



MANUAL TRANSMITTAL

Department of the Treasury
Internal Revenue Service

4.23.9

OCTOBER 6, 2022

EFFECTIVE DATE

(10-06-2022)

PURPOSE

- (1) This transmits IRM 4.23.9, Employment Tax - Penalty, Fraud, and Identity Theft Procedures.

MATERIAL CHANGES

- (1) IRM 4.23.9.1.3. Added that Chief, Employment Tax Examination, is responsible for ensuring examiners follow the guidance included in this IRM.
- (2) IRM 4.23.9.1.4. Changed quality review to National Quality (NQ) and Embedded Quality (EQ).
- (3) IRM 4.23.9.1.7. Added information about Taxpayer Advocate Services resources and added updated Taxpayer Bill of Rights (TBOR) content.
- (4) IRM 4.23.9.2. Changed the name of the Information Return Penalty Report Writing Program to Information Return Penalty Tool and added information about the tool.
- (5) IRM 4.23.9.4. Revised to be consistent with the IRM 20.1.1.2.3.1 and IRC 6751(b).
- (6) IRM 4.23.9.11.1. Added information about non-qualified stock options - administrative waiver of FTD.
- (7) IRM 4.23.9.13.1. Added information on Form 1099-NEC which is for payments of nonemployee compensation for periods after 12/31/2019.
- (8) IRM 4.23.9.13.6. Added information on secured delinquent returns.
- (9) IRM 4.23.9.17. New subsection, Referrals to TEGE of Prohibited Tax Shelter Transactions.
- (10) Exhibit 4.23.9-1. Changed the procedure on securing the consent to extend statute of limitations on IRC 6721 and IRC 6722 penalties.
- (11) Updates are made to this section for procedural and technical changes. Editorial and technical changes, including updating links and IRM cross-references, have been made throughout this section.

EFFECT ON OTHER DOCUMENTS

This material supersedes IRM 4.23.9, dated December 23, 2019.

AUDIENCE

This section contains instructions and guidelines for all Large Business & International (LB&I), Tax Exempt and Government Entities (TE/GE), and Small Business/Self-Employed (SB/SE) employees dealing with employment tax issues.

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4.23.9

Employment Tax Penalty, Fraud, and Identity Theft Procedures

Table of Contents

4.23.9.1 Program Scope and Objectives

4.23.9.1.1 Background

4.23.9.1.2 Authority

4.23.9.1.3 Responsibilities

4.23.9.1.4 Program Objectives and Reviews

4.23.9.1.5 Program Reports

4.23.9.1.6 Acronyms

4.23.9.1.7 Related Resources

4.23.9.2 Introduction

4.23.9.3 Reasonable Cause

4.23.9.4 Managerial Approval

4.23.9.4.1 Computation of Penalty Included in Notice

4.23.9.5 Appeal Procedures

4.23.9.6 Employment Tax Fraud - General

4.23.9.6.1 First Indications of Fraud

4.23.9.6.2 Firm Indications of Fraud

4.23.9.6.3 Criminal Fraud Procedures - General

4.23.9.6.3.1 Criminal Fraud Referrals

4.23.9.6.3.1.1 Acceptance of Initial Criminal Fraud Referral

4.23.9.6.3.1.2 Referral to DOJ of Accepted Fraud Referral

4.23.9.6.3.1.3 Quarterly Conference of Criminal Referrals

4.23.9.6.3.1.4 Discontinuance of Accepted Fraud Referral

4.23.9.6.3.2 Declination of Initial Criminal Fraud Referral

4.23.9.6.4 Civil Fraud Procedures

4.23.9.6.4.1 Civil Fraud Penalty Rates

4.23.9.6.4.2 Civil Resolution of a Criminal Prosecution Case

4.23.9.6.5 Miscellaneous Fraud Procedures and Group Definitions

4.23.9.7 Negligence Penalty

4.23.9.8 Assertion of Penalties Involving IRC 3509

4.23.9.9 Assertion of Failure to File Penalty

4.23.9.10 Assertion of Failure to Pay Penalty

4.23.9.11 Penalty for Failure to Make Timely Deposits

4.23.9.11.1 Non-Qualified Stock Options - Administrative Waiver of FTD

4.23.9.12 First Time Abate (FTA) Waiver

4.23.9.13 Penalties for Failure to File Certain Information Returns or Furnish Certain Statements

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- 4.23.9.13.1 Information Returns Regarding Payments of Remuneration for Services
 - 4.23.9.13.2 Wage and Tax Statements
 - 4.23.9.13.3 Penalty for Failure to File Correct Information Returns
 - 4.23.9.13.4 Penalty for Failure to Furnish Correct Information Returns
 - 4.23.9.13.5 Information Penalty Rates
 - 4.23.9.13.6 Information Return Penalty Statute of Limitations
 - 4.23.9.13.7 Q & A Regarding Failure to File or Furnish Penalties
 - 4.23.9.13.8 Failure to Comply with Other Information Reporting Requirements
 - 4.23.9.14 Trust Fund Recovery Penalty
 - 4.23.9.14.1 Trust Fund Recovery Penalty Procedures
 - 4.23.9.14.2 Instructions for Completing Form 6238, Referral Report for Potential Trust Fund Recovery Penalty Cases
 - 4.23.9.15 Tax Return Preparer Penalty
 - 4.23.9.16 Business Master File (BMF) Identity Theft Procedures for Employment Tax Area 212 - Overview
 - 4.23.9.16.1 Fabricated EIN Procedures
 - 4.23.9.16.2 BMF Identity Theft Procedures
 - 4.23.9.16.3 Confirmed BMF Identity Theft Procedures on Non-filed Returns
 - 4.23.9.16.4 Confirmed BMF Identity Theft Procedures for Filed Returns
 - 4.23.9.16.5 Contact with True EIN Owner
 - 4.23.9.17 Referrals to TEGE of Prohibited Tax Shelter Transactions
- Exhibits
- 4.23.9-1 Instructions for Determining Civil Penalty Statute of Limitations

4.23.9.1
(12-23-2019)
Program Scope and Objectives

- (1) **Purpose:** This section describes procedures for employment tax penalty procedures and identity theft.
- (2) **Audience:** This section contains instructions and guidelines for all Large Business & International (LB&I), Tax Exempt/Government Entities (TE/GE), and Small Business/Self-Employed (SB/SE) employees dealing with employment tax issues.
- (3) **Policy Owner:** Director, Specialty Examination Policy of Small Business / Self-Employed Division.
- (4) **Program Owner:** Program Manager - Employment Tax Policy. The mission of Employment Tax Policy is to establish effective policies and procedures and to support compliance with employment tax laws.
- (5) **Primary Stakeholders:**
 - Employment Tax - Workload Selection and Delivery (SE:S:DCE:HQ:ECS:S:ETEGCS:EWSD)
 - Specialty Examination - Employment Tax (SE:S:DCE:E:SE:ET)
 - Specialty Examination Policy, Employment Tax Policy (SE:S:DCE:E:HQ:SEP:EMTP)
 - Other areas that are affected by these policies and procedures include Appeals, Counsel, SB/SE Examination, LB&I, and TE/GE.

4.23.9.1.1
(12-23-2019)
Background

- (1) It is important that taxpayers be treated equitably and that decisions regarding liability for penalties be based on sound analyses of the reasons advanced by the taxpayer for failing to act.
- (2) In accordance with Policy Statement 20-1, "Penalties are used to enhance voluntary compliance," 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 concerns heard and considered,
 - Require impartiality and a commitment to achieving the correct decision,
 - Allow for prompt reversal of initial determinations when sufficient information has been presented to indicate that the penalty is not appropriate, and
 - Ensure that penalties are used for their proper purpose and not as bargaining points in developing or processing cases.

Note: See IRM 1.2.1.12.1, Policy Statement 20-1 (Formerly P-1-18), Penalties are used to enhance voluntary compliance.
- (3) To ensure consistency, the Service uses a single set of guidelines for all operational and processing functions contained in the IRM subsections of IRM 20.1, Penalty Handbook. The Office of Servicewide Penalties website is an excellent supplemental resource for guidance on all penalties - see <https://portal.ds.irsnet.gov/sites/VL015/Pages/default.aspx>.

- (4) IRM 25.1.1, Fraud Handbook, Overview/Definitions, and IRM 25.1.2, Fraud Handbook, Recognizing and Developing Fraud, provide specific guidance on fraud indicators and the development of fraud cases.

4.23.9.1.2
(12-23-2019)
Authority

- (1) Employment tax provisions are found at Internal Revenue Code Subtitle C:
- Chapter 21, Federal Insurance Contributions Act (FICA),
 - Chapter 22, Railroad Retirement Tax Act (RRTA),
 - Chapter 23, Federal Unemployment Tax Act (FUTA),
 - Chapter 24, Federal Income Tax Withholding (FITW), and
 - Chapter 25, General Provisions relating to employment taxes and collection of income taxes at source.
- (2) The Employment Tax Program is governed by Policy Statements and other internal guidance that apply to all Service personnel regardless of operating division. The Policy Statements found in IRM 1.2.1, Servicewide Policies and Authorities, Servicewide Policy Statements, apply to all employment tax issues and examinations. Examiners should review these Policy Statements to properly perform their examination duties.
- (3) A website, Search Servicewide Delegation Orders, located at <http://irm.web.irs.gov/imd/del/search.aspx> provides a searchable list of Servicewide Delegation Orders issued by the Commissioner of the Internal Revenue, or on his or her behalf by either of the deputy commissioners. Delegation Orders pertaining to each IRS business process can be found in IRM 1.2.2, Servicewide Policies and Authorities, Servicewide Delegations of Authority.
- (4) IRM 4.23 provides Servicewide instructions for all operating divisions with employees involved with the correct filing, reporting, and payment of employment taxes. IRM 4.23 serves as the foundation for consistent administration of employment taxes by various IRS operating divisions. By providing one source of authority for all operating divisions, the Service greatly reduces philosophical and procedural inconsistencies.

4.23.9.1.3
(10-06-2022)
Responsibilities

- (1) Director, Specialty Examination Policy is responsible for the procedures and updates addressed in this IRM.
- (2) Director, Specialty Examination is the executive responsible for examination operational compliance.
- (3) Chief, Employment Tax Examination, is responsible for ensuring examiners follow the guidance included in this IRM.

4.23.9.1.4
(10-06-2022)
Program Objectives and Reviews

- (1) Program Goals: The processes and procedures provided in this IRM are consistent with the objectives or goals for Employment Tax - Examination that are addressed in IRM 1.1.16.5.3.3, Employment Tax Examination, found in IRM 1.1.16.5.5.2.2, Employment Tax Policy.
- (2) Program Effectiveness: Program goals are measured with Employment Tax National Quality (NQ) and Embedded Quality (EQ) Performance Reports that monitor whether quality attributes are applied uniformly and consistently.
- (3) Annual Review: Program Manager - Employment Tax Policy is responsible for reviewing the information in this IRM annually to ensure accuracy and promote consistent tax administration.

4.23.9.1.5
(12-23-2019)
Program Reports

- (1) Program Reports: Information regarding the reporting of program objectives are included on, but not limited to, the following reports submitted to the Director, Examination - Specialty:
 - Headquarters Examination Monthly Briefing,
 - Program Manager Monthly Briefing,
 - Examination Operational Review, and
 - Business Performance Reviews.
- (2) The Quarterly Business Performance Review (BPR) provides updates on the status of Whistleblower claims in Operating Division SME status.

4.23.9.1.6
(10-06-2022)
Acronyms

- (1) Below are common acronyms used in this IRM section. Acronyms not listed below may be found in the *Acronyms Database*.

Acronym	Definition
AIMS	Audit Information Management System
ARC	Aging Reason Code
ASED	Assessment Statute Expiration Date
BMF	Business Master File
BPR	Business Performance Review
CI	Criminal Investigation
CCP	Centralized Case Processing
DC	Disposal Code
DITA	Designated Identity Theft Adjustment
DOJ	Department of Justice
EIN	Employer Identification Number
EO	Exempt Organizations
ERCS	Exam Return Control System
ET- WSD	Employment Tax - Workload Selection and Delivery
FEA	Fraud Enforcement Advisor
FFTF	Fraudulent Failure to File
FICA	Federal Insurance Contributions Act
FOIA	Freedom of Information Act
FTA	First Time Abatement

Acronym	Definition
FTF	Failure to File
FTP	Failure to Pay
FUTA	Federal Unemployment Tax Act
ID Theft	Identity Theft
IMF	Individual Master File
LLC	Limited Liability Company
LB&I	Large Business & International
MFT	Master File Tax
NMF	Non-Master File
NQSO	Non-Qualified Stock Option
OSP	Office of Servicewide Penalties
PMFOL	Payor Master File On-line
PRC	Penalty Reason Codes
RAR	Revenue Agent's Report
RCA	Reasonable Cause Assistant
RRTA	Railroad Retirement Tax Act
SA	Special Agent
SAC	Special Agent in Charge
SB/SE	Small Business/Self-Employed
SC	Status Code
SFR	Substitute for Return
SSA	Supervisory Special Agent
TAS	Taxpayer Advocate Service
TBOR	Taxpayer Bill of Rights
TC	Transaction Code
TE/GE	Tax Exempt and Government Entities
TFRP	Trust Fund Recovery Penalty
TIN	Taxpayer Identification Number
TPEA	Trade Preferences Extension Act

4.23.9.1.7
(10-06-2022)

Related Resources

- (1) The following table lists the primary sources of guidance:

Source	Title	Description of Guidance
IRM 4.23	Employment Tax IRM	IRM sections, the majority of which are owned by SB/SE Specialty Examination Policy, provides servicewide instructions for employees of all operating divisions involved with the correct filing, reporting, and payment of employment taxes. IRM 4.23 serves as the foundation for consistent administration of employment taxes by various IRS operating divisions.

- (2) Other helpful information sources include:

- The SB/SE Knowledge Management home page for Employment Taxes at <https://portal.ds.irsnet.gov/sites/vl014/pages/default.aspx>.
- The Specialist Referral System home page at <https://srs.web.irs.gov/>.
- A list of SB/SE Employment Tax Policy Analysts, including their contact information and program assignments, is found at *Employment Tax Policy Contacts*.
- The website **Working a Case Assigned to You** at <https://portal.ds.irsnet.gov/sites/vl014/lists/workingacaseassignedtoyou/landingview.aspx>.

- (3) The Taxpayer Bill of Rights (TBOR) lists rights that already existed in the tax code, putting them in simple language and grouping them into 10 fundamental rights. Employees are responsible for being familiar with and acting in accord with taxpayer rights. See IRC 7803(a)(3), Execution of Duties in Accord with Taxpayer Rights. For additional information about the TBOR, see www.irs.gov/taxpayer-bill-of-rights.
- (4) The Taxpayer Advocate Service (TAS) is an independent organization within the Internal Revenue Service (IRS), led by the National Taxpayer Advocate. Its job is to protect taxpayers' rights by striving to ensure that every taxpayer is treated fairly and knows and understands their rights under the TBOR. TAS offers free help to taxpayers, including when taxpayers face financial difficulties due to an IRS problem, when they are unable to resolve tax problems they haven't been able to resolve on their own, or when they need assistance to address an IRS system, process, or procedure that is not functioning as it should. TAS has at least one taxpayer advocate office located in every state, the District of Columbia, and Puerto Rico.

- (5) Examiners should consider the disclosure provisions when preparing agreed and unagreed case reports. For further information, see the Privacy, Government Liaison and Disclosure (PGLD) maintained knowledge base at <https://portal.ds.irsnet.gov/sites/vl003/pages/default.aspx>.

4.23.9.2
(10-06-2022)
Introduction

- (1) This section discusses the penalties most frequently asserted in employment tax examinations. The penalties covered in this section should not be considered as all-inclusive and research should be done on a case-by-case basis to ensure correct penalty assessment. Examiners should refer to the various subsections of IRM 20.1, Penalty Handbook, for complete information on penalties. For instructions on determining the statute of limitations on assessment for certain civil penalties, see Exhibit 4.23.9-1, Instructions for Determining Civil Penalty Statute of Limitations.
- (2) Penalties are assessed in the same manner as the taxes to which they are applied. Some employment tax determinations are reviewable by the Tax Court in proceedings to determine employment status under IRC 7436. Penalties in employment tax cases can be subject to deficiency procedures (for example, IRC 7436) or non-deficiency procedures. A penalty in an employment tax case is subject to Tax Court review if the underlying tax on which the penalty is asserted is subject to Tax Court review. Further information on report writing and penalty assessments can be found at:
- IRM 20.1.1.4.2, Deficiency Procedures
 - IRM 20.1.1.4.2.1, Non-Deficiency Procedures
 - IRM 4.23.10.10, Preparation of the Employment Tax Report
- (3) A Civil Penalties Master File has been developed to accommodate most penalties previously assessed on the Non-Master File (NMF) and the W-4 penalty. These penalties are listed on Form 8278, Assessment and Abatement of Miscellaneous Civil Penalties, which is used to forward the assessment/abatement action to Centralized Case Processing (CCP) for input. See IRM 20.1.1, Penalty Handbook, Introduction and Penalty Relief.

Note: EO, Exempt Organizations, should forward the assessment/abatement action to the EO closing unit for input.

- (4) When using the Civil Penalties Master File, the first assessment made on an entity will establish the module, since there is no return filing to create the module prior to the first assessment. The civil penalty module is a single entity module; joint assessments cannot be made. Any joint penalty liability, such as a jointly filed frivolous return, must continue to be made NMF utilizing existing instructions. Only the taxpayer's name against whom the penalty is asserted should be shown on Form 8278 .

Note: See IRM 20.1.1.5, Master File Indicators, for additional information.

- (5) The *Information Returns Penalty Tool* is an Excel spreadsheet available to assist the examiner in creating, calculating, and preparing the forms required for an information return penalty case file. The tool is maintained by the Office of Servicewide Penalties (OSP). It is located at OSP Knowledge Management site under *Working the Information Return Penalty Case*.

Note: For additional information refer to IRM 20.1.7.5, Delinquent Information Return Procedures.

4.23.9.3
(03-27-2017)
Reasonable Cause

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

Note: See IRM 20.1.1.3, Criteria for Relief from Penalties, and IRM 20.1.1.3.2, Reasonable Cause.

- (2) To establish that the failure to act was due to reasonable cause, a written statement setting forth the reason should be obtained from the taxpayer. The examiner will document the decision and the basis for providing relief according to functional guidelines. The examiner will attach a copy of the information to the original return (if available) or other transaction (input) document. See IRM 20.1.1.3.5.2, Taxpayer Entitled to Relief.
- (3) Examiners must consider granting the first time abatement (FTA) waiver before addressing reasonable cause in cases involving:
- Failure to File (IRC 6651(a)(1), IRC 6698(a)(1), and IRC 6699(a)(1)),
 - Failure to Pay (IRC 6651(a)(2) and IRC 6651(a)(3)), and/or
 - Failure to Deposit (IRC 6656) penalties.

See IRM 4.23.9.12, First Time Abate (FTA) Waiver.

4.23.9.4
(10-06-2022)
Managerial Approval

- (1) IRC 6751(b) requires written approval by the immediate supervisor of the examiner prior to issuing any written communication of penalties to a taxpayer that offers the taxpayer an opportunity to sign an agreement or consent to assessment or proposal of the penalty. See IRM 20.1.1.2.3.1, Timing of Supervisory Approval.
- (2) Penalties under IRC 6651 for failure to file tax return or to pay tax and penalties automatically calculated through electronic means are excepted from the approval requirement. A penalty is considered to be **automatically calculated through electronic means** if it is free of any independent determination by a Service employee as to whether or not the penalty should be imposed against a taxpayer.

Example: If the penalty is computed solely with IDRS command code FTDPN, without any independent judgement as to whether the penalty applies by a Service employee, or if the penalty is a computer generated assessment of a delinquency penalty on returns posted after the due date without reasonable cause (for example Transaction Code 166), the penalty does not require supervisory approval.

Note: Despite the fact that IRC 6651 penalties are exempted by statute from the managerial approval requirement, the fraudulent failure to file (FFTF) penalty requires approval from both Counsel and the manager. See IRM 20.1.2.3.7.5.1, FFTF Penalty Assessment—Procedural Requirements, paragraph (2) and (8).

- (3) The manager must approve in writing the employee's initial penalty determination before the Service informs the taxpayer of the proposed penalty

determination. See IRM 20.1.1.2.3.1, Timing of Supervisory Approval, IRM 20.1.5.2.3, Supervisory Approval of Penalties - IRC 6751 Procedural Requirements, and Clay v. Commissioner, 152 T.C. No. 13 (2019).

- (4) The examiner is not required to provide a copy of the written approval to the taxpayer; however, the IRS may wish to provide the taxpayer with a courtesy copy of the document showing that the manager approved the penalties. Taxpayers are entitled to request these documents under the Freedom of Information Act (FOIA). See IRM 20.1.1.2.3, Approval Prerequisite to Penalty Assessments.

4.23.9.4.1
(05-14-2008)
**Computation of Penalty
Included in Notice**

- (1) IRC 6751(a) requires that each penalty notice include the name of the penalty, the Code section imposing the penalty, and a computation of the penalty. The computation must include:
 - a. The formula for computing the penalty,
 - b. The amount of each of the variables in that formula,
 - c. The change in each of these variables since the date of the last notice, and
 - d. The amount of the penalty imposed.
- (2) The penalties shown on the separate explanation sheet must agree with the penalty amounts shown on all employment tax reports issued to the taxpayer. Examples include:
 - Form 2504, Agreement to Assessment and Collection of Additional Tax and Acceptance of Overassessment (Employment Tax Adjustments Not Subject to IRC 7436)
 - Form 2504-S, Agreement to Assessment and Collection of Additional Tax and Acceptance of Overassessment (Employment Tax Adjustments Not Subject to IRC 7436; Worker Classification or Section 530 Issues Not Addressed in this Exam)
 - Form 2504-T, Agreement to Assessment and Collection of Additional Employment Tax and Acceptance of Overassessment (Employment Tax Adjustments Subject to IRC 7436)
 - Form 4666, Summary of Employment Tax Examination
- (3) A notice of penalty for purposes of IRC 6751(a) is any notice on which the Service asserts a penalty. Examples include:
 - Revenue agent's report (RAR)
 - 30-day letter
 - Letter 3523, Notice of Employment Tax Determination Under IRC Section 7436
 - Notice and demand
 - Billing notice mailed subsequent to the notice and demand

4.23.9.5
(12-23-2019)
Appeal Procedures

- (1) The appeal procedures with respect to employment taxes are applicable to unagreed delinquency and other penalties proposed by an examiner. This is true where penalties are in connection with unagreed adjustments to tax, as well as where penalties are the only items at issue.
- (2) The appropriate standard preliminary 30-day letters identified in IRM 4.23.22.6, 30-Day Letters: Unagreed Case Procedures, will be used in all unagreed penalty cases.

4.23.9.6

(03-27-2017)

Employment Tax Fraud - General

- (1) Fraud is deception by misrepresentation of material facts, or silence when good faith requires expression, which results in material damage to one who relies on it and has the right to rely on it. Simply stated, it is obtaining something of value from someone else through deceit. See IRM 25.1.1.3, Definition of Fraud.
- (2) Fraud requires both an underpayment of tax and affirmative acts by the taxpayer that demonstrates gross disregard of employment tax laws. To sustain a charge of fraud in a tax case successfully, it is necessary to:
 - Establish an understatement of tax,
 - Establish that all or part of the employment tax liability is due to a false, material representation of facts by the taxpayer,
 - Show that the taxpayer had knowledge of the false representations made, and
 - Show that the taxpayer intended those false representations to be acted upon or accepted as the truth.

4.23.9.6.1

(03-27-2017)

First Indications of Fraud

- (1) First indications of fraud serve as a sign that a taxpayer may have taken actions for the purpose(s) of deceit, subterfuge, camouflage, concealment, attempting to color or obscure events, or to make things seem other than they are. First indications alone do not establish fraud.
- (2) First indications of fraud, also known as “badges of fraud,” are mere suspicions of fraud. When discrepancies are identified, examiners must ask the taxpayer, the preparer, the representative, or any other involved party for explanations to resolve them. Questions should also be asked to determine the taxpayer’s intent. Examples of fraud indicators can be found in IRM 25.1.2.3, Indicators of Fraud.
- (3) At the first indication of possible fraud, the examiner should review IRM 25.1.1, Fraud Handbook, Overview/Definitions. Investigative techniques can be found in IRM 25.1.2.4, Investigative Techniques.
- (4) The examiner will use their judgment to determine audit techniques necessary to help resolve the badges of fraud. To be effective, examination techniques should be designed to disclose not only errors in accounting and application of law, but also irregularities, such as backdated or forged documents. It is not suggested that fraud exists in every assigned return or case, but examiners must be cognizant of the badges of fraud and address them in cases where they do exist.
- (5) The examiner will document the first indications of fraud in the workpapers and discuss the case with their manager. If the manager concurs that there is a possibility of fraud, a conference (either in person or over the phone) will be held between the examiner, the group manager, and the Fraud Enforcement Advisor (FEA).
- (6) The FEA serves as a resource person for compliance employees to assist in fraud investigations and offer advice on matters concerning tax fraud in all the business organizations.
- (7) When the examiner, the examiner’s manager, and the FEA agree that there is a potential for fraud, the case controls must be updated to Status Code (SC)

“17” (fraud development). This decision must be documented in the case file. Form 11661, Fraud Development Recommendation - Examination, is used to document FEA involvement as well as the decision to update the case to Status Code “17”. See IRM 20.1.5.16.3, Penalty Referral.

Note: The FEA should be notified if a decision is made in the field to return the case to Status Code “12”. Refer to IRM 25.1.2.2, Fraud Development Procedure.

- (8) A plan of action should be developed to establish and document the affirmative acts or firm indications of fraud. Refer to IRM 25.1.2.2, Fraud Development Procedures, for information on the minimum plan for case development. The examiner should continue the audit being alert for other badges of fraud and follow up on initial suspicions of fraud. For a list of common badges of fraud refer to IRM 20.1.5.16.1, Indications of Fraud.

4.23.9.6.2
(05-14-2008)
**Firm Indications of
Fraud**

- (1) Firm indications of fraud, or affirmative acts, establish that a taxpayer **deliberately** took actions with the purpose of deceit, subterfuge, camouflage, concealment, attempting to color or obscure events, or to make things seem other than what they are.
- (2) Fraud may exist where a taxpayer willfully attempts to underreport taxes, or does not pay taxes. For a taxpayer to be guilty of a crime in which willfulness is an element, that individual must have acted deliberately, knowingly, and with the specific intent to violate the law.
- (3) A “firm indication” of fraud must be distinguished from a “first indication” of fraud. A firm indication of fraud is a factual determination that can only be made on a case-by-case basis. Discussions with the group manager and the FEA will help the examiner determine when they have firm indications of fraud warranting development for a civil fraud penalty or a referral to Criminal Investigation (CI) for criminal fraud development. However, under no circumstances shall examiners or managers obtain advice and/or direction from CI for a specific case that is under examination. In addition, if a referral is being considered, an examiner must not solicit an agreement or solicit and receive delinquent returns prior to the submission of a fraud referral.
- (4) When the group manager, FEA, and examiner agree firm indications of fraud are present, a decision must be made regarding whether the case will be referred for criminal prosecution or will be developed for the assertion of the civil fraud penalty. Until this decision is made, the examination should immediately be suspended without disclosing to the taxpayer the reason for such suspension. Examiners are cautioned not to carry the investigation beyond the point where a valid indication of fraud is adequately supported by the workpapers.
- (5) If the case does not meet the guidelines for a criminal referral, the examiner will document the reasons in the case file and proceed with development of the case and the civil fraud penalty. The examiner will continue to work with the FEA to ensure complete development of the facts to support assertion of the civil fraud penalty. Refer to IRM 4.23.9.6.4, Civil Fraud Procedures.
- (6) If the case warrants a criminal referral, the examiner will prepare Form 2797, Referral Report of Potential Criminal Fraud Cases. Refer to IRM 4.23.9.6.3.1, Criminal Fraud Referrals.

4.23.9.6.3
(03-27-2017)
**Criminal Fraud
Procedures - General**

- (1) Information about the source or details of evidence relating to a potential criminal case must be safeguarded and withheld to the extent necessary to avoid prejudice to a case. This general rule is applicable not only during the investigation of a case, but also in any action taken with respect to the civil portions of a case having open criminal aspects. When appropriate, examiners are expected to coordinate proposed disclosure of information through established channels.
- (2) The following code sections are the most common used by examiners when developing criminal fraud cases:
 - a. IRC 7202, Willful failure to collect or pay over tax
 - b. IRC 7203, Willful failure to file return, supply information, or pay tax
 - c. IRC 7206, Fraud and false statements
 - d. IRC 7212, Attempts to interfere with administration of internal revenue laws
 - e. IRC 7215, Offenses with respect to collected taxes (Failure to collect and deposit in a special trust fund account) (IRC 7215 and IRC 7512(b))
 - f. IRC 7512, Separate accounting for certain collected taxes, etc.
- (3) Full cooperation among all levels of operations in the IRS must be maintained to ensure that there is neither duplication in investigations nor unnecessary inconvenience to the public. The examiner will review IDRS to determine if any “-Z” freeze (Transaction Code (TC) 914) conditions exist and if other functions are assigned to the taxpayer case. Criminal Investigation (CI) or the FEA should be contacted prior to beginning case action whenever an un-reversed TC 914 (or other CI code) is present in any module.

Note: CI transaction codes range from 910 to 919.

- (4) If an examiner learns that an assigned case involves a taxpayer who is the subject of a criminal investigation, all activity on the case will be immediately suspended. The examiner’s manager will consult with the Supervisory Special Agent in CI relative to the continuance of employment tax activity on the case. If agreement to either continue the suspension or to resume the employment tax activity on the case cannot be reached at the group or territory level, the issue will be decided at the area level. Where more than one area is involved, the Director of Field Operations having jurisdiction over the criminal investigation will resolve the question.
- (5) In income, estate, and gift tax cases in which criminal prosecution has been recommended (except potential jeopardy cases), the Service generally does not authorize assessment of additional taxes and penalties during the time the recommendation for criminal prosecution is under consideration or during the period such cases may be awaiting trial or pending an appeal. The same procedure will be followed with respect to employment tax cases in which criminal prosecution has been recommended.
- (6) Threat of criminal prosecution shall never be made in any case. If a question concerning civil action arises in a case with open criminal aspects, it will be resolved on the basis of whether the criminal case will be prejudiced by the proposed civil action. IRM 1.2.1.5.11, Policy Statement 4-26 (Formerly P-4-84), Criminal and civil aspects in enforcement, provides that the consequences of civil enforcement actions on criminal investigations for the same taxable

periods and same types of taxes must be carefully weighed. Any discussion or negotiation regarding settlement of civil enforcement actions must be guided by this policy and input from the FEA.

4.23.9.6.3.1
(03-27-2017)

Criminal Fraud Referrals

- (1) Cases are referred to CI by using Form 2797, Referral Report of Potential Criminal Fraud Cases. The FEA is available to assist the examiner with the preparation of the referral. See IRM 25.1.3, Fraud Handbook - Criminal Referrals, for additional instructions.
- (2) Forward the referral through the referring examiner's manager to the FEA for approval by the FEA manager. From there, the referral is sent to CI for approval by the CI Special Agent in Charge (SAC) and the Supervisory Special Agent (SSA) before assignment to a Special Agent (SA).
- (3) The referral should be a detailed, factual presentation of the factors that establish firm indications of fraud. To assist in determining intent and the estimated criminal tax liability, the referral should include, but not be limited to:

- Description of the affirmative act(s) of fraud, and
- The taxpayer's explanation of the affirmative act(s).

Because the referral is made electronically, any additional pages or attachments must be in electronic format. All other items, such as financial statements, public records checks, account transcripts, or a copy of the last filed return may be shared with CI at the ten-day conference. No workpapers or attachments are required with the referral.

- (4) If the examiner discovers indications of fraud but all detailed information is not available, the examiner will work with the FEA to complete Form 2797 to the extent possible.
- (5) Form 2797 should be prepared for the principal individual or legal entity involved in the suspected fraudulent activity. Only one Form 2797 is needed, even if the suspected fraudulent activity involves multiple entities; the related entities should be identified and discussed in the body of the referral. After concurrence and signature by the manager, the referral will be transmitted to the FEA. The FEA will review the Form 2797 and forward it to their manager for approval. After the Form 2797 is approved by the FEAs manager, the referral will be sent to CI for approval by the CI Special Agent in Charge and the SSA before assignment to a SA.
- (6) The SA will contact the examiner to set up an initial meeting within ten business days of receipt, at which time any additional information can be provided to the SA. A second meeting will take place to discuss whether or not the referral will be accepted by CI within 30 business days of receipt of Form 2797.
- (7) Supporting documents and a copy of each referral will be retained in the examiner's case file and will not be transmitted with the Form 2797 referral. Refer to IRM 25.1.3.3, Preparation of Form 2797 - Referral Report of Potential Criminal Fraud Cases, for further instructions.
- (8) If a case involving a collateral examination results in a fraud referral, the affected territories will coordinate the referrals.

4.23.9.6.3.1.1
(03-27-2017)

Acceptance of Initial Criminal Fraud Referral

- (1) If CI accepts the referral, they will finish completing the examiner's original Form 2797 and return it to the FEA. The FEA will retain a copy and forward the original to the referring examiner. In most cases, the referring examiner will become the cooperating agent on the case. The examiner will update the case to Status Code "18" (Accepted by CI) and maintain controls and responsibilities of the civil case.
- (2) The accepted fraud case can be resolved by CI in two ways:
 1. CI refers the case to Department of Justice (DOJ). See IRM 4.23.9.6.3.1.2, Referral to DOJ of Accepted Fraud Referral.
 2. CI determines to not pursue criminal prosecution, discontinues their involvement, and returns the case to the examiner for civil settlement. IRM 4.23.9.6.3.1.4, Discontinuance of Accepted Fraud Referral.

Note: The procedures the examiner follows are dependent upon the case resolution by CI.

4.23.9.6.3.1.2
(03-27-2017)

Referral to DOJ of Accepted Fraud Referral

- (1) When CI refers a case to DOJ, they will prepare a Notice of Department of Justice Referral memorandum. This memorandum identifies the type of referral made and determines the type of suspense in Technical Services. Upon receipt of the Notice of Department of Justice Referral, the examiner will prepare the case for transfer to Technical Services for suspense. If CI:
 - Refers the case for "prosecution recommendation," it is an "administrative fraud suspense case" and the examiner will follow procedures in IRM 25.1.4.4.11, Fraud Suspense.
 - Refers the case for "further investigation," it is a "grand jury suspense case" and the examiner will follow procedures in IRM 25.1.5.3, Grand Jury Suspense, and IRM 25.1.4.4.11 to the extent applicable.
- (2) The Notice of Department of Justice Referral remains in the case file and provides support for the examiner's decision to send the case to Technical Services. The examiner will update the case to Status Code "21" and route the case to their local Technical Services, which will maintain controls until criminal investigation/prosecution is concluded. Upon completion, Technical Services will return the case to the group for civil resolution. See IRM 4.23.9.6.4.2, Civil Resolution of a Criminal Prosecution Case.

4.23.9.6.3.1.3
(03-27-2017)

Quarterly Conference of Criminal Referrals

- (1) Quarterly four-way conferences between the examiner, group manager, SA, and SSA are required on all criminal fraud referral cases regardless of whether or not the examiner is cooperating with CI on the case development. See (5) in IRM 25.1.3.5, Accepted Criminal Referrals. The FEA may be included in these conferences. The quarterly conferences apply to both types of cases, administrative and grand jury. See IRM 25.1.4.4.3, Required Communications, and IRM 25.1.5.4, Cooperating Grand Jury Examiner/Revenue Officer Procedures. These mandatory quarterly conferences continue while the case is in suspense in Technical Services; however, Technical Services is not a party to these conferences.

Note: EO is to follow local procedures.

4.23.9.6.3.1.4
(03-27-2017)

**Discontinuance of
Accepted Fraud Referral**

- (1) CI will notify the examiner and manager if the case no longer has criminal potential. The notification will include Form 13308, Criminal Investigation Closing Report. If in Fraud or Grand Jury Suspense, the civil case will be returned from Technical Services. The examiner will discuss the case with the FEA and manager to determine if the civil fraud penalty will be pursued. See IRM 4.23.9.6.4.2. The examiner will update the case to the appropriate status code "17" or "12" and continue with development of the civil case.

4.23.9.6.3.2
(03-27-2017)

**Declination of Initial
Criminal Fraud Referral**

- (1) The Form 2797 and a memorandum of declination will be provided to the examiner either before the ten-day meeting or at/after the 30-day meeting if the referral is declined. This memorandum will remain in the case file. See IRM 25.1.3.6, Declined Criminal Referrals. The examiner will discuss the case with the FEA and the group manager to determine if civil fraud development will continue. Either the case will remain in Status Code "17" (civil fraud development) or the examiner will update the case back to Status Code "12". In either situation, if the examiner discovers new badges of fraud, they will discuss with the FEA to determine whether to submit a new referral to CI.

4.23.9.6.4
(03-27-2017)

Civil Fraud Procedures

- (1) An assertion of the civil fraud penalty may be made on the development of facts and circumstances of a civil examination or result from a completed criminal prosecution (case returned for civil resolution). See IRM 4.23.9.6.4.2 for additional procedures.
- (2) Assertion of the civil fraud penalty on a case does not require a referral to CI. Determination of the civil fraud penalty is the shared responsibility of the examiner, the group manager, and the FEA. See IRM 25.1.6.3, Procedures. Area Counsel's approval is required for all fraud penalty assertions. If the case involves issues requiring the issuance of a Letter 3523, Notice of Employment Tax Determination Under IRC Section 7436, Area Counsel must approve the civil fraud penalties prior to issuance. The examiner should coordinate with Counsel to ensure their concurrence prior to submitting the case to Technical Services for the issuance of the Letter 3523. If the case involves assessment of employment taxes not subject to IRC 7436, Area Counsel must approve the civil fraud penalties prior to assessment.

Note: As a practical matter, early involvement of Counsel is recommended if assertion of civil fraud penalties is anticipated.

- (3) Recommendations for imposing the civil fraud penalty must receive careful scrutiny to make certain that such penalties are asserted only in appropriate cases. The Service bears the burden of proving civil fraud by clear and convincing evidence in Tax Court. See IRC 7454, Burden of proof in fraud, foundation manager, and transferee cases.

Note: For a discussion on the need for clear and convincing evidence for the assertion of a civil fraud penalty, see IRM 25.1.1.3.1, Requirements of Proof, or IRM 25.1.6.2, Overview.

- (4) The following code sections are the most common used by examiners when developing civil fraud cases:
 - a. IRC 6663, Imposition of fraud penalty (civil fraud)
 - b. IRC 6651, Failure to file tax return or to pay tax (IRC 6651(f), Increase in penalty for fraudulent failure to file)

- (5) IRM 25.1.1, Fraud Handbook, Overview/Definitions, notes several elements that may be indicative of fraud. Examiners should remain continually alert for these and other “badges of fraud.”
- (6) When the group manager, FEA, and examiner agree to pursue the civil fraud penalty on a civil examination, the case will remain in Status Code “17”. If a decision is made that civil fraud is no longer applicable, the examiner will document this decision in the case file, update the case to Status Code “12”, and complete the examination.
- (7) The final examination report will reflect the civil fraud penalties applied to the appropriate adjustments. See IRM 4.23.9.6.4.1, Civil Fraud Penalty Rates.
- (8) Cases returned from CI after criminal prosecution or discontinuance of the criminal investigation will be completed as a civil resolution by the referring examiner. See IRM 4.23.9.6.4.2. However, if the examiner participated in the grand jury investigation and had access to grand jury information, the case cannot be assigned to the cooperating examiner. See IRM 25.1.5.6, Civil Case Resolution.

4.23.9.6.4.1
(03-27-2017)
Civil Fraud Penalty Rates

- (1) IRC 6663(a) provides that if any part of the underpayment of tax required to be shown on the return is due to fraud, a penalty equal to 75 percent of the portion of the underpayment which is attributable to fraud will be added.
- (2) IRC 6663(b) further provides that if the IRS establishes that any portion of the underpayment is attributable to fraud, the entire underpayment shall be treated as attributable to fraud. However, if the taxpayer establishes by a preponderance of evidence that any portion of the underpayment is not attributable to fraud, such portion will be excepted from the fraud penalty.
- (3) IRC 6664(b) provides that the penalty applies only when a return has been filed by the taxpayer.
- (4) IRM 20.1.5.16.2, Penalty Assertion, provides current rates and specific procedures for assertion of the civil fraud penalty under IRC 6663. See IRM 4.23.9.9, Assertion of Failure to File Penalty. See also IRM 20.1.2.3.7.5, Fraudulent Failure to File—IRC 6651(f).

4.23.9.6.4.2
(03-27-2017)
Civil Resolution of a Criminal Prosecution Case

- (1) For civil resolution of a criminal prosecution case, the examiner should contact CI to ascertain which criminal statutes the taxpayer was convicted of before attempting to resolve the related civil fraud penalty and/or the fraudulent failure-to-file penalty. The examiner should obtain a copy of the plea agreement or judgment notating the applicable criminal statutes and years. The examiner will discuss the case with the group manager, FEA, and Counsel to determine if the facts in the case file will support assertion of the fraud penalty. The plea agreement or judgment will be used to support the determination regarding application of the civil fraud penalty and years to which it will apply.
- (2) The case will be updated to Status Code “17” when the case is returned for civil resolution. The case will be updated to Status Code “12” if a decision is made not to pursue these penalties. Form 3999, Statute Expiration Report,

must be prepared in a barred statute situation due to the determination not to pursue the civil fraud penalty. Refer to IRM 4.2.1.13, Statute Expiration Reports.

- (3) Refer to IRM 25.1.6.3, Procedures, specifically paragraphs (7) through (12), for additional requirements on the civil resolution after the prosecution.
- (4) Examiners and managers should be aware of collateral estoppel and the important distinction it can have in civil tax fraud penalty cases. Collateral estoppel is a legal doctrine that prevents a taxpayer, who has been previously convicted of criminal tax evasion under IRC 7201, from asserting a defense to the civil fraud penalty. Refer to IRM 25.1.6.5, Collateral Estoppel, for additional information.
- (5) For civil resolution of a criminal prosecution case, the examiner should calculate the proper amount of employment taxes, penalties, and additions to tax separate and distinct from the calculated amounts at issue in the criminal prosecution case or payable as restitution in the criminal prosecution case.
- (6) Unagreed cases where the fraud penalty or fraudulent failure to file penalty are asserted, or cases that have an AIMS, Audit Information Management System, freeze code "P", should be closed to Technical Services for review. TE/GE should send cases to their review function.

4.23.9.6.5 (03-27-2017)

Miscellaneous Fraud Procedures and Group Definitions

- (1) Update the case to Status Code "17" after the determination is made that the case will be developed for either the civil fraud penalty or for potential criminal referral to CI. If the civil fraud penalty is not pursued, the case will be returned to Status Code "12" for the completion of the examination.
- (2) Update the case to Status Code "18" when a case is accepted by CI after a criminal fraud referral is made. The accepted criminal referral case will remain in Status Code "18" until the criminal investigation is concluded or until the case is referred to DOJ.
- (3) While in Status Code "17" or Status Code "18", cycle time will be excluded from monthly "aging" reports to management. As AIMS and ERCS, Exam Return Control System, include data from all cases, a manual reconciliation to the aging reports will exclude Status Code "17" and "18" cases from both the overage category and the overage percentage.
- (4) When closing a civil fraud case, the examiner will enter:
 - "C" if the 75 percent fraud penalty was asserted under IRC 6663,
 - "F" if criminal prosecution has been successfully concluded, or
 - "B" if both criminal and civil apply.

on the appropriate line of Form 5344, Examination Closing Record, (see IRM 4.4.12.5.47, Item 38: Fraud) or Form 5599, TE/GE Examined Closing Record, (see IRM 4.5.2.7.1.53, Fraud Condition (Item 38)) to ensure capture of the penalty on AIMS. Form 3198, Special Handling Notice for Examination Case Processing, is used to capture fraud penalty amounts on ERCS. Examiners must enter the actual penalty amount, in whole dollars, and the corresponding penalty code section, for example "IRC 6663".

4.23.9.7
(03-27-2017)
Negligence Penalty

(1) Examiners will recommend the assertion of the accuracy-related penalty for negligence or disregard of rules or regulations under IRC 6662 where appropriate. However, the accuracy-related and civil fraud penalties cannot be asserted on the same portion of the same underpayment, except as an alternative position. Refer to (7) of IRM 20.1.5.3.2, Common Features of Accuracy-Related and Civil Fraud Penalties.

(2) Negligence, in the generally accepted legal sense, is the omission to do something which a reasonable person guided by those considerations which ordinarily regulate the conduct of human affairs would do, or doing something which a prudent and reasonable person would not do. Negligence includes any failure to:

- Make a reasonable attempt to comply with the provisions of tax laws,
- Exercise ordinary and reasonable care in tax return preparation, or
- Keep adequate books and records.

The term “disregard” includes careless, reckless, or intentional disregard. The determination that negligence applies in any employment tax case is a combined judgment by the examiner and supervisor.

(3) Examiners will consider an accuracy-related penalty if there has been negligence or a disregard of published rulings and regulations in the preparation of returns, as distinguished from a mere error or a difference of opinion on a controversial question where a willful intent to evade is not present or cannot be substantiated.

(4) IRM 20.1.5.2, Return-Related Penalties, provides pertinent information on the negligence penalty, including describing coordination between the negligence penalty and other penalties. See IRM 20.1.5.8.1, Negligence.

(5) When an underpayment of tax is attributable to the taxpayer’s failure to keep adequate records, the negligence penalty may be asserted if the taxpayer’s records are found to be inadequate upon the initial examination or any subsequent examination. Assertion of the penalty is determined based on the facts and circumstances of the particular case.

(6) Preparation of the return by an agent or employee of the taxpayer does not preclude the application of the penalty. Unlike the fraud penalty, the taxpayer bears the same burden of proof in a negligence case as in an employment tax liability or over-assessment case. IRC 7491(c), however, provides that the Commissioner has the burden of production in any court proceeding with respect to the liability of *any individual* for any penalty, addition to tax, or additional amount (penalties). For the Commissioner to meet this burden of production under IRC 7491(c), the Commissioner must come forward with sufficient evidence indicating that it is appropriate to impose the relevant penalty.

Note: IRC 7491(c) does not apply to taxpayers other than individual persons, such as corporations, partnerships, exempt organizations, and so on.

(7) If an examiner recommends an accuracy-related penalty, the facts forming the basis for the recommendation will be stated in a written explanation of adjustment and enclosed with a copy of the examination report.

- (8) Unlike the fraud penalty, liability for an accuracy-related penalty does not remove the bar of the statute of limitations on assessment. However, if the Service determines fraud exists, there is no bar to the statute of limitations on assessment for the entire underpayment, including that portion not attributable to fraud.
- (9) Examiners will attach Form 3198, Special Handling Notice for Examination Case Processing, to all case files in which the IRC 6662 penalty is to be assessed. Under Special Handling "Other," annotate "Penalty computation required under IRC section 6662."

4.23.9.8
(05-14-2008)
**Assertion of Penalties
Involving IRC 3509**

- (1) IRC 3509 provides reduced rates for computing the withholding tax under IRC 3402 and the employee's share of FICA tax under IRC 3101, (including Additional Medicare Tax under IRC 3101(b)(2)). This substitute method applies if the employer failed to deduct and withhold those taxes by reason of treating the employee as a non-employee. When IRC 3509 applies, the Service cannot compute the applicable penalties on the basis of the higher liability that would have resulted under IRC 3402 and IRC 3101.
- (2) In computing the failure to deposit taxes penalty under IRC 6656, the computation should be based **only** on the **employer's** share of the FICA tax liability determined by IRC 3509. See IRM 4.23.8.5.1, Reduced Tax Rates Under IRC 3509.
- (3) IRC 3509 does not apply to an erroneous classification of "wages" under IRC 3121(a), or to an error in interpreting "employment" under IRC 3121(b). Nor does IRC 3509 apply if the employer intentionally disregarded the requirement to deduct and withhold the tax.

4.23.9.9
(05-14-2008)
**Assertion of Failure to
File Penalty**

- (1) IRC 6651(a)(1) imposes a penalty for the failure to file (FTF) a tax return by its required due date (determined with regard to any extension of time for filing). The penalty rate is 5 percent per month up to a maximum of 25 percent, computed on the amount of tax **required to be shown** on the return. The penalty is assessed unless the taxpayer can show that the failure to file was due to "reasonable cause" and not due to willful neglect. See IRM 20.1.2.3, Failure to File a Tax Return or to Pay Tax—IRC 6651.
- (2) The failure to file penalty rate is reduced when it is combined with the failure to pay penalty, see IRM 4.23.9.10 (5), Assertion of Failure to Pay Penalty and IRM 20.1.2.3.7.3, Limitation Under IRC 6651(c)(1).
- (3) IRC 6651(f) provides that if the failure to file is fraudulent, the penalty increases to 15 percent per month up to a maximum of 75 percent. Refer to IRM 20.1.2.3.7.5, Fraudulent Failure to File—IRC 6651(f).
- (4) Generally, there is no provision for an extension of time to file an employment tax return under IRC 6081. However, deadline extensions may be granted for a Form 940 under Treas. Reg. 31.6081(a)-1(b) and for all employment tax returns under combat zone (IRC 7508) and disaster relief (IRC 7508A) provisions.

4.23.9.10
(12-23-2019)
**Assertion of Failure to
Pay Penalty**

- (1) IRC 6651(a)(2) imposes a penalty for failure to pay (FTP) tax shown on returns, unless the failure to pay is due to reasonable cause and not due to willful neglect. IRC 6651(a)(3) imposes a similar penalty for failure to pay tax not shown on the return within 21 days from the date of notice and demand for the tax (10 business days if the amount equals or exceeds \$100,000). See IRM 20.1.2.3.8, Failure to Pay Tax—IRC 6651(a)(2) and (3).

Note: The IRC 6651(a)(2) penalty is asserted only on the failure to pay amount of tax **shown on the return**. In general, the only time a field examiner will assert this penalty is on a Substitute for Return (SFR), or upon the processing of a secured delinquent return. The FTP penalty is assessed systemically on IMF, Individual Master File, and BMF, Business Master File, returns when the tax liability is assessed with a TC 290, with priority code 2, or with a TC 300, with priority code 3 or 9.

- (2) When a delinquent return is received from a taxpayer during an examination, the examiner will determine whether the failure to pay penalty under IRC 6651(a)(2) should be asserted. The examiner's recommendation for the assertion or non-assertion of the penalty will accompany each delinquent return sent to the Campus. If the delinquent return is received from the taxpayer with remittance, the examiner will solicit payment of the penalty when applicable.

Note: Computer condition code "D" should NEVER be entered on the return unless a determination has already been made that the taxpayer had reasonable cause for failure to pay.

- (3) The operating division that conducted the examination is solely responsible for determining whether the failure to pay penalty is applicable on delinquent returns secured. This procedure also applies when a "Substitute for Return" is prepared in a case where a delinquent return was due from the taxpayer.
- (4) The penalty imposed by IRC 6651(a)(2) is one-half of one percent of the tax shown on the taxpayer's return that remains unpaid at the beginning of each penalty month. The penalty is limited to 25% in the aggregate. If the tax imposed is less than tax shown, the penalty is imposed on the lesser amount.

Example: A taxpayer timely filed a 2020 return with \$2,000.00 tax shown on the return. The taxpayer paid \$800.00 on 10/15/2021, and made no other payments through the current date. The penalty would be one-half of one percent of \$2,000.00 for the six months April 2006 through October 2021 (three percent of \$2,000.00) plus one-half of one percent of \$1,200.00 for 44 months (22 percent of \$1,200.00) for a total of 25 percent in the aggregate, and a total penalty of \$60.00 plus \$264.00 = \$324.00. Note: Penalty cannot exceed 25%.

See IRM 20.1.2.3.8.4.1, Amount Subject to IRC 6651(a)(2), for a definition of tax shown on the return. For rules for determining the unpaid amount of tax, see IRM 20.1.2.3.8.4.2, Months Subject to IRC 6651(a)(2), for a definition of penalty month.

Note: The failure to pay penalty will be automatically computed and assessed by the computer if an SFR return was prepared and the tax is assessed with TC 300 that contains either priority code "3" or "9", or the tax is assessed with

TC 290 (via ADJ54), and the TC 290 contains priority code “2”. See IRM 20.1.2.3.10, Substitute for Return—IRC 6651(g).

- (5) When the failure to file and failure to pay penalties both apply with respect to the same month, the penalty for filing late is reduced by the amount of the penalty for paying late, except when the minimum penalty applies for filing late.

Example: A taxpayer filed a 2021 return in 2022 with \$2,000.00 tax shown and imposed. The taxpayer had an extension of time to file until 10/15/2022, and the taxpayer made a payment of \$800.00 on the extended due date. The taxpayer made no other payments. The failure to file penalty is five percent of \$2,000.00 unpaid tax on the original return due date, beginning on the extended return due date and continuing at five percent per month for five months until 25 percent is reached. (25 percent of \$2,000.00 = \$500.00). The failure to pay penalty for those same five months is one-half of one percent of \$1,200.00 for each of those five months, or two-and-one-half percent of \$1,200.00 = \$30. Therefore, the reduced failure to file penalty is \$500.00 minus \$30.00 = \$470.00.

Note: If a payment was made in the first five months following the return due date (including extensions) and before the return was filed, the FTF and FTP penalties must both be computed for the months during which both penalties apply, and the FTF penalty must then be reduced by the amount of the FTP penalty for those months. See IRM 20.1.2.3.7.3, Limitation under IRC 6651(c)(1).

- (6) See IRC 6651(d) for certain situations in which the failure to pay penalty is increased to one percent. See also IRM 20.1.2.3.8.1.1, 1 Percent Penalty Rate—IRC 6651(d).
- (7) A failure to pay will generally be considered to be due to reasonable cause to the extent that the taxpayer has made a satisfactory showing that he exercised ordinary business care and prudence in providing for payment of his tax liability and was nevertheless either unable to pay the tax or would suffer an undue hardship if he paid on the due date (see Treas. Reg. 301.6651-1(c)). See also IRM 1.2.1.4.2, Policy Statement 3-2 (Formerly P-2-7), Reasonable cause for late filing of return or failure to deposit or pay tax when due, and IRM 20.1.1, Penalty Handbook, Introduction and Penalty Relief.

Note: Interest cannot be reduced for reasonable cause.

- (8) IRC 6651(h) provides for a reduced one-quarter percent penalty rate for paying late for qualified individual taxpayers. An **individual** taxpayer can be a sole proprietor, as single member Limited Liability Company (LLC), or the estate of a decedent. To qualify for the reduced rate, the related return must have been filed on time and the taxpayer must be paying the unpaid tax under an IRS approved installment agreement. If the taxpayer will be unable to fully pay his obligation upon notice and demand and the taxpayer would qualify for this lower penalty rate, the taxpayer should be given Form 9465, Installment Agreement Request, to apply for an IRS approved installment agreement. If the taxpayer owes \$50,000 or less, he may qualify to set up an online installment agreement at <https://www.irs.gov/payments/online-payment-agreement-application>.

4.23.9.11
(05-14-2008)
**Penalty for Failure to
Make Timely Deposits**

- (1) The Campus is primarily responsible for asserting the penalty prescribed by IRC 6656 for failure of taxpayers and their agents to make deposits of certain employment taxes. However, examiners will:
 - a. Review transcripts of account to identify previously assessed penalties and determine if they were paid by the taxpayer or abated by the campuses.
 - b. Review the reasonable cause arguments submitted by the taxpayer and determine if the taxpayer took steps to correct the cause. If not, subsequent penalties may be due.
 - c. Review the record of liabilities on the returns to determine its accuracy and that it is in balance with the stated liabilities on the return. An imbalance could mean an overstated/understated return or incomplete record of liabilities and additional penalties may be due.
 - d. Consider penalties on delinquent taxable returns obtained as a result of an examination, or an adjustment made for a period for which a "Substitute for Return" was prepared by the examiner in lieu of delinquent returns.
- (2) In the above cases, after considering the statement of the taxpayer or the taxpayer's agent regarding late payment and without referring the matter to the campus, the examiner will recommend the assertion or non-assertion of the IRC 6656 penalty in the examination report, together with any appropriate comments in the report transmittal or workpapers. IRM 20.1.4, Penalty Handbook, Failure to Deposit Penalty, contains instructions for computing the penalty for amended or supplemental returns and FUTA or CAWR, Combined Annual Wage Reporting, adjustments.
- (3) The amount required to be deposited includes the employer's share of all employment taxes plus any amounts withheld from employees that were not deposited. If no tax was withheld from employees, the penalty is based only on the employer's share of the tax. See Rev. Rul. 75-191.
- (4) Depositors are encouraged to correct errors in a timely manner based on a four-tier penalty structure. The amount of the penalty varies according to the time taken to correct the error. See IRM 20.1.4.7, Failure to Deposit Penalty Rate.

4.23.9.11.1
(10-06-2022)
**Non-Qualified Stock
Options - Administrative
Waiver of FTD**

- (1) An administrative waiver of the FTD penalty is available in certain circumstances where the FTD penalty is asserted on a \$100,000 next-day deposit obligation of employment taxes arising from the exercise of a non-qualified stock option (NQSO) within a deposit period.
- (2) The waiver allows the next-day deposit requirement to be applied using a settlement date three days from the exercise date or the actual settlement date if earlier than three days.
- (3) Refer to IRM 20.1.4.26.2, Administrative Waivers, for detailed instructions on implementing administrative waiver of the FTD in specific circumstances.

4.23.9.12
(03-27-2017)

**First Time Abate (FTA)
Waiver**

- (1) The first time abate (FTA) is an administrative waiver or abatement available to a taxpayer for:

- Failure to File (IRC 6651(a)(1), IRC 6698(a)(1), and IRC 6699(a)(1)),
- Failure to Pay (IRC 6651(a)(2) and IRC 6651(a)(3)), and/or
- Failure to Deposit (IRC 6656) penalties.

Note: The FTA waiver does not apply to Information Return Penalties.

Reminder: First Time Abate is addressed in IRM 20.1.1.3.6.1, RCA and First Time Abate (FTA) Consideration.

- (2) The FTA waiver will be addressed during an employment tax examination when any of the above penalties are applicable or have been previously assessed.

Note: The FTA waiver must be considered before reasonable cause is addressed.

- (3) The FTA waiver is available to taxpayers who have been in compliance for the three years prior to the audit period, if the following are true:

- a. The taxpayer has not previously been required to file a return, or has no prior penalties (except the estimated tax penalty, TC 17X) for the preceding three years on the same MFT, Master File Tax, and
- b. The taxpayer has filed, or filed a valid extension for, all currently required returns and paid, or arranged to pay, any tax due.

Reminder: Consider the taxpayer current if there is an open installment agreement and the taxpayer is current with the installment payments.

Note: If the taxpayer is not currently in compliance with (b) above, but all other FTA waiver criteria are met, provide the taxpayer an opportunity to fully comply before considering reasonable cause. See IRM 20.1.1.3.6.1.

- (4) The FTA waiver or abatement applies to a single tax period for a given MFT. Penalty waiver or abatement for all subsequent tax periods will be based on the showing of reasonable cause (and, where applicable, the absence of willful neglect).

Note: If the FTA penalty waiver or abatement is being considered for two or more tax periods on the same MFT and the earliest tax period meets FTA waiver criteria, the FTA waiver applies only to the earliest tax period, not all tax periods being considered.

- (5) To determine eligibility for the FTA waiver or abatement, the examiner must:

- Research the three prior years,
- Research all current periods, and
- Document the clean compliance history of the taxpayer.

If the taxpayer has a clean compliance history and the FTA waiver or abatement applies, the examiner will document the clean compliance history of

the taxpayer in Leadsheet 300 - Penalty Approval Form, or appropriate leadsheet. "Clean compliance" is generally defined as "all returns filed and no penalties in prior three years."

- (6) To research the prior three years for purposes of checking the eligibility for the FTA waiver or abatement, the examiner may use IDRS command codes BMFOLT, BMFOLR and TXMODA. The examiner will:
- Review the account for un-reversed penalties. See IRM Exhibit 20.1.1-3, Penalty Transaction Codes, for a listing of all penalty transaction codes.
 - Review all tax periods for the previous three years to determine if the taxpayer has already been granted relief using the FTA waiver criteria as reflected by the FTA PRCs (Penalty Reason Codes). The PRC of "018" signifies the FTA waiver or abatement has been granted due to a manual look-back, rather than by use of the Reasonable Cause Assistant (RCA). The PRC of "020" signifies the FTA waiver or abatement has been granted using the RCA. See IRM 20.1.1.3.6.2, Penalty Reason Codes.

Note: The RCA is a program used at the campus level that assists in determining if a taxpayer is entitled to FTA. Employment Tax field operations do not have access to the RCA, so FTA waiver research must be performed manually.

- (7) If there is a TC 290 for zero with a penalty reason code of "018", "020", or "021", the taxpayer has already been granted the FTA waiver or abatement. In that case, the FTA waiver is no longer available and the examiner must consider reasonable cause to waive or abate any penalties.
- (8) If the FTA waiver or abatement applies and there is no TC 290 for zero with penalty reason code "018", "020", or "021", the examiner must offer the FTA waiver or abatement to the taxpayer and explain why it applies, even if the taxpayer does not specifically request it.

Note: IRM 20.1.1.3.6.1 provides additional information on when an FTA conclusion will not apply.

- (9) If the FTA waiver or abatement is granted, the examiner must notify the taxpayer, either verbally or by letter, that the penalty non-assertion or removal was based on the taxpayer's history of compliance rather than on information the taxpayer provided. The examiner should also include an explanation to educate the taxpayer about how to be compliant in the future. If the examiner prefers to issue a letter to the taxpayer, the examiner must prepare it and issue it with the approval of the group manager. IRM 20.1.1.3.3.2.1, First Time Abate (FTA), paragraph (12) contains language examiners can use to prepare this letter.
- (10) When closing the case to CCP, the examiner will notate **Form 3870, Request for Adjustment, for First Time Abate is included in the file** in the "Special Features/ Other Instructions" block of Form 3198, Special Handling Notice for Examination Case Processing.
- (11) Prepare the Form 3870, completing only the boxes noted:
- Box 1: Enter the TIN, Taxpayer Identification Number.

- Box 2: Enter the Name and Address of the taxpayer.
- Box 4: Enter the MFT associated with this waiver or abatement.
- Box 5: Enter tax period.
- Box 11: Enter "Please input TC 290 for zero with penalty code 018. Taxpayer qualifies for First Time Abate or wavier for (MFT) (Tax Period)."
- Box 13: The examiner must sign and date.
- Box 14: The group manager must sign and date Form 3870 and include their phone and fax numbers.

- (12) For additional information about First Time Abate, including criteria for when FTA conclusion does **not** apply, see IRM 20.1.1.3.6.1.

4.23.9.13
(12-23-2019)

Penalties for Failure to File Certain Information Returns or Furnish Certain Statements

- (1) The penalties for failure to file certain information returns under IRC 6721 and for failure to furnish certain statements under IRC 6722 shall not be imposed with respect to any failure due to reasonable cause and not to willful neglect, see IRC 6724(a). Also see IRM 1.2.1.4.2, Policy Statement 3-2 (Formerly P-2-7), Reasonable cause for late filing of return or failure to deposit or pay tax when due, and IRM 20.1.7.12.1, Reasonable Cause. The entity must make an affirmative showing of reasonable cause in the form of a written statement, under the penalties of perjury, setting forth all the facts alleged as reasonable cause.
- (2) Under IRC 6674, an employer who willfully furnishes a false or fraudulent statement, or who willfully fails to furnish a statement in the manner, at the time, and showing the information required under IRC 6051 or IRC 6053(b) may be subject to a penalty of \$50 for each failure, which shall be assessed and collected in the same manner as the tax on employers imposed under IRC 3111. There is no maximum limit on the amount of penalties under IRC 6674.
- (3) Penalties for failure to file and the failure to furnish Form(s) W-2 are to be considered independently of each other. Filing a Form W-2, Wage and Tax Statement, return with the Social Security Administration under IRC 6051(d) is not a requirement for proposing of the failure to furnish penalty.
- (4) By law, the Form(s) W-2 for back year examinations are delinquent. Only Form(s) W-2 c that are filed by the last day of January of the following year are considered timely filed and not be subject to a penalty. Therefore, if reasonable cause does not exist, the examiner must prepare and enclose a penalty case file in addition to the employment tax case file for delinquent Form(s) W-2. For instructions refer to IRM 4.23.8.11, Information Return Penalty Case File.

Note: Examiners may use the *Information Returns Penalty Tool* on the OSP's Knowledge Base Site. .

4.23.9.13.1
(10-06-2022)

Information Returns Regarding Payments of Remuneration for Services

- (1) IRC 6041, Information at Source, and IRC 6041A, Returns Regarding Payments of Remuneration for Services and Direct Sales, provides that all persons engaged in a trade or business and making payment in the course of such trade or business to another person of remuneration for services of \$600 or more must make and furnish a return to payee on or before January 31st of the year following the calendar year for which the return was made. A copy of Form 1099-MISC, Miscellaneous Income, or Form 1099-NEC, Nonemployee Compensation, may be used for this purpose, as appropriate.

- For calendar years prior to 2020, all reportable payments under IRC 6041(a) were reported by payors on Form 1099-MISC.
 - For calendar years 2020 and thereafter, payors are required to report nonemployee compensation on Form 1099-NEC. All other reportable payments under IRC 6041(a) are reported on Form 1099-MISC.
 - The Form 1099-MISC or Form 1099-NEC must show, among other information, the total amount of nonemployee compensation paid and the total amounts of income tax withheld for each payee in a calendar year.
- (2) Generally, the time for furnishing Form 1099-MISC or Form 1099-NEC is set forth in IRC 6041(d) , “The written statement required under the preceding sentence shall be furnished to the person on or before January 31 of the year following the calendar year for which the return under subsection (a) was required to be made.”
- (3) Treas. Reg. 1.6041– 6 provides that a payor must file all informational returns made under IRC 6041 (Form 1099-MISC or Form 1099-NEC) with a completed Form 1096, Annual Summary and Transmittal of U.S. Information Return, with the Service. Generally, the time for furnishing and filing Form 1099-MISC or Form 1099-NEC depends on the calendar year for which they were made:
- For calendar years prior to 2016, Form 1099-MISC must be filed on or before the last day of February following the calendar year for which they are made when filed on paper, magnetic tape, or other approved media. If filed electronically, Form 1099-MISC must be filed on or before the last day of March following the calendar year for which they are made.
 - For calendar years 2017 and thereafter, information returns relating to nonemployee compensation, for example Form 1099-MISC or Form 1099-NEC, must be filed on or before the last day of January following the calendar year for which they are made regardless of how they are filed per Section 201 of P.L. 114-113 (H.R. 2029, Protecting Americans from Tax Hikes (PATH) Act). This does not apply to a Form 1099-MISC that does not report nonemployee compensation.

Note: Generally, if the taxpayer is required to file 250 or more information returns (for example, Form 1099-MISC, Form 1099-NEC, or Form W-2), magnetic media must be used. See IRC 6011, for more information.

4.23.9.13.2 (03-27-2017) **Wage and Tax Statements**

- (1) IRC 6051(a), Receipts for Employees, and Treas. Reg. 31.6051–1, Statements for Employees, provides that an employer must make and furnish a Form W-2 to employees for remuneration paid during the calendar year. The Form W-2 must show, among other information, the total amount of wages paid subject to withholding of income tax, the total amount of wages paid subject to FICA tax (including Additional Medicare Tax), and the total amounts of income tax and FICA tax (including Additional Medicare Tax) withheld from wages for each employee in a calendar year.
- (2) Generally, the time for furnishing Form(s) W-2 to the employee is set forth in Treas. Reg. 31.6051–1(d), **Each statement required by this section for a calendar year and each corrected statement required for the year shall be furnished to the employee on or before January 31 of the year succeeding such calendar year.**

Note: If an employee whose employment is terminated before the close of the calendar year requests the employer to furnish the Form W-2 at an earlier time, the employer must furnish the Form W-2 within 30 days of the employee's request or within 30 days of the final wage payment, whichever is later.

- (3) Treas. Reg. 31.6051-1 provides that an employer must file a copy of all Form(s) W-2 made and furnished to employees, along with a completed Form W-3, Transmittal of Wage and Tax Statements, with the Social Security Administration. Generally, the time for filing Form W-2 depends on the calendar year for which they were made:
 - For calendar years prior to 2016, Form W-2 must be filed on or before the last day of February following the calendar year for which they are made when filed on paper, magnetic tape, or other approved media. If filed electronically, Form(s) W-2 must be filed on or before the last day of March following the calendar year for which they are made.
 - For calendar year 2016 and thereafter, Form W-2 must be filed on or before the last day of January following the calendar year for which they are made regardless of how they are filed.
- (4) Treas. Reg. 31.6051-1(c) further provides that Form W-2 c, Corrected Wage and Tax Statement, must be furnished to employees whenever the originally issued Form W-2 was incorrect. Treas. Reg. 31.6051-2(b) further provides Form W-2 c along with a completed Form W-3 c, Transmittal of Corrected Wage and Tax Statements, must be submitted to the Social Security Administration on or before the date the information returns for the period that correction is made would be due under Treas. Reg. 31.6071(a)-1(a)(3)(ii).

4.23.9.13.3
(03-27-2017)

**Penalty for Failure to
File Correct Information
Returns**

- (1) IRC 6721 imposes a penalty for failure to file correct (on paper or magnetic media) information returns (including Form W-2 and Form 1099) on the date prescribed under IRC 6041(a) or IRC 6051(a). The provisions for a reduction in these penalty amounts are based on the number of days late. See IRM 4.23.9.13.5, Information Penalty Rates.
- (2) If the failure to timely file correct information returns is due to intentional disregard of the filing requirements, there is no maximum limit on the amount of penalties. See IRM 4.23.9.13.5.
- (3) Exception for de minimis failures: In general, IRC 6721(c) provides that if:
 - a. Information returns have been filed but were filed with incomplete or incorrect information and
 - b. The failures are corrected on or before August 1 of the calendar year in which the returns were due,

then the penalty will not apply to the greater of 10 returns, or one-half of one percent of the total number of information returns required to be filed by the filer during the calendar year.

Note: IRC 6721(c)(3), effective for tax year 2016, provides a safe harbor for certain de minimis errors. The rule provides that filed a information return with an error of no more than \$100 (\$25 for withholding) is considered correct, unless the recipient elects out of the safe harbor de minimis rule.

4.23.9.13.4
(03-27-2017)
**Penalty for Failure to
Furnish Correct
Information Returns**

- (4) IRC 6721(d) provides lower limitations for persons with gross receipts of not more than \$5 million. See IRM 4.23.9.13.5.
- (1) IRC 6722 imposes a penalty for failure to furnish correct payee statements on the date prescribed to a payee when required under IRC 6041(a) or IRC 6051(a). The provisions for a reduction in these penalty amounts are based on the number of days late. See IRM 4.23.9.13.5.
- (2) If the failure to furnish correct information returns is due to intentional disregard of the requirements, there is no maximum limit on the amount of penalties. See IRM 4.23.9.13.5.
- (3) Exception for de minimis failures: In general, IRC 6722(c) provides that if:
- a. Information returns have been filed but were filed with incomplete or incorrect information and
 - b. The failures are corrected on or before August 1 of the calendar year in which the returns were due,
- then the penalty will not apply to the greater of 10 returns, or one-half of one percent of the total number of information returns required to be filed by the filer during the calendar year.

Note: IRC 6722(c)(3), effective for tax year 2016, provides a safe harbor for certain de minimis errors. The rule provides that a payee statement with an error of no more than \$100 (\$25 for withholding) is considered correct, unless the recipients elect out of the safe harbor de minimis rule.

- (4) IRC 6722(d) provides lower limitations for persons with gross receipts of not more than \$5 million. See IRM 4.23.9.13.5.

4.23.9.13.5
(03-27-2017)
**Information Penalty
Rates**

- (1) Effective for returns due on or after January 1, 2016, the Trade Preferences Extension Act (TPEA) of 2015, section 806, increased the IRC 6721 and IRC 6722 penalties and maximum rates as follows:
- Base penalty rate from \$100 to \$250,
 - The intentional disregard penalty rate from \$250 to \$500,
 - The maximum calendar year penalties for large businesses; gross receipts from \$1.5 million to \$3 million,
 - The maximum calendar year penalties for small businesses; gross receipts from \$500,000 to \$1.5 million, and
 - The tiered penalty rates for corrections made on or before August 1 of the filing year.
- (2) **De minimis error safe harbor.** In addition to providing a safe harbor for inaccurate information return and payee statement, IRC 6721(c)(3)(A) and IRC 6722(c)(3)(A) provides that the issuer of an inaccurate information return that is within safe harbor parameters is not required to file a corrected return when an error between the actual amount and reported amount is not greater than \$100 for payments or \$25 for withholding.
- (3) IRC 6721(b) and IRC 6722(b) penalty rates are reflected in the following exhibits:

- IRM Exhibit 20.1.7-1, IRC 6721 & IRC 6722 Penalty Rates for Large Businesses and Government Entities (Other than Federal Entities) with Gross Receipts Over \$5 Million (Average annual gross receipts for the most recent 3 taxable years)
- IRM Exhibit 20.1.7-2, IRC 6721 & IRC 6722 Penalty Rates for Small Businesses with Gross Receipts Less Than or Equal to \$5 Million (Average annual gross receipts for the most recent 3 taxable years)

Note: IRC 6721 and IRC 6722 penalty rates and maximum amounts are subject to inflationary adjustments enacted by the Stephen Beck, Jr., ABLE Act of 2014, section 208, effective for returns required to be filed in a calendar year after 2014. IRC 6721(f) and IRC 6722(f) provides inflation adjustments to the per-failure and maximum penalties for failure to file information returns.

4.23.9.13.6
(10-06-2022)

Information Return Penalty Statute of Limitations

- (1) Each information return “stands alone” for the determination of penalties and the appropriate statute date. Examiners must determine which information documents have been filed and which have not in order to establish the correct statute date for the penalty assessment case file.
- (2) If the information return(s) subject to the proposed penalties have been timely filed, the statute date will be three years from the due date or, if late filed, three years from the actual date filed. IRM 20.1.7.12.2.8, Civil Penalties Statute of Limitations, discusses how to extend the statute of limitations on the assessment of information return penalties. If the information return(s) subject to the proposed penalties have not been filed, Alpha Statute “EE”, non-filed return, will be used for case file controls. If delinquent information returns are secured prior to closing the information return penalty case file, the examiner must update the statute date on Examination Return Control System (ERCS) using Form 5348, AIMS/ERCS Update (Examination Update), as outlined in IRM 4.7.3.5, Updating the ERCS ASSED.
- (3) In situations where examiners have both filed and non-filed documents subject to proposed penalties, the examiner must determine if the statute date on the filed documents is still open. If so, they must use and protect that date when establishing the penalty case file controls. ERCS will allow only one information return penalty case to be established for each taxpayer/year. If the statute date for the filed returns has expired, the examiner may pursue penalties only on the non- filed documents. In this situation Alpha Statute “EE” may be used to establish controls.
- (4) The examiner should date stamp the transmittal of secured informational returns prior to sending them for processing. Examiners must follow the procedures on IRS received date stamping and postmark date stamping outlined in IRM 3.10.72.6, IRS Received Date.
- (5) The Payer Master File On-Line (PMFOL) IDRS Command Code PMFOLD can be used to help with the Assessment Statute Expiration Date (ASED) determination. PMFOLD will reflect a “DTE RECD” under each Form 1096, Annual Summary and Transmittal of U.S. Information Returns, transmittal record. This date is the actual date the Form(s) 1099 were processed and **not necessarily the date they were filed**. The PMFOLD will show how many Form(s) W-2 were filed; however, it does not reflect a received date for the Form(s) W-2 transmittal since this form is filed with the Social Security Administration.

Examiners should consider information returns as being timely filed unless there is evidence of a late filing date when determining the appropriate statute for filed Form(s) 1099 and W-2.

4.23.9.13.7
(12-23-2019)
Q & A Regarding Failure to File or Furnish Penalties

- (1) The following questions and answers provide guidance for the assertion of penalties for failure to file certain information returns or to furnish certain statements.

Question and Answer
<p>Q-1. As a result of reclassification of individuals to employee status, would penalties be applicable against the employer for failure to file and failure to furnish Form(s) 1099?</p>
<p>A-1. No penalty under IRC 6721 for failure to file Form(s) 1099 would be applicable, because no returns are required by IRC 6041(a). The individuals are employees, not independent contractors. Similarly, no failure to furnish penalty under IRC 6722 would be applicable for failure to furnish Form(s) 1099.</p>
<p>Q-2. Would the payor be liable for penalties for failure to file and failure to furnish Form(s) W-2 as a result of the reclassification of individuals to employee status if no Form(s) 1099 were filed or furnished to the payees?</p>
<p>A-2. The payor would be liable for both the failure to file penalty under IRC 6721 and the failure to furnish penalty under IRC 6722, absent reasonable cause. If Form(s) W-2 are secured by the examiner, the IRC 6721 failure to file penalty may be asserted because these returns were not filed on the date prescribed in the regulations. If the Form(s) W-2 are furnished to employees subsequent to the examination, the IRC 6722 penalty may be asserted because these returns were not furnished on the date prescribed in the regulations. If the payor refuses to file Form(s) W-2, assertion of the penalty under IRC 6721 for intentional disregard of the filing requirement may be considered. If the payor refuses to furnish Form(s) W-2, the penalty under IRC 6674 may be considered. There is no maximum limit on the amount imposed under IRC 6674 or for intentional disregard under IRC 6721.</p>
<p>Q-3. If Form(s) 1099 were filed and furnished by the payor prior to reclassification to employee status, could civil penalties be asserted for failure to file and failure to furnish Form(s) W-2?</p>
<p>A-3. Absent reasonable cause, the penalties for failure to file and furnish Form(s) W-2 would be applicable even though the payor previously filed Form(s) 1099, because the requirements of IRC 6051 and the applicable regulations had not been met.</p>
<p>Q-4. Does the fact that an employer withheld or failed to withhold income tax have any effect on the assertion of the failure to file and failure to furnish penalties?</p>

Question and Answer
<p>A-4. The penalties should be asserted against the employer who fails to file and furnish Form W-2, regardless of withholding.</p>
<p>Q-5. If wage adjustments are determined as part of an employment tax examination, will an employer be required to file and furnish Form(s) W-2 c?</p>
<p>A-5. Yes. Form(s) W-2 c must be filed and furnished by the employer pursuant to Treas. Reg. 31.6051-2. Form(s) W-2 c must be furnished to employees on or before January 31 of the year succeeding the calendar year in which the wage adjustment is determined. Form(s) W-2 c must be filed with the Social Security Administration on or before the last day of February for calendar year 2016 only, (and thereafter January) for the year succeeding the calendar year in which the wage adjustment is determined. In an examination situation, the term in which the wage adjustment is determined refers to the period in which the taxpayer settled the employment tax case with the Service. If the Form(s) W-2 c are not secured by the examiner, prepare a Form 5346, Examination Information Report, (tickler file) and send to Employment Tax - Workload Selection and Delivery (ET- WSD) as instructed by IRM 4.23.8.10.2, Delinquent Form(s) W-2/W-2c Not Secured by Examiner. ET-WSD will monitor the filing of the returns and determine if a case warrants assignment to a group for a follow-up examination.</p>
<p>Q-6. If Form(s) W-2 c are required to be filed and furnished after an employment tax examination, should an employer be given a reasonable period of time, such as 30 days, to meet these requirements?</p>
<p>A-6. A reasonable time standard is not appropriate in this instance because the time for filing and furnishing Form(s) W-2 c is set forth in the regulations. Refer to A-5 above. The requirements for filing Form(s) W-2 c are provided to the taxpayer via the bottom part of Form 4668, Employment Tax Examination Changes Report. However, the reasonable time standard should be applied when attempting to secure Form(s) W-2 where reclassification adjustments are imposed.</p>
<p>Q-7. If an employer fails to file and furnish Form(s) W-2 c after an employment tax examination by the time required would the penalties for failure to file and failure to furnish information returns be applicable?</p>
<p>A-7. The penalties for failure to file and failure to furnish Form(s) W-2 at the conclusion of an examination would be equally applicable for failure to file and furnish Form(s) W-2 c at the prescribed time set forth at the bottom of Form 4668 and the employment tax regulations.</p>

4.23.9.13.8
(03-27-2017)

**Failure to Comply with
Other Information
Reporting Requirements**

- (1) IRC 6723 provides a penalty for the failure to include all required information or correct information on either the information return or payee statement. A penalty of \$50 is imposed for each incorrect information return or statement with a maximum penalty of \$100,000 per year.

- (2) The information reporting requirements specified for this purpose include any requirement to include a correct taxpayer identification number on a return or statement and any requirement to furnish a correct taxpayer identification to another person. See IRM 20.1.7.10, Failure to Comply with Other Information Reporting Requirements IRC 6723, and Publication 1586, Reasonable Cause Regulations and Requirements for Missing and Incorrect Name/TINs (including instructions for reading CD/DVDs), for more detailed information.
- (3) No penalty shall be imposed under IRC 6723 if a penalty is imposed under IRC 6721 or IRC 6722.

4.23.9.14
(03-27-2017)
**Trust Fund Recovery
Penalty**

- (1) IRC 6672, the Trust Fund Recovery Penalty (TFRP), provides: “General Rule. Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable for a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under IRC 6653 or part II of Subchapter A of chapter 68 for any offense to which this section is applicable.”
- (2) The purpose of IRC 6672 is to encourage the prompt payment of withheld and other collected taxes and to provide the Service with a secondary source of collection in the event that these taxes are not paid. The withheld taxes are commonly referred to as “trust fund taxes,” reflecting the Code’s provision that such withholdings or collections are deemed to be a “special fund in trust for the United States.” See IRC 7501 and *Slodov v. United States*, 436 U.S. 238 (1978). When the trust fund taxes are not paid by the employer, the TFRP may be assessed against the responsible persons for willful failure to collect or pay over the taxes. IRC 6672 only applies to persons responsible for collection and payment of these trust fund taxes. See *Slodov v. United States*, 436 U.S. 238 (1978).
- (3) The Service’s policy is to collect the full tax only once; from the employer or from one or more of the responsible persons. Policy Statement 5-14 (formerly P-5-60) in IRM 1.2.1.6.3 provides: “The trust fund recovery penalty, applicable to withheld income and employment (social security [FICA, Medicare (including Additional Medicare)] and railroad retirement) taxes or collected excise taxes, will be used to facilitate the collection of tax and enhance voluntary compliance. If a business has failed to collect or pay over income and employment taxes, or has failed to pay over collected excise taxes, the trust fund recovery penalty may be asserted against those determined to have been responsible and willful in failing to pay over the tax. Responsibility and willfulness must both be established. The withheld income and employment taxes or collected excise taxes will be collected only once, whether from the business, or from one or more of its responsible persons.”
- (4) The statutory period for assessment of a TFRP, with respect to any taxable period within a calendar year, is three years from the succeeding April 15 or from the date the return was filed, whichever is later. The statutory period for assessment for any unpaid trust fund tax arising from an adjustment made to a taxpayer filed return remains the original statute date based on the filed return.

- (5) IRC 6672 does not prohibit the assertion of the TFRP against responsible persons where the addition to the tax for fraud is asserted against the employer. IRC 6672 only bars the assertion of the fraud and accuracy-related penalties against a responsible person liable for the TFRP. The fraud and accuracy-related penalties apply to any underpayment of tax and can be asserted against the employer based on the acts of its officers (including fraud, negligence or disregard of rules or regulations).

4.23.9.14.1
(03-27-2017)

**Trust Fund Recovery
Penalty Procedures**

- (1) Requests for Collection determinations for the assertion or non-assertion of the TFRP will be sent to the Collection Advisory group in the geographic area in which the taxpayer is located. They will have an investigation initiated per IRM 5.7.3.4.1, Referral from Examination, by a revenue officer to make the determination. See Pub 4235, Collection Advisory Group Numbers and Addresses, for location of Collection Advisory groups. See IRM 5.7.4, Trust Fund Compliance, Investigation and Recommendation of the Trust Fund Recovery.
- (2) Form 6238, Referral Report for Potential 100 Percent Penalty Cases, will be completed according to the instructions provided in IRM 4.23.9.14.2 below and the original and one copy forwarded to Collection Advisory through the SB/SE field territory manager, the LB&I team manager, or the TE/GE manager.
- (3) For all cases where there is an indication that the TFRP applies, examiners will include appropriate remarks in their workpapers and include a copy of the completed Form 6238 in the case file. If possible, the examiner will secure Form 2750, Waiver Extending Statutory Period for Assessment of Trust Fund Recovery Penalty, from every responsible party for all tax periods when the TFRP assessment statute will expire within two years for unagreed cases; one year for agreed cases. See IRM 4.23.14.7, Form 2750, Waiver Extending Statutory Period for Assessment of the Trust Fund Recovery Penalty, for procedures regarding the Form 2750.
- (4) For those cases where Form 6238 was not prepared, examiners will comment in the workpapers that referral to Collection Advisory was considered but not made and include the reason(s) for not making a referral to Collection Advisory.

4.23.9.14.2
(03-27-2017)

**Instructions for
Completing Form 6238,
Referral Report for
Potential Trust Fund
Recovery Penalty Cases**

- (1) Items 1 through 6 of Form 6238 will be completed by the examiner. Item 7, although on the form, should be left blank. The examiner will include the examiner's name, phone number, and the date the form was prepared. Forward the original and one copy of the form to the Collection Advisory through the SB/SE Field Territory Manager, the LB&I team manager, or the TE/GE manager.
- (2) Item completion instructions are as follows:
- Item 1: Name and Address of Taxpayer: Enter name and current address of taxpayer.
 - Item 2: Employer Identification Number: Enter employer identification number; if none, enter "None".
 - Item 3: Tax Periods: Enter all tax periods for which there is an indication that the Trust Fund Recovery Penalty may apply.
 - Item 4: The statute of limitations for the TFRP is treated like that of the employment tax returns. However, an extended statute date on Form SS-10 **DOES NOT** extend the statute for the TFRP. Form 2750, Waiver Extending Statutory Period for Assessment of Trust Fund Recovery

Penalty, must be used for this purpose. List the earliest statute expiration date for multiple year examinations.

- Item 5: List the employment tax issues for which the trust fund recovery penalty may apply. Enter the total amount of income tax withholding, the total amount of withheld FICA tax, or the total of other withheld taxes (withholding on gambling winnings and withholding at source) that may be subject to the trust fund recovery penalty.
- Item 6: Provide names, titles, and SSNs of all persons who appear responsible for not collecting, accounting for, or paying over the taxes.
- Item 7: Leave blank.

- (3) If the case is going to Appeals, the examiner will provide the location of the Collection Advisory Group and include the following statement on the Form 4665, Report Transmittal: "If case is upheld in Appeals, please forward enclosed Form 6238 to the Collection Advisory group in the geographic area in which the taxpayer is located." See Pub 4235, Collection Advisory Group Numbers and Addresses, for location of Collection Advisory groups.

Note: If the examiner has secured Form 2750, the Form 4665 statement should also include instructions to forward this form to the appropriate Collection Advisory Group.

4.23.9.15
(03-27-2017)
**Tax Return Preparer
Penalty**

- (1) The return preparer penalties under IRC 6694 apply to preparers of all tax returns, including employment tax returns. See IRM 20.1.6, Penalty Handbook, Preparer, Promoter, Material Advisor Penalties, for general procedures and IRM 4.23.17, Preparer Penalty Procedures for SB/SE Employment Tax, for employment tax procedures. Also see IRB 2009-11, Announcement 2009-15 and Treas. Reg. 31.6694-1.

4.23.9.16
(12-23-2019)
**Business Master File
(BMF) Identity Theft
Procedures for
Employment Tax Area
212 - Overview**

- (1) Business Master File (BMF) Identity Theft is defined as creating, using, or attempting to use business' identifying information, without authority, to obtain tax benefits. See IRM 25.23.1.1.2, Terms/Definitions/Acronyms.
- (2) Examiners may encounter potential BMF Identity Theft by a contact made during an examination or based on research found during pre-analysis of the assigned case. Most employment tax cases with possible BMF Identify Theft involve filed Form(s) W-2 where:
- No corresponding employment tax returns have been filed, or
 - The Employer Identification Number (EIN) is not a valid EIN (fabricated EIN), or
 - The EIN cannot be associated with a "live" business, or
 - The EIN is associated with a "live" business but no other business activity can be found, the owner cannot be located, and no other evidence indicates a business exists, or
 - The owner of the EIN is located but is able to document that they had no employees and did not file the Form(s) W-2 in question.
- (3) When an examiner is advised or otherwise suspects that an assigned case involves BMF Identity Theft (ID Theft), the examiner will initially discuss their suspicions with their manager.

- (4) Examiners must conduct specific research to determine whether or not BMF ID Theft exists. The depth of the research will be dependent upon each case.
- (5) If the examiner has contact with the true owner of the EIN, they must ask specific questions to ensure the Form(s) W-2 were not filed by that owner. Some questions that may help with the determination include:
 - a. Has the business changed entities? For example, the business has changed from a sole proprietor to an Limited Liability Company (LLC). A second EIN may exist causing the returns being filed incorrectly.
 - b. Has the company changed payroll companies? Many times a payroll company has been changed but the previous payroll company still files a return or submits Form(s) W-2.
 - c. If there are payments present, did the taxpayer make any payments? Payment research may provide another EIN or entity information.
 - d. Was the business sold or closed?
 - e. Was a final return filed?
 - f. If the taxpayer states they never applied for an EIN or indicate they have been out of business for several years, have they had any ID theft tax related issues under their SSN?
- (6) Additional steps the examiner will perform include:
 - a. A careful review of any documentation the taxpayer has provided in support of their claim.
 - b. Research to rule out a mixed entity or successor corporation and to locate any possible cross-reference TIN. Refer to IRM Exhibit 25.23.9-7, Business Master File (BMF) Identity Theft Research Requirement.
 - c. Internet research to identify the business location and pertinent information regarding the business entity.

Note: The depth and extent of additional research should be discussed with the manager.

- (7) If the research conducted by the examiner reveals no BMF ID Theft, the examiner will continue with the examination following normal procedures.

4.23.9.16.1
(12-23-2019)
**Fabricated EIN
Procedures**

- (1) If the research conducted by the examiner reveals that the EIN under examination is a fabricated EIN, as defined in IRM 25.23.9.8.1, Fabricated or Inactive Employer Identification Number (EIN) Procedures, there are several account actions that must be completed prior to case disposition.
- (2) The examiner will complete Form 14566, BMF Identity Theft Referral, for all required actions. See IRM 25.23.9.8.1(5) for a listing of required account actions. Form 14566 should include all appropriate research and explain all BMF and IMF implications.
- (3) Submit Form 14566 through your manager to the liaison assigned to the Employment Tax function listed in the *Identity Theft - BMF - Liaison Contacts* listing. If the information for all the required account actions are not included in the "Actions requested" section, the referral will be returned to the originator.
- (4) The Employment Tax ID Theft Liaison will forward completed Form 14566 to the appropriate functions and will monitor responses. The examiner **must** hold the case pending input or rejection of Form 14566 and associated account actions.

- (5) ID Theft cases open on AIMS/Exam Return Control System (ERCS) are monitored using Input Aging Reason Code (ARC) "14", (Identity Theft). Examiners must update AIMS/ERCS with ARC "14" for each impacted open tax year when ID theft is suspected. ARC "14" has priority and will overlay all other ARCs.
- (6) If the Form 14566 is accepted and all actions are taken, examiners will follow specific closing actions depending on whether there was an employment tax return filed. See IRM 4.23.9.16.3, Confirmed BMF Identity Theft Procedures on Non-filed Returns, and IRM 4.23.9.16.4, Confirmed BMF Identity Theft Procedures for Filed Returns.

4.23.9.16.2 (12-23-2019) BMF Identity Theft Procedures

- (1) If the research conducted by the examiner reveals BMF ID Theft does exist **and it does not involve a fabricated EIN**, the examiner will complete Form 4844, Request for Terminal Action, to request input of a Transaction Code (TC) 971, Action Code (AC) 522, IDTCLM (IDTCLM is the Tax Administration Code). On Form 4844, enter the date the potential ID theft was identified by the taxpayer or the employee in the "Secondary Date" field. Form 4844 will be submitted through your manager to the liaison assigned to the Employment Tax function listed in the *Identity Theft - BMF Liaison Contacts* listing (<http://serp.enterprise.irs.gov/content/irm-supplements/identity-theft-bmf.html>).
- (2) Employment Tax ID Theft Liaison will submit the Form 4844 to the Designated Identity Theft Adjustment (DITA) for input. The examiner must hold the case pending input or rejection of the Form 4844.
- (3) ID Theft cases open on AIMS/Exam Return Control System (ERCS) are monitored using Input Aging Reason Code (ARC) "14", (Identity Theft). Examiners must update AIMS/ERCS with ARC "14" for each impacted open tax year when ID theft is suspected. ARC "14" has priority and will overlay all other ARCs.
- (4) If the examiner receives new information that shows ID Theft does not exist, the examiner must take steps to reverse the indicators previously input. See IRM Exhibit 25.23.9-5, Reversing Business Master File (BMF) Identity Theft Indicators - Transaction Code (TC) 972 Action Code (AC) 522.
- (5) If the Form 4844 is input, examiners will follow specific closing actions depending on whether there was an employment tax return filed or not. See IRM 4.23.9.16.3 and IRM 4.23.9.16.4.

Note: If the TC 150 was determined to be the perpetrator return, and a second valid return posted and will be selected for examination, examiners must update AIMS/ERCS with ARC "95." This will overlay the previous ARC "14."

4.23.9.16.3 (12-23-2019) Confirmed BMF Identity Theft Procedures on Non-filed Returns

- (1) For fabricated EIN cases, upon posting of TC 971, AC 524 and confirmation from the Employment Tax ID Theft Liaison that all required parties have responded, the examiner can close the case.
- (2) For ID Theft cases other than fabricated EIN cases, Form 4844 will be submitted through their manager to the ID Theft analyst to close the ID Theft

controls. The Form 4844 will request input of TC 971, AC 522, CLSIDT (CLSIDT is the Tax Administration Code). Upon posting, the examiner can close the case.

- (3) To prevent an invalid assessment, the examiner will close the case using Disposal Code (DC) "39" via Form 10904, Request for Record Deletion from AIMS/ERCS. Form 10904 and the appropriate documentation will be submitted to the local AIMS/ERCS analyst for final closure.

4.23.9.16.4
(12-23-2019)
**Confirmed BMF Identity
Theft Procedures for
Filed Returns**

- (1) If an employment tax return was filed and it is determined the return was not filed by the owner of the EIN, the examiner must take steps to correct the module. See IRM 4.10.27.10, Victim Account Corrections—Processing Steps, and IRM 4.10.27.11, Suspension of Collection Activity for Identity Theft Cases.

Note: If the TC 150 was determined to be the perpetrator return, and a second valid return posted and will be selected for examination, examiners must update AIMS/ERCS with ARC "95". This will overlay the previous ARC "14".

- (2) For fabricated EIN cases, after completing the action described above, and upon posting of TC 971, AC 524 and confirmation from the liaison assigned to the Employment Tax function that all required parties have responded, the examiner can close the case.
- (3) For ID Theft cases other than fabricated EIN cases, when the case is ready for final closure, the examiner will submit Form 4844 to the ID Theft analyst to close the ID Theft controls. The Form 4844 will request input of TC 971, AC 522, CLSIDT. Upon posting, the examiner can close the case.

4.23.9.16.5
(12-23-2019)
**Contact with True EIN
Owner**

- (1) If the examiner has contact with the true owner of the EIN, the examiner must:
 - Inform the true owner that their EIN was used to file Form(s) W-2,
 - Advise the true owner to respond immediately to any notices from the IRS,
 - Direct the true owner to the Federal Trade Commission Identity Theft web-page at: <https://www.identitytheft.gov/>, and
 - Document all discussions in the case file.

4.23.9.17
(10-06-2022)
**Referrals to TEGE of
Prohibited Tax Shelter
Transactions**

- (1) If a return involves a tax exempt entity engaging in what appears to be a prohibited tax shelter transaction (for example, a listed transactions, a confidential transaction, or a transaction with contractual protection) or engaging fraudulent activity, the manager should ensure the return is referred to TE/GE on Form 5666, TE/GE Referral Information Report. See IRM 4.32.3.8.1.3, Information Sharing, for information on how to prepare the referral.

Exhibit 4.23.9-1 (10-06-2022)**Instructions for Determining Civil Penalty Statute of Limitations****IRC 6721 and IRC 6722: Failure to File Correct Information Return and Failure to Furnish Correct Payee Statement — Reference Numbers 600/612**

For purposes of assessing the addition to the tax under IRC 6721 and IRC 6722, if the person required to make the return fails to file the return with the Social Security Administration for Form W-2) or to furnish a payee statement, pursuant to IRC 6501(c)(3), the addition to the tax may be assessed at any time. If such person files the return after its due date (including any extension of time to file), the addition to the tax must be assessed within three years of filing the return. A statute extension secured on Form SS-10, Consent to Extend the Time to Assess Employment Taxes, **does not** extend the statute of limitations on these penalties. The consent covers only those penalties that are directly connected to an employment tax adjustment.

To extend the statute of limitations on IRC 6721 and IRC 6722 penalties refer to IRM 20.1.7.12.2.8, Civil Penalties Statute of Limitations.

IRC 6679: Failure to File Returns with Respect to Foreign Corporations or Foreign Partnerships — Reference Number 613

The penalty under IRC 6679 must be assessed within three years after the return is filed with the Service (including any extension of time to file) (IRC 6501(a)). If no return is filed with the Service, the penalty may be assessed at any time (IRC 6501(c)(3)).

IRC 6682: False Information with Respect to Withholding — Reference Number 616

The penalty under IRC 6682 must be assessed within three years after the filing of the return for which the penalized activity takes place.

IRC 6694(a): Understatement of Taxpayer's Liability by Tax Return Preparer : Understatement Due to Unreasonable Position - Reference Number 645

The penalty under IRC 6694(a) must be assessed within three years after the return or claim for refund, with respect to which the penalty is assessed, was filed. Extending the statute on the taxpayer's return does not extend the statute for the return preparer penalty case. The statute for the return preparer penalty case is extended by the execution of a Form 872-D, Consent to Extend the Time on Assessment of Tax Return Preparer Penalty. Refer to IRM 20.1.6.21, Statute of Limitations.

IRC 6694(b): Understatement of Taxpayer's Liability by Tax Return Preparer : Understatement Due to Willful or Reckless Conduct— Reference Number 650

The penalty under IRC 6694(b) may be assessed at any time; there is no statute of limitations.

IRC 6695: Other Assessable Penalties with Respect to Preparation of Income Tax Returns — Reference Numbers 624/626

The statute of limitations is the same as that of IRC 6694(a). Refer to IRM 20.1.6.21, Statute of Limitations.

IRC 6702: Frivolous Tax Submissions — Reference Number 666

If a frivolous return does not constitute a valid return and is not processed by the Service as a return, the IRC 6702 penalty may be assessed at any time. If the frivolous return does constitute a valid return or is processed by the Service as a return, the penalty must be assessed within three years after the return was filed. The frivolous return penalty can also be asserted against an amended return.

