc send the filer Letter 53C explaining our determination, and

ed forward the Form 1096 and associated returns for normal processing.

(e) Do not identify returns filed by Federal agencies for the penalty. See IRM (20)715.3:(9).

(f) Also do not allow the penalty to be assessed if it can be determined that Forms 1099 DIV reported liquidation distributions or were distributed under IRC section 404(k) for an employee stock ownership plan (ESOP).

(2) MCC will enter the received date and provide postmarked material for late filed returns filed on magnetic or electronic media to allow the PMF to automatically generate the penalty proposal for late filing. The notice will generate unless the filer was granted an extension of time to file.

(a) The magnetic media transmittal Forms 4804/4802 are date stamped by MCC for late filed returns.

(b) When a filer requests an explanation of the penalty assessment or disputes the penalty, the transmittal documents must be requested from MCC so that a copy can be sent to the filer. See IRM (20)735.4:(4) for requesting these forms.

(c) If the payer uses the postal service to ship the data to MCC, the postmark is retained and sent to the service center to validate a received date.

(20)735.2 Late Filing Filing Penalty (Prior Year Returns)

(1) These instructions apply to late filed information returns received by the service centers with a due date prior to the current processing year. For processing year 19957, this would apply to returns filed for Tax tax years 19935 and prior. See 735.2:(1) of LEM XX-700.

(2) Penalties for all prior year returns will continue to be assessed manually through IDRS to generate notice CP 215/CP 15 from the Civil Penalty Module (MFT 13/55). See IRM (20)715.31. These notices will not be preceded by Notice 972CG.

(3) Receipt and Control will forward these returns to the area responsible for assessing the IRP penalties. MCC will also forward Forms 4804/4802 for assessment of the late filing penalty for returns filed either magnetically or electronically.

(4) Do not assess any penalties on Forms 1096 if the following conditions are present:

(a) Delinquent returns secured by Examination or Collection -- with "penalty considered" coded on the form (see IRM (20)715.1:(5) and (20)715.2. Examination or Collection previously considered penalties on these returns. If not present, code an "E" in the first box under "Official Use Only" on Forms 1096 secured by Examination and a "C"

in this box for forms secured by Collection.

(b) A "N" has been coded A Form 1096 "N" coded on the top center of the form by Receipt and Control. This indicates that penalties were considered by Receipt and Control, the Form 1096 has been previously considered for penalties.

(c) If any of these conditions exist, notate "Penalty Considered" (if not present) and forward the Forms 1096 and associated returns to the IRP unit in Receipt and Control for processing.

(d) See 735.2:(4)(d) of LEM XX-700.

(5) If the returns were submitted without an explanation, see 735.2:(5) of LEM XX-700.

(6) If the returns were submitted with an explanation for the late filing, consider reasonable cause as appropriate. See IRM (20)792 for definitions of reasonable cause. Also see 735.2:(6) of LEM XX-700.

(a) If the filer's explanation establishes reasonable cause and the penalty will not be assessed, with managerial approval, take the following actions:

1 using CC ADJ54, file the correspondence and a copy of the Form 1096 as source documents. See IRM (20)715.3.

2 send the filed filer Letter 1948C explaining our determinations,

3 review the 1096 to ensure that the date stamp and delinquent indicator Circle out or line through the date stamp and the delinquent return indicator ("X" in first box under "Official Use Only"). are not present. Circle out or line through if present. See IRM (20)735.1:(1)(d)2d prior to making any markings on Form 1096.

4 Annotate the 1096 "Reasonable Cause Established" and forward to the IRP unit in Receipt and Control for processing. (Note: only the 3 most recent prior years can be processed through DIS.) Dispose of older prior years.

(7) If the filer's explanation does not establish reasonable cause and the penalty will be assessed, take the following actions:

(a) Research using MFTRA transcript or IDRS to ensure that the maximum has not been reached before assessing any further penalties.

(b) Use reference number 500 to make assessments for late filed information returns.

(b)(c) Create a case file containing a copy of the Form 1096/1099 or Form 4804 transmittal document and any postmarked material (if sent from MCC).

(c)(d) Enter delinquent indicator "P" in the first box under "Official Use Only" on Form 1096 followed by the received date in MMDDYY order. Forward the original Form 1096 and associated returns to the IRP unit in Receipt and Control for processing.

(d)(e) Forward the case file to Files for association with the adjustment document.

(8) Use reference number 500 to make adjustments for late filed information returns. Do

not assess penalties against any Federal agency. See IRM (20)715.31:(9).

(9) Do not assess penalties against any Federal agency. See IRM (20)715.31:(9).

(20)735.3 Late Filing Penalty (Forms W-2)

(1) Late filed Forms W-2 are identified by the Social Security Administration (SSA). This information is posted to the Payer Master File (PMF) for the penalty program (see 735.3:(1) of LEM XX-700).

(a) Only Forms W-2/W-3 that are included in Notice 972CG (see IRM (20)735.(12)) or that meet penalty criteria (i.e., waiver or extension granted) will appear on the PMF. Other Forms W-2/W-3 submitted by employers are currently not posted to the PMF.

(b) Extensions and waivers for Forms W-2 that meet penalty criteria will also post to PMF.

(2) The PMF records for late filed Forms W-2/W-3 will not include a received date but should include the entry "Late SSA" and penalty indicators 1, 2, or 3 to show whether the \$15, \$30, or \$50 (respectively) penalty applies.

(3) SSA will date stamp Forms W-3 transmittals for delinquent Forms W-2 filed on paper and Forms 6559/6559-A for delinquent Forms W-2 filed on magnetic media.

(4) Microfilm copies of Forms W-3 will be forwarded to the centers from WIRS (Albany District Office). Forms 6559/6559-A from SSA will be sorted by a designated service center and the appropriate forms routed to the other centers.

(5) Explanation of Forms 6559/6559-A:

(a) Form 6559 contains information about the transmitter of the magnetic media file and lists summary W-2 data for the individual employers whose data was reported on the magnetic media file. Either a date stamp or late filed label will be affixed to Form 6559. If the label is present, it will contain the transmitter's name, EIN, address and the received date. The date may be shown in julian date or calendar date format.

(b) Form 6559-A is a continuation form for listing the individual employer data reported on the magnetic media file and summary information from the Forms W-2 transmitted.

(c) Penalties may be assessed for some or all of the employer EINs shown on Forms 6559/6559-A. Note: Some filers listed may have received an extension of time to file.

(d) Form 6559/6559-A may include multiple entries for the same employer EIN. All entries shown for that EIN should be taken into account for the penalty.

(6) See IRM (20)717 if it is necessary to request microfilm prints of Forms W-2/W-3 from WIRS.

(20)735.4 Receiving Responses (Failure to Timely File)

(1) Generally, filers must establish reasonable cause for the penalty to be abated. See IRM (20)790 for definitions of reasonable cause and IRM (20)796 for the special abatement conditions.

(2) If the filer requests a copy of the Form 1096 which resulted in the penalty, request a microfilm print of the Form 1096 and send it to the filer. The DLN of the Form 1096 that resulted in the penalty can be found on the PMF transcript. Follow the instructions in IRM (20)717 to request microfilm prints of Form 1096.

(3) If the microfilm print of the Form 1096 is not available after repeated attempts see 735.4:(3) of LEM XX-700.

(4) Filers may request copies of transmittal Forms 4804/4802, submitted with Forms 1099 etc., filed on magnetic or electronic media or the documents may be required to answer the filer's question about the penalty assessment. These procedures will apply to Notice 972CG and any penalty assessment preceded by this notice.

(a) Service centers must contact MGGMCC to request date stamped copies of these forms for late filed magnetic media returns. NOTE: MCC will continue to provide Forms 4804/4802 in advance for service centers to make certain manual assessments.

(b) MCC needs the filer's name, TIN, and the transmitter's control code (TCC) (available on the PMF transcript). Also provide the return type, number of returns, the received date and the DLN of the submission.

(c) MCC will furnish the forms within two weeks.

(d) Written requests should be submitted to MCC using Form 3210. MCC will also accept requests by FAX.

(e) Centers should batch their requests and submit them to MCC no more than once a week except in extreme cases.

(f) Centers should use their established MCC contact points to coordinate requests by mail or FAX.

(g) If necessary, contact the Headquarters Office for assistance.

(h) To prevent unauthorized disclosures, sanitize Forms 4804/4802 must be sanitized to exclude all other filers' data before being mailed to the filer. This does not apply to the "transmitter" information on Form 4804.

(i) If MCC is not able to provide copies of Forms 4804/4802 in disputed cases, see 735.4:(4)(i) of LEM XX-700.

(5) Transmittal Forms W-3 (paper) and 6559/6559-A (magnetic media) are shipped to the Penalty Unit in advance for the penalty program.

(6) If the filer requests a copy of Form W-3, send a photocopy to the filer. If the Form

W-3 is not available, see 735.4:(6) of LEM XX-700.

(7) If the filer requests a copy of Form(s) W-2 filed on paper or if copies of Form(s) W-2 would help to resolve a case, they may be requested from WIRS (see IRM (20)717). Inform the filer that it will take 6 weeks to receive copies of the documents. DO NOT submit a request to WIRS for Forms W-2 filed on magnetic media.

(8) If the filer requests a copy of Forms 6559/6559A, send a photocopy to the filer. If the form is not available, see 735.4:(8) of LEM XX-700.

(9) When Forms 6559/6559-A are sent to the filer, they must be sanitized to exclude all other employers' data on the form to prevent unauthorized disclosure. This does not apply to the transmitter information.

(10) If the label on Form 6559 has a julian date, convert it to the calendar date and send a quick note to the filer explaining that the date on the label is a julian date. If no date is shown on the label, see 735.4:(10) of LEM XX-700.

(11) Additional paperwork generated by SSA in their processing of Form W-2 data may be received with Forms 6559/6559-A.

(a) Service centers may use discretion to determine when sending a copy of the paperwork in addition to or in lieu of the Form 6559/6559-A may be helpful, e.g., the paperwork shows the actual number of documents processed by SSA which equals the number of documents penalized and the Form 6559/6559-A shows a different count.

(b) Do not send the paperwork if it only duplicates the employer information on Form 6559/6559-A. Centers must ensure that the information on the paperwork applies only to the employer in question to prevent an unauthorized disclosure.

(12) If the filer's response indicates that the Form W-2 data was submitted timely to MCC in error and returned to the filer or transmitter by MCC, see 735.4:(12) of LEM XX-700.

(13) Paperwork received from SSA may include the control sheet, "Display of Master Record" from SSA's control system for magnetic media filers or other documents created by SSA. This information may be helpful in analyzing cases where a penalty was assessed for a late resubmission (original documents returned to the filer to correct unprocessable conditions).

(a) The documents contain the:

1 initial receipt date of a file,

2 (Send DTE or Return Date) - all dates when SSA returned a file due to unprocessable conditions, and

3 Due Date - or date by which the file must be resubmitted to avoid a late penalty, (see 735.4:(13)(a)3 of LEM XX-700), and

4 Received Date or Resubmission Date - or dates a file previously returned to the

filer to correct unprocessable conditions was received for the second or subsequent time, and

5 the number of phone calls (when applicable) SSA made to the filer concerning a problem file.

(b) Dates may be in julian date format.

(14) Returns (Forms 1099 and W-2) filed on magnetic media with unprocessable conditions are returned to the filer by MCC and SSA for corrections. See 735.4:(14) of LEM XX-700.

(15) For the calendar year 1989 returns, penalties were waived on corrections filed on or before October 1, 1990.

(16) When a correction is required to change the return type, e.g., a return originally filed as INT income was actually DIV income, the filer must file two returns to make the correction.

(a) A corrected INT return is filed (with "zero" money amounts) to "zero out" the original INT return, and

(b) a replacement DIV return is filed as an original return. See 735.4:(16) of LEM XX-700.

(17) All current year late filing penalty cases are compared to the extensions of time to file that post to the PMF prior to the generation of penalty notices.

(a) However, if a filer responds with an approval letter from MCC granting an extension, check to see if the filer's TIN appears on the extension listing provided by MCC. Note: SSns appear in EIN format on the extension listing.

(b) If present, the penalty should be abated.

(c) If the TIN is not on the extension listing, see 735.4:(17) of LEM XX-700.

(20)735.5 Responses to Combined Annual Wage Reporting (CAWR) Assessment of Late Filing Penalties (Forms W-2)

(1) Beginning with tax year 1989, the CAWR function began mailing CP 253 Notices to employers requesting Forms W-2 to resolve discrepant issues. Late filing or intentional disregard penalties may have resulted from these mailings.

(a) The penalty will be assessed for Forms W-2 secured by CAWR as a result of their correspondence with employers to reconcile discrepancies between the Social Security Wages reported by the employer on the Form 94X filed with the Service and the Forms W-2 filed with the Social Security Administration (SSA). The contact is made based on the fact that the employer reported more Social Security Wages to the Service than to SSA.

(b) Unless SSA receives correct Social Security Wage information, employees are not credited with the proper earnings for their social security benefits. The Service works these cases because SSA lacks the authority to assess penalties or enforce collection of the Forms W-2.

(c) These cases are referred to the Service, by SSA, after SSA has made at least two contacts with the employer in an attempt to secure missing Forms W-2 and/or to reconcile differences between the SSA and the Service amounts. In some cases SSA has no record of receiving the Forms W-2 and in some cases there is a discrepancy between the amounts reported to SSA and the amounts reported on Form 94X.

(2) Employers are subject to a failure to file penalty because of the initial failure to file Forms W-2 by the due date.

(a) If Forms W-2 are submitted in response to the initial CAWR correspondence (CP253), the employer will be assessed the late filing penalty applicable under IRC section 6721(a) (reference number 500 or 550). See 735.5:(2)(a) of LEM XX-700.

(b) If the employer fails to submit Forms W-2 or provide information to clear up the discrepancy the employer may be subject to a penalty for intentional disregard (reference number 549) under IRC section 6721(e).

1 If the taxpayer does not respond to the CP253, notice CP215 for intentional disregard of the filing requirement will generate automatically after 14 cycles.

2 This penalty may be assessed at the greater of \$100 per return or 10 percent of the aggregate amount of wages required to be reported, with no maximum amount. See IRM 30(153)8.7

(c) If Forms W-2 are secured after the Service assesses the intentional disregard penalty, see 735.5:(2)(c) of LEM XX-700.

(d) The CAWR unit will work these cases through to resolve discrepancies, collection of Forms W-2 (including shipments to SSA) and assessment of penalties. CAWR will handle all responses to the CP253 and intentional disregard penalty notice.

(e) The general reasonable cause criteria in IRM (20)792 and the applicable special abatement conditions in IRM (20)796 must be considered. However, additional administrative abatement criteria may develop as we gain experience in working these cases.

1 Generally, we would expect these criteria to develop out of unique conditions/issues in the CAWR program that may cause us to question the accuracy of the penalty or whether the assessment could be upheld in a court case.

2 The IRP penalty areas should be alert to these situations as they arise in coordination with the CAWR function and bring them to the attention of the Headquarters IRP analyst.

(f) Specific taxpayer references to previous correspondence with SSA or replies to the CP 253 or the intentional disregard penalty should be referred to or coordinated with the CAWR unit. As they arise, other issues must also be coordinated with the CAWR unit.

(g) Given the history of correspondence sent to the taxpayer by SSA and the CAWR unit, caution should be used in abating the penalty. Careful consideration should be given to all filers claiming that they filed the required Forms W-2 timely.

1 A copy of a Form W-3 with a timely signature date should not be accepted alone as evidence because a fictitious document can be easily prepared.

2 In addition, the employer may have submitted returns timely that were returned by SSA for an unprocessable condition, then never resubmitted by the employer. The late filing penalty would be applicable in this situation.

3 If the employer's response indicates that they did not understand why the penalty was assessed, send Letter 1948C using the open paragraph with the following:

a You were assessed a late filing penalty of [\$] for the tax year [] Forms W-2 that you recently submitted to the Service. This penalty was assessed because you did not file the Forms W-2 by the due date.

b The law requires you to file Forms W-2 with the Social Security Administration by the last day of February of the year following the year the wages were earned.

c If the forms are not filed by the due date, a penalty of \$15, \$30 or \$50 per return up to \$250,000 per year may be assessed. The amount of the penalty is determined by the date we receive the forms.

(h) Forms W-3 involved in CAWR penalty assessments will not appear on PMFOL or the PMF transcript.

(1) The Service assesses penalties for cases referred by the Social Security Administration (SSA) when there is a discrepancy between wages reported on Forms W-2 and what is reported to the Service on Forms 941. SSA will make two attempts to contact the employer to resolve the discrepancy.

(a) If SSA is unable to resolve the discrepancy, the cases are sent to the Service.

1 A SSA discrepancy is identified when the employer reports more Social Security Wages to the Service than to SSA.

2 A SSA discrepancy is resolved when the employer provides missing Forms W-2, amends their Form 94X or submits other information to resolve the discrepancy.

(b) An agreement between the Service and SSA requires the Service to correspond with the employer in an effort to secure missing Forms W-2 from the employer.

1 SSA does not have the authority to assess penalties or enforce collection of the

Forms W-2.

2 SSA refers these cases to the Service in a tape format that is compared to the Business Master File (BMF).

3 If a match is made, a CP253 notice is issued to the employer requesting the information necessary to resolve the discrepancy.

(2) Penalty Assessment: If the discrepancy is not resolved by either the filing of the missing Forms W-2, an amended Form 94X, or by providing an explanation of the discrepancy, the Service is directed to assess a penalty.

(a) The Late Filing penalty will be assessed for Forms W-2 secured by CAWR.

1 If Forms W-2 are submitted in response to the initial CAWR correspondence (CP 253):

a the employer will be assessed the late filing penalty (\$50 per form) applicable under IRC section 6721(a),

b the penalty is assessed using Reference Number 550 and the assessment notice CP215 is sent to the employer.

(b) The Failure to File penalty is assessed if Forms W-2 are not submitted or the discrepancies are not resolved in response to the initial CAWR correspondence.

1 If Forms W-2 are not submitted in response to the initial CAWR correspondence (CP 253), the employer will be assessed a Failure to File penalty (the greater of \$100 per missing return or 10 percent of the total wages that were required to be reported) IRC section 6721(e), Intentional Disregard,

2 The penalty is assessed using Reference Number 549.

(c) If Forms W-2 are secured after the Service assesses the intentional disregard penalty, see 735.5:(2)(c) of LEM XX-700.

(3) The CAWR Unit will work these cases through to resolve discrepancies, collection of Forms W-2 (including shipments to SSA) and assessment of penalties. See IRM 30(153)0, CAWR Reconciliation Balancing, for specific CAWR Program information. CAWR will handle all responses to the CP 253 and CP 215 (Reference Number 549 and Reference Number 550) penalty notices.

(4) Penalty Relief: The general penalty relief criteria is discussed in IRM (20)130, and IRM (20)792. Special abatement conditions as discussed in IRM (20)796 must also be considered. Additional administrative abatement criteria may develop while working these cases.

(a) Generally, we would expect these criteria to from unique conditions/issues in the CAWR program. When unique conditions are identified, they should be brought to the

attention of the Headquarters CAWR Analyst.

(b) Prior to abating a CAWR penalty, be aware of the numerous attempts made by both the Service and SSA to solicit the correct information from the employer.

1 If a payor claims the forms were filed, contact the local SSA office to verify that they have received the missing Forms W-2.

2 Failure to secure and properly credit the missing Forms W-2 will impact an individual's SSA earnings record and ultimately that individual's retirement benefits.

(5) Given the history of correspondence sent to the taxpayer by SSA and CAWR unit, caution should be used in abating the penalty. Careful consideration should be given to all filers claiming that they filed the required Forms W-2 timely.

(a) a copy of a Form W-3 with a timely signature date should not be accepted alone as evidence because a fictitious document can be easily prepared. However, if a taxpayer provides a copy of the Form W-3 and copies of Forms W-2 other than copy A along with a timely dated "return receipt", all penalties should be abated.

(b) the employer may have submitted returns timely that were returned by SSA for an unprocessable condition, then never resubmitted by the employer. The penalty would be applicable in this situation.

(c) Proof of submission can be made by contacting SSA as outlined in IRM 30(153)0, Section 8.

(6) If the employer's response indicates that they did not understand why the penalty was assessed, send Letter 1948C using the open paragraph with the following:

(a) You were assessed a late filing penalty of [\$] for the tax year [] Forms W2 that you recently submitted to the Service. This penalty was assessed because you did not file the Forms W-2 by the due date.

(b) The law requires you to file Forms W-2 with the Social Security Administration by the last day of February of the year following the year the wages were earned.

(c) If the forms are not filed by the due date, a penalty of \$15, \$30 or \$50 per return up to \$250,000 per year may be assessed. The amount of the penalty is determined by the date we receive the forms.

(7) Forms W-3 involved in CAWR penalty assessments will not appear on PMFOL or the PMF transcript.

(20)735.6 Penalty for Failure to File Certain Information Returns on Magnetic Media

The Payer Master File (PMF) generates a penalty proposal notice when a filer fails to comply with the magnetic media filing requirements for information returns. A penalty of \$50 per return is proposed for each return filed on paper in excess of the magnetic media threshold. This criteria criterion applies separately to each document type and separately for amended returns. The

penalty should not be assessed if an undue hardship waiver was granted by MCC and posted to the PMF. See 735.6 of LEM XX-700.

(20)735.7 Receiving Responses (Failure to File on Magnetic Media)

(1) Filers may avoid a penalty by establishing reasonable cause for the failure. See IRM (20)790 for definitions of reasonable cause and IRM (20)796 for the special abatement conditions.

(2) See 735.7:(2) of LEM XX-700.

(3) All current year magnetic media penalty cases are compared to the waivers of the magnetic media filing requirement that post to the PMF prior to the generation of penalty notices.

(a) If However, if a filer responds with an approval letter from MCC granting a waiver of the magnetic media filing requirement, check to see if the filer's TIN appears on the waiver listing provided by MCC. NOTE: SSNs appear in EIN format on the waiver listing. If present, the penalty should be abated using the correct Penalty Reason Code (PRC).

(b) If present, the penalty should be abated. If the TIN is not on the waiver listing, see 735.4:(17) of LEM XX-700.

(c) If the TIN is not on the waiver listing, see 735.4:(17) of LEM XX-700.

(4) If the taxpayer's response indicates that duplicate data was provided on paper and magnetic media:

(a) First attempt to verify using the PMF transcript and any supporting documentation sent by the filer.

(b) If no supporting documentation is found on the PMF transcript, contact MCC and provide the filer's name, TIN, EIN, Transmitter Control Code (TCC) (if available), tax year, type of return and the number of returns filed. See 735.7:(4)(b) of LEM XX-700.

(5) If the filer requests a copy of the Form(s) 1096 which resulted in the assessment, request a microfilm print (see IRM (20)717) of the Form(s) 1096 and send it to the filer. The DLN of the Form 1096 can be found on the PMF transcript.

(6) If the microfilm print of Form 1096 is not available after research, sanitize the page(s) of the PMF transcript containing the 1096 record(s) relevant to the penalty and send the filer a copy with an explanation.

(7) If the filer requests a copy of the Form(s) W-3 which resulted in the assessment, send a photocopy to the filer.

(a) If the Form W-3 is not available, sanitize the page(s) of the PMF transcript containing the W-3 record(s) relevant to the penalty and send the filer a copy with an

explanation

(b) Do not submit a request to WIRS for copies of the Forms W-3.

(8) If the filer requests a copy of the Forms W-2 which resulted in the assessment, request the documents from WIRS using the microfilm sequence number(s) provided on the PMF transcript. Indicate "W-3 and all W-2s" in the remarks area. Inform the filer that it will take about 6 weeks to obtain microfilm copies of the Forms W-2.

(a) When the Forms W-2 are received from WIRS, count to verify that the penalty agrees with the number of documents processed (eliminate blanks, voids, and subtotal forms).

(b) If the volume is lower than the penalty assessed, send the documents to the filer with a quick note explaining that the penalty will be adjusted accordingly. See 735.7:(8)(b) of LEM XX-700).

(9) The following information will be useful when working responses to Form W-2 magnetic media penalty cases. However, see 735.7:(9) of LEM XX-700 for further information.

(a) If the filer questions why the number of Forms W-2 penalized does not agree with the volume entered on Form(s) W-3 by the filer, explain that the penalty is based on the actual number of returns processed by SSA. Blanks, voids, and subtotal forms are not counted. In addition, the discrepancy may have occurred because the preparer entered an incorrect figure on Form W-3.

(b) If the response indicates that only magnetic media was filed or if the filer does not seem to understand why the penalty was assessed, send a copy of the Form W-3 along with a quick note explaining that the W-3 is a record of the paper forms filed with SSA.

(c) If the filer used a prior year Form W-3, check the signature date to determine what year the returns were submitted.

**(20)735.8 Penalty for Failure to File Information Returns in the Proper Format
(Unprocessable Returns)**

(1) The penalty for failure to file in the proper format is assessed for unprocessable paper returns and magnetic media returns identified by the service centers and MCC. This penalty is manually assessed by the service centers (CP 215 or CP 15), It is not preceded by Notice 972CG.

(a) For both paper and magnetic media, the documents are returned to the filer (during initial processing) along with a letter explaining the problem and requesting correction and resubmission by a specific date.

1 NOTE: For paper returns, only a sample of the unprocessable returns are returned to the filer to identify the problem.

2 However, the filer is asked to resubmit the entire submission.

(b) Filers are also advised of the applicable penalties for not resubmitting the returns timely. If processable returns are submitted beyond the date requested, the filer is subject to a late filing penalty.

(c) Returns are referred to the penalty unit for the improper format penalty if they are still unprocessable at the processing cut-off for the year.

(d) The penalty will be assessed at \$50 per return and is computed by multiplying the number of unprocessable returns by \$50. See 735.8:(1)(d) of LEM XX-700.

(2) The penalty unit will receive copies of no response and unsatisfactory responses to Letters 1865C from Receipt and Control along with the Forms 1096 and the payee documents that cannot be processed (see IRM 3(10)80).

(3) MCC will refer Forms 4804/4802 to the centers for assessment of the penalty. The case is referred to the service center for the penalty only if the filer does not return the file to MCC or if the file was returned but was still unprocessable at the end of the processing year.

(4) If it appears that the filer only corrected the sample of unprocessable paper returns that were mailed with Letter 1865C, the service centers may contact the filer to clarify that the entire submission must be resubmitted (per Letter 1865C). Allow the filer 30 days to respond before assessing the penalty.

(5) Prior to assessing the penalty for unprocessable magnetic media returns (Forms 4804/4802), check IDRS or MFTRA for the presence of a late filing or magnetic media penalty assessed for the same number of returns filed on paper. Also, see 711.3 of LEM XX-700.

(a) If an assessment is present, request a PMF transcript or request the case from files for manual assessments to determine if the penalty is for the same returns.

(b) If confirmed, notate the date and "Penalty Considered" on the 4804, associate with the closed case and refile. See 735.6 of LEM XX-700.

(c) If it is determined that the previous assessment is for different returns, assess the penalty based on the information on Forms 4804/4802.

(6) Only the actual returns which cannot be processed will be subject to the failure to file in the proper format penalty. Receipt and Control will separate the submission into processable and unprocessable.

(a) Any processable returns will have been input with the original Form 1096.

(b) The unprocessable returns will be forwarded to the Penalty Unit for assessment action with a photocopy of Form 1096. NOTE: The "Total number of documents" field on Form 1096 should have been changed by Receipt and Control to reflect the number of unprocessable documents subject to penalty.

1 Verify the number of unprocessable documents subject to penalty by excluding:
a voided and blank forms, and

b returns not required to be filed by law based on the dollar amount reported or exempt status. See Exhibit (20)700-4.

(7) If returns are received from Receipt and Control which are processable, return the entire submission to the IRP Unit in Receipt and Control with an explanation. See IRM 3(10)80 for unprocessable criteria.

(8) The penalty is to be assessed on the Civil Penalty Module. See IRM (20)715.3.

(a) If the unprocessable returns were also filed late the first time they were filed, check PMFOL to see if an extension was granted for the return type and tax year in question.

1 If an extension was also granted, use reference number 503.

2 If an extension was not granted, use reference number 506.

(b) If a sufficient number of returns were submitted to require magnetic media filing, check PMFOL to see if a waiver was granted for the return type and tax year in question. See 715.38:(2)(c)2 of LEM XX-700.

1 If a magnetic media waiver was also granted, use reference number 503.

2 If a waiver was not granted, use reference number 508.

(c) If the returns were filed late and the volume was large enough to require magnetic media filing, check for the extension and waiver.

1 If both were granted, use reference number 503.

2 If neither was granted, use reference number 511.

3 If an extension was granted but no waiver, use reference number 508.

4 If a waiver was granted but no extension, use reference number 506.

(9) If the assessment is input on or before July 1 of filing year, the centers should include a quick note with the notice. The quick note should contain the following statement: "The penalty was assessed at \$50 per return but it will be reduced appropriately if the corrected forms are submitted on or before August 1, 19XX."

(10) Processable returns (paper) resubmitted after the date requested in Letter 1865C may be referred to the penalty unit for assessment of the late filing penalty. MCC may also refer these cases to the service centers with Form 4804 for assessment. MCC will separate cases subject to late filing penalty from those subject to the unprocessable penalty. See 735.8:(10) of LEM XX-700.

(a) In this situation, the penalty unit should assess a late filing penalty (reference

number 500).

(b) If the filer filed more than 250 returns (paper), use PMFOL to determine whether a waiver was granted. If the waiver was granted, assess the late filing penalty only. If no waiver was granted, assess the combination late/magnetic media penalty using reference number 504.

(20)735.9 Receiving Responses (Failure to File Information Returns in the Proper Format)

(1) Generally filers must establish reasonable cause for the penalty to be abated. See IRM (20)790 for definitions of reasonable cause and IRM (20)796 for the special abatement conditions. See 735.9:(1) of LEM XX-700 for further instructions.

(2) If the filer submits corrected returns in response to the penalty notice, Receipt and Control will notate the CP15/215 "Processable returns submitted" and also notate the received date and the number of returns submitted.

(a) Review the filer's response to determine if the explanation establishes reasonable cause. If so, abate the penalty.

(b) If the filer's explanation does not establish reasonable cause, and the received date indicates that the \$50 penalty should be reduced (see 735.9:(2)(b) of LEM XX-700), recalculate the penalty at \$15 or \$30 per return as appropriate. The penalty should only be adjusted for the number of processable returns received as noted on the CP15/215.

(c) Also include the following explanation: "We received your corrected information returns on . The penalty you were previously assessed for filing unprocessable Forms has been reduced to \$XX.XX per return. You will receive an adjusted balance due notice."

(3) If the filer submits processable returns in response to the notice but the explanation provided does not meet reasonable cause, disallow the claim. See IRM (20)715.3.

(20)735.(10) Penalty for Missing and Incorrect TINs

Filers who file an information return with a missing TIN, or a TIN determined to be incorrect or not currently issued by the Service, are subject to a penalty of \$50 per return.

(2) After the TIN validation process is performed to identify payee records with missing and incorrect TINs/names, this data is transmitted to the Payer Master File for inclusion in the penalty proposal notice.

(3) See Exhibit (20)700-7 for details on how the Service performs TIN validation to determine which TINs are incorrect or not currently issued. NOTE: When a TIN is identified as incorrect, either the TIN or name may be incorrect.

(4) A paper or tape listing of payee records with missing or incorrect TINs is sent to the filer along with the proposal notice. Publication 1586, Reasonable Cause Regulations and Requirements as They Apply to Missing and Incorrect TINs, is also included in this mailing. It provides a detailed explanation of the actions the filer is required to take upon receiving the

listing.

(5) Filers are required to review payee accounts to verify whether or not they have completed the required solicitations (request TINs from payees) to show reasonable cause to have the penalty waived or abated.

(20)735.(11) Receiving Responses (Missing and Incorrect TINs)

See IRM (20)793 for the general solicitation requirements for TINs and the general reasonable cause criteria in IRM (20)792 to determine if the penalty should be waived or abated.

(2) Also see 796:(11) of LEM XX-700 for the special abatement criteria.

(3) If the filer's response indicates they do not understand why they received the notice and/or what actions they are required to take, provide a brief explanation and refer them to the Publication 1586.

(4) If the filer has included corrected returns for prior years in response to the notice, advise the filer that corrections for name/TINs are not required for prior years. Filers should be advised to update their records and reflect the correct data on any returns filed in the future.

(5) If corrected returns are provided for current year returns, route them to the Receipt and Control Function for processing if they are received prior to the service center Program Completion Date (PCD). NOTE: Filers are required to submit other corrections for information returns (e.g., money amounts) for current and prior year returns.

(6) If the filer submits examples of garbled information on the TIN listing, apologize for the inconvenience and advise that no action is necessary.

(7) Filers must compare the listings of incorrect and/or not currently issued TINs received from the Service with their records to determine if the name/TIN combination included on the listings agrees or disagrees with their records.

(8) In general, if an account number is provided on the listing, the filers need only identify any account or accounts with that corresponding number or designation that has the same name/TIN combination. If no account number is provided, the filers must use reasonable care to identify all accounts that relate to the same incorrect name/TIN combination.

(9) If the name/TIN combination on the listing agrees with their records, the filer must perform the required annual solicitation (see Publication 1586) if not completed previously.

(10) If the name/TIN combination on the listing disagrees with their records, the filer must determine whether:

(a) An error was made when filing the information return. If so, the filer must include the correct information on any future information returns,

(b) the information in their records has changed since filing the information return. If

so, the filer must include that information on any future information returns,

(c) the Service changed the information during processing. If so, the filer should notate their records and take no further action.

(11) Annually, MCC conducts the Quality Supplier Award program for payers who file data with no format (processing) errors for two or more consecutive years. These payers receive a letter from the IRS commending them on the quality of the data submitted. This program is conducted to acknowledge the positive contributions of these filers to the Information Reporting Program.

(a) Filers should not interpret the MCC letter as an indication that the data in the file was accurate as far as missing and incorrect TINs, money amounts, etc., are concerned.

(b) In past years, MCC letters may have implied that the data was valid in all respects. The letters will be revised to eliminate possible confusion on the part of recipients.

(20)735.(12) Notice 972CG, Notice of Proposed Civil Penalty

(20)735.(12)1 General

(1) Beginning with tax year 1992 returns, Notice 972CG, Notice of Proposed Civil Penalty, will be mailed to give filers an opportunity to establish reasonable cause for waiver of penalties prior to assessment. The notice will include proposed penalties for late filing, failure to file on magnetic media and missing and incorrect TINs. Notice 972CG will be assigned the reference number which corresponds to the penalty proposed, e.g., reference number 500 for the late filing penalty.

(2) Filers are allowed 45 days to respond to the notice and are asked to submit an explanation to show why the penalty should be waived. Filers may also submit a payment if they fully or partially agree or sign a consent statement to allow the Service to send a bill for the balance due.

(3) The penalty will be assessed against filers who do not submit a satisfactory explanation or who fail to respond to the notice. All penalties will be manually assessed following the procedures in IRM (20)715.3. See LEM 735.(12)1.

(4) Notice 972CG is not posted to the master file or shown on any IDRS or CFOL Command Codes. Centers may open an IDRS control base on MFT 13 or 55 after mailing the notices or immediately upon receipt of a reply. This will prevent a delay in taking necessary interim or closing actions after the response is reviewed. When the control base is opened enter "Notice 972CG" in the remarks.

(5) See IRM (20)718 for procedures that may be required to create entities if there is no IMF or BMF account to penalize or to create a Civil Penalty Name Line (IMF accounts, only) if it has not already been established on the Master File. These procedures are necessary to prevent unpostable conditions.

(6) Centers should maintain a suspense file for Notice 972CG which contains the:

- (a) notice,
- (b) TIN listing (if applicable)
- (c) the PMF transcripts, and
- (d) CP215/15A, Summary of Your 1992 Information Return Penalties.
- (e) These files should be maintained in TIN order.

(20)735.(12)2 Receiving Responses (Notice 972CG)

Review responses to Notice 972CG to determine if the penalty should be waived for reasonable cause in the same manner as replies to penalty assessment notice (CP 215/15). See the appropriate section in IRM (20)735 to respond to replies for penalties proposed for late filing, magnetic media, and TINs. Also, see IRM (20)715.3 for complete adjustment actions.

(2) Also see IRM (20)792 for reasonable cause criteria and IRM (20)796 for special abatement conditions.

(3) Filers may be granted an extension for up to 30 days to respond to the notice. For notices that were initially undeliverable, or required a recreate (see IRM(20)715.36), the new notice date is the date stamped when the notice is mailed a second time. See 735.(12)2:(3) of LEM XX-700.

(4) Centers must review replies fully and give filers the opportunity to submit additional information regarding their case before making a decision of whether or not to assess the penalty.

(a) If the explanation establishes reasonable cause:

- 1 Send letter 1948C explaining our decision,
- 2 input a TC 290.00 on MFT 13 or 55, using Blocking Series 15, Reason Code 62, and the appropriate Penalty Reason Code (Exhibit (20)100-3).
- 3 file Notice 972CG and correspondence.

(b) If the filer agrees with part of the penalty and establishes reasonable cause for the remainder (no disallowed amounts):

- 1 Send letter 1948C explaining our decision, indicate that the balance due notice will follow (if not paid in full). Use Reason Code 62 and the appropriate Penalty Reason Code (Exhibit (20)100-3),
- 2 input the assessment on MFT 13 or 55 for the agreed penalty amount following the procedures in IRM (20)715.3,
- 3 monitor the assessment to ensure that it posts.

(c) If the explanation does not establish reasonable cause or the abatement request is

partially denied:

1 Input the assessment for any penalty amount which the filer did not provide an acceptable explanation. Do not use reason code 62. If the assessment is against an IMF entity, it should only be against the responsible individual and not a joint account. See IRM (20)718.3.

2 Send Letter 854C stating the reason(s) the explanation was not accepted. Also state the penalty amount assessed and indicate that a balance due notice will follow. Correspondence should only be sent to the responsible individual and not to a joint account. See IRM (20)718.3.

3 Input a separate transaction using TC 290.00 in Blocking Series 98 with reason code 62. To delay the posting of the second transaction for one cycle, use Posting Delay Code "1" with this transaction.

4 Monitor the assessments to ensure that they posts post.

5 See (6) below before assessing the penalty if the reply indicates that the filer is no longer in business or there was a change in business organization, i.e., partnership to corporaton. (Assess the penalty unless the criteria in (6) below applies.)

(d) Use care when adjusting penalty amounts when two or more penalties (late, magnetic media, or TIN) apply to the same document. For example:

1 If 500 Forms 1099-DIV were filed late (April 5) and fifty of these returns had incorrect TINs, the proposed penalty on Notice 972CG would be calculated at $50 \times \$50$ (TINs) plus $450 \times \$15$ (late).

2 If the filer submits a satisfactory explanation for the 50 incorrect TINs, but not for filing late, the penalty should be recalculated at $500 \times \$15$ for the CP215/15 notice.

(de) If a payment was received, the amount will be notated on the response page by the Deposit function. Acknowledge any payment received in correspondence with the filer.

(ef) If a full payment is received and there are no disagreed items or a partial payment is received and the filer submits a satisfactory explanation for the remainder, input the adjustment on MFT 13 or 55. Use Hold Code 3.

(5) See 735.(12)2:(5) of LEM XX-700 for purge dates.

(6) Prior to assessing the penalty for undeliverables or no response cases (see IRM (20)716.2:(5)):

(a) use BMFOL to check Form 941 (MFT 01) modules for the presence of Collection transactions:

1 TC 530 with CC10 (defunct corporation), or

2 TC 530 with CC07 (bankrupt/insolvent corporation).

(b) Check the tax year in question and subsequent years.

(c) If either transaction code is present, do not assess the penalty.

(6) Prior to assessing the penalty, check for the following:

(a) check for undeliverables (see IRM (20)716.2:(5)) or no response cases.

1 use BMFOL to check Form 941 (MFT 01) modules for the presence of Collection transactions:

a TC 530 with CC10 (defunct corporation), or

b TC 530 with CC07 (bankrupt/insolvent corporation), (See IRM (20)796 for more information on bankruptcies.) or

c TC 480 (Offer in Compromise pending (OIC)).

d If a TC 530 with either closing code is present, do not assess the penalty (see IRM (20)735.(12)2:(6)b.

(b) Check the tax year in question and subsequent years.

(c) If either transaction code is present, do not assess the penalty.

1 If an unreversed TC 480 is present:

a check for the case file assignment number and notify the responsible Collection function of the pending assessment.

b Collection must include this assessment in the OIC.

(c) A TC 480 may be reversed with:

1 TC 481 - OIC requested,

2 TC 482 - OIC withdrawn, or

3 TC 483 - Correction of an erroneous TC 480. (NOTE: Since it is not unusual to have more than one TC 480 posted in a module, a careful review of the entire module should be done before taking any action.)

(7) Also, apply the criteria in (6)(ba)-(ce) if a filer's response to Notice 972CG indicates they are either a defunct or bankrupt corporation; check for the appropriate transaction code.

(8) A monthly report should be submitted to the Headquarters Office to measure how effective Notice 972CG is in prompting a response from filers. The report should be submitted by the 10th of the month for the previous month's activity. Title the report "Notice 972CG Monthly Activity Report". Enter the service center name and the date at the top of the report. On a monthly basis the centers should review the suspense file and provide the

following information to the Headquarters Office. Service centers should provide monthly as well as cumulative totals for each category.

(a) Number of Notices 972CG:

- 1 mailed and
- 2 referred to Exam (RTC/FDIC Notices during mail-out),
- 3 total Notices mailed and referred to Exam.

(b) Number of replies/no responses as follows Number of receipts (replies) Notice 972CG:

- 1 Reasonable Cause Waiver Granted,
- 2 Reasonable Cause Waiver Denied--assessment for full amount,
- 3 Reasonable Cause Waiver Partially Denied--Partial assessment,
- 4 Penalty Waived for Other than Reasonable Cause,
- 5 Partially Agreed--no disallowed items,
- 6 Fully Agreed,
- 7 Undeliverables,
- 8 Open (reply received),
- 9 No Reply,
- 10 Purged--assessment input for no reply cases, 11 Total.

(c) Abatements (after CP215/15) Number of replies/no responses as follows:

- 1 Full Reasonable Cause Waiver Granted,
- 2 Partial Reasonable Cause Waiver Denied--assessment for full amount,
- 3 Requested by Appeals (also count in 1 and 2) Reasonable Cause Waiver Partially Denied--Partial assessment,
- 4 Penalty Waived for Other than Reasonable Cause,
- 5 Partially Agreed--no disallowed items,
- 6 Fully Agreed,
- 7 Cases closed to Exam,
- 8 Purged--assessment input for no reply and undeliverable cases,

9 Open replies (Cum receipts minus item 5-10),

10 No reply Suspense (line 3 minus CUM receipts minus line 12),

11 Total of items 5 through 14 on the report.

(d) Only count notices in one category. Receipts (Replies) to CP 215/15.

(e) The cumulative total Line 12) of categories ((b)1 through 11) should equal the total notices generated for the

service center (line (a)3). Abatements (after CP215/15):

1 Full,

2 Partial,

3 Referrals to Appeals,

4 Number (abatements) requested or done by Appeals.

(f) The monthly report should continue until the center has purged "no reply" cases and resolved all "open cases (reply received)" for Notice 972CG. Service centers will be notified when to stop reporting for abatements of CP 215/15. Only count notices in one category.

(g) The monthly report should continue until the center has purged "no reply" cases and resolved all "open cases (reply received)" for Notice 972CG. Service centers will be notified when to stop reporting for abatements of CP 215/15.

(20)740 Failure to Furnish Correct Payee Statements IRC Section 6722

(20)741 General

(1) For returns required to be filed after December 31, 1989, a penalty of \$50 will be imposed for each failure to:

(a) furnish a payee statement on or before the due date to the person to whom the statement must be furnished,

(b) furnish all information required, and

(c) furnish correct information.

(2) No more than one penalty will be imposed per payee statement, even though a statement may contain more than one failure.

(3) The total amount imposed on any filer for all failures to furnish a payee statement during any calendar year shall not exceed \$100,000.

(4) A composite substitute payee statement is a single document created by the filer to reflect several types of payments made to the same payee. Each composite statement shall be

treated as though each type of payment (or other required information) were a separate statement with each type of payment being subject to the penalty.

(5) This statement must be on a form acceptable to the Service. See Publication 1179, Specifications for Paper Document Reporting and Paper Substitutes for Forms 1096, 1098, 1099, Series 5498 and W-2G.

(6) The \$50 penalty for failure to furnish payee statements is not reduced if returns are corrected or filed after the due date.

(20)742 Intentional Disregard

(1) The Intentional Disregard of the Rules and Regulations Penalty applies when the facts and circumstances show that the filer knowingly or willfully failed to comply with the requirements of IRC sections 6722.

(2) Intentional disregard occurs when a filer who knows, or should know of a rule or regulation, chooses to ignore its requirements. The facts should show the filer:

- (a) was required to provide a statement,
- (b) knew or should have known of the requirement to provide the statement, and
- (c) consciously chose not to provide the statement or recklessly disregarded (i.e. ignored) the duty to provide the statement.

1 Treas. Reg 301.6721-1(f)(3)(i) provides that a pattern of failures indicates intentional disregard. The greater the number of failures, the greater the likelihood some of those failures could be due to intentional disregard.

2 Additional indications of the existence of intentional disregard are:

- a did the filer correct the failure promptly after the discovery of the failure,
- b did the filer correct the failure within thirty days after notification of the failure by the Service,

c did the filer avoid an administrative inconvenience, and

d was the cost of compliance greater than the IRC section 6722(a) penalty. Intentional disregard may exist when it would be less expensive to pay the penalty under 6722(a) rather than to comply with the requirement to provide a statement. Treas. Reg. 301.6722-1(c)(2).

(3) For payee statements required to be filed after December 31, 1989, the Intentional Disregard of the Rules and Regulations Penalty amounts to:

- (a) \$100 for each payee statement required to be filed, or if greater:
- (b) 10 percent of the amount of income required to be reported on payee statements for dividends, patronage dividends, interest, fishing boat operators, royalties, and wage

and tax statement, or

(c) 5 percent of the amount required to be reported on the payee statements for brokers, exchange of partnership interest, or disposition of donated property payments.

(4) Form 8300 Penalty. The Intentional Disregard penalty for failing to provide a payor of cash with a statement as required by IRC sections 6050I(e) after December 31, 1989, is the greater of \$100 or 10 percent of the amount required to be provided on the statement.

(a) These penalties are asserted by field Examination personnel.

(b) The taxpayer may be offered an administrative preassessment appeal.

(5) There is no dollar limitation for the Intentional Disregard of the Rules and Regulations Penalty under IRC section 6722.

(6) No more than one penalty per failure can be imposed, even if there is more than one failure on the same statement.

(20)743 Exceptions and Special Rules

(1) The penalty shall not be assessed if an error or omission is inconsequential. An error or omission is inconsequential when the failure does not prevent:

(a) the timely receipt of correct information, or

(b) the payee from putting the information to its intended use.

(2) Errors or omissions are never considered inconsequential if they relate to:

(a) a dollar amount,

(b) a significant item in the payee address,

(c) use of the appropriate form for the information provided, whether or not it is an acceptable substitute for the official IRS form, and/or

(d) the delivery of the information return to the payee either in person or by first class mail (in a mailer which alerts the payee that the statement is enclosed) under the following:

1 IRC section 6042(c), Returns Regarding Payments of Dividends and Corporate Earnings and Profits,

2 IRC section 6044(e), Returns Regarding Payments of Patronage Dividends,

3 IRC section 6049(c), Returns Regarding Payments of Interest, and/or

4 IRC section 6050N(b), Returns Regarding Payments of Royalties.

(20)750 Failure to Comply with Other Information Reporting Requirements IRC Section 6723

(20)751 General

(1) For any information return or payee statement due (without regard to extensions) after December 31, 1989, a penalty of \$50 per failure will be imposed for each failure to provide all the required information timely.

(2) No more than one penalty can be imposed for the same return. For example, if a return has more than one error or omission and the penalty amount for those failures differs, the penalty will be imposed at the higher amount.

(3) For returns and statements required to be filed after December 31, 1989, a penalty of \$50 is imposed for failure to comply timely with specified information reporting requirements or for each failure to include correct information. The maximum penalty for failure to comply with all specified information reporting requirements is \$100,000 per year.

(4) Multiple penalties may be imposed on one document if the failures relate to more than one of the following requirements:

(a) IRC section 6050K(c)1 - notification of exchange of partnership interest,

(b) IRC section 6109 - supplying identifying numbers,

1 includes his/her TIN on a return, statement or document other than an information return or payee statement,

2 furnishes his or her TIN to another person,

3 the TIN of any other person whose number is required to be shown on a return, statement or document other than an information return or payee statement,

4 the TIN of a return preparer.

(c) IRC section 215 - Alimony, etc., Payments,

1 the person receiving separate maintenance is required to furnish his or her TIN to the individual making separate maintenance payments, and

2 the person making the separate maintenance payment is required to furnish on their return, the TIN of the person receiving the separate maintenance payment.

(d) IRC section 6109(e) - Furnishing Number for Certain Dependents, Include on his/her return, the TIN for any dependent who:

1 is claimed as an exemption on an income tax return, and

2 has reached 1 year of age before the close of the taxable year.

(5) However, no more than one penalty per document may be imposed if the failure could be penalized for both a:

(a) failure to timely comply, or

(b) failure to include all the required information.

(20)752 Intentional Disregard

The Intentional Disregard penalty as it applies to IRC section 6723 was repealed by P.L. 101-239. For returns and statements required to be filed after December 31, 1989, Intentional Disregard is will not be considered.

(20)753 Exceptions and Special Rules

(1) An inconsequential error or omission is not considered a failure to comply with a specified information reporting requirement. Therefore, the penalty shall not be assessed.

(a) The term inconsequential means any failure:

1 that does not make it difficult for the Service to put the information to its intended use, or

2 prevent a payee from timely receiving correct information and reporting it on his or her return.

(20)760 Regulations Requiring Returns on Magnetic Media IRC Section 6011(e)

(1) Information Returns due after December 31, 1989:

(a) The magnetic media filing requirement for Forms 1099-B, INT, DIV, PATR and OID changed as a result of OBRA '89. A filer must file on magnetic media when filing more than 250 returns of the same type.

(b) If a filer timely filed paper returns, but was required to file magnetic media returns, the \$50 failure to file penalty will apply to the number of returns, of one type, required to be filed that exceed 250.

(20)770 Failure to File Certain Information Returns, Registration Statements, Etc. IRC Section 6652(e)

(1) The penalty for failing to file information returns required in connection with certain plans of deferred compensation applies for each failure to file Forms 1099-R due after December 31, 1986.

(a) The penalty amounts to \$25 per day for each failure to file Forms 1099-R.

(b) The maximum penalty is limited to \$15,000.

(c) The standard for abating the penalty is reasonable cause.

(2) Specific information relating to Employee Plans and Exempt Organizations will be addressed in IRM (20)(12)00, Employee Plans and Exempt Organizations.

(20)780 Failure to Provide Reports on Individual Retirement Accounts or Annuities

(20)781 Penalties Relating to Designated Nondeductible Contributions IRC Section 6693(a)

(1) As the result of the Deficit Reduction Act of 1984, (effective December 31, 1984) the trustee of an Individual Retirement Account, the issuer of an IRA, or Simplified Employment Pension (SEP) may be assessed a penalty of \$50 for each failure to:

- (a) furnish or file a return (Form 5498) within the time and manner prescribed, or
- (b) furnish or file a disclosure statement, a governing instrument, or an amendment.

(2) There is no limitation to the amount of the penalty for returns required under IRC section 6693(a).

(3) The regulations for IRC section 6693(a) were not revised by OBRA '89.

(4) The penalty under IRC section 6693(a) shall not apply if the trustee or issuer of an annuity establishes reasonable cause. See IRM (20)790 and IRM (20)300 (20)130.

(20)782 Overstatement of Designated Nondeductible Contributions IRC Section 6693(b)

(1) IRC section 408(o)(4) generally requires any individual who makes a nondeductible contribution to an individual retirement plan for any taxable year, to file Form 8606, Nondeductible IRAs (Contributions, Distributions and Basis).

(a) A \$100 penalty may apply if an individual overstates the amount of their nondeductible contributions for any taxable year.

(b) The penalty may be abated if the overstatement is due to reasonable cause.

(2) Deficiency procedures do not apply.

(20)790 Waivers, Definitions and Special Rules IRC Section 6724

(20)791 General

(1) For returns due after December 31, 1989, OBRA '89 consolidated the waiver standards relating to information reporting into IRC section 6724. Generally, an information reporting penalty may be waived if it can be shown that the error was due to reasonable cause and not due to willful neglect.

(2) See IRM (20)130, for a discussion of Penalty Relief. The term "Penalty Relief" includes Reasonable Cause, Statutory Exception, Administrative Waiver, or Service Error.

(20)792 Reasonable Cause

(1) The Service may waive (abate or not assess) an information return penalty when a filer requests a waiver of the penalty and establishes reasonable cause. See 792:(1) of LEM XX-700.

(2) If the request properly establishes reasonable cause, the penalty may be abated using normal procedures. See IRM (20)715.1, (20)715.2 or (20)715.3.

(3) If reasonable cause is not established, disallow the request using normal procedures. See IRM (20)715.1, (20)715.2 or (20)715.3.

(4) If additional information is needed to substantiate a request for the waiver of a penalty due to reasonable cause, contact the taxpayer.

(5) In all cases involving unauthorized third party requests, correspond directly with the taxpayer to inform them of the action taken. Send letter 135C to the unauthorized third party explaining that you have responded directly to the taxpayer or include a paragraph in the taxpayer's letter requesting that the taxpayer notify the third party of our direct reply to the taxpayer. See 792:(5) of LEM XX-700.

(6) A statement signed under penalty of perjury must contain the affected taxpayer's signature or the signature of the taxpayer's authorized representative. Return correspondence to the taxpayer with Letter 1382C. The signature requirements are as follows:

(a) For corporations, the statement must be signed by the president, vice-president, treasurer, assistant treasurer, chief accounting officer or other officer duly authorized to sign returns and other documents. The fact that an individual within the corporation signed the statement shall be accepted as evidence that the individual is authorized to sign on behalf of the corporation (IRC section 6062).

(b) For partnerships, the statement may be signed by any one of the partners.

(c) For joint individual accounts, the statement must contain the signature of one of the taxpayers who signed the original return.

(7) Reasonable cause for the information return penalties exists when:

(a) the filer acted in a responsible manner, both before and after the failure occurred, and

(b) There are significant mitigating factors, or

(c) the failure was the result of circumstances beyond the filer's control.

(8) Acting in a Responsible Manner would include exercising the same degree of care that a reasonably prudent person (or organization) would use in the course of its business in determining filing obligations and in handling account information such as account numbers and balances. See IRM (20)793. The filer must act in a responsible manner both before and after the failure occurs.

(a) An example of the "same degree of care" would be:

1 a bank exercises a great deal of caution to ensure that they supplied correct saving account identification numbers and account balances for their customers,

2 a reasonably prudent person would consider that the same bank did not exercise the same degree of care, if that bank supplied incorrect taxpayer identifying numbers to the Service.

(b) Acting in a responsible manner also includes taking steps to avoid the failure, for example:

1 requesting appropriate extensions of time to file when practical to avoid the failure,

2 attempting to prevent a failure if it was foreseeable, and

3 correcting the failure as promptly as possible.

(c) When reviewing a filer's request for a waiver, the following questions must be addressed to determine if the filer has acted in a responsible manner.

1 Do the reasons address the penalty that was assessed?

2 Does the length of time between the event cited as a reason and the filing date negate the event's effect?

3 Does the continued operation of a business after the event that caused the filer's noncompliance negate the event's effect?

4 Should the event that caused the filer's noncompliance or increased liability have reasonably been anticipated?

5 Was the penalty the result of carelessness or did the filer appear to have made an honest mistake? (Carelessness and forgetfulness are the same as civil willful neglect and are not examples of ordinary business care and prudence).

6 Has the filer provided sufficient detail (dates, relationships) to determine whether they exercised ordinary business care and prudence?

7 Is a non-liable person being blamed for the filer's noncompliance? What is the nature of the relationship between the taxpayer and the individual? Is the individual an employee of the taxpayer or an independent third party such as an accountant or lawyer?

8 Has the filer documented all pertinent facts, i.e., death certificate, doctor's statement, insurance statement for proof of fire, etc.?

9 Does the filer have a history of being assessed the same penalty?

10 Could the filer have requested an extension or filed an amended return?

(d) A waiver should not be automatically granted where the filer claims ignorance of the filing requirements. See IRM (20)333.5. However, ignorance of the law may be considered as one factor which may indicate that the filer acted in a responsible manner if all the other facts support this contention.

(9) Significant mitigating factors - For the filer to establish reasonable cause under this category, the filer must show that they acted in a responsible manner as well as the existence of a significant mitigating factor. Events generally considered to be significant mitigating factors include, but are not limited to:

(a) First time filer: prior to the failure, the filer had not previously been required to file this particular form or statement (see 792:(9)(a) of LEM XX-700), or

(b) The filer has a history of complying with the information return reporting requirements. See 792:(9)(b) of LEM XX-700). Significant consideration is given to:

1 If the filer was previously penalized under IRC sections 6721, 6722, or 6723. For example:

a failures which are not penalized because they are within the de minimis exception are not considered to have been penalized for purposes of evaluating a filer's compliance history.

b Generally, a filer may not continually rely on the same explanation to establish reasonable cause, when the filer's compliance history indicates a pattern of failures.

c A filer is expected to take significant steps to prevent future failures of the same type.

2 Determine if the filer was previously penalized. If so, did the error rate decrease from one year to the next?

3 The filer's history of compliance should be considered whether or not the filer specifically requests abatement on this basis.

4 Compliance history must be considered, along with the other evidence provided, to determine if the penalty should be abated.

a The fact that the filer previously had a penalty should not be the only criteria used to decide if the penalty should be abated/waived: For example:

b a good compliance history may benefit a filer who can show that they acted in a responsible manner, but

c cannot show that an event beyond the filer's control caused the failure.

d However, if the filer can show that:

e he/she acted in a responsible manner and

f the failure was due to an event beyond the filer's control, (see IRM (20)792:(8)) then

g a penalty in a prior year should not be used as cause not to abate/waive the penalty.

(c) The filer contacted a tax advisor who was competent on the specific tax matter, furnished necessary and relevant information, and was then incorrectly advised that the filing of a return was not required. If the filer exercises normal business care and prudence based on their information and knowledge in determining whether to secure further advice, reasonable cause may apply.

(d) A filer may treat penalties under IRC section 6721 through IRC section 6723, that were self-assessed prior to January 1, 1990, under IRC section 6724(c) and IRC section 6676(d), as penalties that were not assessed.

(10) Events beyond the filer's control - for the filer to establish reasonable cause under this category, the filer must show that they acted in a responsible manner, as well as the event being beyond the filer's control. Events generally considered beyond the control of the filer include (but are not limited to):

(a) Actions by the Service. To establish an event beyond the filer's control as the result of Actions by the Service, the filer must show it relied on erroneous written information provided by the Service. The filer must also show that reliance on the written advice was reasonable and that they relied in good faith on the information. The filer must provide:

1 a copy of the written information provided by the Service including:

a the name of the Service employee, and

b the date the erroneous advice was received,

2 a copy of the request for information including,

a the steps taken and the specific facts given to the Service, and

b the answer received.

3 This information should be used in determining whether the taxpayer has shown reasonable cause for taking their position on the return giving rise to the penalty.

4 Reasonable cause will not be established if the filer did not provide the Service with all the facts and circumstances when requesting the advice.

5 Reasonable cause may be established if the filer did not file their returns after receiving erroneous information from the Service other than written, or the filer timely requested necessary tax forms and instructions, and the Service did not provide them

timely.

(b) Actions of an Agent. For a filer to establish events beyond the filer's control as the result of Actions of an Agent (imputed reasonable cause), the filer must show that:

1 they exercised reasonable business judgment when contacting the agent, allowing the agent to timely:

a file correct returns, or

b furnish correct payee statements,

2 the filer provided the agent with proper information well in advance of the due date of the return or statement, and

a the agent satisfied the significant mitigating factors, or

b an event beyond the agent's control criteria required to establish reasonable cause. See IRM (20)792:(9) and (10).

3 Filer's who contracted with an agent and cannot establish reasonable cause based on the actions of the agent as described above, the filer may be able to demonstrate reasonable cause on their own merits by:

a having an established history of complying with the information reporting requirements, see 792:(9)(b) of LEM XX-700 and

b otherwise acting in a responsible manner both before and after the failure occurred. See IRM (20)792:(8).

(c) Actions by the Payee or any other Person. For the filer to establish reasonable cause as the result of actions by the payee or any other person with respect to the return or payee statement, the filer must show that:

1 the payee, or other person, failed to provide the necessary information to the filer, or

2 the payee, or other person failed to provide correct information to the filer.

3 The filer must provide documentary evidence when requested by the Service showing that the failure was attributable to the payee.

4 See IRM (20)793 for special solicitation requirements that a filer must follow to establish reasonable cause if the failure of the filer to provide a TIN was due to the actions of the payee.

5 The filer contacted a tax advisor who was competent on the specific tax matter, furnished necessary and relevant information, and was then incorrectly advised that the filing of a return was not required. If the filer exercises normal business care and prudence based on their information and knowledge in determining whether to secure

further advice, reasonable cause may apply. (See P-2-7, P-2-8, P-2-9, and P-2-11.)

(d) Unavailability of business records - the business records must have been unavailable:

1 as a result of unforeseen conditions, and

2 in a manner which would prevent timely compliance (ordinarily at least a two week period prior to the due date (or extended due date) of the information return), and

(e) the unavailability was caused by a supervening event. A supervening event includes, but is not limited to:

1 A fire or other casualty that damages the business records or impairs the system for processing such records,

2 a statutory or regulatory change that relates directly to the data processing and is made so close to the time the information return or statement is required that for all practical purposes the change cannot be made,

3 the unavoidable absence (death or serious illness) of the person with the sole responsibility for filing a return or furnishing a statement. For additional information see IRM (20)333.

a In the case of a corporation, estate, trust, etc., the death or serious illness must have been that of an individual having sole authority to file the return (not the individual preparing the return). See 792:(10)(e)3a of LEM XX-700.

b If another person shares responsibility for filing the return and that other person is unaffected by the event, the event is not an event beyond the filer's control.

(f) The return was delivered to the IRS after its due date by the United States Postal Service if it was correctly addressed, mailed, and postmarked before the due date by:

1 The United States Postal Service, or

2 a private postal meter, (see 792:(10)(f)2 of LEM XX-700) as long as delivery was within the time period a document mailed from the same point of origin ordinarily would be received if mail on the last day prescribed for filing the return.

3 If the return is received after the due date, the filer must establish:

a the return was deposited in the mail on or before the due date,

b the delay in receiving the return was due to a delay in the transmission of the mail, and

c the cause of the delay.

(g) The taxpayer's statement that they erroneously addressed their return to the state taxing agency does not in itself constitute reasonable cause for filing late, since a properly addressed envelope is a legal requirement in determining timely mailing/filing (IRC section 7502(a)(2)(B)).

(h) Further documentation of the circumstances that resulted in the taxpayer misdirecting the returns must be considered evidence the taxpayer acted in a responsible manner and was nevertheless unable to file on time.

(i) Acceptable documentation must include all of the following:

1 an excellent filing compliance record, (see (10)92:(9)(b))

2 dated or certified mail documents showing filing made to the state or local taxing agency on or before the return due date, and

3 evidence that the act of misdirecting the return was due to extenuating circumstances, and not to carelessness or willful neglect. An example of an extenuating circumstance would be confusion caused by a death or serious illness in the immediate family at the time of filing.

(j) Undue Economic Hardship related to filing on Magnetic Media. When a filer with over 250 returns or statements fails to file on magnetic media as required, the filer must show that they failed to file on magnetic media because of a lack of hardware and that to meet the requirement would have caused an undue economic hardship. See 792:(11)(f) of LEM XX-700.

1 The filer attempted to contract out the magnetic media filing, and the cost was prohibitive as determined on the due date of the return.

2 The filer supported the prohibitive costs with two estimates from unrelated service bureaus or computer software/hardware companies.

3 The filer provides an estimate of the cost for self-prepared magnetic media compared to their estimate of the cost for filing on paper, and

4 the filer filed the returns on paper.

5 The undue economic hardship criteria does not prevent the filer from establishing reasonable cause based on other criteria that would be applicable to the magnetic media penalty. However, caution should be used to ensure that other reasonable cause criteria would be appropriate to the filer's failure to file on magnetic media.

(k) Additional magnetic media events which may be considered beyond the filer's control include:

1 the filer relied upon an internal computer system which encountered major hardware and/or software problems. Reasonable cause should consider the filer's documentation of the following:

a nature and severity of problems and efforts to correct in a timely fashion,

b timely and consistent effort exercised by responsible officials within the organization to monitor problems and execution of corrective action, and

c efforts undertaken by the filer to meet filing obligations, including but not limited to: (1) contracting out to third parties, and/or (2) filing the returns on paper to meet the due date.

2 Reasonable cause may be met if the filer provides documented evidence that they contacted two service bureaus and was informed that service bureaus would not contract for preparation of magnetic media information returns without contracting for a range of data processing functions such as:

a preparation of payroll/W-2 data,

b range of accounting functions such as preparation of Profit & Loss, balance sheets, etc., and

c other functions currently performed by the filer "in-house" or contracted to other third parties.

3 Reasonable cause may be met if a filer is located in geographically remote areas (e.g., Alaska) and has found it impossible to arrange for a magnetic media processing service. Care should be taken to review filer's documentation to ensure they were diligent in repeated attempts to contract for such service sufficiently in advance of the filing due date.

(l) If the filer received an undue economic hardship waiver in a prior year, reasonable cause related to undue economic hardship will be determined on a case by case basis and not ordinarily be established for any subsequent year.

(11) Also see (20)796 for the special abatement conditions that may require abatement of the penalty whether or not reasonable cause exists.

(20)793 Responsible Manner

(20)793.1 General

(1) In general, a filer will have acted in a responsible manner if the filer:

(a) Exercised reasonable care to,

1 determine its filing obligations, and

2 handle the account numbers and balances.

(b) Took significant steps to avoid a failure, such as:

1 Requested an extension of time to file,

- 2 attempted to prevent a foreseeable failure,
 - 3 acted to remove the cause of a failure once it had occurred, and
 - 4 corrected the failure promptly once the cause of the failure had been removed.
- (2) Correction of a failure is ordinarily considered prompt if made within 30 days after:
- (a) The cause of the failure is removed,
 - (b) the failure is discovered, or
 - (c) the filer's last regular submission for corrections is made (a submission is considered "regular" only if made at intervals of 30 days or less).

(20)793.2 Responsible Manner - Missing TINs

In general, if the filer failed to include a TIN because the payee failed to provide the TIN, the filer will have acted in a Responsible Manner only by making the required solicitations.

- (2) The term "solicitation" means a request to the payee to provide a TIN.
- (3) The TIN will be treated as missing if it:
 - (a) does not contain nine digits, or
 - (b) includes a mixture of digits and letters.

(20)793.3 Solicitations - Missing TINs

In general, an initial solicitation and two annual solicitations are required for missing TINs.

(2) An initial solicitation must be made at the time the account is opened. The term account includes accounts, relationships, and other transactions. This requirement is considered met if the TIN is requested either orally or in writing. The request can be made by mail, telephone or other electronic means.

- (3) If after the initial solicitation, the filer did not receive the TIN:
 - (a) A first annual solicitation must be made by December 31 of the year the account was opened (or the year the transaction occurred), if before December, or
 - (b) by January 31st of the following year (for accounts opened or transaction which occurred in the preceding December).
- (4) If after the first annual solicitation, a TIN was not received:
 - (a) A second annual solicitation must be made by December 31 of the first year following the calendar year in which the account was opened or transaction occurred.
 - (b) The initial and the first annual solicitations relate to the year the account was opened or the transaction occurred.

(c) The second annual solicitation relates to the year following the year the account was opened or transaction occurred.

(5) Forms 1098 require an annual solicitation to the payee until a TIN is obtained.

(6) Once the payee's TIN is received, the filer must include the TIN on all information returns filed in the future.

(20)793.4 Responsible Manner - Incorrect TINs

In general, if the filer has been notified by the Service or a broker of an incorrect TIN, they will have acted in a responsible manner only by making the required annual solicitations.

(2) The TIN will be treated as incorrect if the name/TIN combination does not match or cannot be found on the Service or SSA records.

(3) Not currently issued TINs and Name/TIN mismatch accounts are considered to be incorrect for purposes of solicitations and penalty assessments under IRC section 6724.

(4) For exceptions and limitations see IRM (20)793.7.

(20)793.5 Solicitations - Incorrect TINs

In general, the filer is required to make an initial solicitation and no more than two annual solicitations for incorrect TINs.

(2) An initial solicitation must be made at the time the account is opened or transaction occurs. This requirement is considered met if the TIN is requested either orally or in writing. The request can be made by mail, telephone or other electronic means.

(3) If the filer is notified by the Service or broker that the TIN is incorrect:

(a) A first annual solicitation must be made by December 31 of the calendar year in which the filer has been notified, or

(b) January 31 of the following year if notified in December.

(c) The mailing of the first "B" Notice under IRC section 3406(a)(1)(B) satisfies this requirement. See IRM (20)7(10)1:(1).

(4) If the filer is notified by the Service or broker in any calendar year, following the first notification that the TIN is incorrect:

(a) A second annual solicitation must be made by December 31 of the calendar year following the calendar year in which the filer was notified, or

(b) January 31 of the following year if notified in December.

(c) The mailing of the second "B" Notice under IRC section 3406(a)(1)(B) satisfies this requirement. See IRM (20)7(10)1:(1). NOTE: Filers are not required to show that they backup withheld on payee accounts to satisfy the requirement for waiver of the

penalty under IRC section 6724.

(5) If a filer has been notified of an incorrect name/TIN combination under IRC section 3406(a)(1)(B), the filer generally must notify the payee that the payee's account contains an incorrect TIN within 15 business days after the date of the notice from the Service or a broker.

(6) Forms 1098 require an annual solicitation to the payee until a TIN is obtained.

(7) If a corrected TIN (or name) is received, the filer must include it on all information returns filed in the future.

(20)793.6 Making Annual Solicitations

An annual solicitation by mail must include:

(a) a letter stating that the payee must provide their TIN or the payee will be subject to a \$50 penalty imposed by the Service,

(b) a Form W-9 or acceptable substitute form on which the payee may provide their TIN, and

(c) a return envelope.

(2) An annual solicitation made by telephone must:

(a) be made in a manner that will encourage the payee to provide their TIN,

(b) be a completed call to each person with a missing TIN and include a conversation with an adult member of the household or to an officer of the business or the organization,

(c) include a request for the TIN of the payee, and

(d) inform the payee that if the payee fails to furnish their TIN, the payee is subject to a \$50 penalty.

(3) The filer must maintain concurrent records showing the solicitations were properly made, and provide concurrent records to the Service upon request.

(4) For solicitations required under IRC section 3406(a)(1)(B), see IRM (20)7(10)1.

(20)793.7 Exceptions and Limitations

When an information reporting provision specifically provides the time and manner for obtaining a TIN, the solicitation requirements in IRM (20)793 will not apply. To act in a responsible manner, the filer should comply with the time and manner requirements for requesting the TIN under the applicable IRC section. For Example:

(a) For Forms 1099-S, the filer is only required to make an initial solicitation on or before the related real estate closing date.

(b) For Forms 1098, the filer is required to do an annual solicitation until the TIN is

received.

(2) The penalty waiver provisions apply when:

- (a) The solicitation requirements under Treas. Regs. 301.6724-1(e) or (f), or
- (b) Treas. Regs. 3406(d)-5 are met.

(3) Annual solicitation is not required for a year if:

- a Payments were not made, or
- b a return was not required to be filed.

(4) If an account is closed in the same year in which a penalty notice is received for the account, the filer must do the solicitation if a payment is required to be made or if the filer is otherwise required to file a return that year.

(5) To avoid making more than two annual solicitations, filers should follow the provisions of Treas. Regs. 3406(a)(1)(B) for accounts subject to backup withholding mailing requirements rather than the mailing requirements for Treas. Regs. 301.6724-1(e) and (f). This would apply to Forms 1099-B, INT, DIV, OID, MISC, and PATR.

(6) If a filer fails to make one or more of the required solicitations, the filer may satisfy the solicitation requirement by:

- (a) making two consecutive annual solicitations in subsequent years, and
- (b) after receiving the TIN, including it on any information return filed in the future.
- (c) The penalty will apply to:
 - 1 the years the solicitation was not made, and
 - 2 subsequent years until the filer has completed the make-up solicitations.

(7) Financial institutions are not required to make annual solicitation by mail on accounts with:

- (a) Stop-mail, or
- (b) hold-mail instructions,
- (c) as long as they deliver the solicitation in the same manner as they deliver the mail.

(8) A filer is not required to make annual solicitations on accounts if the filer completed two consecutive annual solicitation mailings by December 31, 1989.

(9) A filer is not required to make annual solicitations by mail on accounts where:

- (a) Previous solicitations have been returned as undeliverable,

- (b) other mailings have been returned as undeliverable, and
- (c) no new address has been provided to the filer.

(10) In general, no more than two annual solicitations are required to establish that the filer acted in a responsible manner.

(20)794 Due Diligence-Safe Harbor

For information returns (Forms 1099-INT, DIV, OID and PATR) due prior to January 1, 1990, filers may establish reasonable cause by satisfying the requirements for due diligence 6676(b) under the Interest and Dividend Tax Compliance Act of 1983, prior to OBRA 89. See IRM (20)792.

(20)795 Transitional Rules

(20)795.1 General

For returns required to be filed or payee statements required to be furnished after December 31, 1989, and on or before April 22, 1991, (tax year 1989 and 1990) consider reasonable cause criteria satisfied, if the filer would have satisfied reasonable cause under the applicable IRC sections 6721, 6722, or 6723 and the related regulations that were required prior to OBRA '89.

(20)795.2 TINs - Special Rules

For returns required to be filed after December 31, 1989, and on or before April 22, 1991, which contained a missing or incorrect TIN consider reasonable cause criteria satisfied if:

(2) At the time the account was opened the filer:

(a) Exercised due diligence, or

(b) fulfilled the requirements of Treas. Q/A-56 of section 35a.9999-1 (which describes the solicitation requirements under IRC section 6676(d) prior to its repeal by OBRA 89), and

(c) The TIN was requested as follows:

1 according to the time and manner of the information provision under which the information return is filed, or if none then,

2 under IRC section 6109, Identifying Numbers, or

3 in a manner that would otherwise have satisfied reasonable cause criteria under IRC section 6676(a) prior to January 1, 1990.

(20)796 Special Abatement Conditions

(1) Bankruptcy. An unreversed TC 520 and a Freeze code -V are used to identify a payer/filer that is in bankruptcy status. These codes will be present on the MFTRA transcripts.

(a) If the unreversed TC 520 has a transaction date of October 22, 1994 or earlier, the assessment is generally prohibited by the Bankruptcy Reform Act of 1994 (The bankruptcy law supersedes the Internal Revenue Code).

(b) If there is a TC 520 and a -V freeze on the account:

1 Check directly with the Collection Special Procedures Office in the District. Special Procedures will advise how to proceed.

2 The TC 520 and -V freeze must be present before a penalty abatement can be considered. However, the penalty should not be abated solely because the response states there is a bankruptcy.

(c) If there is no TC 520 and -V freeze on the account, but the payer can provide the following information, notify the District Office Collection Special Procedures function.

1 A bankrupt payer will know:

- a the bankruptcy petition date,
- b the court where the petition was filed, and
- c the docket number.

(d) Banks, Trusts Companies, Savings and Loans. (1) Penalties and collection of penalties assessed against insolvent or bankrupt banks, trust companies, or savings and loan associations may be prohibited under IRC section 7507(a).

(a)1 Abate all penalties Contact Special Procedures in the District if the response indicates they are a respondent is a bank, trust company or savings and loan association, and

(b) 2 the organization is are bankrupt and/or protected under IRC section 7507(a). Freeze code -V and an unreversed 520 will be present on MFTRA transcripts.

(c) The penalty should not be abated solely because the response states there is a bankruptcy. The TC 520 and -V freeze must be present.

(d) If there is not a TC 520 and a -V freeze on the account, but the payor can provide the following information, notify the District Office Collection Special Procedures function.

2 A bankrupt payor will know:

- a the bankruptcy petition date,
- b the court where the petition was filed, and
- c the docket number.

(2) If a filer other than those listed above protests an assessment on a bankruptcy tax module, forward the correspondence to the District Office Special Procedures function

(Collection).

(3) Also See 796:(3) of LEM XX-700.

(4) For state agencies, see 796:(4) of LEM XX-700.

(5)(2) If the reply to the penalty proposal or penalty notice indicates that:

(a) a failed savings and loan is under the receivership of the Resolution Trust Corporation (RTC), or

(b) a failed bank is under the receivership of the Federal Deposit Insurance Corporation (FDIC), refer the case to the Examination Classification Specialist for your service center. The reply from RTC/FDIC may be received in response to either the penalty proposal notice or after the assessment is made. (Also see (46) below.)

(c) If Exam decides that the penalty should be waived, they will refer the case back to the penalty unit to close out the case (or proposal) or to do abate the abatement penalty.

(d) If the penalty will be sustained, Exam will return the case to the penalty unit to input the adjustment (for or proposals) and/or correspond with RTC/FDIC. Exam will provide language to explain to RTC/FDIC why the penalty is not being abated.

(e) Exam will notify the penalty unit of their decision to abate or not abate within 10 working days. If not, the penalty unit will follow-up with the designated classification specialist.

(6) (f) If a penalty proposal notice with RTC/FDIC shown in the entity was referred to Exam before being mailed, the response from Exam will indicate whether or not the center should mail the proposal notice or close the case with no further action.

(3) For imputed interest See 796:(2) of LEM XX-700.

(4) For state agencies, see 796:(3) of LEM XX-700.

(7)(5) If the taxpayer's response indicates that the information returns which are being penalized reported liquidation dividends (Form 1099-DIV), abate or do not assess the penalty or the applicable portion that applies to the liquidation distribution.

(8)(6) IRC section 404(k) dividend distributions, reported on Form 1099-DIV, are not subject to penalties under IRC section 6721, 6722, or 6723. These dividends are not true dividend distributions reportable under IRC section 6042, but are treated as Employee Stock Ownership Plan distributions reportable under IRC section 6047, and therefore are subject to penalties under IRC section 6652(e). The Service has allowed the filing community to report ESOP distributions on Form 1099-DIV.

(9)(7) For multiple payee documents to an individual payee, see 796:(97) of LEM XX-700.

(10)(8) For magnetic media penalties resulting from corporate mergers see 796:(108) of

LEM XX-700.

(11)(9) If a filer is penalized for returns not required to be filed by law, the penalty must be reduced by the number of returns not required to be filed. The filing requirements for all returns are listed in Exhibit (20)700-4.

(a) These returns are being dropped systemically systematically for the paper returns processed through OCR and for magnetic media filed returns. However, for DIS input returns, the returns must be counted manually to determine how many meet the penalty criteria, therefore, it is possible for some errors to occur in counting returns that should be deleted from the count based on the dollar amount.

1 DIS returns can be identified by the presence of a service center code in the first two positions of the DLN.

2 If the filer states that the returns were not required to be filed by law (based on the dollar amount), examine the PMF transcript for evidence of the DIS input returns before making a determination.

3 If found DIS input is verified, abate the applicable portion of the penalty. For example, if the filer submits 100 Forms 1099-INT late and indicates in the reply that 10 were not required to be filed, reduce the penalty by \$500 (10 X \$50 10 times applicable penalty amount) if the returns were processed through DIS.

(b) If all returns on the PMF transcript were filed on magnetic or electronic media or OCR processed (first two positions of the DLN are other than the service center code), send letter 1948C and advise the filer that returns not required to be filed were deducted before we calculated the penalty.

(c) If the filer claims that returns are not required to be filed by law for other reasons, check Exhibit (20)700-4 for the exception. Additional exceptions to the filing requirements are shown in the Instructions to filers of Forms 1099, 1098, 5498, and W-2G. See 796:(11) of LEM XX-700

(1210) The penalty may be waived for a limited number of incorrect TINs if the TIN is incorrect due to a clerical or processing error and the following conditions are met:

(a) the filer must show that he acted in a responsible manner by requesting the TIN from the payee,

(b) an inadvertent processing or clerical error occurred in preparing the data, which caused the wrong name or TIN to be filed on the information return.

(c) See 796:(11)(10)(b) of LEM XX-700.

(13 11) Also see 796:(13 10) of LEM XX-700 for unprocessable returns.

(20)7(10)0 Backup Withholding (BUWH) IRC Section 3406(a)(1)(B)

(20)7(10)1 General

(1) Under IRC section 3406(a)(1)(B), filers who receive a notification from the Service that a TIN is incorrect (or not currently issued) are required to send a backup withholding or "B" notice to payees.

(2) Notices CP 2100 or 2100A mailed to filers serve as the notification from the Service of the requirement to send a "B" notice. The date of the CP 2100/2100A is considered the date of the official "B" notice.

(3) Notices CP 2100 and 2100A also contain payee records filed with missing TINs. Filers are not required to mail a "B" notice for missing TINs. However, they should use the listing to verify that they are already backup withholding on these accounts. The filer should request the TIN from the payee if it has not been requested previously. Backup withholding must continue until the TIN is received.

(4) This program applies only to Forms 1099 "B", INT, DIV, OID, PATR and MISC returns filed for tax year 1989 or later years. See Exhibit (20)700-7 for an explanation of the TIN validity process used to determine whether a TIN is incorrect.

(5) Notices are usually mailed to filers in October of each year. A "second pass" mailing is made in the subsequent calendar year, after late filed, previously unpostable or unprocessable returns have been processed. The second mailing normally takes place in March.

(6) The actions that the filer and payees must take upon notification of an incorrect TIN is determined by whether the notice is the first or second notification of an incorrect TIN for the same payee received within three calendar years. The CP2100/2100A CP 2100/2100A is generic and any mailing after tax year 1989 could include payee records for the first and or second notification. It is the responsibility of the filer to track the status of accounts.

(7) When a filer receives a first notification of an incorrect TIN:

(a) The filer must send a copy of the first "B" notice (see Exhibit (20)700-8), a Form W-9, Request for Taxpayer Identification Number and Certification, or an acceptable substitute and an optional reply envelope to the payee within 15 business days of the date of the notice or the date the CP 2100/2100A is received (whichever is later). The outer envelope must be clearly marked "Important Tax Information Enclosed" or "Important Tax Return Document Enclosed."

(b) Payees are required to respond within 30 calendar days.

(c) Filers who do not receive a newly signed Form W-9 from the payee within 30 calendar days of the date of the "B" notice must begin backup withholding. The filer must begin backup withholding within 30 business days if the payee does not respond with a newly signed Form W-4.

(8) If a filer receives a second notification of an incorrect TIN for the same payee within three calendar years:

(a) The filer must send a copy of the second "B" notice (see Exhibit (20)700-9) and an optional reply envelope to the payee within 15 business days of the date of the notice or the date the CP2100/2100A CP 2100/2100A is received (whichever is later). The outer envelope must be clearly marked "Important Tax Information Enclosed" or "Important Tax Return Document Enclosed."

(b) The payee must request verification of their the filer's TIN from SSA (for SSNs) or the Service (for EINs).

(c) Filers who do not receive verification from SSA (SSA Form 7028, see Exhibit (20)700-10) or Service Letter 147C from the payee within 30 business days after the receipt of the second notice, must begin backup withholding. The filer also has the option of beginning backup withholding on reportable payments immediately upon receipt of the second notification. Backup withholding must continue until the requested verification is received.

(9) Filers must compare the listings of incorrect and/or not currently issued TINs received from the Service with their records to determine if the name/TIN combination included on the listings agrees or disagrees with their records.

(10) In general, if an account number is provided on the listing, the filer need only only needs to identify an the account or accounts account(s) with that corresponding number or designation that has the same name/TIN combination. If no account number is provided, the filer must use reasonable care to identify all accounts that relate to the same incorrect name/TIN combination.

(11) If the name/TIN combination on the listing agrees with their records, the filer must send the appropriate "B" notice.

(12) If the name/TIN combination on the listing disagrees with their records, the filer must determine whether:

(a) An error was made The mismatch was due to an error in their submission (when filing the information return). If so, the filer must correct their records and include the correct information on any future information returns they file. A "B" notice is not required.

(b) The information in their records has changed since filing the information return. If so, the filer must include that information on any future information returns they file. A "B" notice is not required, or

(c) The Service changed the information during processing. If so, the filer should notate their records and take no further action. A "B" notice is not required.

(13) When backup withholding is required, filers must withhold 31 percent of the reportable payment.

(14) Filers must remit backup withholding using Form 8109, FTD Deposit Coupon, in each appropriate quarter and report those amounts annually on Form 945, Annual Return of

Withheld Federal Income Tax. They must have an Employer Identification Number (EIN) to file both forms. An EIN can be obtained by calling the TELETIN number found on the back of Form SS-4, Application for Employer I.D. Number.

(20)7(10)2 Processing CP 2100/2100A Notices

Service centers will electronically receive tapes generated by the Payer Master File(PMF), which will create CP2100/2100A notices CP 2100/2100A Notices followed by listings of Forms 1099-B, -DIV, -INT, -MISC, -OID, and -PATR filed with missing, incorrect, and/or not currently issued TINs.

(a) The CP2100A CP 2100A Notice will be mailed to payers whose listings total 50 or fewer information returns.

(b) The CP2100 CP 2100 Notice will be mailed to payers whose listings total between 51 and 250 information returns.

(c) MCC will mail the CP 2100 Notice with tape listings of missing, incorrect, and/or not currently issued TINs to payers whose listings include 251 or more information returns.

(2) The service Service center(s) must retain a second printed file copy of the CP2100/2100A Notice and listings and the tape reels for 90 days after the date of the notice date. This will insure ensure that they are available for recreate requests from filers. See IRM (20)7(10)36.

(3) A separate tape will create a control listing of the filers, paper and tape, who will receive a notice. This listing will include the filer's TIN (EIN or SSN), name, address, (street, city, state and zip code), account access key, sequential number, and transmittal number, and tape/paper indicator. Mail labels will also be generated.

(4) Headquarters will notify each service center of the actual dates date that the tape files will arrive be transmitted. and the file number of each tape.

(20)7(10)3 Mailing CP 2100/2100A Notices

Produce the CP 2100/2100A's and the accompanying listing and mail them to the filer.

(2) Each service center should ensure that they have the capability of providing a duplicate notice and listing if it is determined that a filer should have received a notice but did not. If a recreate is necessary, mail a copy of the printed file copy. Do not mail the original. See IRM (20)7(10)6.

(3) A complete package from the service centers should contain:

(a) The CP2100/2100A CP 2100/2100A Notice (2 copies), and

(b) the listing of missing, incorrect, or not currently issued TINs , and

(c) Publication 1281 or Publication 1679.

(4) A complete package from MCC should contain:

(a) The CP 2100 CP 2100 Notice (2 copies), and

(b) the magnetic tape listing of missing, incorrect or not currently issued TINs , and

(c) Publication 1281.

(5) The notice and listing(s) should be mailed in an E-130 or E-44A envelope as appropriate.

(6) Ensure that a garbled data review is performed.

(7) Misrouted mail:

(a) If a filer contacts the service center indicating that they have erroneously received a CP2100/2100A Notice for another filer, apologize and advise them to immediately return the notice to a designated contact person.

(b) NOTE: Service centers should establish a designated contact person to expedite the return of misrouted mail. When received, remail the notice to the correct filer and complete the required local disclosure procedures.

(8) If a filer contacts the Service stating that they were scheduled to receive a CP 2100/2100A CP 2100/2100A Notice but did not, see IRM (20)715.36.

(20)7(10)4 Responses (CP2100/2100A CP 2100/2100A Notices)

While there is no response required to the CP2100/2100A Notice, service Service centers may receive correspondence and/or documentation concerning the notice CP2100/210A Notices, even though filers are not required to respond back to the Service.

(a) If the filer's response indicates that they do not understand why they received the a CP 2100/2100A Notice, provide a brief explanation and refer them to Publication 1281 or, Publication 1679, or to the Information Reporting Program (IRP) Centralized Call Site in Martinsburg, WV. (The telephone number is referenced in both publications as well as on the CP 2100/2100A).

(b) If the filer has submitted original Forms W-8, Certificate of Foreign Status, Form W-9, Request for Taxpayer Identification Number and Certification, or Form 4669, Employee Wage Statement, return them to the filer and advise the filer that the forms should be retained for their records. If copies of these forms are received from the filer, they do not have to be returned and, therefore, may be destroyed.

(c) If a filer submits examples of garbled data, apologize for the inconvenience and advise that no action is necessary. A "B" notice should not be sent to the payee.

(d) Filers are not required to file corrections for missing or incorrect names and TINs.

1 Therefore, filers who contact the Service concerning the need to submit a correction for a missing or incorrect name or TIN in response to a CP2100/2100A notice should be advised that they are not required to submit corrections.

2 Filers should be advised to update their records and reflect the correct information on any returns filed in the future. This also applies if the filer questions whether it's necessary to submit name/TIN corrections for other prior year returns related or unrelated to a CP2100/2100A CP 2100/2100A notice.

3 However, filers who contact the Service concerning the need to submit corrections for name/TIN errors for returns filed for a current processing year return, may be encouraged to submit a correction if the contact is made on or before August 1 of the filing year. (See 7(10)4:(1)(d)3 of LEM XX-700).

4 Filing the correction by August 1 would reduce the applicable \$50 penalty to \$15 or \$30 per return if the filer is not able to establish reasonable cause to have the penalty waived. See IRM (20)793.1.

5 If the contact is made after August 1, filers may be encouraged to submit the correction since this would allow the Service to update the payee's record during the processing year, but, the filer should be informed that filing the correction will not reduce the applicable \$50 penalty. However, the penalty will be waived if filer is able to establish reasonable cause for filing the return with the missing or incorrect TIN.

6 Filers are required to continue to submit corrections for other types of errors (other than names and TINs). If the filer needs to make a correction and there is also a name/TIN error on the same return, the filer should be advised to correct all information when submitting the return.

7 Route corrected returns (current or prior year) to the Receipt and Control function for processing according to the guidelines in IRM 3(10)80.

(e) Occasionally, a filer will receive notification of missing, incorrect, and not currently issued TINs with Notice a CP2100/2100A Notice when they have previously filed corrections. Due to processing cut-offs for the BUWH program, some corrections may not be taken into consideration for the first mailing of the CP2100/2100A's. The filer is not required to take any action provided their records have been updated.

(f) There is no requirement to backup withhold on exempt recipients. Refer to the Form W-9 instructions for the exceptions to backup withholding.

(g) Backup withholding is not required on non-resident nonresident aliens provided the filer has on file the proper certified documentation (i.e., Form W-8 or Form 1001, Ownership, Exemption, or Reduced Rate Certificate).

(h) A partnership may obtain credit for backup withholding shown on Form 1099 by placing that amount on Schedule K, line 13a of the Form 1065, and then carrying the amount through to each partner on Schedule K-1. Line 13a is then claimed as a credit on

the individual Form 1040.

(i) Filers are not required to wait 30 business days following receipt of the CP2100/2100A CP 2100/2100A Notice to begin backup withholding,; they may elect to impose backup withholding at any time after receipt of the CP 2100/2100A Notice.

(j) If a payee requests a copy of the Form SSA-7028 issued by SSA, inform them that the document is an SSA form and that SSA will mail it directly to the filer after the required research has been completed. If SSA makes a change because of the information submitted to them by the payee on Form SS-5, Application for a Social Security Number Card (Original, Replacement or Correction), a new Social Security Card will be mailed to the payee.

(k) If Form 941C, Statement to Correct Information Previously Reported on Employers Tax Return, is received from a filer who has an EIN, Form 941 filing requirements, and a previously filed Form 941 for the quarter specified, the form should be routed to BMF adjustments for resolution.

(20)7(10)5 Undeliverable Notice CP2100/2100A CP 2100/2100A

Research for a different address using IDRS. If one is found, re-mail remain the notice.

(2) Do not change the original date on the undeliverable notice. Filers will have 15 business days from the date of receipt to complete all "B" notice mailings.

(3) If no other address is found, file the undeliverable notice, listing, and original envelope with the printed file copy and destroy 90 days after the notice date.

(20)7(10)6 Recreating CP 2100/2100A Notices

Filers may contact either a service center or the MCC IRP Centralized Call Site to request recreates (copies) of CP2100/2100A notices CP 2100/2100A Notices. These requests may be received at any time after the initial mailing of each notice.

(2) The retention period for CP 2100/2100A Notices is four years from the original notice date. However, the procedures for filling requests for recreated notices differ for paper notices and tape notices, and are based on when a request is received.

(a) For paper notices:

1 Service centers are required to retain a second printed "file" copy of the CP2100/2100A notices mailed and the tapes used to create them CP 2100/2100A Notices for at least 90 days from the notice date. If a center uses the method described in section 2a below, the printed file copy must also be retained for the 90-day period.

Service centers will fill all requests received for paper listings of missing and/or incorrect TINS within the 90-day period by: photocopying the "file" copy of the notice and mailing to the filer. These requests may be received directly at the service center or may be forwarded to the service center, through the Management Analyst, from the

MCC IRP call site.

2 Service centers will fill all requests received for paper listings of missing and/or incorrect TINs within the 90 day period by:

a Retaining a printed file copy of the CP 2100/2100A Notice(s) and listing(s) mailed. Photocopying the file copy and mailing it to the filer, or

b Printing a CP 2100/2100A Notice and the accompanying listing(s) from the tapes using the "Control D" Method (restore or load the file, go into Control D, and use the find command to locate the TIN). Mail the recreate to the filer.

3 Headquarters Office, After the 90-day period, Headquarters Office, Information Systems function (IS) will fill recreate requests received after the 90-day period (for service centers that cannot retain them). Requests received by service centers must be routed through the IRP Centralized Call Site to Headquarters Office IS function. A contact sheet will be used for this purpose.

(b) For tape notices:

1 The MCC IRP Centralized call site Call Site will fill all requests received for tape listings of missing and/or incorrect TINs within the four-year retention period (i.e., 4 years from the original CP 2100/2100A Notice date).

2 Requests for tape recreates received by service centers must be routed, through the Management Analyst Support Branch analyst, to the MCC IRP call site Centralized Call Site.

Exhibit (20)700-1 500 Series Reference Numbers

Reference numbers 500 through 514 are used for penalties assessed after December 31, 1989. These reference numbers are also used for penalty proposal notices (beginning with tax year 1992).

(1) Reference numbers 500 - 514:

(a) will be used for tax years 1989 and subsequent by the IRP Program and apply to penalties assessed under IRC section 6721.

(b) an explanation for each reference number is also contained on Notice 925.

(2) Reference numbers 52X - 53X are reserved

Reference	Description	Number
500	Late Filing Penalty	

A penalty is charged for each Form 1098, 1099, W-2G, or W-2 that was not correctly and timely filed. IRC section 6721

501

Magnetic Media Penalty

A penalty is charged for each Form 1098, 1099, W-2G, or W-2 (over 250 forms of each type) not filed either electronically or by magnetic media as required by IRC section 6011(e) (2) (aA). IRC section 6721

502

Missing or Incorrect TIN Penalty

A penalty is charged for each Form 1098, 1099, W-2G, or W-2 submitted with missing or incorrect TINs. IRC section 6721

503

Improper Format Penalty

A penalty is charged for each Form 1098, 1099, W-2G, or W-2 submitted in an improper format as provided for in either the IRC, Treas. Regs, or SSA procedures. IRC section 6721

Exhibit (20)700-1 Con't. - 1 500 Series Reference Numbers

504

Late and Magnetic Media Penalty

A penalty is charged for each Form 1098, 1099, W-2G, or W-2 that was not filed: correctly and timely, and either electronically or using by magnetic media. (over 250 forms) IRC section 6721

505

Late and Missing or Incorrect TIN Penalty

A penalty is charged for each Form 1098, 1099, W-2G, or W-2 that was: not correctly and timely filed, and submitted with a missing or incorrect TIN. IRC section 6721

506

Late and Improper Format Penalty

A penalty is charged for each Form 1098, 1099, W-2G, or W-2 that was not: correctly and timely filed, and submitted in the proper format as provided for in either the IRC, Treas. Regs., or SSA procedures. IRC section 6721

507

Magnetic Media and Missing or Incorrect TIN Penalty

A penalty is charged for each Form 1098, 1099, W-2G, or W-2 that was: not filed either electronically or using by magnetic media, (over 250 forms) and filed with missing or incorrect TINs. IRC section 6721

508

Magnetic Media and Improper Format Penalty

A penalty is charged for each Form 1098, 1099, W-2G, or W-2 that was: not filed either electronically or using by magnetic media (over 250 forms of each type) and submitted in the proper format as provided for in either the IRC, Treas. Regs., or SSA procedures. IRC

section 6721

Exhibit (20)700-1 Con't. - 2 500 Series Reference Numbers

509 Missing or Incorrect TIN and Improper Format
Penalty

A penalty is charged for each Form 1098, 1099, W-2G, or W-2 that was filed: with a missing or incorrect TIN, and in an improper format as provided for in either the IRC, Treas. Regs., or SSA procedures. IRC section 6721

510 Late, Magnetic Media, and Missing or
Incorrect TIN Penalty

A penalty is charged for each Form 1098, 1099, W-2G, or W-2 that was: not correctly and timely filed, not filed either electronically or by magnetic media (over 250 forms of each type) as required by IRC section 6011(e) (2) (aA), and filed with missing or incorrect TINs. IRC section 6721

511 Late, Magnetic Media, and Improper Format
Penalty

A penalty is charged for each Form 1098, 1099, W-2G, or W-2 that was not: correctly and timely filed, filed either electronically or by magnetic media (after the first 250 forms of each type) required by IRC section 6011(e) (2) (aA), and submitted in the proper format as provided for in either the IRC, Treas. Regs., or SSA procedures. IRC section 6721

512 Late, Missing or Incorrect TIN, and Improper
Format Penalty

A penalty is charged for each Form 1098, 1099, W-2G, or W-2 that was: not correctly and timely filed, filed with missing or incorrect TINs, and not submitted in the proper format as provided for in either the IRC, Treas. Regs., or SSA procedures. IRC section 6721

Exhibit (20)700-1 Con't. - 3 500 Series Reference Numbers

513 Magnetic Media, Missing or Incorrect TIN, and
Improper Format Penalty

A penalty is charged for each Form 1098, 1099, W-2G, or W-2 that was: not filed either electronically or using magnetic media (over 250 forms of each type), filed with missing or incorrect TINs, and not submitted in the proper format as provided for in

either the IRC, Treas. Regs.,
section 6721

or SSA procedures. IRC

514 Late, Magnetic Media, Missing or Incorrect
TIN, and Improper Format Penalty

A penalty is charged for each Form 1098,
W-2 that was:

1099, W-2G, or

not correctly and timely filed,

not filed either electronically or using
(over 250 forms of each type),

magnetic media

filed with missing or incorrect TINs, and

not submitted in the proper format as
either the IRC, Treas. Regs.,
section 6721

provided for in
or SSA procedures. IRC

CAWR

549 Failure to File Form W-2

A penalty is charged for each Form W-2 that
as required by IRC section

6051.

was not filed

550 Late Filing Penalty Form W-2

A penalty is charged for each Form W-2
after the due date as required
section 6051.

that was filed
by IRC

Exhibit (20)700-2 600 Series Reference Numbers

(1) Three digit reference numbers in the 600 series are
assessed/abated on MFT 13 or 55 and are the result of an action
taken by a compliance function with access to the taxpayer's
records.

(2) Reconsideration criteria should be applied to requests
for abatement of a 600 series penalty reference number. See IRM
4144.34 for reconsideration procedures.

(3) The following 600 series reference codes are used for tax
years 1989 and subsequent tax years.

Reference	Description	Number
IRC section 6721	Failure to File an Information Return	
600	A penalty is charged for each information return that was not:	
	filed timely,	
	filed accurately showing correct and or	complete information,
	filed in the correct format (i.e. paper,	mag-media or

other machine readable form).

651 Failure to file Form 8300 reporting cash transactions greater than \$10,000.

652 Intentional Disregard of the requirement to file Form 8300 reporting cash transactions greater than \$10,000.

Exhibit (20)700-2 Cont-1 600 Series Reference Numbers

IRC section 6722 Failure to Provide a Payee Statement

612 A penalty is charged for each payee statement that:

was not furnished on or before the due date to the person to whom the statement is due;

did not provide all the required information, and or

did not furnish correct information.

653 Failure to provide a written statement to each person named on the Form 8300.

654 Intentional Disregard of the requirement to provide a written statement to each person named on the Form 8300.

IRC section 6723 Failure to Comply With Other Information Reporting Requirements

621 A penalty is charged for the failure to comply with "Other Information Reporting Requirements". See IRM (20)750 for a definition of this reference code.

674 IRC section 6723

Failure to provide a notice of exchange of partnership interest (6050K(c)(1)).

Exhibit (20)700-3 PMF Civil Penalty Transcript

1. Entity Information.
2. Linked - Indicated a match between the IMF/BMF entities and the PMF entities.
3. Filing History:
 - a. Indicates if Information Returns were filed in the tax year.
 - b. Penalty indicator codes
4. Submission Record:

- a. Original transmitted - Paper or magnetic media.
 - b. Amended transmitted - Paper or magnetic media.
 - c. Replace transmitted magnetic media only.
 - d. Number of documents subject to a penalty.
 - e. Received date for late filing.
 - f. DLN of the Form 1096, MSN of Form W-3
 - g. Total money amount and withholding reported on forms filed.
5. Summary:
- a. Total original, amended, replace documents submitted.
 - b. Number of documents subject to penalty.
 - c. Total amount reported.
 - d. Backup withholding.
 - e. Waiver and extensions granted.
 - f. Summary of penalties by return type.
 - g. Dollar amount of penalty assessed.

Exhibit (20)700-3 Con't. - 1 PMF Civil Penalty Transcript

Exhibit (20)700-3 Con't. - 2 PMF Civil Penalty Transcript

Exhibit (20)700-4 Information Return Filing Requirements

FORM NUMBER PENALTY RULES	AMOUNTS REQUIRED TO BE REPORTED	SPECIAL
------------------------------	---------------------------------	---------

1098 \$600 or more No reporting required for interest received from an entity other than an individual.

1099-A All Amounts No reporting required for a loan made to an individual and secured by an interest in tangible personal property that is neither held for investment nor used in a trade or business.

1099-B All Amounts Farm managers are exempt from filing Form 1099-B on behalf of the owner with respect to the manager's farm activities.

1099-C \$600 or more None

1099-DIV \$10 or more except \$600 or more for liquidations. Penalty does not apply to liquidation distribution. No penalty applies to dividends distributed under IRC section 404(k) on stock held by an employee stock ownership plan (ESOP).

1099-G \$10 or more for unemployment compensation and tax refunds. \$600 or more

for others.

No penalties apply.

Exhibit (20)700-4 Cont Information Return Filing Requirements

FORM NUMBER
PENALTY RULES

AMOUNTS REQUIRED TO BE REPORTED SPECIAL

1099-INT \$10 or more except \$600 or more if related to a trade or business. No reporting required if interest is tax-exempt or paid to a corporation. REMIC's are required to report to corporations that are regular interest holders.

1099-MISC All payments to crew members by fishing boat owners or operators. \$10 or more: royalties and substitute dividend and interest payments; \$600 or more: rents; prizes and awards; health care payments; services performed for a business by non-employees.

None

1099-OID \$10 or more None

1099-PATR \$10 or more None

1099-R All Amounts None

1099-S All Amounts None

5498 All contributions (including rollovers) and fair market value of accounts.

None

W-2G Generally, \$600 or more (\$1200 bingo or slots; \$1500 from Keno

None

W-2 All Amounts

None

Exhibit (20)700-5 Notice 925, Penalty Code Explanations

Exhibit (20)700-5 - Con't. Notice 925, Penalty Code Explanations

Exhibit (20)700-6 Instructions for Form 8487

Exhibit (20)700-7 TIN Validation

The TIN Validation process compares the taxpayer identification number (TIN) and name control (the first four characters of a surname or first four characters of the first significant word in a non-individual's title) against certain IRS or Social Security Administration (SSA) files.

The NAP-1 file, a number bank which contains all social security numbers (SSNs) ever issued

and all of the name controls ever associated with those SSNs.

The weekly accretion file, a weekly update to the NAP-1 received by SSA.

The EIN/Name Control file, a file created and maintained by the Service which contains all employer identification numbers (EINs) and the name controls associated with them.

The matching process:

The Service attempts to match each name and TIN combination provided on all information returns against the three files listed above.

The first attempt is made against the NAP-1 file. If no match is found, an attempt is made against the EIN/Name Control file.

If the TIN matches, an attempt to match the name control provided is made.

If the name control is not provided, an attempt to develop name controls is made by creating name controls from each word separated by space on each name line. Both name lines 1 and 2 are read, totaling 80 characters, 40 characters for each name line.

Extract matches are attempted first, followed by proximal matches.

Extract matches occur when the name/TIN combination provided on the information return exactly matches the name/TIN combination on either file. This applies to both SSNs and EINs.

Proximal matches allow for transposition of the second and third characters of the name control provided. NOTE: THIS APPLIES TO SSNs ONLY.

Exhibit (20)700-8 First "B" Notice

Exhibit (20)700-8 - Con't. First "B" Notice

Exhibit (20)700-9 Second "B" Notice

Exhibit (20)700-10 Notice of Third Party Social Security Number Assignments

Exhibit (20)700-11 Service Center and D.O. Codes for SCRIPS, OCR and DIS Forms 1096 - Tax Year 1994

SCRIPS

Service Center Service Center Code

District Office Codes

KCSC 09 39,41,43

CSC 17 35,55,61

AUSC 18 48,76,85

OSC 29 45,46,47

MSC 49 63,64,65

OCR

Service Center Service Center Code

District Office Code

ATSC 07 57,58,59

ANSC 08 01,02,03

KCSC 09 36,37,42

CSC 17 31,34,38

AUSC 18 73,74,75

BSC 19 11,13,22

PSC 28 23,25,51

OSC 29 83,84,86

MSC 49 56,62,71

FSC 89 77,94,99

Compare the first two digits of the DLN with the corresponding District Office Code to determine which service center processed Forms 1096.

Exhibit (20)700-11 Con't Service Center and D.O.Codes for SCRIPS, OCR and DIS Forms 1096 - Tax Year 1994

DIS

Service Center Service Center Code DIS District Office Code Same as Service Center Code)

ATSC 07 07

ANSC 08 08

KCSC 09 09

CSC 17 17

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AUSC 18 18

BSC 19 19

PSC 28 28

OSC 29 29

MSC 49 49

FSC 89 89

Chapter (20)800 EP/EO Penalties

(20)810 Introduction

(20)811 General

(1) This chapter covers the penalty provisions of the Internal Revenue Code (IRC) that apply to Employee Plans (EP) and Exempt Organizations (EO).

(2) Decisions on penalty issues are to be guided by the applicable statutes, regulations, and procedural instructions issued by the Service. All employees should keep in mind the objectives in this handbook and the Penalty Policy Statement

P-1-18 when handling each penalty case.

(3) Other civil penalties that are common to EP/EO returns are discussed in the following chapters of IRM (20)000:

- (a) Failure to File and Failure to Pay, IRM (20)200,
- (b) Estimated Tax Penalty, IRM (20)300,
- (c) Failure to Deposit, IRM (20)400,
- (d) Return Related Penalties, IRM (20)500,
- (e) Return Preparer Penalties, IRM (20)600, and
- (f) Information Return Penalties, IRM (20)700.

(20)812 Common Features

(20)812.1 Failure to File and Failure to Pay

(1) When a delinquent income or excise tax return is received from an entity during an examination, the EP/EO employee will determine whether the failure to file and/or failure to pay penalties under IRC section 6651(a)(1) and (2) should be asserted. See IRM (20)200, Failure to File/Failure to Pay.

- (a) The excise tax returns required to be filed in connection with employee plans and

exempt organizations are:

- 1 Form 5330, Return of Initial Excise Taxes Related to Employee Benefit Plans,
- 2 Form 4720, Return of Certain Excise Taxes on Charities and Other Persons Under Chapter 41 and 42 of the IRC.

(b)The income tax returns required of certain exempt organizations and trusts are:

- 1 Form 990C, Farmer's Cooperative Association Income Tax Return,
- 2 Form 990PF, Return of Private Foundation or Section 4947(a)(1) Trust Treated as a Private Foundation,
- 3 Form 990T, Exempt Organization Business Income Tax Return,
- 4 Form 1041, U.S. Income Tax Return for Estates and Trusts,
- 5 Form 1120POL, U.S. Income Tax Return for Certain Political Organizations.

(2)If any portion of the tax is subject to a penalty under IRC section 6663, Fraud, that same portion of tax cannot be subject to a penalty under IRC section 6651, Failure to File Tax Return or Pay Tax. See IRM (20)570.

(20)812.2 Accuracy-Related Penalty

IRC Section 6662(f)

Substantial Overstatement of Pension Liabilities

812.21 General

IRC section 6662(a) imposes a penalty on a taxpayer equal to 20 percent of any income tax underpayment attributable to deductions for employer contributions to a defined benefit plan or retirement annuity plan where such deductions are based on a substantial overstatement of liabilities under the plan.

812.22 Penalty Assertion

(1) In general, there is an overstatement of pension liabilities if the actuarial determination of pension liabilities taken into account for deduction purposes, under section 404(a)(1) or (2) of the Code, exceeds the amount determined to be the correct amount of such liability.

(a)Examples of when an overstatement of pension liabilities may occur:

1 When the valuation of such liabilities is based on unreasonable actuarial assumptions or methods that accelerate deductions either in a manner that is inconsistent with the regulations under section 412, relating to acceptable funding methods, or by taking into account benefits in excess of those

2 When the Service has determined that deductions are to be disallowed because liabilities are overstated for other reasons based on the facts and circumstances.

(2) A substantial overstatement occurs when the actuarial determination of the liabilities taken into account for purposes of computing the deduction under section 404 (a)(1) or (2) is 200 percent or more of the amount determined to be the correct amount.

(3) Due Date. This is an accuracy related penalty, and as such there is no due date.

(4) Penalty Computation. The penalty under IRC section 6662(a) is computed by multiplying the underpayment of tax attributable to the substantial overstatement of pension liabilities by 200 percent. No penalty is imposed unless the portion of the underpayment for the taxable year attributable to the substantial overstatement of pension liabilities exceeds \$1,000.

(5) The penalty under IRC section 6662(a) by reason of any substantial overstatement of pension liabilities is identified by the EP field agent.

812.23 Penalty Relief

(1) IRC section 6664(c) provides for non-assertion of the penalty with respect to any portion of the underpayment if it is shown that there was a reasonable cause for such portion and the taxpayer acted in good faith with respect to such portion.

(2) See IRM (20)130 for a discussion of penalty relief.

(20)813 How to Assess/Abate

(20)813.1 Service Center Procedures

(Reserved)

(20)813.2 EP Procedures

(1) Penalties on Employee Benefit Plan forms are assessed on Non-Master File.

(2) To assess penalties associated with income tax forms the employee must complete the Form 5734, Non-Master File Assessment Voucher. Form 5734 and the case file (source documents) will be sorted by MFT code and forwarded to the service center Receipt and Control function on Form 3210, Document Transmittal.

(3) To assess penalties that are not associated with an income tax return the employee must complete Form 8278, Computation and Assessment of Miscellaneous Penalties.

(20)813.3 EO Processing Procedures

(1) Penalties under this chapter (except for the IRC section 6684 penalty) may be assessed without issuing a statutory notice of deficiency. The IRC section 6684 penalty should be included in the statutory notice issued for the Chapter 42 tax.

(b) The amount of the deductible contribution is limited to the excess of:

1 any money and the value of any property (other than money), contributed by the donor, that exceeds

2 the value of the goods or services received.

(3) The penalty is assessed using NMF procedures in IRM (20)813.3.

(4) See IRM (20)813 and IRM (20)140 for post-assessment appeal procedures.

(20)827.3 Penalty Computation

IRC section 6714 provides for a penalty of \$10 per failure to provide the required written statement to the payor (donor). The maximum penalty per fund raising event or mailing shall not exceed \$5,000.

(20)827.4 Penalty Relief

(1) The penalty does not apply if the organization can establish that the failure to provide the written statement was due to reasonable cause.

(2) When asserting the penalty use NMF procedures in IRM (20)813.3.

(3) See IRM (20)130 for a discussion of penalty relief.

(20)830 Employee Plans

(20)831 Introduction

(20)831.1 General

(1) In general, Employee Plan (EP) penalties involve plans which are subject to the Employee Retirement Income Security Act of 1974 (ERISA) which defer the receipt of compensation. This chapter discusses some of the EP penalties which are frequently encountered.

(2) In general, EP penalties are subject to deficiency procedures described in IRM (20)143. Where this is not the case, the exceptions have been noted.

(20)831.2 Penalty Relief

(1) Recent review of criteria previously identified as reasonable cause has been clarified. See IRM (20)130 for a discussion of all forms of penalty relief. Penalty relief falls into four separate categories. They are:

(a) Reasonable Cause,

(b) Statutory Exceptions,

(c) Administrative Waivers, and

- (2) Generally, the statute of limitations for assessment of these penalties will be the same as the statute for the return or statement to which the penalties relate. Some penalties such as the IRC section 6710 penalty do not relate to a return. These penalties should be assessed as soon as possible even though it appears they do not have a statute of limitations.
- (3) Taxpayers who disagree with the assertion of a penalty are entitled to a post-assessment appeal under the provisions of Treas. Reg. section 601.106(a)(1)(iii). The examining specialist should advise the taxpayer of this right and explain the the appeal may be filed prior to payment. For additional information on appealing penalties, see IRM (20)140.
- (4) Penalties should not be assessed if the total amount of tax and penalties is less then the amount specified in text (13)10 of the LEM Part IV.
- (5) If a penalty is to be assessed using Non-Master File (NMF) procedures the agent will:
- (a) If the penalty is asserted against a person (manager) or an organization (such as in an IRC section 6710 case):
 - 1 Complete all blocks (except for the Document Locator Number (DLN) and the computation of interest) on the Form 5734 (Non-Master File Assessment Voucher). The Abstract Number can be found in the ADP and IDRS Information Book (Document 6209).
 - 2 Prepare a penalty case file to transmit Form 5734. Attach Form 3198 (Special Handling Notice) to the outside of the folder and annotate "Civil Penalty Assessment". Any source documents providing the basis for the penalty assessment will be included in the file. The agent will forward the file to EP/EO-SP (Employee Plans and Exempt Organizations Special Procedures) with instructions to assess the penalties immediately.
 - 3 If multiple penalties are being assessed, separate penalty files are required. If the penalty file is related to an unagreed issue and the specialist separates the file, the Form 3198 should state the fact of and reason for the separation.
 - (b) If the case involves a NMF account (which is possible in an IRC section 6684 case) which is open on AIMS, the agent will provide the penalty information to EO/EP-SP for preparation of Form 2859 (Request for Quick Assessment). The penalty amount will be entered in Item 35 of Form 5599, E.O. Examined Closing Record.
- (6) If the penalty is to be assessed through the Business- Master File (BMF), the agent will complete Form 5599.
- (a) If the agent secures a subsequent year delinquent return and applies a failure to file penalty, the agent will prepare Form 3198 (Special Handling Notice) to request the assessment.
 - (b) The agent will forward Form 3198 along with the delinquency return package to the EP/EO-SP. The agent will include in Item 34 of Form 5599 the amount of the penalty.

(20)814 Chapter Outline

(1)The penalties discussed in this chapter are as follows:

(a)IRM (20)820 - Exempt Organizations and Certain Trusts,

1 IRC section 6652(c),

2 IRC section 6684,

3 IRC section 6685,

4 IRC section 6710,

5 IRC section 6711,

6 IRC section 6714,

(b)IRM (20)830 - Employee Plans,

1 IRC section 6652(d),

2 IRC section 6652(e),

3 IRC section 6652(h),

4 IRC section 6652(i),

5 IRC section 6690,

6 IRC section 6692,

7 IRC section 6693,

8 IRC section 6704.

(20)820 Exempt Organizations and Certain Trusts

(20)821 Introduction

(1)Organizations which are exempt from federal income tax are organized and operated for one or more of the purposes designated in IRC section 501. Examples include charitable, religious, scientific, educational, political, social, and business related organizations.

(2)Exempt Organizations under IRC sections 6033 and 6043(b) are required to file:

(a)Form 990, Return of Organization Exempt from Income Tax,

(b)Form 990BL, Information and Initial Excise Tax Return for Black Lung Benefit Trusts & Certain Related Person,

(c)Form 990PF, Return of Private Foundation or Section 4979(a)(1) Trust treated as a

Private Foundation,

(3) Certain Trusts under IRC section 6034 are required to file Form 1041 A, U.S. Information Return Trust Accumulation of Charitable Amounts.

(20) 822 IRC Section 6652(c) Failure to File Certain Information Returns

(20) 822.1 General

(1) Public Law 104-168 amended IRC section 6652(c) for tax years ending on or after July 30, 1996. IRC section 6652(c) was added by Public law 91-172 and became effective for taxable years beginning after Dec. 31, 1969.

(2) IRC section 6652(c)(1) - Returns by Exempt Organizations

(a) IRC section 6652(c)(1)(A) - Penalty Imposed on the Organization

1 IRC sections 6033 and 6043(b) require exempt organizations to file returns, and IRC section 6034 requires certain trusts to file returns on the date and in the manner prescribed. IRC sections 6652(c)(1) and (2) impose a penalty on organizations failing to meet the requirements of IRC sections 6033, 6034 and 6043(b).

2 IRC section 6652(c)(1)(A) imposes a penalty on exempt organizations required to file returns under IRC section 6033 of \$20 for each day, for tax years ending on or after July 30, 1996, during which a failure to file continues (determined with regard to extensions) or for a failure to include any of the information required to be shown on a return filed under IRC section 6033 or to show the correct information. The penalty is not to exceed \$10,000 (for tax years ending on or after July 30, 1996) or 5 percent of the gross receipts of the organization for the year, whichever is less. (For tax years ending prior to July 30, 1996, the penalty rate is \$10 per day with a maximum of \$5,000 or 5 percent of gross receipts).

3 IRC section 6652(c)(1)(A) imposes a penalty on an organization having gross receipts exceeding \$1,000,000 for any year, with respect to the return required under section 6033 for such year, of \$100 per day with the maximum penalty of \$50,000 per return. This applies to tax years ending on or after July 30, 1996.

(b) IRC section 6652(c)(1)(B) - Penalty Imposed on the Manager or Person Failing to Comply

1 IRC 6652(c)(1)(B) requires organization manager(s) to file returns required under IRC section 6033 after the Secretary has made demand for filing under that provision.

2 A penalty of \$10 is charged for each day after the expiration of the time specified

in the written demand during which such failure continues.

3 The maximum penalty imposed under this section on all persons for failure to file any 1 return is limited to \$5,000.

(c)IRC section 6652(c)(1)(C) -Public Inspection of Annual Returns

1 IRC section 6104(d) requires manager(s) of private foundations to comply with rules relating to public inspection of annual returns on the date and in the manner prescribed in IRC section 6104(d).

aIRC section 6652(c)(1) imposes a penalty of \$20 for each day during which such failure continues.

bThe total penalty on all manager(s) under this section with respect to one annual return shall not exceed \$10,000.

2 IRC section 6104(e)(1) requires exempt organizations, other than Private Foundations covered under IRC section 6104(d), to make available for public inspection a copy of their annual information returns on Form 990 for years beginning after December 31, 1986.

aIRC section 6652(c)(1) imposes a penalty of \$20 for each day during which the failure to provide information returns continues.

bThe total penalty on all manager(s) under this section with respect to one annual return shall not exceed \$10,000.

(d)IRC section 6652 (c)(1)(D) - Public Inspection of Applications

1 IRC section 6104(e)(2) also requires exempt organizations to make available for public inspection a copy of their application for recognition of tax exemption on Form 1023 or Form 1024. An application filed prior to July 15, 1987, is required to be made available if the organization had a copy of the application on that date.

aIRC section 6652 (c)(1)(D) imposes a penalty of \$20 for each day during which the failure to provide applications for exemption continues.

bThe Code does not set a limit on the maximum penalty to be assessed.

2 Prior to asserting penalties for failure to allow the public inspection of returns and exemption applications required under IRC section 6104, the Service should receive, in writing, the name of the person(s) who refused to provide the return or application, as well as the date of the refusal and a description of the facts of the refusal.

(3) IRC section 6652(c)(2) - Trusts and Exempt Organizations

(a) IRC section 6652(c)(2)(A) - Penalty on the Organization or Trust

1 IRC section 6652(c)(2)(A) provides for a daily delinquency penalty to be asserted on the exempt organization or trust that fails to file a return required under IRC section 6034 (trusts) or IRC section 6043(b) (terminations, etc., of exempt organizations) on the date and in the manner prescribed.

2 The daily delinquency penalty for any one return for this section shall not exceed:

a \$10 per day for each day the failure continues,

b with a maximum penalty of \$5,000 per return.

(b) IRC section 6652(c)(2)(B) - Penalty on Managers.

1 IRC section 6652(c)(2)(B) provides for a daily delinquency penalty to be asserted on the person that fails to comply with the demand that a return required under IRC section 6034 or 6043(b) be filed or information be furnished by a reasonable future date (90 days after the mailing date of the demand).

2 The daily delinquency penalty for any one return for this section shall not exceed:

a \$10 per day for each day the failure continues,

b with a maximum penalty of \$5,000 per return.

(20)822.2 Penalty Assertion

(1) Penalties for late filing of required returns are usually asserted at Service Centers when returns are processed.

(2) Penalties may be asserted by examining officers for delinquent returns secured by them, or for failures described above.

(3) IRC sections 6652(c)(1)(A) and (c)(2)(A) penalties should be assessed using Master File procedures. All other IRC section 6652(c) penalties discussed in this chapter should be assessed using Non-Master File procedures. See IRM (20)813.3.

(20)822.3 Penalty Computation

(1) "Person" refers to any officer, director, trustee, employee or other individual under a duty to perform the act which is the cause of the violation.

(2) There is joint and several liability for these penalties whenever more than one person is liable.

(20)822.4 Penalty Relief

(1) No penalties should be asserted under IRC section 6652 if any failure is due to reasonable cause. Recent examination of criteria previously identified as reasonable cause was clarified.

Penalty relief falls into four separate categories. They are:

- (a) Reasonable Cause,
- (b) Statutory Exceptions,
- (c) Administrative Waivers, and
- (d) Correction of Service Error.

(2) See IRM (20)813 and IRM (20)140 for post-assessment appeal procedures.

(3) See IRM (20)130 for a discussion of penalty relief.

(20)823 IRC Section 6684

Assessable Penalties with Respect to Liability for Tax Under Chapter 42

(20)823.1 General

IRC section 6684 was added to the Code by Public Law 91-172 and affects private foundation managers after December 31, 1968. Public Law 100-203, effective after December 22, 1987, amended IRC section 6684, making the provisions also applicable to managers of "other tax-exempt organizations."

(20)823.2 Penalty Assertion

(1) IRC section 6684 provides that a penalty may be asserted on any person, as defined by IRC section 7701(a)(1), liable for tax under Chapter 42, Private Foundations and Certain Other Tax Exempt Organizations (except IRC section 4940, Excise Tax Based on Investment Income or IRC section 4948(a), Application of Taxes and Denial of Exemption with Respect to Certain Foreign Organizations) when they acted improperly or failed to act if:

- (a) that person was previously liable for private foundation tax, or
- (b) the act or failure to act is both willful and flagrant.

(2) The term "willful and flagrant" is defined in IRC section 507(a)(2)(A) as:

- (a) willful repeated acts (or failures to act), or
- (b) willful and flagrant acts (or failures to act).

(3) The penalty is assessed using Non-Master File (NMF) procedures. See IRM (20)813 and IRM (20)140 for post-assessment appeal procedures.

(20)823.3 Penalty Computation

The penalty is equal to the amount of the excise tax for which it is determined the person is liable.

(20)823.4 Penalty Relief

(1)The penalty does not apply if reasonable cause for the act or failure to act can be affirmatively shown by the person upon whom the penalty is imposed.

(2)See IRM (20)130 for a discussion of penalty relief.

(20)824 IRC Section 6685

Assessable Penalty with Respect to Public Inspection Requirements for Certain Tax Exempt Organizations

(20)824.1 General

(1)IRC section 6685 was added to the Code by Public Law 91-172 and became effective for taxable years beginning after December 31, 1969. IRC section 6685 was amended by Public Law 100-203, for years beginning after December 31, 1986. Public Law 104-168 amended IRC section 6685 to increase the penalty to \$5,000 effective on or after the 60th day after the IRS issues regulations. This amendment extend the penalty to managers of all tax-exempt organizations and for:

(a)applications for exemption submitted to the Service after July 15, 1987, and

(b)copies of applications for exemption on hand which were submitted prior to July 15, 1987.

(2)This penalty will be assessed using Non-Master File procedures. The specialist will prepare a Form 5734 and a Penalty Case File. See IRM (20)813.3.

(3)The penalty in IRC section 6685 is in addition to the penalty imposed by IRC section 7207 (relating to Fraudulent Returns, Statements, or other Documents).

(20)824.2 Penalty Assertion

(1)IRC section 6685 provides that the penalty is asserted on the person who fails to make an annual return or application for exemption available for public inspection as required by IRC section 6104(d) and (e).

(2)Prior to taking action with regard to IRC section 6104, the Service should receive information in writing that documents the name of the person who refused to provide the return or application and the date on which the refusal occurred.

(3)For this IRC section, a person is defined as any officer, director, trustee, employee, member, or other individual whose duty it is to perform the act.

(4) See IRM (20)813 and IRM (20)140 for post-assessment appeal procedures.

(20)824.3 Penalty Computation

(1)IRC section 6685 imposes a penalty of \$1,000 with respect to each return or application for the willful failure to satisfy the public inspection requirements of any private foundations' annual

returns (IRC section 6104(d) or (e)).

(2)Public Law 104-168 amended IRC section 6685 to increase the penalty from \$1,000 to \$5,000 effective on or after the 60th day the IRS issues regulations.

(20)824.4 Penalty Relief

The penalty may not be waived for reasonable cause.

(20)825 IRC Section 6710

Failure to Disclose that Contributions are Nondeductible

(20)825.1 General

(1)IRC section 6710 was added by Public Law 100-203 and is effective for solicitations made after January 31, 1988. This IRC section imposes a penalty on an organization that fails to disclose that contributions or gifts made to this organization (or on behalf of this organization) are not deductible as charitable contributions for federal income tax purposes (IRC section 6113).

(20)825.2 Penalty Assertion

(1)Each solicitation must disclose (in a conspicuous and easily recognized format) that contributions or gifts made to this organization are not deductible as charitable contributions for Federal Income Tax purposes.

(2)Generally, the penalty applies to organizations which are not described in IRC section 170(c) but are described in IRC section 501(c) and are tax exempt under IRC section 501(a).

(3)When asserting the penalty use NMF procedures in IRM (20)813.3.

(4) See IRM (20)813 and IRM (20)140 for post-assessment appeal procedures.

(20)825.3 Penalty Computation

(1)IRC section 6710(a) provides for a penalty of \$1,000 per day for each day the failure occurred up to a maximum of \$10,000 during any calendar year.

(2)IRC 6710(c) provides an exception to the maximum annual penalty of \$10,000. When it is shown that the failure was due to intentional disregard, the penalty shall be the greater of:

(a)\$1,000 per day or

(b)50 percent of the daily combined cost of all the solicitations where a failure to disclose occurred and the penalty shall be taken into account in applying such limitations to other penalties under IRC section 6710(a).

(3)Consider the following when determining the day a failure to meet the requirement occurred. If the solicitation was:

(a)by television or radio, the failure occurs when the solicitation is televised or

broadcast;

(b)by mail, the failure occurs when the solicitation is mailed;

(c)not by mail but in written or printed form, the failure occurs when the solicitation is distributed;

(d)by telephone, the failure occurs when the solicitation is made.

(20)825.4 Penalty Relief

(1)IRC section 6710(b) provides that no penalty shall be imposed if the failure under IRC section 6710(a) was due to reasonable cause.

(2)IRC section 6710(c) does not provide a reasonable cause exception for the Intentional Disregard penalty.

(3)See IRM (20)130 for a discussion of penalty relief.

(20)826 IRC section 6711

Failure to Disclose that Information or Service is Available from Federal Government

(20)826.1 General

IRC section 6711 was added by Public Law 100-203 and is effective for offers and solicitations made after January 31, 1988.

(20)826.2 Penalty Assertion

(1)IRC section 6711 provides that when a tax-exempt organization offers to sell (or solicits money for) specific information or offers to provide routine service for any individual that could be readily obtained by such individual free of charge (or for a nominal charge) from an agency of the Federal Government, the tax-exempt organization must, when making such offer or solicitation make "an express statement" that the information can be obtained from the Federal Government.

(2) This requirement applies only if the information to be provided involves the specific individual solicited. For example, the requirement applies with respect to obtaining the social security earnings record or the social security identification number of an individual solicited.

(3)Material and/or services available from the Federal Government for less than \$2.50, including postage and handling costs, meet the nominal charge requirement.

(4)This penalty is assessed using NMF procedures in IRM (20)813.3.

(5) See IRM (20)813 and IRM (20)140 for post-assessment appeal procedures.

(20)826.3 Penalty Computation

(1)For each day a failure occurred, the penalty shall be the greater of:

(a)\$1,000 per day or

(b)50 percent of the daily combined cost for all the offers and solicitations where a failure to disclose occurred.

(2)Consider the following when determining the day a failure to meet the requirement occurred. If the solicitation was:

(a)by television or radio, the failure occurs when the solicitation is televised or broadcast;

(b)by mail, the failure occurs when the solicitation is mailed;

(c)not by mail but in written or printed form, the failure occurs when the solicitation is distributed;

(d)by telephone, the failure occurs when the solicitation is made.

(20)826.4 Penalty Relief

The penalty may not be waived for reasonable cause.

(20)827 IRC Section 6714

Failure to Meet Disclosure Requirements Applicable to Quid Pro Quo Contributions

(20)827.1 General

IRC section 6714 was added by Public Law 103-66 and is effective for quid pro quo contributions made after December 31, 1993. This IRC section provides for a penalty to be asserted against organizations that did not disclose quid pro quo contributions in excess of \$75 as required under IRC section 6115(a).

(20)827.2 Penalty Assertion

(1)IRC section 6115(b) defines "quid pro quo contribution" as a payment:

(a)made partly as a contribution and partly in consideration for goods or services provided to the payor (donor) by the donee organization; and

(b)not made to a religious organization, in return for which the taxpayer received only an intangible religious benefit that generally would not be sold in a commercial transaction.

(2)IRC section 6115 provides that organizations described in IRC section 170(c) (except governmental instrumentalities described in IRC section 170(c)(1)) are required to provide a written statement to each donor in connection with the solicitation or receipt of the contribution.

(a)That statement must provide the donor with a good faith estimate of the amount of the contribution that is deductible for Federal income tax purposes.

(b)The amount of the deductible contribution is limited to the excess of:

1 any money and the value of any property (other than money), contributed by the donor, that exceeds

2 the value of the goods or services received.

(3)The penalty is assessed using NMF procedures in IRM (20)813.3.

(4) See IRM (20)813 and IRM (20)140 for post-assessment appeal procedures.

(20)827.3 Penalty Computation

IRC section 6714 provides for a penalty of \$10 per failure to provide the required written statement to the payor (donor). The maximum penalty per fund raising event or mailing shall not exceed \$5,000.

(20)827.4 Penalty Relief

(1) The penalty does not apply if the organization can establish that the failure to provide the written statement was due to reasonable cause.

(2)When asserting the penalty use NMF procedures in IRM (20)813.3.

(3)See IRM (20)130 for a discussion of penalty relief.

(20)830 Employee Plans

(20)831 Introduction

(20)831.1 General

(1) In general, Employee Plan (EP) penalties involve plans which are subject to the Employee Retirement Income Security Act of 1974 (ERISA) which defer the receipt of compensation. This chapter discusses some of the EP penalties which are frequently encountered.

(2) In general, EP penalties are subject to deficiency procedures described in IRM (20)143. Where this is not the case, the exceptions have been noted.

(20)831.2 Penalty Relief

(1)Recent review of criteria previously identified as reasonable cause has been clarified. See IRM (20)130 for a discussion of all forms of penalty relief. Penalty relief falls into four separate categories. They are:

(a)Reasonable Cause,

(b)Statutory Exceptions,

(c)Administrative Waivers, and

(d) Correction of Service Error.

(2) IRM (20)133.34, discusses the fact that reliance on the advice of a tax advisor is limited to issues generally considered technical or complicated.

(3) United States v. Boyle, 469 U.S. 241 (1985), states that the responsibility to file, pay or deposit taxes cannot be excused by reliance on the advice of a tax advisor. It requires no special training or effort on a taxpayer's part to ascertain a deadline and ensure that it is met.

(20)832 IRC Section 6652(d)

Annual Registration and Other Notification by Pension Plan

(20)832.1 IRC Section 6652(d)(1)

(20)832.11 General

(1) IRC section 6652(d)(1) imposes a penalty on a plan administrator (see IRC section 6057(a)(1)) for the failure to file by the due date, the Schedule SSA, Annual Registration Statement Identifying Separated Participants with Deferred Vested Benefits. In general, plans subject to this requirement are those which result in the deferral of compensation.

(a) Plans subject to this requirement include:

- 1 all qualified plans or annuities under IRC section 401(a) or 403(a), and
- 2 in general, other deferred compensation plans.

(b) Plans not subject to this requirement include:

- 1 IRC section 414(d), government plans;
- 2 IRC section 414(e), church plans where no IRC section 410(d) election has been made;
- 3 any plan which has not (after September 2, 1974) provided employer contributions;
- 4 any plan established and maintained by a society, order, or association described in IRC section 501(c)(8) or (9), if no part of the contributions are made by employers of participants in such plan; and
- 5 any plans exempted pursuant to ERISA section

102, such as top hat and excess benefit plans.

(20)832.12 Penalty Assertion

(1) In general, IRC section 6057(a) requires a plan administrator to file a registration statement for each plan year. This registration statement should include:

- (a) the name of the plan;
- (b) the name and address of the plan administrator,
- (c) the name and taxpayer identification number of each participant in the plan, who:
 - 1 is separated from service covered by the plan during the plan year. If not reported in the year of separation, such separated participant must be reported in the following year,
 - 2 is entitled to a deferred vested benefit, and
 - 3 did not receive retirement benefits,
- (d) the nature, amount and form of deferred vested benefit, and
- (e) other information the Service may require.

(2) The Schedule SSA must be filed as an attachment to Form 5500, Annual Return/Report of Employee Benefit Plan.

(3) Due Date: See IRM (20)833.2(3).

(4) Extensions of time to file: See IRM (20)833.2(4).

(5) Assess penalties under IRC sections 6652(d)(1) on the plan administrator (as defined in of IRC section 414(g), Plan Administrator).

(6) Penalties under IRC section 6652(d)(1) are assessed on NMF. They are computed after the return is processed at the Master File, or they may be asserted by the specialist.

(20)832.13 Penalty Computation

(1) The penalty for failing to file on the due date, is equal to:

- (a) \$1 for each participant (for whom the required information was not filed),
- (b) multiplied by the number of days the failure continues.
- (c) The penalty shall not exceed \$5,000 for any plan year.
- (d) For purpose of the penalty, the failure to report either the participant's name or SSN is considered a failure to report the participant.

1 Note: Exceptions are granted for Foreign Nationals who are not required to have an SSN.)

2 Example 1: Form contains 10 names, but only 8 show an SSN. The penalty would be \$2 times (b) above.

3 Example 2: Form contains 50 names, but it showed 60 SSNs. The penalty would be \$10 times (b) above.

(20)832.14 Penalty Relief

(1) IRC section 6652(d)(1) provides for non-assertion of the penalty if the plan administrator can show reasonable cause for the failure to timely file.

(2) The request for "penalty relief" due to reasonable cause must be made in the form of a written statement providing all the facts alleged as reasonable cause. The statement must contain a declaration by the appropriate individual that the statement is made under penalties of perjury.

(3) See IRM (20)130 for a discussion of penalty relief.

(20)832.2 IRC Section 6652(d)(2)

Notification of Change of Status

(20)832.21 General

(1) IRC section 6652(d)(2) imposes a penalty on the plan administrator for the failure to notify the Service, by the due date, of changes in the status of a plan as required in IRC section 6057(b).

(2) In general, the plans subject to this requirement are those plans which result in the deferral of compensation.

(a) Plans subject to this requirement include:

- 1 all qualified plans or annuities under IRC section 401(a) or 403(a), and
- 2 in general, other deferred compensation plans.

(b) Plans not subject to this requirement include:

- 1 IRC section 414(d), government plan;
- 2 IRC section 414(e), church plan where no IRC section 410(d) election has been made;
- 3 a plan which has not (after September 2, 1974) provided employer contributions; and
- 4 a plan established and maintained by a society, order, or association described in IRC section 501(c)(8) or (9), if no part of the contributions are made by employers of participants in such plan.
- 5 any plans exempted pursuant to ERISA section 102 such as top hat or excess benefits plans.

(20)832.22 Penalty Assertion

(1) IRC section 6057(b) requires the plan administrator to notify the Service of:

(a) any change in the name of the plan,

- (b) any change in the name and address of the plan administrator,
- (c) termination of the plan,
- (d) merger or consolidation of the plan with any other plan, or
- (e) division of the plan into two or more plans.

(2) Due Date: See IRM (20)833.2(3).

(3) Extensions of time to file: See IRM (20)833.2(4).

(4) Assess penalties under IRC sections 6652(d)(2) on the plan administrator (as defined in IRC section 414(g), Plan Administrator).

(5) Penalties under IRC section 6652(d)(2) are assessed on NMF. They are computed after the return is processed at the Master File, or they may be asserted by the specialist.

(20)832.23 Penalty Computation

(1) The penalty for failing to file the form on the due date in the prescribed manner is equal to:

- (a) \$1 for each failure,
- (b) multiplied by the number of days the failure continues.
- (c) The penalty shall not exceed \$1,000 for failure to file any notification.

(20)832.24 Penalty Relief

(1) IRC section 6652(d)(2) provides for non-assertion of the penalty if the plan administrator can show reasonable cause for the failure to timely file.

(2) The request for "penalty relief" due to reasonable cause must be made in the form of a written statement providing all the facts alleged as reasonable cause. The statement must contain a declaration by the appropriate individual that the statement is made under penalties of perjury.

(3) See IRM (20)130 for more information relating to penalty relief.

(20)833 IRC Section 6652(e)

Information Required in Connection with Certain Plans of Deferred Compensation, Etc.

(20)833.1 General

(1) Prior to January 1, 1997, IRC section 6652(e) imposes a penalty for failure to file annual returns and statements by the due date and in the prescribed manner required under:

- (a) IRC section 6058, relating to certain plans of deferred compensation,
 - (b) IRC section 6047(d), relating to certain trusts, annuity and bond purchase plans,
- and

(c) IRC section 6039D, relating to certain fringe benefit plans.

(2) After December 31, 1996, IRC section 6652(e) continues to impose a penalty for failure to file annual returns and statements by the due date and in the prescribed manner required under:

(a) IRC section 6058, relating to certain plans of deferred compensation, and

(b) IRC section 6039D, relating to certain fringe benefit plans.

(c) However, IRC section 6047(d), relating to certain trusts, and annuity and bond purchase plans, is penalized under IRC section 6721.

(3) In general, IRC section 6058(a), requires the employer, or the plan administrator, of each funded plan of deferred compensation, to file an annual return (Form 5500 (series), Annual Return/Report of Employee Benefit Plan). See Exhibit (20)800-1, Plans Filing Requirements, and Exhibit (20)800-2, Plans Exempt From Filing.

(4) Due Date: In general, the due date for the Form 5500, Annual Return/Report of an Employee Benefit Plan, and appropriate schedules is:

(a) Full plan year: The appropriate Form 5500 and its applicable schedules must be filed by the last day of the 7th month after the plan year ends.

(b) Short plan year: Form 5500 and its applicable schedules must be filed by the last day of the 7th month after the short plan year ends.

(5) Extension of Time to File: A one time extension of time to file (up to 2½ months) may be granted for filing the Form 5500 (series) and its required schedules. An extension of up to 6 months may be granted for filing Form 5330 (Return of Initial Excise Taxes Related to Employee Benefit Plans). Form 5558 (Application for Extension of Time to File Certain Employee Plan Returns) must be filed before the normal due date of the Form 5500 (series) and Form 5330.

(6) Plans are automatically granted extensions of time to file Form 5500 and its required schedules until the extended due date of the Federal income tax return of the employer and are not required to file Form 5558, if all the following conditions are met:

(a) the plan year and the employer's tax year are the same;

(b) the employer has been granted an extension of time to file its Federal income tax return to a date later than the normal due date for filing the Form 5500; and

(c) a copy of the extension of time to file the Federal income tax return is attached to the Form 5500 filed with the Service.

(7) Plans granted an extension under the conditions in (5) above, cannot further extend the due date by filing a Form 5558.

(20)833.2 Penalty Assertion

(1) The penalty is imposed against the person responsible for:

(a) failing to file the annual return (Form 5500 series). The plan administrator (within the meaning of IRC section 414(g)) or the employer may be jointly and severally liable for the penalty.

(b) failing to file Form 5310-A in case of a merger, consolidation, or transfer of plan assets or liabilities. The plan administrator is liable for the penalty.

(c) failing to file Form 1096 or 1099R. In the case of:

1 a trust, the trustee is liable for the penalty.

2 a custodial account, the custodian is liable for the penalty.

3 an annuity contract, the issuer is liable for the penalty.

(2) In general, IRC section 6058(b), requires a plan administrator to file an actuarial statement of valuation evidencing compliance with IRC section 401(a)(12).

(a) The Form 5310-A, Notice of Plan Merger, Consolidation, or Transfer of Plan Assets or Liabilities, was designated by the Service as the form to be used for satisfying the requirements.

(b) The Form 5310-A should be filed when there is a plan merger, consolidation, spinoff, or when there is a transfer of assets or liabilities to another plan. When meeting this criteria, Form 5310-A should be filed by the plan administrator or plan sponsor for:

1 a pension plan,

2 a profit-sharing plan, or

3 another deferred compensation plan, (except a multi-employer plan covered by PBGC insurance).

(c) The Form 5310-A must be filed at least 30 days prior to a plan merger, consolidation, spinoff, or transfer of liabilities to another plan. The form is late if not filed at least 30 days before any of these referenced activities.

(d) The instructions to Form 5310-A provide that a Form 5310-A is not to be filed for:

1 an eligible rollover that is paid directly to an eligible retirement plan in a direct rollover as described in IRC section 401(a)(31), Optional Direct Transfer of Eligible Rollover Distributions, or

2 the plan merger or consolidation, spinoff, or transfer of plan assets or liabilities complies with:

a Treas. Regs. 1.414(1)-1(d), Merger of defined contribution plans,

b Treas. Regs. 1.414(1)-1(h), De minimis rule for merger of defined benefit plan,

cTreas. Regs. 1.414(1)-1(m), Spinoff of a defined contribution plan, or

dTreas. Regs. 1.414(1)-1(n)(2), Spinoff of a defined benefit plan, De minimus rule.

(3) In general, IRC section 6047(d) requires Form 1096 (Annual Summary and Transmittal of U.S. Information Returns) and Form 1099-R (Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRA's, Insurance) to be filed by the employer maintaining, or the plan administrator of, a plan from which designated distributions may be made, or by the issuer of a contract under which such distributions may be made.

(a) Designated distributions are defined in IRC section 3405(e)(1) and include, generally, any includible non-wage distributions from an employer deferred compensation plan, an IRA, or a commercial annuity.

(b) A separate Form 1099-R must be made for each payee, but is not required if the aggregate payment to the payee is less than \$10.

(c) Form 1099-R is required to be furnished to the payee by January 31 following the year of the distribution; Form 1096 with Forms 1099-R is required to be filed with the Service by February 28 following the year of the distribution.

(d) The penalty under IRC section 6652(e) does not apply to Forms 1099-R due (determined without extensions) after December 31, 1996. Instead, the penalties under IRC sections 6721 and 6722 apply.

(4) In general, IRC section 6039D requires every employer maintaining a specified fringe benefit plan, file a Form 5500 and Schedule F, Fringe Benefit Plan Annual Information Return, must be attached to page 1 of Form 5500, or 5500 C/R, Return/Report of Employee Benefit Plan.

(a) Plans generally required to file:

1 IRC section 125, Cafeteria Plans and

2 IRC section 127, Educational Assistance Programs.

(b) Plans generally not required to file:

1 IRC section 127, Educational Assistance Programs, when only job-related training that is deductible under IRC section 162, Trade or Business Expenses.

2 IRC section 79, Group Term-Life Insurance Purchased for Employees;

3 IRC section 105, Amounts Received Under Accident and Health Plans;

4 IRC section 106, Contributions By Employer to Accident and Health Plans;

5 IRC section 120, Amounts Received Under Qualified Group Legal Services Plans; and

6 IRC section 129, Dependent Care Assistance Programs.

(5) Rev. Rul. 84-54, 1984-1 C.B. 260, provides that IRC section 6652(e) penalties do not apply to the failure to file the following Form 5500 schedules, but rather the penalties imposed by IRC section 6692 and 6652(d)(1).

(a) Schedule B, Actuarial Information,

(b) Schedule SSA, Annual Registration Statement Identifying Separated Participants with Deferred Vested Benefits,

(6) Assess penalties under IRC section 6652(e) on the plan administrator (as defined in IRC section 414(g), Plan Administrator).

(7) The penalty under IRC section 6652(e) is assessed on NMF. It is computed after the return is processed at the Master File, or it may be asserted by the specialist.

(20)833.3 Penalty Computation

(1) The penalty for failing to file the form on the due date in the prescribed manner is equal to:

(a) \$25 for each failure,

(b) multiplied by the number of days the failure continues.

(c) The penalty shall not exceed \$15,000 on any person for the failure to file any return.

(20)833.4 Penalty Relief

(1) IRC section 6652(e) provides for non-assertion of the penalty if reasonable cause can be shown.

(2) The request for "penalty relief" due to reasonable cause must be made in the form of a written statement providing all the facts alleged as reasonable cause. The statement must contain a declaration by the appropriate individual that the statement is made under penalties of perjury.

(3) In Alton OB-Gyn, Ltd. v. United States, 789 F.2d 515 (7th Cir. 1986), the taxpayer's reliance on a bank, as plan's trustee, to handle ministerial duties of taxpayer's pension and profit-sharing plans, did not constitute reasonable cause for the failure to timely file the required Form 5500 series return.

(20)834 IRC Section 6652(h)

Failure to Give Notice to Recipients of Certain Pension, Etc., Distributions

(20)834.1 General

IRC section 6652(h) imposes a penalty for each failure to give notice concerning withholding to recipients of distributions from an employer's deferred compensation plan or an IRA as required by IRC section 3405(e)(10)(B). The penalty is imposed on the payor.

(20)834.2 Penalty Assertion

(1) In general, IRC section 3405(e)(10)(B) requires that the "Payor" of:

(a) any annuity or similar periodic payment must provide the "Payee" a notice of the right to elect not to have withholding made on such payment, or

(b) any distribution which is not in the form of an annuity or a periodic distribution must provide the "Payee" a notice of the right to elect not to have withholding made on such payment.

(2) In general, these requirements pertain to payments and distributions made from employee deferred compensation plans, individual retirement plans, and commercial annuities.

(3) Due Date: The notice of election must be transmitted no earlier than six months before the first payment and no later than when the first payment is made.

(a) For periodic payments, notice must also be provided at least once in each calendar year of the right to make and revoke the election.

(b) Temporary Regulations 35.3405-1 D-21, D-22, D-25, and d-26 provides examples of notices which can be used to satisfy the notice requirements.

(4) The penalty under IRC section 6652(h) is identified by the EP field agent.

(5) The penalty is assessed on NMF.

(20)834.3 Penalty Computation

The penalty under IRC section 6652(h) is \$10 for each failure to give notice, up to a maximum penalty of \$5,000 for all such failures per calendar year.

(20)834.4 Penalty Relief

(1) IRC section 6652(h) provides for non-assertion of the penalty if the payor can show that the failure was due to reasonable cause and not willful neglect.

(2) See IRM (20)130 for a discussion of penalty relief.

(20)835 IRC Section 6652(i) Failure to Give Written Explanation of Qualifying Rollover Distributions

(20)835.1 General

IRC section 6652(i) imposes a penalty for each failure to timely provide a written explanation of a rollover distribution as required by IRC section 402(f), Written Explanation to Recipients of Distributions Eligible for Rollover Treatment.

(20)835.2 Penalty Assertion

(1) In general, IRC section 402(f) requires plan administrators of qualified plans to provide a written explanation to recipients of eligible rollover distributions that explains:

(a) the rules under which a recipient may elect a direct rollover to an eligible retirement

plan;

(b) withholding of income tax if there is no direct rollover; and

(c) the rules which permit tax deferral on the distribution if it is rolled over into an eligible retirement plan within 60 days of distribution.

(d) If applicable, the notice must also contain information regarding IRC section 402(d), Tax on Lump Sum Distributions, and (e) Other Rules Applicable to Exempt Trusts.

(2) In general:

(a) an eligible retirement plan includes:

1 IRC section 408(a), individual retirement accounts,

2 IRC section 408(b), individual retirement annuity (other than an endowment contract),

3 IRC section 401(a), trustee plans, and

4 IRC section 403(a) annuity plans, or

(b) an eligible rollover distribution means any distribution to an employee of all or part of the balance to the credit of the employee in a qualified trust, other than certain periodic payments and distributions required by IRC section 401(a)(9).

(3) Due Date: The explanation must be provided no less than 30 days and no more than 90 days before the date of the distribution.

(4) The penalty under IRC section 6652(i) is identified by the EP field agent.

(5) The penalty is assessed on NMF.

(20)835.3 Penalty Computation

(1) The penalty under IRC section 6652(i) is \$10 for each failure to provide a written explanation, up to a maximum penalty of \$5,000 for all such failures per calendar year.

(2) In addition, effective for statements due after January 1, 1997, section 1455 of the Small Business Job Protection Act amends the computation of the section 6652(i) penalty, by changing the \$10 penalty to \$100 and the \$5,000 maximum to \$50,000.

(20)835.4 Penalty Relief

(1) IRC section 6652(i) provides for non-assertion of the penalty if the payor can show that the failure was due to reasonable cause and not willful neglect.

(2) See IRM (20)130 for a discussion of penalty relief.

(20)836 IRC Section 6690

Fraudulent Statement or Failure to Furnish Statement to Plan Participant

(20)836.1 General

(1) IRC section 6690 imposes a penalty on a plan administrator who:

(a) willfully fails to furnish a statement to a plan participant at the time and in the manner, required by IRC section 6057(e), Individual Statement to Participant, and Treas. Reg. section 301.6057-1(e), Individual Statement to Participant, or

(b) willfully furnishes a false or fraudulent statement.

(20)836.2 Penalty Assertion

(1) In general, the individual statement to a participant, required by IRC section 6057(e) and Treas. Reg. 301.6057-1(e) must include:

(a) a description of the participant's deferred vested retirement benefit,

(b) information filed with respect to the participant or Schedule SSA, Annual Registration Statement Identifying Separated Participants with Deferred Vested Benefits, and

(c) advise the participant of any benefits that are forfeitable in the participant dies before a certain date.

(d) See IRC section 6057(a).

(2) **Due Date:** The due date for delivering the statement to the individual is no later than the due date (including extensions) for the Schedule SSA that reports information with respect to the individual.

(3) The penalty under IRC section 6690 can be identified by the EP field agent.

(4) The penalty is assessed on NMF.

(5) The penalty under IRC section 6690 is not subject to deficiency procedures described in IRM (20)143.1.

(20)836.3 Penalty Computation

The penalty is imposed at \$50 for each act or failure with no maximum.

(20)836.4 Penalty Relief

IRC section 6690 provides a penalty for willfully failing to provide the statement, or willfully furnishing a false or fraudulent statement, therefore, this Code section does not provide for reasonable cause consideration.

(20)837 IRC Section 6692 Failure to File Actuarial Report

(20)837.1 General

IRC section 6692 imposes a penalty on the plan administrator of a defined benefit plan to which IRC section 412 (Minimum Funding Standard) applies, when the plan administrator fails to file an actuarial report (Form 5500, Sch B), in the time and manner as required by IRC section 6059, Periodic Report of Actuary.

(20)837.2 Penalty Assertion

(1)The penalty under IRC section 6692 is imposed if there is a failure to file Schedule B, Actuarial Information, which must be filed as an attachment to the appropriate Form 5500 (series) return.

(a)Failure to base information required by Form 5500, Sch B, upon an actuarial valuation of the plan made within the time and in the manner required by IRC section 412(c)(9),(Annual Valuation) is considered a failure to file the actuarial report.

(b)Failure to provide material information requested on Form 5500, Sch B, is considered a failure to file the report. For example,

1 the signature of an enrolled actuary is considered a material item of information.

2 material qualification of a statement required by Regs. 301.6059-1(c)(4) or (5) is a failure to provide a material item of information.

(2)The penalty is imposed on the plan administrator. If more than one plan administrator is responsible for the failure, all are jointly and severally liable.

(3)Due Date: See IRM (20)833.2(3).

(4)The penalty under IRC section 6692 is assessed on NMF.

(5)The penalty may be computed when the returns is filed or asserted by the EP field agent.

(20)837.3 Penalty Computation

(1)The penalty is imposed at \$1,000 for each failure to file:

(a)a required Schedule B, or

(b)when material information requested has not been provided (the signature of an enrolled actuary for example).

(2)The penalty is computed after the return is processed at the master file.

(20)837.4 Penalty Relief

(1) IRC section 6692 provides for non-assertion of the penalty unless the responsible party can show that the failure was due to reasonable cause.

(2) Note: The failure of an actuary to give the plan administrator a complete Schedule B on time is not reasonable cause.

(3) The request for "penalty relief" due to reasonable cause must be made in the form of a written statement providing all the facts alleged as reasonable cause. The statement must contain a declaration by the appropriate individual that the statement is made under penalties of perjury.

(4) See IRM (20)130 for a discussion of penalty relief.

(20)838 IRC Section 6693

Failure to Provide Reports on Individual Retirement Accounts or Annuities, Penalties Relating to Designated Nondeductible Contributions

(20)838.1 General

(1) The penalties of IRC section 6693 are in lieu of any penalty imposed by IRC section 6652(e) for a violation of IRC section 6047(d), with respect to any failure to furnish a file described in this section.

(2) Note: Section 1455 of the Small Business Job Protection Act amends section 6693(a) to provide that the penalty thereunder does not apply to information returns or payee statements regarding payments to other persons required by IRC section 408(i) or section 6047(d).

(3) This section of the IRM will address each of the penalties imposed by IRC section 6693:

(a) IRC section 6693(a), Person required to report or file a disclosure statement,

(b) IRC section 6693(b)(1), Overstatement of Designated Nondeductible Contributions, and

(c) IRC section 6693(b)(2), Failure to File Form.

(20)838.2 Penalty Assertion

(20)838.21 IRC Section 6693(a)

(1) IRC section 6693(a) imposes a penalty on the failure to furnish a report required by IRC section 408(i) and (1).

(a) IRC section 408(i) requires that annual calendar year reports be made on Form

5498, Individual Retirement Arrangement Information, concerning the status of the account of annuity.

(b) IRC section 408(i) also requires that each trustee or issuer required to file Form 5498 is also required to furnish the participant a statement containing the information required to be furnished on Form 5498 plus the value of the account of annuity at the end of the calendar year. A copy of the Form 5498 may be used to satisfy this requirement.

(c) IRC section 408(i) also requires that the disclosure statements and copies of the governing instruments be provided to benefitted individuals. A benefitted individual is the individual for whom an individual retirement account, individual retirement annuity, or an endowment contract is established. A benefitted individual also includes both the working and non-working spouse in the case of spousal individual retirement accounts.

(d) IRC section 408(i) also requires that the trustee of an individual retirement account or the issuer of an individual retirement annuity who makes a distribution during any calendar year to an individual from such an account or under such annuity shall make a report on Form 1099R.

(e) IRC section 408(i) also requires that the trustee of an individual retirement account or the issuer of an individual retirement annuity, required to file Form 1099R is also required to furnish a copy of the form to the person whose identifying number is shown (or should be shown) on such form.

(f) IRC section 408(l) requires that an employer who makes contributions to a simplified employee pension (SEP) on behalf of employees make reports to employees upon adoption of the SEP indicating its adoption, contribution requirements, and allocation basis.

(g) IRC section 408(l) also requires that an employer who adopts a SEP furnish employees a written statement each calendar year indicating the amount of employer contribution to the employee's IRA. This requirement is satisfied if the information is contained on the employee's W-2 for the calendar year in which the contribution is made.

(2) The penalty for failure to satisfy the requirements of IRC section 408(i) is imposed on:

(a) the trustee of an individual retirement account, or

(b) the issuer of an individual retirement annuity or endowment contract. This includes an account or annuity that is a simplified employee pension.

(c) The penalty for failure to satisfy the requirements of IRC section 408(l) is imposed on the employer maintaining the SEP.

(3) Due Date:

(a) The annual report is to be filed, accompanied by transmittal Form 1096, on or before May 31, following the calendar year for which the report is required. Copies are to

be furnished participants on or before May 31 following the calendar year in for which the Form 5498 is required.

(b) In general, the disclosure statement and a copy of the governing instrument must be received by the benefitted individual at least seven days preceding the earlier of the date of establishment or purchase of the account, annuity, or endowment contract.

(c) Distribution reports made on Forms 1099R, and their related transmittal forms, are to be filed after the close of the applicable calendar year and on or before February 28 of the following year. Copies are to be furnished participants after November 30 of the year of distribution and on or before January 31 of the following year.

(d) Reports required on the adoption of a SEP are to be furnished to an employee no later than a reasonable time after the later of the time the employee becomes employed or the time of the adoption of the simplified employee pension arrangement.

(e) SEP contribution reports made on Form W-2 are required to be furnished to the employee no later than the later of 30 days after the contribution or January 31 of the calendar year for which the contribution was made.

(20)838.22 IRC Section 6693(b)(2)

(1) IRC section 6693(b)(2) imposes a penalty on the failure to furnish information under IRC section 408(o)(4).

(2) IRC section 408(o)(4) requires an individual who makes designated nondeductible contributions to an IRA for any taxable year or receives a distribution from an IRA to which nondeductible contributions have been made for any taxable year report such contribution or distribution, as well as other information, on Form 8606, Nondeductible IRAs (Contributions, Distributions, and Basis).

(3) IRC section 6693(b)(1) imposes a penalty on the overstatement of designated nondeductible contributions made on Form 8606.

(4) The penalty for failure to satisfy the requirements of IRC section 408(o) is imposed on the taxpayer who made the contribution or received the distribution.

(5) Due Date. Form 8606 is required to be filed as an attachment to the Form 1040 (series). If no 1040 return is required the Form 8606 must still be filed by the due date of the Form 1040.

(6) The penalty under IRC section 6693(a) and (b):

(a) can be identified by the EP field agent,

(b) is assessed on NMF, and

(c) is not subject to deficiency procedures described in IRM (20)143.1.

(20)838.3 Penalty Computation

- (1)The penalty for failure to file Form 8606 is \$50 for each failure to file.
- (2)The penalty for overstating designated nondeductible contributions is \$100 for each overstatement.

(20)838.4 Penalty Relief

- (1) IRC section 6693 provides for non-assertion of the penalty if it is shown that the failure is due to reasonable cause.
- (2)In accordance with Treas. Reg. section 301.6693-1(d), the penalties imposed pursuant to IRC section 6693 are in lieu of any penalty imposed by IRC section 6652(f) for violation of IRC section 6047(d) with respect to any failure to furnish or file.
- (3)The request for "penalty relief" due to reasonable cause must be made in the form of a written statement providing all the facts alleged as reasonable cause. The statement must contain a declaration, made by the appropriate individual, that the statement is made under penalties of perjury.
- (4)See IRM (20)130 for a discussion of penalty relief.

(20)839 IRC Section 6704 Failure to Keep Necessary Records

(20)839.1 General

IRC section 6704 imposes a penalty on any person who has or may have a duty to report any information under the reporting requirements of IRC section 6047(d), Reports by Employer, Plan Administrators, etc., and fails to keep records as required by forms or regulations.

(20)839.2 Penalty Assertion

- (1)In general, IRC section 6047(d) requires any person who has the duty to report (the plan administrator, employer, or any person issuing a contract from which "designated distributions" may be made), make returns and reports to the Service, as well as to participants and beneficiaries of the plan. IRC section 6704 imposes a penalty on the failure to keep the records required for reporting.
- (2)Designated distributions (IRC section 3405(e)(1)) are defined as:

- (a)any distribution or payment from an employer deferred compensation plan;

(b) a IRC section 408(a) individual retirement account;

(c) a IRC section 408(b) individual retirement annuity, or a commercial annuity.

(d) See IRC section 3405(e)(1)(B) for exceptions to the designated distribution rule.

(3) Due Date: This is not a return-based penalty. There is no due date.

(4) The penalty under IRC section 6047(d) is identified by the EP field agent.

(5) The penalty is assessed on NMF.

(20)839.3 Penalty Calculation

The penalty under IRC section 6704 is asserted for a calendar year at \$50 per individual with respect to whom such failure occurs in such year. The maximum penalty for any person for any calendar year is \$50,000.

(20)839.4 Penalty Relief

(1) IRC section 6704 provides for non-assertion of the penalty on any failure by a person, if such failure is attributable to a prior failure penalized under IRC section 6704 and the responsible person made all reasonable efforts to correct the failure.

(2) IRC section 6704 provides for non-assertion of the penalty on any person for any failure shown to be due to reasonable cause and not willful neglect.

(3) See IRM (20)130 for a discussion of penalty relief.

Exhibit (20)800-1 -- FILING REQUIREMENTS UNDER IRC SECTION 6058(A)

Pension benefit plans required to file include defined benefit plans and defined contribution plans. The following are among the pension benefit plans for which a return/report must be filed:

1. Annuity arrangements under IRC section 403(b)(1).

2. Custodial accounts established under IRC section 403(b)(7) for regulated investment company stock.

3. Individual retirement accounts (IRAs) established by an employer under IRC section 408(c).

4. Pension benefit plans maintained outside the United States primarily for nonresident aliens if the employer who maintains the plan is:

a. A domestic employer, or

b. A foreign employer with income derived from sources within the United States (including

foreign subsidiaries of domestic employers) if contributions to the plan are deducted on its U.S. income tax return. For this type of plan, enter code D on line 6c.

5. Church plans electing coverage under IRC section 410(d).

6. A plan that covers residents of Puerto Rico, the Virgin Islands, Guam, Wake Island, or American Samoa. This includes a plan that elects to have the provisions of section 1022(i)(2) of ERISA apply.

Exhibit (20)800-2 -- PLANS EXEMPT FROM FILING UNDER IRC SECTION 6058(A)

Do not file a return/report for an employee benefit plan that is any of the following:

1. A pension benefit plan maintained outside the United States if it is a qualified foreign plan within the meaning of IRC section 404A(e) that does not qualify for the treatment provided in IRC section 402(e)(5).
2. An annuity arrangement described in 29 CFR 2510.3-2(f).
3. A simplified employer pension (SEP) described in IRC section 408(k) that conforms to the alternative method of compliance described in 29 CFR 2520.104-48 or 29 CFR 2520.104-49. A SEP is a pension plan that meets certain minimum qualifications regarding eligibility and employer contributions.
4. A church plan not electing coverage under IRC section 410(d).
5. A governmental plan.

Chapter (20)900 International Penalties

(20)910 (4-3-95) Introduction

(20)911 (4-3-95) Chapter Outline

(1) The penalties listed below are discussed in detail in this chapter. As of the date of publication of this IRM, regulations have not been issued regarding the penalty or the application of the penalty so noted [*]. Therefore, the penalty should not be imposed until regulations are published. CAUTION: It is important that, before assertion of any penalty, the examiner be aware of the statute, regulations, any exceptions or limitations, etc. that may apply to the case at hand. This chapter only provides a brief description of each penalty and is not meant to be a substitute for research.

IRM	IRC Section	Description
(20)930	6038(b)	Failure to furnish information with respect to controlled foreign corporation. IRC section 6038(a).

(20) 940	6038 (c)	Failure to furnish information with respect to controlled foreign corporation. IRC section 6038(a).
(20) 950	6038A(d)	Failure to furnish information or to maintain records by certain 25 percent foreign owned corporations. IRC section 6038A(a).
(20) 960	6038A(e)	Failure to authorize an agent or failure of a reporting corporation to substantially and timely comply with a summons for records. IRC section 6038A(e).
(20) 970	6038B(b)	Failure to furnish information on transfers of property to foreign persons. IRC section 6038(a).
(20) 980	6038C(c) *	Failure to furnish information or maintain records by a foreign corporation engaged in U.S. trade or business. IRC section 6038C(a). Regulations have not been issued.
(20) 990	6038C(d) *	Failure to authorize an agent or failure of a reporting corporation to substantially and timely comply with a summons for records. IRC section 6038A(e). Regulations have not been issued.
(20) 9(10) 0	6652 (f) *	Failure to provide information on foreign persons holding direct investment in U.S. real property. IRC section 6039C. Regulations have not been issued.
(20) 9(20) 0	6677	Failure to file information returns with respect to certain foreign trusts. IRC section 6048.
(20) 9(30) 0	6679*	Failure to file required information with respect to certain foreign corporations or foreign partnerships. IRC sections 6035, 6046 and 6046A. Regulations have not been issued under IRC section 6046A.
(20) 9(40) 0	6683	Failure of a foreign corporation to file return of personal holding company tax. IRC section 541.
(20) 9(50) 0	6686	Failure by DISC or FSC to file return or supply information. IRC section 6011(c).
(20) 9(60) 0	6688	Failure to meet requirements of coordination of U.S. and possession individual income tax as specified. IRC section 7654.
(20) 9(70) 0	6689	Failure to file notice of redetermination of foreign tax. IRC sections 905(c) and 404A(g).
(20) 9(80) 0	6712	Failure to disclose treaty-based return

(2) A quick reference chart of reporting/filing responsibilities of taxpayers, and applicable penalties is in Exhibit (20)900-1 of this chapter.

(3) The guidelines and administrative procedures for the penalties are discussed in IRM (20)920, Penalty Guidelines and Procedures.

(4) Exhibit (20)900-2 provides a list and description of the forms mentioned in this chapter.

(20)912 (4-3-95) Purpose

(1) The purpose of the penalties outlined in this chapter is to enhance voluntary taxpayer compliance with statutory reporting, filing, and record maintenance requirements. Decisions on penalty issues are to be guided by the applicable statutes, regulations, and procedural instructions issued by the Service. All employees should keep in mind the objectives enumerated in this handbook and the Penalty Policy Statement when evaluating each penalty case. (Refer to IRM (20)100.)

(2) These penalties are assessed against taxpayers that are U.S. persons doing business outside the United States, and foreign entities doing business in the United States. Unless otherwise indicated, the term "U.S. person" includes individuals, corporations, partnerships, estates or trusts. Refer to IRC section 7701(a).

(3) This chapter includes penalties that are subject to either deficiency or non-deficiency procedures.

(20)913 (4-3-95) Other Applicable Penalties

(1) U.S. and foreign taxpayers are subject to criminal penalties such as willful failure to file a return (IRC section 7203) and filing a false or fraudulent return (IRC section 7206).

(2) IRC sections 6662(e) (Substantial Valuation Misstatement under Chapter 1) and 6662(h) (Increase in Penalty in case of Gross Valuation Misstatements) address the coordination of IRC section 482 and the accuracy-related penalty.

(a) Specifically, these penalties apply to substantial and gross valuation misstatements attributable to IRC section 482 transfer price adjustments on returns with years ending after November 5, 1990.

(b) Return Related Penalties are discussed in another chapter of this IRM. Also refer to Rev. Proc. 94-33.

(3) The following reporting/filing requirements are subject to penalties discussed in other IRM (20)000 chapters. For example: Failure to File, Failure to Pay, Failure to Deposit and the Miscellaneous Penalty chapters.

(a) IRC sections 1441 and 1442--Withholding of Tax on Non-resident Aliens and

Foreign Corporations. Forms 1042 and 1042S.

(b) IRC section 1445--Withholding of Tax on Dispositions of U.S. Real Property Interests. Forms 8288 and 8288A.

(c) IRC section 1446--Withholding Tax on Foreign Partner's Share of Effectively Connected Income. Forms 8804, 8805, and 8813.

(d) IRC section 6039E--Information Concerning Resident Status. Statement required.

(4) See Exhibit (20)900-2 for a list of forms mentioned in this chapter.

(20)920 (4-3-95) Penalty Guidelines and Procedures

(20)921 (4-3-95) Common Features

(1) In General. Contained in this section are some items common to all the penalties discussed in this chapter. Exceptions are noted in the discussions of the specific penalties.

(2) Statute of Limitations. Penalties that are not considered taxes generally have no statute of limitation for assessment. For penalties subject to deficiency procedures, the limitation for assessment is three years after the return is due or filed, whichever is later. Refer to IRC 6501(c) for some exceptions.

(3) Reasonable Cause. Determinations as to whether or not reasonable cause exists must be based on a careful consideration of the facts and circumstances of each case prior to the assertion of a penalty. Examiners should consider any reason a taxpayer provides in conjunction with the guidelines, principles and evaluating factors set forth in the Reasonable Cause chapter (20)300, as well as the applicable IRC section and Treas. Regs. relating to the specific penalty.

(20)922 (4-3-95) Penalty Assertion

(1) The penalties included in this chapter are asserted by examiners (i.e. international examiners, revenue agents, tax auditors, or service center personnel).

(2) The examiner determines whether a taxpayer has failed to comply with the reporting/filing requirements, solicits any facts regarding reasonable cause from the taxpayer, and makes a determination of whether the taxpayer has established reasonable cause. If reasonable cause does not exist, or exists for only a portion of the time, the examiner then computes the amount of the penalty to be asserted.

(20)923 (4-3-95) Administrative Procedures

(1) In General. When an examiner secures a delinquent information return and/or statement, the examiner will date stamp and photocopy the document and place it in the Penalty Case File. The original delinquent information return and/or statement will be forwarded to the appropriate service center.

(2) Forms 5471 and 5472 Only.

(a) The examiner who secures a delinquent Form 5471 or 5472 will write in red "DELINQUENT RETURN-SECURED BY EXAMINATION-PENALTY CONSIDERED" across the top of the Form with the date received. A copy of the delinquent form with the above annotation must be forwarded to the Director, Service Center, 11601 Roosevelt Boulevard, Philadelphia, PA 19155, Attention: Statistics of Income Forms 5471 and 5472 Processing Coordinator, P:DP Unit F, Drop Point DP 335.

(b) District Directors and Service Center Directors are authorized to make determinations that failure to file these information returns was due to reasonable cause.

(3) Foreign information returns not secured by examiners in the International Enforcement Program (IEP). These returns will be routed through the local Examination Support and Processing Branch to the District Program Manager-International for evaluation regarding IEP participation. Refer to IRM 42(10)0.

(20)924 (4-3-95) Assessment Procedures

(20)924.1 (4-3-95) General

(1) Certain penalties and additions to tax are treated as taxes and therefore are subject to the notice of deficiency procedures. IRC section 6671 provides that penalties shall be assessed and collected in the same manner as taxes, but its application is limited to the penalties contained in Subtitle F, Chapter 68B (Assessable Penalties). However, some of these penalties are by statute assessable without regard to deficiency procedures.

(2) Some of the penalties for failure to file information returns are governed by IRC section 6665(b). This IRC section specifically exempts failure to file under IRC section 6651 from deficiency procedures, except in the case of an addition to tax which is attributable to a deficiency in tax as defined in IRC section 6211.

(3) EXHIBIT (20)900-3 of this chapter lists those penalties subject to deficiency or non-deficiency procedures for assessment processing purposes.

(4) The penalties are generally assessed by the function's closing unit in the field or in the service center.

(20)924.2 (4-3-95) Penalties NOT Subject to Deficiency Procedures

(1) Penalties not subject to deficiency procedures are usually assessed, collected, and posted to the Master File. Two MFTs (IMF 55, BMF 13) were created to process an assessment (or abatement) of these non-deficiency penalties via the Civil Penalty Module. These miscellaneous penalty cases are not controlled on AIMS.

(2) CAUTION: These penalties should not be entered on Forms 870, 4549, 4549A, or any other examination report. For the preparation of the International Examiner's report refer to IRM 42(10)7.

(a) The taxpayer's signature is not required with respect to these penalties. If the taxpayer agrees to the penalty assessment, solicit full payment.

(b) Payments will be processed using Form 3244. Transaction Code (TC) 640 should be used to indicate an advance payment and TC 670 should be used for any payments received after assessment.

(3) The examiner will complete the computation of the penalty on Forms 3645 and 8278.

(a) Form 3645. A separate Form 3645 must be used for each tax period to be assessed. Under the "Explanation" section, provide a concise explanation of the reason(s) for assertion of the penalty and whether agreed or unagreed. The examiner will consider reasonable cause and record on Form 886-A, if needed, all pertinent information including, facts, law, taxpayer's position and conclusion. This will be attached to Form 3645 which becomes part of the examination report.

(b) Form 8278. This Form is the adjustment document for the Civil Penalty Module. The penalty adjustment is posted to the module using the Reference Codes reflected on the Form 8278.

1 A separate Form 8278 is required for each tax year and code section for which a penalty assessment is made. That is, one Form 8278 cannot be used to assess penalties under different code sections, even if all penalties are to be assessed against the same tax year. Multiple violations of an IRC section are to be shown as a single assessment.

2 When additional penalties are to be assessed for continued failure after notification (e.g., under IRC section 6038A(d)), a Form 8278 must be prepared for each subsequent assessment that is to be made.

3 Refer to the back of the Form 8278 for preparation instructions. NOTE: for Box 5 of Form 8278, a Fiscal or Calendar Year may be used with Reference Codes 614, 619, 623, and 625.

4 The Reference Codes included in the Penalty Description section of Form 8278 are the Reference Numbers referred to in Exhibit (20)900-3 of this chapter.

(4) Preparation of Penalty Case File.

(a) Examiners will establish a separate case file for penalties that contains:

1 the Forms 8278 and 3645 with 886A if needed,

2 a copy of the information return and/or statement, plus a copy of page one of the income tax return,

3 a current transcript,

4 the contact sheet or case history worksheet,

5 taxpayer's statement of reasonable cause including a copy of any written advise given to the tax payer, any explanation for denying reasonable cause with a copy of the associated workpapers.

(b) Form 3198 should be attached to the outside of the penalty case file and annotated in the "Other" section as follows: "Assess [IRC Section] Civil Penalty as indicated on Form 8278."

(c) NOTE: It is advantageous to maintain a copy of the penalty case file documentation with the tax case file (if one exists). This is done in order to assist in making an abatement determination or for appeal purposes while the penalty case file is still being processed.

(d) More than one penalty case file is required when penalties have been proposed under more than one IRC section.

(20)924.3 (4-3-95) Penalties Subject to Deficiency Procedures

(1) Penalties within this chapter that are subject to deficiency procedures are assessed just as any other penalty would be that relates to an examination determined deficiency (see (20)924.1 above).

(2) Form 5344 (initiated in examination) is used to assess penalties subject to deficiency procedures. The Examination Support and Processing area will code and edit the form using established procedures (IRM 48(13)1 and IRM 48(13)2). Assessment amounts with the appropriate Reference Numbers are entered in the positive field portion of Item 15 of Form 5344. Abatement amounts are entered in the negative portion.

(20)925 (4-3-95) Abatement of Penalties (Unpaid Assessments)

(1) In certain instances, taxpayers will ask for reconsideration of a penalty that has been assessed but not paid. The examiner will determine whether all the facts were considered when the penalty was assessed.

(2) If the taxpayer shows reasonable cause after the penalty is assessed, abate the portion of the penalty only for the period for which the taxpayer shows reasonable cause.

(a) Enter Penalty Reason Code 62 (on Form 3870 or Form 5344, as appropriate) for adjustments involving reasonable cause consideration, whether or not the abatement is allowed. Refer to IRM (20)170 and Exhibit (20)100-3 for additional information on use of penalty reason codes.

(b) The procedures for abating the penalty are the same as they are for assessing the penalty.

(3) If the taxpayer disagrees with the examiner's final determination, an informal conference may be requested with the examiner's manager. If the taxpayer still disagrees, the examiner will advise the taxpayer in writing (by appropriate pattern letter) that the adjustment has been reviewed.

(20)926 (4-3-95) Penalty Appeals

(1) IRM (20)400, Method of Appealing Penalties, provides a discussion of the various legislative and administrative remedies for those taxpayers disagreeing with the Service's determination.

(2) The method for appealing penalties is dependent upon whether the penalties are subject to deficiency procedures or to postassessment appeals (see IRM (20)422 and IRM (20)430 respectively).

(20)930 (4-3-95) IRC Section 6038(b) [Dollar Penalty]

(20)931 (4-3-95) Penalty Description

(1) Background. P.L. 97-248, (TEFRA), supplemented the existing reduction of the foreign tax credit under IRC section 6038 by adding a fixed dollar penalty of \$1,000 up to \$25,000 for failure to furnish information with respect to a controlled foreign corporation. This penalty applies to information for annual accounting periods ending after September 3, 1982.

(2) Reporting/Filing Requirement.

(a) IRC section 6038(a) and Treas. Reg. 1.6038-2(a) require a U.S. person to furnish information with respect to any controlled foreign corporation. The information required includes, among other things, foreign corporation entity data, stock ownership data, financial statements, and intercompany transactions with a related person.

(b) A taxpayer meets the requirement by providing the required information on a timely filed Form 5471. A Schedule M attached to Form 5471 is used to report related party transactions. The information is for the annual accounting period of the foreign corporation ending with or within the U.S. person's taxable year. Form 5471 is filed with the U.S. person's income tax return on or before the date required by law for the filing of that person's income tax return. Treas. Reg. 1.6038-2(i).

(20)932 (4-3-95) Penalty Assertion

(1) The examiner must establish that the taxpayer

(a) was a U.S. person,

(b) owned stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote, or more than 50 percent of the total value of shares of all classes of stock of the foreign corporation, and

(c) failed to timely file the required information on Form 5471.

(20)933 (4-3-95) Penalty Computation

(1) In General. The basic penalty is \$1,000 per failure to timely file complete information on the Form 5471 and Schedule M.

(2) Increase in Penalty for Continued Failure.

(a) If failure continues for more than 90 days after notice by the District Director (or his/her authorized delegate), the penalty shall be increased in the amount of \$1,000 for each 30 day period, or fraction thereof, during which such failure continues after the

expiration of the 90-day period.

(b) Example. Taxpayer files Form 1120 return for the 1990 calendar year on March 15, 1991, but does not file required Form 5471. On February 1, 1992, notice is issued to the taxpayer regarding the penalty assessed. Examiner calculates the penalty from May 1, 1992, the first day after expiration of the 90 day period, to August 1, 1992, when the delinquent return was received. In addition to the \$1,000 basic penalty, the taxpayer is assessed \$3,000 because the failure to file information continued for three full months after expiration of the 90-day period.

(c) NOTE: The total penalties for IRC 6038(b) are limited to \$25,000.

(3) Coordination with IRC section 6038(c). The amount of the IRC section 6038(c) penalty is reduced by the amount of the dollar penalty imposed by IRC section 6038(b).

(20)940 (4-3-95) IRC Section 6038(c) [Reduction of Foreign Tax Credit]

(20)941 (4-3-95) Penalty Description

(1) Background. P.L. 86-780 added IRC section 6038(c) (formerly (b)) effective for taxable years beginning after December 31, 1960. This section provides for a reduction in foreign tax credit for a failure to furnish information with respect to a controlled foreign corporation that is required to be filed under IRC section 6038:

(a) Language was later added limiting the foreign tax credit reduction to the greater of \$10,000 or the income of the foreign corporation for the applicable accounting period, effective for annual accounting periods beginning after December 31, 1962.

(b) P.L. 97-248, (TEFRA) amended IRC section 6038 by redesignating subsection (b) as subsection (c), and by changing the subsection title to read Penalty of Reducing Foreign Tax Credit. The amendment was effective for annual accounting periods ending after September 3, 1982.

(2) Reporting/Filing Requirement. See IRM (20)(13)31 above.

(20)942 (4-3-95) Penalty Assertion

Refer to IRM (20)932 above.

(20)943 (4-3-95) Penalty Computation

(1) In General.

(a) Application of IRC section 901. The amount of taxes paid or deemed paid is reduced by 10 percent.

(b) Application of IRC sections 902 and 960. The amount of taxes paid or deemed paid is reduced by 10 percent. The 10 percent reduction is not limited to the taxes paid or deemed paid by the foreign corporation with respect to which there is a failure to file information but may apply to the taxes paid or deemed paid by all foreign corporations

(c) P.L. 101-508, (OBRA'90), amended IRC section 6038A(a), changing the application of the reporting and record maintenance requirements and enacted IRC section 6038C to apply the rules of IRC section 6038A to foreign corporations engaged in U.S. trade or business at any time during the taxable year.

(2) Reporting/Filing Requirement.

(a) IRC section 6038A(a) and Treas. Reg. 1.6038A-2 require a reporting corporation to furnish the following information: name, business address, nature of business, country in which organized or resident, nature of relationship to reporting corporation, and description and value of transactions between reporting corporation and related party.

(b) A taxpayer meets the requirement by timely filing the required information on Form 5472.

1 A separate Form 5472 must be filed with regard to each related party that has reportable transactions with the reporting corporation.

2 Form 5472 is due on the same date, including extensions, as the income tax return that is required to be filed.

3 A taxpayer must file Form 5472 at the appropriate service center, and must also file a copy of Form 5472 with any attachments and schedules at the Philadelphia Service Center (duplicate filing required). Failure to file at both places may result in a penalty assessment.

(c) A taxpayer is also specifically required to maintain relevant records sufficient to allow determination of the correct tax treatment of the transactions with a related party (as defined in IRC section 6038A(c)(2)).

(d) De minimis rules.

1 A reporting corporation that has less than \$10,000,000 in U.S. gross receipts for a taxable year is not subject to the record maintenance requirement or the authorization of agent requirement.

2 If the total value of all gross payments (both made and received) from a foreign related party is not more than \$5,000,000 and is less than 10 percent of its U.S. gross income, the reporting corporation is not subject to the record maintenance requirement and the authorization of agent requirement for those transactions.

(3) Applicable Definitions.

(a) Reporting Corporation. A reporting corporation is a domestic corporation that is 25 percent foreign-owned. NOTE: Beginning on November 6, 1990, a foreign corporation engaged in a trade or business within the U.S. at any time during the taxable year is a reporting corporation under IRC 6038C. Prior to that time a foreign corporation was subject to the 25 percent foreign-owned requirement.

(b) 25 Percent Foreign-Owned. A corporation is 25 percent foreign-owned if it has, at

controlled by that person.

(c) **Additional Penalty for Continued Failure.** If such failure continues for more than 90 days after notice by the District Director (or his/her authorized delegate), the amount of the reduction is 10 percent plus an additional 5 percent for each 3-month period, or fraction thereof, during which such failure continues after the expiration of the 90-day period.

(2) **Limitation.** The amount of the foreign tax reduction for each failure to furnish information with respect to a foreign corporation may not exceed the greater of:

(a) \$10,000, or

(b) the income of the foreign corporation for its annual accounting period with respect to which the failure occurs.

(3) **NOTE:** No taxes may be reduced more than once for the same failure. Also, the regulations have not been updated; where the IRC currently refers to a foreign corporation's "post 1986 undistributed income", the regulations still refer to "accumulated profits".

(4) **Coordination with IRC section 6038(b).** The amount of the IRC section 6038(c) penalty is reduced by the amount of the dollar penalty imposed by IRC section 6038(b).

(20)950 (4-3-95) IRC Section 6038A(d) [Monetary Penalty]

(20)951 (4-3-95) Penalty Description

(1) Background.

(a) IRC section 6038A(d) was added by P.L. 97-248, (TEFRA), for tax years beginning after December 31, 1982. It provides for a monetary penalty for failure to furnish information or to maintain records as required by IRC section 6038A.

(b) P.L. 101-239, (OBRA'89), amended IRC section 6038A, to be effective generally for tax years beginning after July 10, 1989, by:

- 1 reducing the level of foreign ownership of a U.S. subsidiary from 50 percent to 25 percent;
- 2 adding a record maintenance requirement;
- 3 adding an authorization of agent requirement;
- 4 increasing the monetary penalty from \$1,000 to \$10,000;
- 5 increasing the additional monetary penalty from \$1,000 to \$10,000 for each 30 day period during which the failure continues after receipt of notice of the failure; and
- 6 removing the \$24,000 cap on the increase in the monetary penalty for continued failure.

(c) P.L. 101-508, (OBRA'90), amended IRC section 6038A(a), changing the application of the reporting and record maintenance requirements and enacted IRC section 6038C to apply the rules of IRC section 6038A to foreign corporations engaged in U.S. trade or business at any time during the taxable year.

(2) Reporting/Filing Requirement.

(a) IRC section 6038A(a) and Treas. Reg. 1.6038A-2 require a reporting corporation to furnish the following information: name, business address, nature of business, country in which organized or resident, nature of relationship to reporting corporation, and description and value of transactions between reporting corporation and related party.

(b) A taxpayer meets the requirement by timely filing the required information on Form 5472.

1 A separate Form 5472 must be filed with regard to each related party that has reportable transactions with the reporting corporation.

2 Form 5472 is due on the same date, including extensions, as the income tax return that is required to be filed.

3 A taxpayer must file Form 5472 at the appropriate service center, and must also file a copy of Form 5472 with any attachments and schedules at the Philadelphia Service Center (duplicate filing required). Failure to file at both places may result in a penalty assessment.

(c) A taxpayer is also specifically required to maintain relevant records sufficient to allow determination of the correct tax treatment of the transactions with a related party (as defined in IRC section 6038A(c)(2)).

(d) De minimis rules.

1 A reporting corporation that has less than \$10,000,000 in U.S. gross receipts for a taxable year is not subject to the record maintenance requirement or the authorization of agent requirement.

2 If the total value of all gross payments (both made and received) from a foreign related party is not more than \$5,000,000 and is less than 10 percent of its U.S. gross income, the reporting corporation is not subject to the record maintenance requirement and the authorization of agent requirement for those transactions.

(3) Applicable Definitions.

(a) Reporting Corporation. A reporting corporation is a domestic corporation that is 25 percent foreign-owned. NOTE: Beginning on November 6, 1990, a foreign corporation engaged in a trade or business within the U.S. at any time during the taxable year is a reporting corporation under IRC 6038C. Prior to that time a foreign corporation was subject to the 25 percent foreign-owned requirement.

(b) 25 Percent Foreign-Owned. A corporation is 25 percent foreign-owned if it has, at

any time during the taxable year, at least one direct or indirect 25 percent foreign shareholder (a person owning at least 25 percent of the total voting power of all classes of stock of such corporation entitled to vote, or the total value of all classes of stock of such corporation). The attribution rules of IRC section 318 apply - see IRC section 6038A(c)(5).

(c) Related Party. The term "related party" means.

1 any direct or indirect 25 percent foreign shareholder of the reporting corporation

2 any person who is related (within the meaning of IRC section 267(b) or 707(b)(1)) to the reporting corporation or to a 25 percent foreign shareholder of the reporting corporation, and

3 any other person who is related within the meaning of IRC section 482 to the reporting corporation.

(d) Foreign Person. The term "foreign person" means any person who is not a U.S. person as defined in IRC section 7701(a)(30), except that any individual who is a citizen of any possession of the U.S. (but not otherwise a citizen of the U.S.) and who is not a resident of the U.S. shall not be treated as a U.S. person.

(20)952 (4-3-95) Penalty Assertion

(1) A penalty is asserted when the examiner determines that:

(a) a U.S. corporation is 25 percent foreign-owned during a taxable year, and has had transaction(s) with a related party,

(b) has failed to timely file Form 5472 or

(c) has failed to maintain records of the transaction(s) with the related party.

(2) NOTE: The penalty also applies in the case of records maintained outside of the U.S. See Treas. Regs. 1.6038A-4(c) and 1.6038A-3(f)(2). A 25 percent foreign-owned corporation may be considered to have complied with the requirement to maintain records in the U.S. if it makes the records available to the Service within 60 days of the request to produce them or brings the records to the United States and complies with notice requirements under Treas. Reg. 1.6038A-3(f)(2)(ii). If this is not done, however, the penalty would be applicable.

(20)953 (4-3-95) Penalty Computation

(1) In General. The basic penalty is \$10,000, for each taxable year, for each related party, for which the Form 5472 was not filed, records were not maintained, or records maintained outside the U.S. were not produced.

(2) Increase in Penalty for Continued Failure. If any failure described above continues for more than 90 days after the day on which the District Director (or his/her authorized delegate) mails notice of such failure to the reporting corporation, the penalty shall be increased in the amount of \$10,000 for each 30-day period, or fraction thereof, during which failure continues after the expiration of the 90-day period.

(3) NOTE:

(a) The basic penalty is applied only once to each set of transactions with a related party, even though the taxpayer may be in violation of multiple failures (failure to file, failure to maintain records, and/or failure to comply with the non-U.S. maintenance requirements).

(b) After notification, the additional penalty can be assessed for each failure with respect to each related party. See Treas. Reg. 1.6038A-4.

(20)954 (4-3-95) Reasonable Cause

(1) The reasonable cause exception shall be applied liberally in the case of a small corporation that:

(a) had no knowledge of the IRC section 6038A requirements,

(b) has limited presence in and contacts with the United States, and

(c) promptly and fully complies with all requests by the District Director related to the failure.

(2) NOTE: A small corporation can only qualify once under this special rule, because once notified by the IRS of the failure, the corporation will have knowledge of the IRC section 6038A requirements.

(3) The reporting corporation must make an affirmative showing of all the facts alleged as reasonable cause in a written statement.

(4) See Treas. Reg. 1.6038A-4(b) in its entirety for a discussion of reasonable cause as it relates to the applications of this IRC section.

(20)960 (4-3-95) IRC, Section 6038(e) [Noncompliance Penalty]

(20)961 (4-3-95) Penalty Description

(1) Background. P.L. 101-239, (OBRA'89), effective for tax years beginning after July 10, 1989, requires that a foreign related party must authorize the reporting corporation to act as its limited agent for the purpose of an IRS summons regarding transaction(s) with the related party. The penalty for failure to authorize an agent or for failure to produce records is described in IRC

section 6038A(e)(3).

(2) Meeting of Requirement. A taxpayer meets the requirement by providing an executed authorization of agent within 30 days of a request by the Service or, in the case of production of records, by complying with the request for books, records or documents. The penalty is not imposed if a taxpayer quashes a summons other than on grounds that the records were not maintained as required by IRC section 6038A(a).

(3) Applicable Definitions. See the definitions discussed in IRM (20)951 above.

(20)962 (4-3-95) Penalty Assertion

(1) A penalty is asserted when the examiner determines that:

(a) the reporting corporation has failed to respond substantially and timely to a proper summons for records, or

(b) a foreign related party, upon request, fails to authorize the reporting corporation as its agent for IRS summons purposes, pursuant to the requirements set forth in Treas. Reg. 1.6038A-5.

(2) NOTE: IRM 42(10)6.2 provides specific guidance for implementing IRC section 6038A(e).

(20)963 (4-3-95) Penalty Computation

The noncompliance penalty adjustment permits the Service, in its sole discretion, to deny deductions and adjust cost of goods sold with respect to the related party transaction(s) based upon information available to the Service. See IRC section 6038A(e)(3). The noncompliance penalty is reflected in the notice of deficiency.

(20)964 (4-3-95) Statute of Limitations

The running of any period of limitations under IRC sections 6501 and 6531 may be suspended as provided in IRC section 6038A(e)(4)(D).

(20)965 (4-3-95) Reasonable Cause

THERE IS NO REASONABLE CAUSE EXCEPTION TO THIS PENALTY.

(20)970 (4-3-95) IRC Section 6038B(b)

(20)971 (4-3-95) Penalty Description

(1) Background. P.L. 98-369, (TRA'84), added IRC section 6038B which requires information to be furnished with respect to certain transfers of property by a U.S. person to a foreign corporation. This section also includes a substantial penalty for failure to furnish the information.

(2) Reporting/Filing Requirement.

(a) Transfers of Property. IRC section 6038B(a) and the temporary regulations issued

thereunder require that any U.S. person that transfers property (including stock or securities) in an exchange described in IRC section 367(a) or (d) to a foreign corporation must report certain information concerning the transfer. See Treas. Reg. 1.6038B-1T(a). These rules are generally effective with respect to transfers occurring after December 31, 1984, in taxable years ending after such date.

(b) A taxpayer meets the requirement by filing Form 926 along with the Federal income tax return at the Internal Revenue Service Center where that return is required to be filed. Temporary regulation 1.6038B-1T(b)(1) states that notwithstanding any statement to the contrary on Form 926, the form and attachments must be filed with the transferor's tax return for the taxable year that includes the date of the transfer.

(3) Description of Transfer.

(a) A transfer is described in IRC section 367(a) if a U.S. person transfers property to a foreign person in connection with an exchange described in IRC section 332, 351, 354, 356, or 361, provided an exception in IRC section 367(a) is not applicable. An exchange described in IRC section 332 is subject to IRC section 6038B only in limited instances. See (4)(b) below.

(b) A transfer is subject to IRC section 6038B if a person has made an election under IRC section 1492(2)(B) to apply the principles of this section to a transfer described in IRC section 1491.

(c) NOTE: A transfer is described in IRC section 367(d) if a U.S. person transfers intangible property to a foreign corporation in an exchange described in IRC section 351 or 361.

(4) Transactions Not Covered.

(a) IRC section 336 distributions. Although IRC section 6038B(a)(2) provides that U.S. persons may be required to provide information with respect to IRC section 336 distributions to foreign persons, the temporary regulations limit the application of IRC section 6038B to transfers described in IRC section 367(a) or (d). Thus, IRC section 336 distributions by U.S. persons to foreign persons are not subject to IRC section 6038B. See Treas. Reg. 1.6038B-1T(b)(2).

(b) IRC section 367(e) distributions. Although IRC section 6038B(a)(1) provides that U.S. persons may be required to provide information with respect to distributions described in certain IRC sections including 355 and 332, the regulations under IRC section 6038B state that no notice shall be required with respect to a distribution described in IRC section 367(e). See Treas. Reg. 1.6038B-1T(b)(2). Because IRC sections 355 and 332 are both described in IRC section 367(e), no reporting under IRC section 6038B generally is required with respect to such distributions. However, a transfer of intangible property by a U.S. subsidiary to its foreign parent pursuant to an exchange described in IRC section 332 is described under IRC section 637(a) and is thus subject to reporting under IRC section 6038B. See Treas. Reg. 1.367(a)-5T(e).

(20)972 (4-3-95) Penalty Assertion

(1) A penalty is asserted when the examiner establishes that the taxpayer:

(a) is a U.S. person and has made a transfer described in IRC section 367(a) or (d) to a foreign corporation,

(b) has failed to file timely Form 926 and attachments as specified in IRC section 6038B, and

(c) has not shown that such failure to comply was due to reasonable cause.

(20)973 (4-3-95) Penalty Computation

(1) If a U.S. person fails to furnish information in accordance with IRC section 6038B regarding some or all of the property transferred, then, with respect to such property:

(a) it is not considered to have been transferred for use in the active conduct of a trade or business outside the U.S. and does not qualify for any other exception under the regulations of IRC section 367(a), and gain must be recognized with respect to that property to the extent provided in IRC section 367(a);

(b) the U.S. person must pay a penalty equal to 25 percent of the amount of gain realized on the transfer of such property (without regard to whether gain is recognized on the transfer); and

(c) the period for limitations on assessment of tax on the transfer of such property does not begin to run until the date on which the U.S. person does comply with the reporting requirements.

(2) Example.

(a) On January 1, 1989, in an IRC section 351 exchange, domestic corporation ABC transferred to NEWCO, a wholly-owned foreign subsidiary, the following property: machinery to be used in the active conduct of NEWCO's trade or business outside the U.S., inventory, and all the stock of XYZ, another wholly-owned foreign subsidiary of ABC. ABC did not furnish any information to the IRS with respect to the transfer as required by IRC section 6038B.

(b) The adjusted basis, the fair market value, and resulting gain/loss for the property transfer is as follows:

ASSET	ADJ. BASIS	FMV	GAIN/ (LOSS)
Machinery	\$100,000	\$150,000	\$ 50,000
Inventory	\$ 60,000	\$100,000	\$ 40,000
XYZ stock	\$290,000	\$200,000	(\$ 90,000)

(c) As a result of the failure to report:

1 The \$50,000 gain on the transfer of the machinery must be recognized regardless of the fact that under IRC section 367(a)(3), and Treas. Reg. 1.367(a)-2T, no gain (other than any depreciation recapture required under Treas. Reg. 1.367(a)-4T(b)) would have been required to be recognized if ABC had properly reported the transfer of the machinery.

2 The \$40,000 gain on the transfer of the inventory does not qualify for an exception. This gain must be recognized. Treas. Reg. 1.367(a)-5T(b).

3 The \$90,000 loss realized on the transfer of the XYZ stock is not recognized under IRC section 367(a) and Treas. Reg. 1.367(a)-1T(b)(3)(ii).

(d) In addition to the above, ABC must pay a penalty equal to 25 percent of the \$90,000 gain, or \$22,500.

(20)974 (4-3-95) Statute of Limitations

NOTE: The exception of IRC section 6501(c)(8) only applies to the tax imposed by reason of IRC section 367(a), (d), or (e) and not to the IRC section 6038B(b) penalty.

(20)980 (4-3-95) IRC Section 6038C(c) [Monetary Penalty]

(20)981 (4-3-95) Penalty Description

(1) Background. P.L. 101-508, (OBRA'90), added IRC section 6038C. This addition makes foreign corporations engaged in U.S. business subject to the same information reporting and record maintenance requirements that apply under IRC section 6038A to U.S. 25 percent foreign-owned corporations, and penalizes them in the same manner. Refer to IRM (20)950 above.

(2) Reporting/Filing Requirements. Foreign corporations subject to this section must maintain any records that were in existence on or after March 20, 1990.

(20)982 (4-3-95) Penalty Computation

NOTE: Regulations under IRC 6038C have not been issued. Therefore, no penalty can be asserted at this time unless the taxpayer has destroyed records in existence on or after March 20, 1990. But see Treas. Reg. 1.6038A-3(h) for banks and other financial institutions. At this time no regulations have been published that apply the record maintenance rules of Treas. Reg. 1.6038A-3 to these institutions.

(20)990 (4-3-95) IRC Section 6038C(d) [Noncompliance Penalty]

(20)991 (4-3-95) Penalty Description

(1) Background. P.L. 101-508, (OBRA'90), added IRC section 6038C(d). This section requires that a foreign related party authorize the reporting corporation to act as its limited agent for

summons purposes and requires that the reporting corporation maintain and produce records regarding transaction(s) with the foreign related party.

(a) This penalty parallels the penalty discussed above in IRM (20)960. The difference is that the IRC section 6038A(e) penalty applies to 25 percent foreign-owned U.S. corporations, and

(b) IRC section 6038C(d) penalty applies to foreign corporations engaged in a trade or business in the U.S. at any time during the taxable year, within the meaning of IRC section 864(b).

(2) Meeting of Requirement. The requirement is the same as that of IRC section 6038A as found in IRM (20)961. Foreign corporations subject to section must maintain any records that were in existence or on after March 20, 1990.

(3) Definitions. See the definitions discussed in IRM (20)961 above.

(20)992 (4-3-95) Penalty Computation

NOTE: Regulations under IRC 6038C have not been issued. Therefore, no penalty can be asserted at this time unless the taxpayer has destroyed records in existence on or after March 20, 1990. But see Treas. Reg. 1.6038A-3(h) for banks and other financial institutions. At this time no regulations have been published that apply the record maintenance rules of Treas. Reg. 1.6038A-3 to these institutions.

(20)9(10)0 (4-3-95) IRC Section 6652(f)

(20)9(10)1 (4-3-95) Penalty Description

(1) Background. IRC section 6652(f) provides a penalty for failure to meet reporting requirements under IRC section 6039C.

(2) Reporting/Filing Requirements.

(a) IRC section 6039C requires any foreign person holding a direct investment in U.S. property interests for a calendar year to file a return.

(b) The requirement is met by providing information such as name and address, a description of all U.S. real property interests, and other information prescribed by regulation.

(20)9(10)2 (4-3-95) Penalty Assertion

The penalty is applicable when it has been established that the foreign person has failed to meet the above requirements.

(20)9(10)3 (4-3-95) Penalty Computation

NOTE: Regulations under IRC 6039C have not been issued. Therefore, the penalty is not

to be assessed for failure to file as required by this section.

(20)9(20)0 (4-3-95) IRC Section 6677

(20)9(20)1 (4-3-95) Penalty Description

(1) Background. P.L. 87-834, The Revenue Act of 1962, added IRC section 6677 effective on October 17, 1962. This section provides a penalty for failure to file an information return with respect to a foreign trust as required under IRC section 6048.

(2) Reporting/Filing Requirement.

(a) Form 3520 is required to be filed by a U.S. Person who either creates a foreign trust or transfers money or property to a foreign trust. The form is due no later than the 90th day after the creation of the trust or transfer of the money, or property to a trust.

(b) Form 3520A is required to be filed by a U.S. person who previously filed a Form 3520, as long as the trust has at least one U.S. beneficiary. The form is due by the 15th day of the fourth month following the end of the taxable period covered by the return.

(20)9(20)2 (4-3-95) Penalty Assertion

A penalty is asserted when it has been established that the grantor or transferor of a foreign trust has failed to meet filing requirement discussed above. The penalty applies if the Forms 3520 and 3520-A do not contain all of the required information.

(20)9(20)3 (4-3-95) Penalty Computation

The penalty for failure to file a timely, complete Form 3520 is 5 percent of the amount transferred to a trust. For failure to file a timely, complete Form 3520-A, the penalty is 5 percent of the value of the corpus of the trust at the close of the taxable year. The penalty is limited to \$1,000 for failure to file either Form 3520 or Form 3520A.

(20)9(30)0 (4-3-95) IRC Section 6679

(20)9(30)1 (4-3-95) Penalty Description

(1) Background. P.L. 87-834, the Revenue Act of 1962, added IRC section 6679 effective on October 17, 1962. This section, as amended, provides a penalty for failure to furnish information and timely file a return under IRC section 6035, 6046, or 6046A.

(2) Reporting/Filing Requirement.

(a) IRC section 6035 requires a U.S. citizen or resident who is an officer, director or 10 percent shareholder of a foreign personal holding company to file Form 5471 with Schedule N by the due date of the taxpayer's income tax return, including extensions.

(b) IRC section 6046 requires Form 5471 with Schedule O, to be filed by the due date of the taxpayer's income tax return, including extensions and must be filed by:

1 a U.S. Citizen or resident who is an officer or director of a foreign corporation, 5 percent or more in value of the stock of which is owned by a U.S. person,

2 a U.S. person who owns 5 percent or more in value of the stock of a foreign corporation,

3 each person who is treated as a U.S. shareholder under IRC section 953(c), or

4 each person who becomes a U.S. person while owning 5 percent or more in value of the stock of a foreign corporation.

(c) IRC section 6046A requires any U.S. person who acquires or disposes of an interest in a foreign partnership, or whose interest in a foreign partnership changes substantially to file such form as Treas. Regs. provide. The return is due on the 90th day after the day on which the U.S. person becomes liable to file (or later date if prescribed by regulations).

(20)9(30)2 (4-3-95) Penalty Assertion

The examiner must establish that the taxpayer has not provided the required information on a timely filed return.

(20)9(30)3 (4-3-95) Penalty Computation

(1) The penalty is \$1,000 per failure.

(2) NOTE: Regulations under IRC sections 6046A have not been issued. Therefore, until issued the penalty under IRC section 6679 should not be assessed for failure to file as required by this IRC section.

(20)9(40)0 (4-3-95) IRC Section 6683

(20)9(40)1 (4-3-95) Penalty Description

(1) Background. P.L. 89-809 (11-13-66), the Foreign Investors Tax Act of 1966, added IRC section 6683 effective on January 1, 1967. This section provides a penalty for failure to file a true and accurate return of the tax imposed by IRC section 541 (Personal Holding Company Tax).

(2) Reporting/Filing Requirement.

(a) Any foreign corporation which is a personal holding company (as defined in IRC section 542) is subject to personal holding company tax with respect to its income from sources within the U.S.

(b) A Schedule PH must be filed with a Form 1120. The due date is the same as for Form 1120.

(20)9(40)2 (4-3-95) Penalty Assertion

A penalty is asserted when it has been established that a foreign corporation is a personal

holding corporation, and has failed to timely file Schedule PH (Form 1120).

(20)9(40)3 (4-3-95) Penalty Computation

The penalty is computed by multiplying the personal holding company's income tax (including personal holding company tax imposed by IRC section 541) by 10 percent.

(20)9(40)4 (4-3-95) Statute of Limitations

The personal holding company tax may be assessed at any time within 6 years after the Form 1120 for such year was filed. Treas. Reg. 301.6501 (f)-1.

(20)9(50)0 (4-3-95) IRC Section 6686

(20)9(50)1 (4-3-95) Penalty Description

(1) Background. P.L. 92-178, The Revenue Act of 1971, added IRC section 6686 effective for taxable years ending after December 31, 1971.

(2) Reporting/Filing Requirement. IRC section 6011(c) requires the following taxpayers to furnish certain information to their shareholders, furnish certain information to the IRS, and keep satisfactory financial books and records:

(a) a DISC or IC-DISC is required to supply its shareholders information on Schedule K (Form 1120 DISC or Form 1120 IC-DISC), which is due to the shareholders on or before the last day of the second month following the close of its taxable year;

(b) a FSC is required to file Form 1120-FSC by the 15th day of the third month after the end of corporation's tax year;

(c) a corporation that has elected to be an Interest Charge DISC effective for taxable years beginning after December 31, 1984, (or a DISC for prior years) is required to file Form 1120-IC-DISC, (or Form 1120-DISC in the case of taxable years of DISCs beginning prior to January 1, 1985) due on or before the 15th day of the 9th month following the end of its tax year; and

(d) a DISC, IC-DISC, or FSC shall keep records supporting its reporting of gross income, deductions, credits and other matters on its income tax forms.

(20)9(50)2 (4-3-95) Penalty Assertion

(1) A penalty is asserted when the examiner has established that:

(a) the entity is a DISC, former DISC, an IC-DISC, FSC, or former FSC as defined in IRC sections 992(a) and 922, and has failed to timely file Form 1120-DISC, Form 1120-IC-DISC, Or Form 1120-FSC, as applicable, or

(b) the entity is an IC-DISC or DiSC and has failed to supply timely information to shareholders on Schedule K.

(20)9(50)3 (4-3-95) Penalty Computation

The penalty under IRC section 6686 is \$100 for each failure to supply information to shareholders on Schedule K. This penalty is limited to a total of \$25,000. The taxpayer is assessed a penalty of \$1,000 for each failure to file Form 1120-DISC, Form 1120-IC-DISC, or Form 1120-FSC,

(20)9(50)4 (4-3-95) Statute of Limitations

NOTE: It is the Service's position that there is no statute of limitations for the DISC or IC-DISC.

(20)9(60)0 (4-3-95) IRC Section 6688

(20)9(60)1 (4-3-95) Penalty Description

(1) Background. P.L. 93-406 amended IRC section 6667 by renumbering it as IRC section 6688, and making it effective for taxable years beginning after December 31, 1972. This section provides a penalty for failure to provide the IRS with information allowing it to implement the provisions of IRC section 7654 with respect to bonafide residents of Guam, American Samoa, The Northern Mariana Islands and the Virgin Islands. NOTE: TRA '86 made IRC section 7654(a) applicable to the Virgin Islands and American Samoa although the Current regulations under IRC section 7654 are only applicable to Guam and The Northern Mariana Islands.

(2) Reporting/Filing Requirement.

(a) The implementation of IRC section 7654(a) requires that bona fide residents of the above cited U.S. possessions provide information allowing for the proper allocation of income between the U.S. and such possessions.

(b) Pending new regulations under IRC section 7654, bona fide residents of these U.S. possessions must generally maintain records that identify the proper allocation of income between the U.S. and such possessions.

(20)9(60)2 (4-3-95) Penalty Assertion

The examiner asserts a penalty on establishing that an individual, as described above, has not filed timely information.

(20)9(60)3 (4-3-95) Penalty Computation

The examiner computes the penalty at \$100 per failure to report.

(20)9(70)0 (4-3-95) IRC Section 6689

(20)9(70)1 (4-3-95) Penalty Description

(1) Background. IRC section 6689 was added by P.L. 96-603 applicable for taxable years beginning after 1979. This section provides a penalty for failure to notify the Service of a foreign

tax redetermination with respect to:

(a) the amount of foreign taxes paid or accrued pursuant to IRC section 905(c), or

(b) the amount of the deduction for certain foreign deferred compensation plans under IRC Section 404A(g).

(2) Reporting/Filing Requirement.

(a) Foreign Tax Redetermination.

1 A taxpayer is required to notify the Service of any foreign tax redetermination that may affect U.S. tax liability. A taxpayer must provide notice by filing Form 1040X or 1120X and Form 1116 or 1118 with 180 days after a foreign tax redetermination. See Treas. Reg. 1.905-4T(b).

a If a foreign tax redetermination results in an additional assessment of foreign tax, the taxpayer has the 10-year period provided by IRC section 6511(d)(3)(A) to file a claim for additional foreign tax credits.

b NOTE: When a foreign tax redetermination affects the indirect or deemed paid credit under IRC section 902 for taxable years after 1986, the taxpayer must provide notice by filing Form 1120X and Form 1118 for all tax years affected by the foreign tax credit redetermination. See Treas. Reg. 1.905-3T(d)(2)(iii).

2 Notwithstanding the requirement in 1 above, Treas. Reg. 1.905-4T(d) provides that in no event shall the notice be required prior to the issuance of an announcement or regulations concerning the manner in which the notice must be filed. NOTE: Until guidance has been issued, the timeliness standard is effectively suspended, and the penalty may not be enforced.

(b) Redetermination of IRC Section 404A Deduction. A taxpayer is required to notify the Service, in the time and manner specified in regulations, if the foreign tax deduction for deferred compensation expense is adjusted. See IRC Section 404A(g)(2)(B).

(3) Definition. Foreign Tax Redetermination. Treas. Reg. 1.905-3T(c) defines a foreign tax redetermination as a change in the foreign tax liability that may affect a U.S. taxpayer's foreign tax credit and includes:

(a) a refund of foreign taxes,

(b) a difference between the dollar value of the accrued foreign tax and the dollar value of the foreign tax actually paid attributable to differences in the units of foreign currency paid and the units of foreign currency accrued, or

(c) a difference between the dollar value of the accrued foreign tax and the dollar value of the foreign tax actually paid attributable to fluctuations in the value of the foreign currency relative to the dollar between the date of accrual and the date of payment.

(20)9(70)2 (4-3-95) Penalty Assertion

A penalty is asserted when the taxpayer has failed to notify the Service of a foreign tax redetermination.

(20)9(70)3 (4-3-95) Penalty Computation

(1) The examiner determines the deficiency attributable to the foreign tax redetermination and to this deficiency is added a penalty computed as follows:

(a) 5 percent of the deficiency if the failure is for not more than 1 month, with

(b) an additional 5 percent of the deficiency for each month (or fraction thereof) during which the failure continues, but not to exceed in the aggregate 25 percent of the deficiency.

(2) NOTE: If this penalty applies, then the penalty imposed under IRC section 6662(b)(1), formerly in IRC section 6653(a), relating to failure to pay by reason of negligence or disregard of rules or regulations, shall not apply.

(20)9(70)4 (4-3-95) Statute of Limitations

IRC section 6501 (c)(5) independently suspends the normal statute of limitations for additions to tax resulting from a redetermination of foreign tax. IRC section 905(c) contains special rules for such changes.

(20)9(80)0 (4-3-95) IRC Section 6712

(20)9(80)1 (4-3-95) Penalty Description

(1) Background. IRC section 6712 was added by P.L. 100-647, TAMRA'88, for returns the due date for which occurs (without extensions) after December 31, 1988. This section provides a penalty for failure to disclose a treaty-based return position.

(2) Reporting/Filing Requirement.

(a) IRC section 6712 enforces IRC section 6114. IRC section 6114 generally requires that if a taxpayer takes a position that any treaty of the U.S. overrules or modifies any provision of the IRC, the taxpayer must disclose the position.

(b) A taxpayer meets the disclosure requirement by attaching Form 8833 or a statement to the appropriate tax return in the format outlined in Treas. Reg. 301.6114-1(d) with taxpayers name, TIN or EIN, address, name and address of payor of income, a statement of citizenship or residency, and a statement of facts regarding each separate position taken.

(c) NOTE: A taxpayer may be able to aggregate certain similar types of income as a single payment or income item for disclosure purposes. See Treas. Reg. 301.6114-1(d)(4)(i) for guidance on rules for aggregating separate payments or income

items.

(20)9(80)2 (4-3-95) Penalty Assertion

The penalty is asserted when the examiner determines that the taxpayer failed in a material way to disclose a treaty based return position under IRC section 6114.

(20)9(80)3 (4-3-95) Penalty Computation

The penalty is \$1,000 for each separate treaty-based position taken and not properly disclosed, in the case of an individual taxpayer. For a C corporation, the penalty is \$10,000 for each separate failure to disclose a treaty-based position.

(20)9(80)4 (4-3-95) Waiver Criteria

(1) Treas. Reg. 301.6712-1(b) provides the Assistant Commissioner (International), the District Director, or the Director of the Service Center with the authority to waive, in whole or in part, the penalty imposed under IRC section 6712 if the taxpayer's failure to disclose the required information is not due to willful neglect.

(2) An affirmative showing of lack of willful neglect must be made in the form of a written statement setting forth all the facts alleged to show lack of willful neglect and must contain a declaration by the taxpayer that the statement is made under penalties of perjury.

Exhibit (20)900-1 Quick Reference Guide to International Penalties for Failure to Meet Filing and Other Obligations

TAXPAYER	REQUIREMENT	AUTHORITY IRC Section	PENALTY IRC Section
U.S. person with controlling interest in foreign corporation. IRC section 7701(a)(30) and section 6038(a).	File Form 5471 with Sch. M	6038(a)	6038(b) & (c)
25 percent foreign owned U.S. corporation.	File Form 5472	6038A(a)	6038A(d)
(1) 25 percent foreign-owned U.S. corporation or,	Authorize an agent or substantially comply with summons	6038A(e)	6038A(e)
(2) foreign corporation engaged in a U.S. trade or business.	for books and records on transactions with related foreign party.	6038C(d)	6038C(d)
Transferor of certain property to foreign persons.	File Form 926	6038B(a)	6038B(b)

Foreign corporation engaged in U.S. trade or business.	File Form 5472	6038C(a)	6038C(c)
Foreign person holding direct investment in U.S. real property.	Provide certain information	6039C(a)	6652(f)
Grantor of (or transferor of) property to a foreign trust IRC section 7701(a) (31).	File Form 3520 and 3520-A	6048	6677
U.S. person who is an officer, shareholder, or director of foreign personal holding company.	File Form 5471 with Sch. N	6035	6679

TAXPAYER	REQUIREMENT	AUTHORITY IRC Section	PENALTY IRC Section
U.S. Citizen or resident who is an officer, shareholder, or director of certain foreign corporations. IRC section 6046(a)	File Form 5471 With Sch. O	6046	6679
Interest in foreign partnership held by U.S. person.	Such Form as Treas Regs. prescribe	6046A	6679
Foreign Corp. which is a Personal Holding Company. IRC section 542.	File Sch. PH attached to Form 1120	541	6683
DISC, IC-DISC, or FSC	File Form 1120-DISC, 1120-IC-DISC, or 1120-FSC as appropriate	6011(c)	6686
Taxpayer for whom coordination of U.S. and U.S. possession individual income tax becomes necessary.	File Form 5074	7654	6688
U.S. persons subject to foreign tax redetermination.	File Form 1040X/1120X with Form 1116/1118	905(c) & 404A(g)	6689
Taxpayer taking treaty based return position.	File Form 8833 or a statement attached to the applicable tax return with complete information	6114	6712

(20)(10)(140)1 General

IRC section 7342 provides for a Penalty for Refusal to Permit Entry or Examination against a person who refuses to admit any officer or employee of the Treasury Department or refuses to permit him to examine such article or articles.

(20)(10)(140)2 Penalty Computation

(1) For each refusal to permit entry or examination:

(a) \$500 for each refusal, or

(b) \$1000 for each refusal related to a place where taxable fuel is stored or produced (see Section 4083(c)(3)).

(20)(10)(140)3 Assertion

This penalty is asserted by Compliance using Reference Number 655 on any document used to assess/assert this penalty.

(20)(10)(140)4 Penalty Relief

(1) There is no reasonable cause exception to this penalty.

(2) If the taxpayer disagrees with the penalty, two options are available:

(a) Make an administrative appeal to the Exam group manager at the time the violation is found or

(b) Pay the penalty and file a timely Form 843 claim for refund.

(3) If the claim is disallowed, the taxpayer can file suit in either US District Court or US Court of Federal Claims per IRC 6532.

(4) If the penalty was erroneously assessed, it must be abated.

(20)(10)(150)0 IRC section 7519(f)(4)

Penalty for Failure to

Pay on Date Prescribed

(20)(10)(150)1 General

IRC section 7519(f)(4) provides for a penalty for Failure to Pay on the Date Prescribed if a partnership or S corporation willfully fails to comply with the required payment rules.

(20)(10)(150)2 Penalty Computation

(1) IRC section 7519(f)(4)(a) provides for a ten percent underpayment penalty on Section 444 election payment amounts unpaid on or before the payment due date, May 15.

- (2) The Section 444 ten percent election penalty is NOT subject to reasonable cause.
- (3) See IRM 3(15)(148)0, BMF and NMF Adjustments, regarding Section 444 elections.

(20)(10)(150)3 Assessment

(1) For tax returns filed after December 31, 1991, TC 246, reference code 684 will be computer-generated to assess the ten percent election penalty when Form 8752 posts to a tax module (MFT 15) which is not fully paid by May 15.

(2) The ten percent election penalty may be manually assessed, if applicable and not computer-generated at the time the return posted by inputting TC 290 with reference code 684 for the correct penalty amount to MFT 15. (The manual penalty assessment will result in TC 240 with reference code 684 posting to master file MFT 15.)

(3) The ten percent election penalty may be manually abated by inputting TC 290 with reference code 684 for the correct NEGATIVE amount to MFT 15. (The manual penalty abatement will result in TC 241 with reference code 684 posting to master file MFT 15.)

Exhibit (20)900-2 Reference Guide to Forms

FORMS	DESCRIPTIONS
886-A	Explanation of Items (Audit Report)
870	Waiver of Restrictions on Assessment and Collect. of Deficiency in Tax & Acceptance of Overassessment
926	Return by Transferor of Property to a Foreign Corporation, Foreign Estate or Trust, or Foreign Partnership.
1040X	Amended U.S. Individual Income Tax Return
1042	Annual Withholding Tax Return for U.S. Source Income of Foreign Persons
1042S	Foreign Person's U.S. Source Income Subject to Withholding
1116	Computation of Foreign Tax Credit (Individual Fiduciary or Nonresident Alien Individual)
1118	Computation Of Foreign Tax Credit - Corporations
1120 (Sch PH)	U.S. Personal Holding Company (PHC) Tax
1120-FSC	U.S. Income Tax Return of a Foreign Sales Corporation
1120-DISC	Domestic International Sales corporation Return
1120-IC-DISC	Interest Charge Domestic International Sales corporation Return
1120X	Amended U.S. Corporation Income Tax Return

Exhibit (20)900-2 Cont. (1) Reference Guide to Forms

FORMS	DESCRIPTIONS
3198	Special Handling Notice
3210	Document Transmittal
3244	Payment Posting Voucher
3520	Creation of or Transfers to Certain Foreign Trusts
3520A	Annual Return of Foreign Trust with U.S. Beneficiaries
3645	Computation of Penalty for Failure to File Information Returns or Furnish Statements

3870	Request for Adjustment
4549	Income Tax Examination Changes
4549A	Income Tax Examination Changes
5074	Allocation of Individual Income Tax to Guam or the Commonwealth of the Northern Mariana Islands
5344	Examination Closing Record
5471	Information Return of U.S. Person with Respect to Certain Foreign Corporations
5472	Information Return of a 25% Foreign-Owned U.S. Corporation Engaged in a U.S. Trade or Business
Exhibit (20)900-2 Cont. (2) Reference Guide to Forms	

FORMS	DESCRIPTIONS
8278	Computation and Assessment of Miscellaneous Penalties
8288	U.S. Withholding Tax Return for Disposition by Foreign Persons of U.S. Real Property Interests
8288A	Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests
8804	Annual Return for Partnership Withholding Tax (Section 1446)
8805	Foreign Partner's Information Statement of Section 1446 Withholding Tax
8813	Partnership Withholding Tax Payment (Section 1446)
8833	Treaty Based Return Position Disclosure

Exhibit (20)900-3 Processing International Penalties

CIVIL PENALTY MODULE

Non-Deficiency Procedures

IRC Section	Reference Number	MFT 13/55
6038 (b)	623	X
6038A(d)	625	X
6038B (b)	676	*

6038C(C)**	---	
6677	677	X
6679/6046	613	X
6679/6035	614	X
6679/6046A**	619	*

RETURN RELATED MODULE

Deficiency Procedures

IRC Section	Reference Number	MFT 02/30
6038(C)	***	*
6038A(e)	***	*
6038C(d)**	---	
6652(f)**	---	
6683	***	*
6686	***	*
6688	***	*
6689	***	*
6712	685	*

* Validation pending at Master File

** Regulations not issued - Penalty not to be assessed

*** Number to be issued

Chapter (20)(10)00 Miscellaneous Penalties

(20)(10)10 Introduction

(20)(10)11 General

(1) This section of the consolidated penalty IRM discusses the following miscellaneous penalties:

(a) IRM (20)(10)20 IRC section 6166(g)(3)

Failure to Make Payment of Principal or Interest Payment of Estate Tax

(b) IRM (20)(10)30 IRC section 6652

Failure to File Certain Information Returns, Registration Statements, etc.

1 IRC section 6652(a)

2 IRC section 6652(j)

3 IRC section 6652(k)

4 IRC section 6652(l)

(c)IRM (20)(10)40IRC section 6653

Failure to Pay Stamp Tax

(d)IRM(20)(10)50IRC section 6657

Bad Checks

(e)IRM (20)(10)60IRC section 6674

Fraudulent Statement or Failure to Furnish Statement to Employee

(f)IRM (20)(10)70IRC section 6675

Excessive Claims with Respect to the Use of Certain Fuels

(g)IRM (20)(10)80IRC section 6697

Assessable Penalties with Respect to Liability for Tax of Regulated Investment Companies

(h)IRM (20)(10)90IRC section 6702

Frivolous Income Tax Return

(i)IRM (20)(10)(10)0 IRC section 6705

Failure by Broker to Provide Notice to Payors

(j)IRM (20)(10)(20)0 IRC section 6706

1 6706(a)

Failure to Show Information on Debt Instrument

2 6706(b)

Failure to Furnish Information to Secretary

(k)IRM (20)(10)(30)0 IRC section 6707

Failure to Furnish Information Regarding Tax Shelters

(l)IRM (20)(10)(40)0 IRC section 6708

Failure to Maintain Lists of Investors in Potentially Abusive Tax Shelters

(m)IRM (20)(10)(50)0 IRC section 6709(c)

Penalties with Respect to Mortgage Credit Certificates

(n)IRM (20)(10)(60)0 IRC section 6715

Dyed Fuel Sold for Use or Used in Taxable Use

(o)IRM (20)(10)(70)0 IRC section 7268

Possession with Intent to Sell in Fraud of Law or to Evade Tax (Alcohol, Tobacco & Firearms(AT&F))

(p)IRM (20)(10)(80)0 IRC section 7271

Penalties for Offenses Relating to Stamps

(q)IRM (20)(10)(90)0 IRC section 7273

Penalties for Offenses Relating to Special Taxes

(r)IRM (20)(10)(100)0 IRC section 7304

Penalty for Fraudulently Claiming Drawback (AT&F)

(s)IRM (20)(10)(110)0 IRC section 7342

Penalty for Refusal to Permit Entry or Examination

(t)IRM (20)(10)(120)0 IRC section 7519(f)(4)

Penalty for the Failure to Make the Required Payments for Entities Electing Not to Have Required Taxable Year

(20)(10)12 Common Features

(20)(10)12.1 General

(1)In general, each penalty discussed in this chapter is unique and will stand alone unless otherwise indicated. Exceptions and additional information are noted in the discussions of the specific penalties. However, some general procedures will apply.

(2)Statute of Limitations. Penalties that are **not** considered **taxes** generally have **no statute of limitation** for assessment. For penalties subject to deficiency procedures (generally, income taxes) or non-deficiency procedures (generally, employment or excise tax) the limitation for assessment is three years after the return is due or filed, whichever is later. See IRM (20)143 for a discussion of deficiency versus non-deficiency procedures.

(3)Reasonable Cause. Determination as to whether or not reasonable cause exists must be based on a careful consideration of the facts and circumstances of each case prior to the

assertion of a penalty. Examiners should consider any reason a taxpayer provides in conjunction with the guidelines, principles and evaluating factors identified in the Penalty Relief Chapter. See IRM (20)130, Penalty Relief, as well as the applicable IRC section and Treas. Regs. relating to the specific penalty.

(4) Abatements. Information on penalty abatements and penalty reason codes (PRC) are discussed in IRM (20)100.

(5) Penalty Transaction Codes. See Exhibit (20)100-5 for a list of penalty transaction codes.

(6) Penalty Reference Numbers. See Exhibit (20)100-6 and 7 for a list of penalty reference numbers.

(20)(10)12.2 Who Asserts/Assesses

(1) A service center or compliance function may determine that a penalty should be imposed.

(a) At a service center the penalty may generate automatically, or

(b) compliance functions consider the penalty during an examination or during personal contact with the taxpayer.

(2) Reference numbers are used to assess non tax return related penalties (conduct or information returns).

(a) Five hundred (500) series referenced numbers are generally generated as a result of computer matching programs and used to identify the failure.

(b) Six hundred (600) series reference numbers are generally used to assess penalties as the result of an examination or other compliance activity.

(c) See Exhibit (20)100-6 and (20)100-7 for a complete list of current reference numbers.

(20)(10)20 IRC section 6166(g)(3)

Failure to Make Payment

of Principal or Interest

(20)(10)21 General

(1) IRC section 6166, Extension of Time for Payment of Estate Tax Where Estate Consists Largely of Interest in Closely Held Business, under certain circumstances provides for the deferral of tax and/or installment payment plan for tax imposed by IRC section 2001.

(2) IRC section 6166(g)(3), Failure to Make Payment of Principal or Interest, provides that if any payment payable under IRC section 6166(a) is not paid when due but is paid within 6 months of the due date, there is imposed a penalty in an amount equal to 5 percent of the

amount of the payment multiplied by the number of months (or fractions thereof) after the due date and before payment is due.

(3) The estate tax installment agreement is monitored in the Service Center Accounting Branch. The service center procedures for assessment/abatement will be the primary focus under this penalty section.

(20)(10)22 Penalty Computation

(1) During the four year principal deferral (or shorter period if elected by the executor), the Estate is billed for interest only.

(2) If the taxpayer fails to make the installment (interest) payment, CP-191, Notification to Service Center Accounting to update the installment billing clerks file, will not generate.

(a) A manual review of the payment pending file will be necessary 45 days after the installment due date.

(b) If the review shows an unpaid installment, research:

1 IDRS for misapplied payment, and

2 Form 4768, Application for Extension of Time to File U.S. Estate Tax Return and/or Pay Estate Tax.

(c) If no payment or extension is located:

1 compute the Late Installment (LI) Penalty on the unpaid installment (interest) at 5% per month (or fraction thereof) from the installment due date to the date of Notice and Demand.

2 Input TC 240 for LI Penalty on IDRS.

3 Compute interest on the unpaid installment (interest) from the installment due date to the date of Notice and Demand.

4 Input TC 340 for interest on IDRS.

5 Prepare and issue Form 6335, Unit Ledger Card, for the unpaid installment, including accrued penalty and interest.

6 Suspense for 45 days.

(d) If after 90 days, no response is received from Service Center Collection Branch (SCCB), contact them to determine status of account.

(20)(10)23 Assessment

(1) If the taxpayer fails to make the installment (principal and interest) payment, a manual

review of the payment pending file will be necessary 45 days after the installment date.

(a) Compute Late Installment (LI) penalty on the unpaid installment (principal and interest) at 5% per month (or fraction thereof) from the installment due date to the date of Notice and Demand. Input TC 240 for LI Penalty on IDRS.

(b) Compute Failure to Pay (FTP) Penalty on the principal portion of the installment from the installment due date to the date of Notice and Demand. Input TC 270 for FTP penalty on IDRS.

(c) Compute interest (at the existing rate) on the unpaid installment (principal and interest) from the installment due date to the date of Notice and Demand. Input TC 340 for interest on IDRS.

(2) Use Hold Codes, Priority Codes, Posting Delay Codes and Penalty Reasons Codes as applicable. See IRM 3(15)60 and Document 6209 for additional information regarding these codes and indicators.

(3) Prepare and issue "Certified Letter" (return receipt requested) for the unpaid installment, accrued penalty and interest. Suspense for 45 days.

(4) If the payment is not received within 45 days of the Certified Letter, see IRM 3(17)(243)0.

(20)(10)24 Penalty Relief

No penalty relief provisions, including reasonable cause, exist. It should be noted, however, that prior to the due date of the payment, the estate may seek an extension of the time for payment under IRC section 6161, Extension of Time for Paying Tax.

(20)(10)30 IRC section 6652

(20)(10)31 IRC section 6652(a)

Reserved. See (20)(10)31 of LEM XX.

(20)(10)32 IRC section 6652(j)

Failure to File Certification with Respect to Certain Residential Rental Projects

(1) IRC section 6652(j) provides a penalty of \$100 per failure to provide the certification as required by IRC section 142(d)(7).

(a) Form 8703, Annual Certification by Operator Qualified Residential Rental Project should be filed by March 31 after the close of the calendar year for which the certification is made.

(b) Form 8610, Annual Low-Income Housing Credit Agencies Report, should be filed by February 28 of the year following the calendar year for which an

allocation of credit is made.

(2) The Service does not apply the penalty when the failure to timely file Form 8703 or Form 8610 is due to reasonable cause and not willful neglect.

(3) The penalty is subject to deficiency procedures.

(4) Effective January 1, 1997, procedures for assessment/abatement will be in IRM 3(11)25.

(5) Currently, Philadelphia Service Center processes these forms in a special processing unit.

(20)(10)33 IRC section 6652(k)

Failure to Make Reports

Required by IRC section 1202

Reserved. See (20)(10)33 of LEM XX-(10)00.

(20)(10)34 IRC section 6652(l)

Failure to File a Return required by

IRC section 6043(c)

Reserved. See (20)(10)34 of LEM XX-(10)00.

(20)(10)40 IRC section 6653

Failure to Pay Stamp Tax

IRC section 6653 is administered by the Bureau of Alcohol, Tobacco and Firearms.

(20)(10)50 IRC section 6657

Bad Checks

(20)(10)51 General

(1) Generally, this penalty will be assessed by the Service Center using penalty transaction codes.

(a) TC 280 - Manual assessment of a bad check penalty, or

(b) TC 286 - Computer generated assessment of a bad check penalty initiated by the posting of any one of the following Transaction Codes: 611, 621, 741, 651, 661, 671, 681, 691 and 721.

(c) TC 287 is computer generated which reverses the Transaction Code 280 or 286 if the status is 06 and the module balance is debit and net 28X amount equals the module

balance.

(2) A CP 587 notice will be sent to the taxpayer informing them of the dishonored check or money order and any applicable penalty and interest assessed.

(20)(10)52 Penalty Computation

(1) IRC section 6657 provides for the assertion of a penalty when a taxpayer's check or money order is dishonored.

For checks or money orders that were dishonored:

(a) on or before November 10, 1988, a penalty of in an amount equal to:

1 1% of the amount of the check, or

2 if the amount of the dishonored check/money order was \$500 or less;

then the penalty was \$5 or

the amount of the check/money order whichever was less.

(b) after November 10, 1988, the Technical Corrections Act of 1988 increased the amount of the penalty to:

1 2% of the amount of the check, or

2 if the amount of the dishonored check/money order is \$750 or less;

then the penalty is \$15.00 or

the amount of the check/money order, which ever is less.

(20)(10)53 Assessment

(1) A dishonored check/money order is identified on IDRS when a payment/deposit is reversed.

(a) For example, check/money order received with a return is identified as a TC 610. If the check/money order received with the return, was dishonored when presented to a bank, it would be identified on IDRS as a TC 611.

(b) When a payment/deposit received by the Service is dishonored, the dishonored payment will be reversed using one of the following: TC 611, 621, 641, 651, 661, 671, 681, 691, 721.

(c) The penalty associated with the dishonored check/money order will be identified on IDRS as a TC 280 or TC 286.

(20)(10)54 Penalty Relief

(1) The taxpayer may request penalty abatement by providing a reason why the

check/money order was dishonored. Review the request for abatement, bank letter or other information to determine if the penalty should be abated (see (20)130, Penalty Relief).

(2) When it is determined that the penalty should be abated:

(a) Input a TC 281 for the amount of the penalty previously assessed

(b) Indicate the reason for the penalty abatement in the adjustment remarks area.

(c) Use reason codes, penalty reason codes, hold codes, priority codes, or posting delay codes as required.

(d) Notify the taxpayer that the penalty has been abated (letter 608C or by telephone).

(3) When it is determined that the penalty should not be abated:

(a) provide the taxpayer with a written explanation (854C or equivalent)

(b) input TC 290 .00, BK 98/99, RC 62.

(20)(10)54.1 Reasonable Cause

(1) In addition to the reasons discussed in IRM (20)130, the following should be accepted as reasonable cause for dishonored checks.

(a) The taxpayer furnished evidence that their bank account contained sufficient funds at the time the check was submitted, but due to an error the check/money order was dishonored in error. In this situation, the bank should provide a letter of explanation.

(b) A check was not honored because of the death of the taxpayer after the date the check was issued.

(c) Payment of a check was stopped on the advice or recommendation of an employee of the Service.

(d) No penalty will be assessed on third party checks involving cash register seized property.

(e) See (10)54:(1)(e) of LEM XX.

(20)(10)60 IRC section 6674

Fraudulent Statement or Failure to Furnish

Statement to Employee

(20)(10)61 General

(1) IRC section 6674 provides for a penalty for a Willful Failure to Furnish (IRC section 6051 or 6053(b)) or for Willfully Furnishing a False or Fraudulent Statement (31.6051-1 or 31.6053-2) to an employee.

(a)IRC section 6051, Receipts for Employees

(b)IRC section 6053(b), Statements Furnished by Employers

(20)(10)62 Penalty Computation

The penalty is \$50 for each willful failure to provide or furnishing a false or fraudulent statement.

(20)(10)63 Assertion

(1)When an indication of willful failure is discovered, the investigating Compliance office will suspend the inquiry and report findings in accordance with IRM 52(10)1 to the Criminal Investigation function.

(2)Examination will assert the civil penalty.

(20)(10)64 Penalty Relief

(1) Reasonable cause provisions do not apply to IRC section 6674. See IRM (20)130.

(20)(10)70 IRC section 6675

Excessive Claims with

Respect to the Use of

Certain Fuels

(20)(10)71 General

(1)IRC section 6675 provides for a penalty if an excessive claim is filed for certain federal excise taxes.

(a)IRC section 6420 - gasoline used on farms;

(b)IRC section 6421 - gasoline used for certain nonhighway purposes; and

(c)IRC section 6427 - fuels not used for taxable purposes.

(20)(10)72 Penalty Computation

(1)The penalty is an amount equal to the greater of:

(a)Two times the excessive amount; or

(b)\$10.

(2)The penalty does not apply to excessive credit taken for such taxes on an income tax return.

(3)The penalty may apply to excessive payment on the claim.

(20)(10)73 Assertion

(20)(10)74 Penalty Relief

(1) Reasonable cause does apply. See IRM (20)132.

(20)(10)80 IRC section 6697

Penalty with Respect

to Liability for Tax

of Regulated Investment

Entities

(20)(10)81 General

(1) IRC section 6697 provides for a penalty to be imposed on a regulated investment company or a real estate investment trust which uses the deficiency dividend procedure of IRC section 860 to retain its qualified status.

(2) Prior to 1987, this penalty applied to a real estate investment trust.

(20)(10)82 Penalty Computation

(1) The amount of the penalty is equal to the interest charge paid by the trust on the deficiency dividend.

(2) The penalty may not exceed 50% of the deficiency dividend deduction allowed by IRC section 860(a).

(20)(10)83 Assertion

(1) The penalty may be assessed and collected without the normal deficiency procedure.

(2) For tax years beginning after 1986, the penalty does not apply to a real estate investment trust (REIT) that uses the deficiency dividend procedure to retain its qualified status.

(20)(10)84 Penalty Relief

(1) Reasonable cause does not apply. See IRM (20)132.

(20)(10)90 IRC section 6702

Frivolous Return Penalty

Frivolous Return Penalty

(20)(10)91 General

(1) IRC section 6702 provides for an immediate assessment of a \$500 civil penalty against individuals who file frivolous income tax returns or frivolous amended income tax returns. The penalty is not based on tax liability. There does not need to be an underpayment of tax or understatement of liability in order for the penalty to be imposed in addition to any other penalty. The intent of the law is to stop the flow of returns, amended returns, or documents which purport to be returns, that contain altered line items or claim clearly unallowable deductions or credits based on a frivolous position.

(2) The penalty can be asserted on a frivolous Form 1040, Form 1040X Amended Return, Form 843, Claim and others which:

(a) Do not contain sufficient information to judge the correctness of the tax, or

(b) Contain information that on its face indicates the self-assessment is incorrect, and

(c) The conduct referred to in (a) or (b) is due to a position which is frivolous or a desire to delay or impede the administration of the tax laws.

(3) Some of the schemes which may cause the assertion of the penalty are:

(a) Unallowable deductions such as the gold standard, discounted Federal Reserve Notes and War tax;

(b) wages are not income;

(c) constitutional claims (i.e., Fourth, Fifth and Sixteenth amendments);

(d) invalid returns; and

(e) nonprocessable returns.

(4) The frivolous return penalty is not applied against partnerships, corporations or estates.

(5) Statute of Limitations. A frivolous return:

(a) Does not constitute a valid return when the Service is unable to process the return, therefore, the IRC section 6702 penalty may be assessed at any time.

(b) Does constitute a valid return when the Service is able to process the return. Therefore, the IRC section 6702 penalty must be assessed within 3 years after the return was filed.

(6) See Exhibit (20)100-7, for the applicable penalty reference numbers.

(20)(10)92 Penalty Computation

(1)The civil penalty is \$500 per frivolous document.

(2)A taxpayer can have multiple penalties. However, for a joint return, only one \$500 penalty is assessed against the husband and wife, per frivolous document.

(3)See (20)(10)92:3 for LEM XX-(10)00.

(20)(10)93 Assertion

(1)Generally, the service center identifies frivolous returns and assesses the penalty.

(2)If the field receives a return that warrants a frivolous return penalty, the employee should indicate this on a Form 3198, Special Handling Notice, attached to the original return.

(3)A Form 8278, Computation and Assessment of Miscellaneous Penalties, will be completed and used for assessment unless the penalty is related to a joint return. The Non-Master File Assessment Voucher, Form 5734, will be used for the joint assessment of the penalty. See IRM Part IV for further information.

(20)(10)94 Penalty Relief

Taxpayers seeking judicial review of the imposition of the penalty must first pay the entire penalty. A Letter of Disallowance is sent to the taxpayer and the taxpayer can file suit contesting this penalty in the district court or U.S. Court of Federal Claims Court.

(20)(10)(10)0 IRC section 6705

Failure by Broker to

Provide Notice to Payors

(20)(10)(10)1 General

(1)IRC section 6705 provides a \$500 penalty for Failure by Broker to Provide Notice to Payors that a payee is subject to backup withholding.

(2)Under IRC section 3406(d)(2)(B), a broker who acquires a readily tradable instrument for a payee (customer) must notify the payor of such instrument within 15 days of the acquisition that the payee is subject to backup withholding if either of the following conditions exist:

(a) The payee fails to furnish the TIN to the broker.

(b) The IRS notifies the broker that the TIN is incorrect.

(c)The payee has not provided the broker with a certification that the payee is not subject to backup withholding, or

(d)The IRS has notified the broker before the acquisition that the payee is subject to backup withholding.

(3) Any broker who intentionally fails to provide the required notice is subject to the penalty of \$500 for each such failure.

(4) The penalty applies to payments made after 1983.

(20)(10)(10)2 Penalty Computation

(1) The penalty is computed at \$500 per failure by the broker to provide the notice to the payor.

(20)(10)(10)3 Assertion

(1) Compliance employees request the assessment of the penalty using Form 8278.

(2) The penalty is assessed using penalty reference number 632.

(20)(10)(10)4 Penalty Relief

Reasonable cause does not apply. See Exhibit (20)(10)00-1.

(20)(10)(20)0 IRC section 6706

(20)(10)(20)1 IRC section 6706(a)

Failure to Show

Information on Debt

Instrument

(20)(10)(20)1.1 General

(1) IRC section 6706(a) provides for a penalty of \$50 for Failure to Show Information on Debt Instrument.

(2) In the case of any debt instrument having original issue discount, the following information must be shown on the Debt Instrument,

(a) amount of the original issue discount, and

(b) the issue date.

(3) Statutory notice of deficiency procedures do not apply to this penalty.

(20)(10)(20)1.2 Penalty Computation

(1) In the case of any debt instrument having original issue discount that does not contain the required information, a penalty of \$50 per failure to show information on a debt instrument will be assessed.

(20)(10)(20)1.3 Assertion

This penalty is asserted by Compliance.

(20)(10)(20)1.4 Penalty Relief

Reasonable cause does apply. See IRM (20)132.

(20)(10)(20)2 IRC section 6706(b)

Failure to Furnish

Information to

Secretary

(20)(10)(20)2.1 General

(1) IRC section 6706(b) provides for a penalty of 1% of the aggregate issue price of such issue, not to exceed \$50,000 for Failure to Furnish Form 8281, Information Return for Publicly Offered Original Issue Discount Instruments.

(2) An issuer of a publicly offered debt instrument (obligation) having Original Issue Discount (OID), such as a bond, debenture, or note, must file Form 8281.

(3) Form 8281 must be filed within 30 days of the date of issuance of an OID instrument.

(4) A separate Form 8281 must be filed for each issue.

(5) Statutory notice of deficiency procedures do not apply to this penalty.

(20)(10)(20)2.2 Penalty Computation

A penalty of 1% of the aggregate issue price of a publicly offered original discount instrument, not to exceed \$50,000 for the failure to notify the Service within the time specified will be assessed.

(20)(10)(20)2.3 Penalty Assertion

The Multi-Functional Compliance Team (MFCT) in Detroit Data Center (DDC) has primary responsibility for this program.

(20)(10)(20)2.4 Penalty Relief

Reasonable cause does apply. See IRM (20)132.

(20)(10)(30)0 IRC section 6707

Failure to Furnish Information

Regarding Tax Shelters

(20)(10)(30)1 General

(1) Failure to register a tax shelter:

(a) IRC section 6111(a) defines those people required to register a tax shelter and the time for the required registration.

(b) IRC section 6707(a) provides a penalty for those people who fail to register or fail to register timely.

(c) Form 8264, Application for Registration of a Tax Shelter, is used for this purpose.

(2) Failure to furnish identifying number:

(a) IRC section 6111(b)(1) defines the requirement to furnish a tax shelter identification number to an authorized person upon request.

(b) IRC section 6707(b)(1) provides a penalty for each failure to do so.

(3) Failure to include an identifying number on a return:

(a) IRC section 6111(b)(2) defines the requirement to include the identification number on any return as required.

(b) IRC section 6707(b)(2) provides a penalty for each failure to supply the number as required.

(4) The penalty applies to interests in tax shelters which are first offered for sale after ~~October 22, 1986~~ August 31, 1984. See (20)(10)(40)(2)(a).

(20)(10)(30)2 Penalty Computation

(1) After 10/22/86:

(a) ~~(1)~~ IRC section 6707(a) provides a penalty of 1 percent of the aggregate amount invested in the tax shelter or \$500, whichever is greater, for the failure to register a tax shelter.

(b) ~~(2)~~ IRC section 6707(b)(1) provides a penalty of \$100 for each failure to furnish an identifying number as required.

(c) ~~(3)~~ IRC section 6707(b)(2) provides a \$250 penalty for each failure to include an identifying number on a return.

(2) Prior to 10/23/86:

(a) For failure to register a tax shelter shall be an amount to the greater of \$500 or the lesser of (i) 1 percent of the aggregate amount invested in such shelter, or (ii) \$10,000.

(b) IRC section 6707(b)(1) provides a penalty of \$100 for each failure to furnish an identifying number as required.

(c) IRC section 6707(b)(2) provides a \$50 penalty for each failure to include an identifying number on a return.

(20)(10)(30)3 Penalty Assertion

These penalties are asserted by Examination function.

(20)(10)(30)4 Penalty Relief

The reasonable cause exception applies to the penalties in IRC section 6707 except the penalty under section 6707(b)(1). See IRM (20)130 for a discussion of reasonable cause.

(20)(10)(40)0 IRC section 6708

Failure to Maintain List

of Investors in Potentially

Abusive Tax Shelters

(20)(10)(40)1 General

(1) The requirement to maintain a list of investors in potentially abusive tax shelters is defined in IRC section 6112. IRC section 6708 provides a penalty for each investor not included on the list.

(2) The penalty applies to tax shelters which are first offered for sale after ~~October 22, 1986~~ August 31, 1984.

(a) August 31, 1984 to October 22, 1986 - \$50,000 maximum.

(b) After October 22, 1986 - \$100,000 maximum.

(20)(10)(40)2 Penalty Computation

IRC section 6708 provides a penalty of \$50 for each investor not included on the list with a maximum penalty of \$100,000 after October 22, 1986. Prior to October 23, 1986, maximum penalty of \$50,000.

(20)(10)(40)3 Penalty Assertion

These penalties are asserted by Examination function.

(20)(10)(40)4 Penalty Relief

The penalty is not asserted if there is reasonable cause and the failure was not due to willful neglect. See IRM (20)130 for a discussion of reasonable cause.

(20)(10)(50)0 IRC section 6709(c)

Failure to File Report

for Mortgage Credit

Certificates

(20)(10)(50)1 General

(1) IRC section 6709(c) provides for a penalty of \$200 for Failure to File a report with respect to any mortgage credit certificates required by IRC section 25(g).

(2) Any person (lender) who makes a loan that is a certified indebtedness amount on any Mortgage Credit Certificate (MCC) must provide IRS with information regarding the issuance of MCCs under IRC section 25.

(3) Form 8329 is due by January 31 following the close of the calendar year in which the lender made certified indebtedness loans.

(4) Each issuer (states and political subdivisions) of MCCs are to provide IRS with information required by IRC section 25 and Treas. Reg. 1.25-8T(b).

(5) Form 8330 must be filed on a quarterly basis beginning with the quarter in which the election was made.

(20)(10)(50)2 Penalty Computation

(20)(10)(50)3 Assertion

This penalty is asserted by Compliance.

(20)(10)(50)4 Penalty Relief

Reasonable cause does apply. See IRM (20)132.

(20)(10)(60)0 IRC section 6715

Improper Sale, Use, or Alteration

of Dyed Diesel Fuel

(20)(10)(60)1 General

(1) IRC section 4081 imposes a tax on certain removals, entries, or sales of diesel fuel. Generally, diesel fuel that is dyed pursuant to the regulations under IRC section 4082 is exempt from tax.

(2) Effective January 1, 1994, IRC section 6715 imposes an assessable penalty on the misuse of dyed fuel. Generally, misuse occurs when a person sells, holds for sale, uses, or holds for use, dyed fuel for a taxable use. A typical taxable use is use as a fuel in a registered

diesel-powered highway vehicle. The IRC section 6715 penalty also applies if a person wilfully alters, or attempts to alter, the strength or composition of the dye in dyed fuel.

(20)(10)(60)1.1 Improper Sale of Dyed Fuel

(1) If any dyed fuel is sold or held for sale by any person for any use that such person knows or has reason to know is not a nontaxable use of such fuel, then such person shall pay an IRC section 6715 penalty in addition to the tax (if any).

(2) "Dyed fuel" means any dyed diesel fuel, whether or not the fuel was dyed pursuant to IRC section 4082.

(3) "Nontaxable use" has the meaning given to the term by IRC section 4082(b).

(20)(10)(60)1.2 Improper Use of Dyed Fuel

(1) If any dyed fuel is held for use or used by any person for a use other than a nontaxable use and such person knew, or had reason to know, that such fuel was so dyed, then such person shall pay an IRC section 6715 penalty in addition to the tax (if any).

(2) "Dyed fuel" means any dyed diesel fuel, whether or not the fuel was dyed pursuant to IRC section 4082

(3) "Nontaxable use" has the meaning given to the term by IRC section 4082(b).

(20)(10)(60)1.3 Willful Alteration of Dye Concentration

(1) If any person willfully alters, or attempts to alter, the strength or composition of any dye or marking done pursuant to IRC section 4082 in any dyed fuel, then such person shall pay a penalty in addition to the tax (if any).

(2) This penalty does not apply in the following cases:

(a) Diesel fuel that is dyed pursuant to the regulations under IRC section 4082 is blended with any undyed liquid and the resulting product satisfies the dyeing requirements of the regulations under IRC section 4082.

(b) Diesel fuel that is dyed pursuant to the regulations under IRC section 4082 is blended with any other liquid (other than diesel fuel) that contains the type and amount of dye required for diesel fuel dyed in accordance with the regulations under IRC section 4082.

(c) Diesel fuel that is not dyed pursuant to the regulations under IRC section 4082 is blended with diesel fuel that is dyed pursuant to IRC section 4082 and the blending occurs as part of nontaxable use.

(20)(10)(60)2 Penalty Calculation

(1) For the first violation, the amount of the penalty on each act is the greater of--

(a) \$1,000, or

(b) \$10 for each gallon of the dyed fuel involved.

(2) For additional violations, the amount in (1)(a) is determined by multiplying \$1,000 times the number of prior penalties imposed by IRC section 6715 on such person (or a related person or any predecessor of such person or related person).

(3) Thus, for example, if 50 gallons of dyed fuel is involved in a person's first violation, the penalty would be \$1,000 because that amount is greater than $50 \times \$10$. If 150 gallons of dyed fuel is involved in that person's second violation, the penalty would be \$2,000 because that amount ($\$1,000 \times 2$ violations) is greater than $150 \times \$10$.

(4) If a penalty is imposed under IRC section 6715 on any business entity, each officer, employee, or agent of such entity who willfully participated in any act giving rise to such penalty is jointly and severally liable with such entity for such penalty.

(20)(10)(60)3 Assessment

(1) This penalty is assessed by District Office Examination using Form 5734, Non Master File Assessment Voucher or Form 2859, Request for Quick or Prompt Assessment.

(2) Use penalty Reference Number (PRN) 656 on forms requiring a PRN.

(20)(10)(60)4 Penalty Relief

(1) This is no reasonable cause exception to this penalty.

(2) However, note the "knowledge" requirement in (20)(10)(60)2(1) and (20)(10)(60)3(1) and the requirement for "willfulness" in (20)(10)(60)4(1).

(20)(10)(70)0 IRC section 7268

Possession with Intent

to Sell in Fraud of Law

or to Evade Tax

IRC section 7268 is administered by the Bureau of Alcohol, Tobacco and Firearms. See (20)(10)(70)0 of LEM XX.

(20)(10)(80)0 IRC section 7270

Insurance Penalties

IRC 7270 provides for penalties for the issuance of insurance policies by foreign insurers with the intent to evade tax.

(20)(10)(90)0 IRC section 7271

Penalties for Offenses

Relating to Stamps

IRC section 7271 is administered by the Bureau of Alcohol, Tobacco and Firearms. See (20)(10)(80)0 of LEM XX.

(20)(10)(100)0 IRC section 7272

Penalties for Failure to Register as Required by Subtitle E

IRC section 7272 relates to penalties for failure to register as required by subtitle E, Alcohol, Tobacco and certain other excise taxes.

(20)(10)(110)0 IRC section 7273

Penalties for Offenses

Relating to Special Taxes

IRC section 7273 is administered by the Bureau of Alcohol, Tobacco and Firearms. See (20)(10)(90)0 of LEM XX.

(20)(10)(120)0 IRC section 7275

Penalties for Offenses

Relating to Airline Tickets

and Advertising

IRC section 7275 provides that any person who violates the provisions of this section is guilty of a misdemeanor for each violation and upon conviction shall be fined not more than \$100.

(20)(10)(130)0 IRC section 7304

Penalty for Fraudulently

Claiming Drawback

IRC section 7304 is administered by the Bureau of Alcohol, Tobacco and Firearms. See (20)(10)(100)0 of LEM XX.

(20)(10)(140)0 IRC section 7342

Penalty for Refusal to

Permit Entry or

Examination

