



# MANUAL TRANSMITTAL

Department of the Treasury  
Internal Revenue Service

25.1.6

JUNE 10, 2021

## EFFECTIVE DATE

(06-10-2021)

## PURPOSE

- (1) This transmits revised IRM 25.1.6, Fraud Handbook - Civil Fraud.

## MATERIAL CHANGES

- (1) IRM 25.1.6.1 - Added new subsection, Program Scope and Objectives, to provide internal controls information. Subsections added under Program Scope and Objectives include Background; Authority; Roles; Program Management and Review; Program Controls; Acronyms; Terms; and Related Resources. Also rearranged existing IRM content to place information involving internal controls under this subsection. The addition of this subsection renumbered existing subsections.
- (2) IRM 25.1.6.1(1) - The mission of the Office of Fraud Enforcement (OFE) has been added.
- (3) IRM 25.1.6.2(1) - A paragraph was added describing the OFE advisor program and where a list of the fraud enforcement advisors (FEAs) can be found.
- (4) IRM 25.1.6.2(2) - A paragraph was added describing the role of the FEA and to use the Specialist Referral System (SRS) to contact the FEA.
- (5) IRM 25.1.6.3(1) - A paragraph was added to document the examiner will discuss cases that have first indicators of fraud with his/her group manager.
- (6) IRM 25.1.6.3(2) - This paragraph was added to document that the examiner will contact the FEA if the group manager agrees there are indicators of fraud. by submitting a request through the SRS.
- (7) IRM 25.1.6.3(3) - The website for the Specialist Referral System (SRS) was added.
- (8) IRM 25.1.6.3(4) - A sentence was added that the FEA has two days to contact the compliance employee after the SRS request has been submitted.
- (9) IRM 25.1.6.3(6) - The FEA is required to provide a Plan of Action on Form 11661 and forward the form to the examiner and examiner's group manager. This requirement has been added to this section.
- (10) IRM 25.1.6.4(2) - Last bullet item, education and experience was removed.
- (11) IRM 25.1.6.4(4) - Comment was added to document that all SB/SE compliance examination field operations employees should document fraud considerations on cases involving adjustments to taxable income and/or credits resulting in an underpayment of tax due.
- (12) IRM 25.1.6.6(3)(b) - Added IRM references for additional guidance.
- (13) All references to LB&I Senior Fraud Program Analyst were replaced with LB&I Fraud Coordinator.
- (14) Editorial changes were made throughout the IRM; website links and program names were updated. All references to Fraud Technical Advisor (FTA) were replaced with Fraud Enforcement Advisor (FEA).

**EFFECT ON OTHER DOCUMENTS**

This material supersedes IRM 25.1.6, dated April 29, 2016.

**AUDIENCE**

Criminal Investigation (CI), Large Business & International (LB&I), Small Business/Self-Employed (SB/SE), Tax Exempt/Government Entities (TE/GE), and Wage & Investment (W&I)

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25.1.6

Civil Fraud

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25.1.6.1  
(06-10-2021)  
**Program Scope and  
Objectives**

- (1) **Mission.** The mission of the Office of Fraud Enforcement (OFE) is to promote compliance by strengthening the IRS' response to fraud and mitigating emerging threats. This includes:
  - Improving fraud detection and development to address areas of high fraud/risk noncompliance.
  - Cultivating internal and external partnerships to identify new treatment streams to enhance enforcement.
  - Pursuing civil fraud penalties and recommending criminal cases that will lead to prosecutions, where appropriate.
- (2) OFE builds strong internal and external partnerships and serves as the primary civil liaison to IRS-Criminal Investigation. By supporting cases throughout the life cycle and through full consideration of available treatments, OFE facilitates optimal disposition of cases with civil or criminal fraud potential.
- (3) **Purpose.** This section discusses the procedures to follow in a civil fraud case.
- (4) **Audience.** This handbook is a comprehensive guide for IRS employees servicerwide in the recognition and development of potential fraud issues; referrals for criminal fraud; duties and responsibilities in joint investigations; civil fraud cases; and other related fraud issues.
- (5) **Policy Owner.** Director, OFE, Small Business Self Employed (SB/SE) Division.
- (6) **Program Owner.** OFE, Policy, SBSE.
- (7) **Primary Stakeholders.** The primary stakeholders are IRS compliance employees and Criminal Investigation (CI).

25.1.6.1.1  
(06-10-2021)  
**Background**

- (1) A civil fraud penalty case may be developed based on facts and circumstances of a civil examination or result from a case initiated by Criminal Investigation (CI).

25.1.6.1.2  
(06-10-2021)  
**Authority**

- (1) By law, the IRS has the authority to conduct examinations under Title 26, Internal Revenue Code Subtitle F – Procedure and Administration, Chapter 78 - Discovery of Liability and Enforcement of Title, Subchapter A - Examination and Inspection.

25.1.6.1.3  
(06-10-2021)  
**Roles**

- (1) The Director, OFE, is the executive responsible for providing fraud policy and guidance for civil compliance employees and ensuring consistent application of policies and procedures in this IRM.
- (2) The fraud enforcement advisor (FEA) serves as a resource and liaison to civil compliance employees in all operating divisions. The FEA is available to assist in civil fraud investigations and offer advice on matters concerning tax fraud.
- (3) Employees who work potential fraud cases are responsible for following the procedures in this IRM. All examiners and their managers working potential fraud cases should familiarize themselves with the information contained in this IRM.

25.1.6.1.4  
(06-10-2021)  
**Program Management  
and Review**

- (1) The Office of Fraud Enforcement Policy staff prepares and issues the following reports to servicewide customers:
  - Three-year reports prepared using Fraud Information Tracking System (FITS) data
  - Status 17 reports using Audit Information Management System (AIMS) or AIMS Centralized Information System (ACIS) data
- (2) OFE Policy staff can create reports by area, territory or group. These reports help manage fraud inventory and provide review information for managerial use:
  - Cases on FITS but not on AIMS or ACIS
  - Cases on AIMS or ACIS but not on FITS
  - Cases in fraud development status
  - Cases in criminal fraud status
- (3) Ad-hoc reports are produced as requested by OFE customers.
- (4) Operational reviews of the FEA group managers are completed by the OFE program manager twice a year. These reviews measure program consistency, effectiveness in case actions, and compliance with fraud policy and procedures.
- (5) FEA managers utilize reports generated from FITS to monitor and track FEA inventory assignments.

25.1.6.1.5  
(06-10-2021)  
**Program Controls**

- (1) FEA managers verify program and procedural compliance by conducting case consultations, case reviews, performance reviews, and security reviews with all FEAs.
- (2) FEAs are required to follow-up on all cases in fraud development status at least every 60 days as required by IRM 25.1.2.2, Fraud Development Procedures.
- (3) FEAs are required to monitor accepted criminal referrals each quarter to ensure that CI and compliance are holding productive quarterly meetings as required under IRM 25.1.4.4.3, Required Communications.

25.1.6.1.6  
(06-10-2021)  
**Acronyms**

- (1) The following table defines acronyms commonly used throughout this IRM section:

<b>Acronym</b>	<b>Definition</b>
AC	Action Code
ACS	Automated Collection System
ACIS	AIMS Centralized Information System
ACTC	Additional Child Tax Credit
AIMS	Audit Information Management System
AIS	Automated Insolvency System
AOIC	Automated Offer in Compromise
AOTC	American Opportunity Tax Credit
ASED	Assessment Statute Expiration Date
ATAT	Abusive Tax Avoidance Transactions
ATFR	Automated Trust Fund Recovery
AUSA	Assistant U.S. Attorney
BD	Balance Due
BMF	Business Master File
BSA	Bank Secrecy Act
CCFC	Collection Campus Fraud Coordinator
CCP	Centralized Case Processing
CFC	Campus Fraud Coordinator
CFFC	Collection Functional Fraud Coordinator
CI	Criminal Investigation
COIC	Centralized Offer In Compromise
COP	Conditions of Probation
CSCO	Compliance Services Collection Operations
CSED	Collection Statute Expiration Dates
CTC	Child Tax Credit
CTR	Currency Transaction Report
DEL RET	Delinquent Return
ECS	Exam Case Selection
EFC	Examination Fraud Coordinator
EITC	Earned Income Tax Credit
EPR	Examination Planning and Review
ERCS	Examination Returns Control System
FBAR	Foreign Bank and Financial Accounts

<b>Acronym</b>	<b>Definition</b>
FCQ	FinCEN Query
FEA	Fraud Enforcement Advisor
FFC	Functional Fraud Coordinator
FFTF	Fraudulent Failure to File Penalty
FinCEN	Financial Crimes Enforcement Network
FIRM	Fraudulent Intent Referral Memorandum
GM	Group Manager
ICS	Integrated Collection System
IDRS	Integrated Data Retrieval System
IMF	Individual Master File
IRC	Internal Revenue Code
IRM	Internal Revenue Manual
IRP	Information Return Processing
IRS	Internal Revenue Service
LB&I	Large Business & International
ODC	Other Dependent Credit
OFE	Office of Fraud Enforcement
OIC	Offer in Compromise
OS	Offer Specialist
PII	Personally Identifiable Information
PSP	Planning and Special Programs
RA	Revenue Agent
RAR	Revenue Agent's Report
RICS	Return Integrity and Compliance Services
RO	Revenue Officer
SA	Special Agent
SAC	Special Agent in Charge
SAR	Special Agent's Report or Suspicious Activity Report
SB/SE	Small Business/Self Employed
SOL	Statute of Limitation
SSA	Supervisory Special Agent
TBOR	Taxpayer Bill of Rights



Acronym	Definition
TC	Transaction Code
TE/GE	Tax Exempt/Government Entities
TFRP	Trust Fund Recovery Penalty
TM	Territory Manager
TP	Taxpayer
TS	Technical Services
W&I	Wage & Investment

25.1.6.1.7  
(06-10-2021)

#### Terms

- (1) Compliance employees must be familiar with the following legal terms to understand the requirements of proof. The following table defines terms commonly used throughout this IRM section:

Term	Definition
Burden of Proof	Includes both the burden of producing evidence and persuading a court (judge or jury) by clear and convincing evidence that the facts support the contention of civil fraud. In tax fraud cases, the burden of proof is on the government.
Circumstantial Evidence	Evidence that relies on an inference to connect it to a conclusion of fact.
Clear and Convincing Evidence	Evidence showing that the assertion made is highly probable or reasonably certain. This is a greater burden of proof than preponderance of the evidence but less than beyond a reasonable doubt.
Direct Evidence	Evidence in the form of documents or testimony from a witness who actually saw, heard, or touched the subject of questioning. Direct evidence, which is believed, proves existence of fact in issue without inference or presumption.
Evidence	Data presented to a judge or jury to prove the facts in issue. Evidence includes the testimony of witnesses, records, documents, or objects. Evidence is distinguished from proof, in that proof is the result or effect of evidence.
Fraud	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.
Inference	A logical conclusion from given facts.

Term	Definition
Preponderance of Evidence	Evidence that will incline an impartial mind to one side rather than the other so as to remove the cause from the realm of speculation. It does not relate merely to the quantity of evidence. Simply stated, evidence which is more convincing than the evidence offered in opposition.
Presumption (of law)	A rule of law that a judge or jury will draw a particular inference from a particular fact, or from particular evidence, unless and until the truth of such inference is disproved.
Reasonable Doubt	The evidence must be so convincing that a reasonable person would not question the defendant's guilt.
Willful Intent to Defraud	An intentional wrongdoing with the specific purpose of evading a tax believed by the taxpayer to be owing.

25.1.6.1.8  
(06-10-2021)

#### Related Resources

- (1) IRM 20.1, Penalty Handbook, provides specific procedures for assertion of the civil fraud penalty.
- (2) Specific guidance on fraud indicators and the development of fraud may be found in IRM 25.1.1, Overview/Definitions, and IRM 25.1.2, Recognizing and Developing Fraud.
- (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: <https://www.irs.gov/taxpayer-bill-of-rights>

25.1.6.2  
(06-10-2021)

#### Overview

- (1) The Office of Fraud Enforcement Advisor Program is a servicewide program. The groups are comprised of revenue agents and revenue officers who are located strategically throughout the country to assist with the development of fraud. A list of the groups, FEA group managers and the FEAs can be found on the Fraud Development Knowledge Base website <https://portal.ds.irsnet.gov/sites/vl019/lists/fraudawareness/fraudenforcementsadvisorscontactinformation.aspx>
- (2) The fraud enforcement advisor (FEA) plays a vital role in the development of a potential fraud case. The FEA will be consulted in all cases involving potential criminal fraud, as well as those cases that have potential for a civil fraud penalty. The FEA is available to assist in fraud investigations and offer advice on matters concerning tax fraud. Upon initial recognition of indicators of fraud, the employee will discuss the case at the earliest possible opportunity with his/her manager. If the compliance group manager concurs, the FEA will be contacted immediately through the Specialist Referral System, and both the compliance group manager and FEA will provide guidance to the compliance employee on how to proceed. Compliance managers will encourage the early

involvement of the FEA in all potential fraud cases. Local area counsel is also available for consultation and advice when badges of fraud are first identified.

- (3) Civil fraud penalties will be asserted when there is clear and convincing evidence to prove that some part of the underpayment of tax was due to fraud. Such evidence must show the taxpayer's intent to evade the assessment of tax, which the taxpayer believed to be owing. Intent is distinguished from inadvertence, reliance on incorrect technical advice, sincerely-held difference of opinion, negligence or carelessness. In the case of a joint return, intent must be established separately for each spouse as required by IRC 6663(c). The fraud of one spouse cannot be used to impute fraud by the other spouse. Thus, the civil fraud penalty may be asserted only on one spouse, unless there is sufficient evidence that both spouses participated in the fraudulent act(s) resulting in the underpayment reported in their joint return.

**Note:** When considering the civil fraud penalty under IRC 6663 the fact that a taxpayer has tax due is not sufficient to assert the civil fraud penalty. An affirmative act of fraud, as stated in IRM 25.1.1.4(2), Affirmative Acts (Firm Indications) of Fraud, must also be present.

25.1.6.3  
(06-10-2021)  
**Procedures**

- (1) The examiner will discuss cases that have first indicators of fraud with his/her group manager. If the group manager agrees there are indicators of fraud then the examiner will contact the FEA using the Specialist Referral System (SRS).
- (2) To request a consultation with the FEA, the compliance employee will submit a request through the SRS. The FEA assigned to the examiner's case will contact the examiner within two business days to discuss the case. The SRS is located at the following website: <https://srs.web.irs.gov/default.aspx>

**Note:** For TEGE cases: If the group manager agrees there are indicators of fraud, then the examiner will contact the TEGE SME. The SME will contact the FEA using the SRS.

- (3) Upon concurrence of the compliance group manager and FEA, fraud development cases will be updated on AIMS to status code 17 (Fraud Development), via Form 11661, Fraud Development Recommendation - Examination.
- (4) The FEA is required to provide a plan of action on the Form 11661 and forward the form to the examiner and examiner's group manager. Where the FEA and compliance group manager do not agree on whether a case should be developed for potential fraud, the compliance group manager may update the case to AIMS status code 17 without the FEA's concurrence. However, the compliance group manager should contact the FEA group manager to discuss the situation prior to updating the status code. Regardless, to ensure consistent treatment of all fraud cases, preparation of Form 11661 is required to document the compliance group manager's decision for fraud development. Ultimately, the final decision on an examination case rests with the compliance group manager. See Exhibit 25.1.6-1.
- (5) Determination of the civil fraud penalty is the shared responsibility of the examiner, his/her group manager and the FEA. For LB&I cases, FEA concurrence is mandatory. See IRM 25.1.10.7(3) .

**Note:** Campus fraud procedures are prescribed in IRM 4.19.10.4, Fraud Referrals. The SB/SE campuses are positioned to develop and assert the civil fraud penalty, and to impose a 10-year ban on earned income tax credit (EITC) cases and other credits.

**Note:** Campus fraud procedures prescribed in IRM 4.19.10.4, Fraud Referrals, also apply to the five W&I Campuses. The civil fraud program is centralized at the Austin campus, and receives transfers of potential fraud cases from all W&I campuses, with the FEA's approval for case development. The FEA assigned to the Austin campus assists the Austin examination fraud coordinator (EFC) with case development, write-up, and review, as necessary.

Each campus' assigned FEA will assist with the development, write-up and review of the civil fraud penalty issues. Each campus also has dedicated Counsel to assist with review and approval of the penalty issues for Statutory Notice of Deficiency (SNOD) purposes, if needed. See IRM 4.19.10.4.10.3, 90-Day Procedures, for additional guidance.

- (6) The FEA works with the examiner to ensure the fraud penalty narrative does, in fact, substantiate the assertion of the civil fraud or fraudulent failure to file penalties, see IRM 25.1.7, Failure to File. The FEA will recommend enhancements to the fraud narrative, as needed, to clearly explain the indicators of fraud. The affirmative acts in each case should be described in such detail as to leave no doubt as to why assertion of the civil fraud penalty or fraudulent failure to file penalty is justified. If the FEA recommends that the examiner further develop the case, the FEA will document the reason(s) why and note the required additional steps in the Plan of Action.
- (7) If the FEA concurs with the examiner's fraud narrative and no additional information is required, the FEA will indicate his/her concurrence with the assertion of the civil fraud penalty or fraudulent failure to file penalty on Form 11661. A copy of the Form 11661 will be forwarded to the compliance group manager and the original will be returned to the examiner for inclusion in the administrative case file.
- (8) If the compliance group manager disagrees with the FEA recommendation that the civil fraud penalty should be asserted, this should be documented and discussed with the examiner and his/her group manager. The case will be returned to AIMS status code 12 and the Form 11661 will be documented by the FEA to reflect the compliance group manager's decision. Ultimately, the final decision on such a case rests with the compliance group manager.

**Note:** For LB&I cases, after discussion with the compliance group manager, the FEA should contact the LB&I Fraud coordinator for further discussion.

- (9) If the compliance group manager disagrees with the FEA recommendation that the civil fraud penalty should not be asserted, this should also be documented and discussed with the examiner and his/her group manager. The case will remain in AIMS status code 17 and the Form 11661 will be documented by the FEA to reflect the compliance group manager's decision. Ultimately, the final decision on such a case rests with the compliance group manager.
- (10) For civil disposition of a post-prosecution case, the examiner should contact CI to ascertain the criminal statutes under which the taxpayer was convicted

before attempting to resolve the related civil fraud penalty. If a taxpayer is criminally convicted under IRC 7201, the conviction precludes the taxpayer from objecting to the civil fraud penalty for the year at issue under the doctrine of collateral estoppel. See IRM 25.1.6.5 for additional information. However, the amount of the liability and the "underpayment" upon which the civil fraud penalty is based must be fully developed. Further, collateral estoppel would only apply to the year or years for which a conviction under IRC 7201 was obtained. For years where the conviction was obtained under a statute other than IRC 7201, or for years for which the taxpayer was not criminally convicted, the examiner must develop the civil fraud penalty prior to recommending its assertion. The examiner should consult the local FEA and Area Counsel for assistance in developing the case. The examiner should obtain a copy of the plea agreement or judgment notating the applicable criminal statutes and years. See IRM 25.1.5, Grand Jury Investigations, for procedures in securing information for use in the civil settlement of cases investigated through grand jury procedures.

- (11) In cases where fraud was considered and the civil fraud penalty is not recommended, the examiner must explain fully in the work papers consideration of the penalty and why it was not asserted.
- (12) The civil fraud penalty and/or the fraudulent failure to file penalty must be asserted if a taxpayer was successfully prosecuted by the Department of Justice under Title 26 (i.e. IRC 7201, 7203, 7206(1) ) and the prosecution involved additional tax assessment(s) as opposed to payment of existing assessment(s). Any exceptions to this rule must be approved by Area Counsel. In unsuccessful prosecution cases, non-assertion of the civil fraud penalty and/or the fraudulent failure to file penalty is the discretion of the compliance group manager in charge of the civil disposition case. Compliance group managers are encouraged to consult with their local FEA for assistance. This rule also applies in the case of any related taxpayer involved in the same transaction and to any other year or period of the same taxpayer which is related to or affects the year or period for which criminal prosecution was successful.

**Note:** Refer to IRM 25.1.6.5, Collateral Estoppel.

**Caution:** LB&I cases with court ordered restitution may require special handling, contact the LB&I Fraud Coordinator for additional guidance.

- (13) Assertion of the civil fraud penalty or fraudulent failure to file penalty should be considered when a taxpayer is successfully prosecuted by the Department of Justice under Title 18 and the facts underlying the criminal case directly relate to additional assessments. The nature and scope of the civil action in such cases is at the discretion of the compliance group manager. Compliance group managers are encouraged to consult with their local FEA for assistance and Area Counsel should be consulted as appropriate.
- (14) For SB/SE cases where criminal restitution can be assessed as a tax under IRC 6201(a)(4), contact SB/SE Area Counsel for further guidance.
- (15) For LB&I cases with criminal restitution, contact the LB&I fraud coordinator upon receipt for guidance.
- (16) Cases returned to the field from fraud or grand jury suspense for civil disposition are returned in AIMS status code 17. Based on the facts and

circumstances of the case, if and when a joint determination by the examiner, his/her manager and the FEA is made to not develop and/or assert the civil fraud penalty, the case will be updated to AIMS status code 12. The case must clearly document the reason(s) for such determination.

- (17) Area Counsel must approve the civil fraud penalty prior to issuance of a SNOD.

25.1.6.3.1  
(06-10-2021)  
**Determination of Underpayment**

- (1) On December 30, 2015, the Office of Chief Counsel issued Chief Counsel Notice 2016-004 <https://www.irs.gov/pub/irs-ccdm/cc%202016%20004.pdf> cancelling the guidance previously provided in Chief Counsel Notice 2014-007 to conform with the courts decision in Rand v. Commissioner. Section 209 of the Protecting Americans from Tax Hikes Act of 2015 (PATH Act), Pub. L. 114-113 Div. Q (2015) amends IRC 6664(a) to provide that “a rule similar to the rule of IRC 6211(b)(4) shall apply for purposes of this subsection”. Under IRC 6664 as amended, disallowed refundable credits must be taken into account when determining the tax shown on the return and can reduce the tax shown on a return below zero for purposes of calculating the underpayment subject to penalty under IRC 6662 and IRC 6663. Section 209(d)(1) of the PATH Act provides that the amendment is effective for all returns filed after December 18, 2015, and all returns filed on or before December 18, 2015, for which the period of limitations specified in IRC 6501 had not expired as of that date.
- (2) The recommendation to impose the 10-year EITC ban is independent of whether the taxpayer’s reporting results in an underpayment per IRC 6664, on which the civil fraud penalty is based. For a discussion of the civil fraud (and accuracy-related) penalties, see IRM 20.1.5.3..2, Common Features of Accuracy-Related and Civil Fraud Penalties; and IRM 20.1.5.16, IRC 6663, Civil Fraud Penalty.
- (3) Issues that could impact assertion of the fraud penalty, but should not impact consideration of the 10-year EITC ban include:
  - Rand Cases - In Rand v. Commissioner, 141 T.C. 376 (2013), the Tax Court reduced or eliminated application of the accuracy-related and fraud penalty in some cases involving disallowed refundable credits, including the Earned Income Tax Credit. As noted above, section 209(a) of the PATH Act reversed the Tax Court’s decision in Rand. If examiners have questions regarding whether the Rand decision affects imposition of the fraud penalty, please contact local Counsel. For more information relating to these changes, visit the Office of Servicewide Penalties website at: <https://portal.ds.irsnet.gov/sites/vl015/Pages/default.aspx> and consult CC Notice 2014-007 and CC Notice 2016-004.
  - “Frozen Refund” Cases - The Office of Chief Counsel issued written guidance in 2012 in which it provided that: “When a taxpayer claims a refundable credit, such as the EITC, for which he is ineligible and the Service does not pay the taxpayer a refund or approve a carry-forward credit of such tax credit, and there is no other mis-reporting by the taxpayer on the return, this is not a section 6664 “underpayment”. Thus, no civil fraud penalty is appropriate in this situation. The 10-year EITC ban falls under a different Internal Revenue Code section and should, nonetheless, be considered for assertion.”



25.1.6.4  
(06-10-2021)  
**Evidence of Fraud**

- (1) Since direct proof of fraudulent intent is rarely available, fraud must be proven by circumstantial evidence and reasonable inferences. Fraud generally involves one or more of the following elements:
  - Deception
  - Misrepresentation of material facts
  - False or altered documents
  - Evasion (i.e., diversion or omission)
- (2) The courts focus on key badges, also known as indicators, of fraud in determining whether there was an “intent to evade” tax. A determination of fraud is based on the taxpayer’s entire course of conduct, with each badge of fraud given the weight appropriate to a particular case. An evaluation of fraud is based on the weight of the evidence rather than the quantity of the factors. Some of the common “first indicators (or badges) of fraud” include:
  - Understatement of income (e.g., omissions of specific items or entire sources of income, failure to report substantial amounts of income received)
  - Fictitious or improper deductions (e.g., overstatement of deductions, personal items deducted as business expenses)
  - Accounting irregularities (e.g., two sets of books, false entries on documents)
  - Obstructive actions of the taxpayer (e.g., false statements, destruction of records, transfer of assets, failure to cooperate with the examiner, concealment of assets)
  - A consistent pattern over several years of underreporting taxable income
  - Implausible or inconsistent explanations of behavior
  - Engaging in illegal activities (e.g., drug dealing), or attempting to conceal illegal activities
  - Inadequate records
  - Dealing in cash, and
  - Failure to file returns
- (3) The Facts section of the penalty narrative should include a detailed description of all applicable badges of fraud. Additionally the examiner should include other items of deception or instances where the taxpayer may have misled or misrepresented facts to the government.
- (4) A comment regarding consideration of fraud must be documented by all compliance examination field operations employees on cases involving adjustments to taxable income and/or credits resulting in an underpayment of tax due.

25.1.6.5  
(06-10-2021)  
**Collateral Estoppel**

- (1) Examiners and managers should be aware of collateral estoppel and the important impact it can have in civil fraud penalty cases.
- (2) 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. “Collateral estoppel, like the related doctrine of res judicata, has the dual purpose of protecting litigants from the burden of relitigating an identical issue with the same party or his privy and of promoting judicial economy by preventing needless litigation.” (Parklane Hosiery Co. v. Shore, 439 U.S. 322, 326 (1979)). The courts routinely look to the presence of several factors in applying collateral estoppel;

- The issue for which estoppel is being sought must have been necessary in reaching the original decision (see *Parklane* case cited above),
- The party to be estopped had a “full and fair opportunity to litigate” the issue in the original suit (*Montana v. United States*, 440 U.S. 147, 154 (1979)), and
- The issue must have been part of a valid and final judgment. (*Ashe v. Swenson*, 397 U.S. 436, 443 (1970)).

The doctrine of collateral estoppel applies only to the years for which the taxpayer has been convicted. Intent must be established for non-conviction years.

**Note:** Although a taxpayer is collaterally estopped from asserting a defense to the civil fraud penalty, he may still argue the actual tax amount and amount of the underpayment reported in the return due to fraud are incorrect.

- (3) A conviction under IRC 7206(1), False return, does not collaterally estop the taxpayer from asserting a defense to the civil fraud penalty since conviction under IRC 7206(1) does not require proof of fraudulent intent to evade federal income taxes. In these cases, additional development is required to establish the taxpayer’s intent to evade assessment of a tax to be due and owing.

25.1.6.6  
(06-10-2021)  
**Case Closing**

- (1) Monitoring fraud-related activities on AIMS:
  - a. Form 5344, Examination Closing Record, is used to capture the following information in item 38:
    - Enter “F” if criminal prosecution has been successfully concluded,
    - Enter “C” if the 75% fraud penalty was asserted under IRC 6663 or
    - Enter “B” if both apply.
  - b. Form 5599, TE/GE Examined Closing Record, is used by TE/GE to capture the same information in item 38.
- (2) Form 3198, Special Handling Notice, must be used for routing of civil fraud penalty cases. The examiner must identify the applicable penalty code section and computed penalty amount for each tax period on this form and provide any special closing instructions for Centralized Case Processing (CCP) and/or Technical Services.
- (3) Mandatory review by Technical Services:
  - a. Certain civil resolution cases (after the criminal prosecution) require mandatory review by Technical Services prior to closure. This includes:
    - Cases successfully prosecuted under Title 26. See IRM 25.1.6.3 (12) .
    - Cases with tax-related (specifically Examination-related) conditions of probation. IRM 25.1.4.5, Special Conditions of Probation.
    - Cases where restitution is assessable under IRC 6201(a)(4). IRM 25.26.1.3.2.2(1)c, Field Examination Restitution-Based Responsibility.
  - b. These cases will generally include AIMS Freeze Code “P”, Civil Disposition, and/or AIMS Criminal Restitution Code “1”. Refer to IRM 4.8.11.6.1(6) , Responsibilities of Examination for Tax-Related Conditions of Probation and IRM 4.8.11.7.2 , AIMS Criminal Restitution Code.



**Note:** For any cases identified under (a), even if the AIMS Freeze Code “P” or Criminal Restitution Code “1” are not posted on AIMS, the case must still be transferred to Technical Services for mandatory review prior to closure.

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**Exhibit 25.1.6-1 (06-10-2021)**  
**Procedural Decision Guide**

<b>If</b>	<b>Then</b>	<b>Next steps</b>
The FEA concurs with the examiner's fraud narrative and no additional information is required	The FEA will indicate his/her concurrence with the assertion of the civil fraud penalty or fraudulent failure to file penalty on Form 11661 .	A copy of the Form 11661 will be forwarded to the compliance group manager and the original will be returned to the examiner for inclusion in the administrative case file.
The FEA recommends further development	The FEA documents the reason(s) why and notes the required additional steps in the Plan of Action within Form 11661.	Form 11661 is returned to examiner and examiner's group manager.
The compliance group manager disagrees with the FEA's recommendation that the civil fraud penalty should be asserted	The FEA documents and discusses with the examiner and examiner's group manager. The case will be returned to AIMS status code 12.	Ultimately, the final decision on such a case rests with the compliance group manager. <b>Note:</b> For LB&I cases, after discussion with the compliance group manager, the FEA should contact the LB&I Fraud Coordinator for further discussion.
The compliance group manager disagrees with the FEA's recommendation that the penalty should not be asserted	The FEA documents and discusses with the examiner and examiner's group manager. The case will remain in AIMS status code 17.	Ultimately, the final decision on such a case rests with the compliance group manager.

