



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

June 20, 2025

Control Number: SBSE-04-0625-0025

Expiration Date: 06-20-2027

Affected IRM: 4.10.6

MEMORANDUM FOR AREA DIRECTORS, FIELD EXAMINATION

FROM: Heather J. Yocum /s/ *Heather J. Yocum*
Director, Examination Field and Campus Policy

SUBJECT: Procedures for Assessing IRC 6698 and IRC 6699 Penalties

This memorandum issues interim guidance for assessing IRC 6698, *Failure to File Partnership Return*, and IRC 6699, *Failure to File S Corporation Return*, penalties until IRM 4.10.6, *Penalty Considerations*, is published. This memorandum supersedes IGM SBSE-04-0723-0014. Please distribute this information to all affected employees within your organization.

Background: Programming changes allow IRC 6698 and IRC 6699 penalties to be assessed using transaction code (TC) 240, *Assessment of Miscellaneous Civil Penalty*, under the applicable tax module (Master File Tax (MFT) 02 or MFT 06) and tax year. Examiners no longer establish separate controls in Examination Returns Control System (ERCS) for IRC 6698 and IRC 6699 penalties.

Examiners must maintain all documentation (including the penalty lead sheet) associated with the penalty assessment in the electronic case file of the partnership, S corporation, or U.S. Real Estate Mortgage Investment Conduit (REMIC).

Procedural Change: Examiners must assess IRC 6698 and IRC 6699 penalties using partial assessment procedures in Attachment 1 – Interim Guidance, SBSE-04-0625-0025, and guidance in IRM 20.1.2.4.4.1, *Procedures for Assessment or Abatement After 01/01/2022*, and IRM 20.1.2.6.4.1, *Procedures for Assessment or Abatement After 01/01/2022*.

Effect on Other Documents: This guidance will be incorporated into IRM 4.10.6, *Penalty Considerations*, by a date not to exceed two years from the date of this memorandum.

Contact: Ronald Zarriello, Program Manager, Examination Field and Campus Policy, Field Examination General Processes.

Attachment 1 – Interim Guidance

Distribution: IRS.gov

Attachment 1 – Interim Guidance: SBSE-04-0625-0025

The following changes are hereby effective as of the date of this memorandum for IRM 4.10.6.X.

4.10.6.X

IRC 6698 and IRC 6699 Penalty Overview

(1) Generally, failure to file penalties under IRC 6698, *Failure to File Partnership Return*, and IRC 6699, *Failure to File S Corporation Return*, are assessed by Field Examination when:

- A substitute for return (SFR) transaction code (TC) 150, *Return Filed & Tax Liability Assessed*, is posted on the module and the case is closed agreed or unagreed without securing a return (see IRM 4.12.1.8.4, *Substitute for Return*, and IRM 4.4.9.5, *SFR*, for additional guidance);
- A substitute for return (SFR) TC 150 is posted on the module and a delinquent Form 1065, *U.S. Return of Partnership Income*; Form 1066, *U.S. Real Estate Mortgage Investment Conduit (REMIC) Income Tax Return*; or Form 1120-S, *U.S. Income Tax Return for an S Corporation*, is secured by the examiner during an audit (see IRM 4.4.9.6, *Delinquent Return Received After SFR TC 150 Posted at MF*, for guidance on processing the return);

Note: If a delinquent return is secured and there's no TC 150 on the module, the examiner must process the return following the procedures in IRM 4.4.9.4, *Delinquent Return Secured – No TC 150 Posted*.

- The statute of limitations hasn't expired prior to assessment of the penalty, for late filed returns. See IRM 20.1.2.2.8, *Restrictions on Assertions*;

Note: There is no statute of limitations for assessing any penalty for filing late when a return has not been filed by the taxpayer.

- The correct penalty amount wasn't assessed when the delinquent Form 1065, Form 1066, or Form 1120-S return was processed;
- The taxpayer doesn't meet the criteria in Notice 2022-36, *Penalty Relief for Certain Taxpayers Filing Returns for Taxable Years 2019 and 2020*; or

Note: Relief under Notice 2022-36 doesn't apply to returns filed after September 30, 2022.

- Reasonable cause (see IRM 4.10.6.X.1(2)) and first time abate (FTA) (see IRM 4.10.6.X.1(3)) relief aren't applicable.

4.10.6.X.1

IRC 6698 and IRC 6699 Penalty Consideration

(1) Prior to asserting an IRC 6698 or IRC 6699 penalty, the examiner must verify the penalty wasn't previously assessed by researching either BMFOLT or TXMODA. See IRM 20.1.2.4.1(4) & (5), *Assertion Criteria*, and IRM 20.1.2.6.1(4) & (5), *Assertion Criteria*, for applicable transaction codes and penalty reference numbers (PRN).

(2) IRC 6698 and IRC 6699 penalties are subject to reasonable cause relief. The examiner must consider if the taxpayer meets the reasonable cause relief provision prior to assessing IRC 6698 and IRC 6699 penalties. See IRM 20.1.1.3.2, *Reasonable Cause*; IRM 20.1.2.4.3, *Penalty Relief*; IRM 20.1.2.6.3, *Penalty Relief*; and IRM 20.1.2.4.3.1, *Revenue Procedure 84-35*, for additional guidance. If the taxpayer qualifies for reasonable cause relief, the examiner must take the following steps when closing the case:

- a. On Form 5344, *Examination Closing Record*, Item 2, *Penalty Reason Code*, include the appropriate penalty reason code (PRC) from the first table in Exhibit 20.1.1-2, *Penalty Reason Code Chart*.
- b. On Form 3198, *Special Handling Notice for Examination Case Processing*, check *Other Instructions* and include: "Taxpayer met criteria for reasonable cause relief. Enter PRC from Item 2 of Form 5344."

(3) IRC 6698(a)(1) and IRC 6699(a)(1) penalties are subject to first time abate relief. The examiner must consider if the taxpayer meets the FTA relief provision prior to assessing IRC 6698(a)(1) and IRC 6699(a)(1) penalties, and if FTA relief is applicable, follow all procedures in IRM 20.1.1.3.3.2.1, *First Time Abate (FTA)*, and IRM 20.1.1.5.1, *Master File Penalty Reason Codes*. If the taxpayer qualifies for FTA relief, the examiner must take the following steps when closing the case:

- a. On Form 5344, Item 2, *Penalty Reason Code*, include either PRC 018 or 020; see IRM 20.1.1.3.3.2.1(15), for guidance on which PRC to use.
- b. On Form 3198 check *Other Instructions* and include: "Taxpayer met criteria for first time abate. PRC (enter PRC from Item 2 of Form 5344)."

(4) The examiner must document consideration of IRC 6698 and IRC 6699 penalties, including assertion or non-assertion, on *Lead Sheet 300-01, Civil Penalty and Approval Form (LS 300-01)*. See IRM 4.10.9.8.6, *Workpapers: Documenting Penalties*.

Reminder: When asserting an IRC 6698 or IRC 6699 penalty, the examiner must create a "New Issue" in the partnership's or S corporation's electronic case file and use the generic lead sheet to create a penalty issue lead sheet. See Documenting Penalties - Creating a Penalty Issue; IRM 4.10.15.8.9.1, *Issue Types*; IRM 4.10.15.8.10(2), *Workpapers/Adjustments – Penalties*; and IRM 4.10.9.7.2, *Issue Lead Sheets*.

Reminder: Examiners no longer establish separate controls in Examination Returns Control System (ERCS) for IRC 6698 and IRC 6699 penalties.

4.10.6.X.2

IRC 6698 and IRC 6699 Supervisory Approval

(1) IRC 6698 and IRC 6699 penalties must be approved (in writing) by the immediate supervisor of the individual making the initial determination or such higher level official as the Secretary may designate, dated, and retained in the case file. See IRM 20.1.1.2.3, *Approval Prerequisite to Penalty Assessments*.

(2) Generally, written supervisory approval is documented on the Civil Penalty Approval Form (Tab 2 within Lead Sheet 300-01), with the applicable penalty listed in the Primary Position section:

- IRC 6698, *Failure to File Partnership Return*, or
- IRC 6699, *Failure to File S Corporation Return*.

(3) The examiner must save the signed Civil Penalty Approval Form in RGS Office Documents (OD) and ensure the file is named correctly (e.g., 300-01.02 – 6698 Penalty Approval). See RGS File Naming Conventions Job Aid.

4.10.6.X.3

IRC 6698 and IRC 6699 Penalty Computation

(1) The examiner should compute the penalty using the Penalty Computation Tool. See IRM 20.1.2.4.2, *Penalty Computation*, and IRM 20.1.2.6.2, *Penalty Computation*.

(2) The examiner should save the penalty explanation in the Penalty Computation Tool as a PDF in the RGS OD folder and ensure the file is named correctly with the appropriate reference code and descriptive name (e.g., 501-02 – 6698 Penalty Computation). See RGS File Naming Conventions Job Aid.

(3) Once the penalty amount is computed, the examiner must use partial assessment procedures to assess the penalty. See IRM 4.10.6.X.4, *IRC 6698 and IRC 6699 Penalty Assessment*, and IRM 4.10.6.X.4.1, *IRC 6698 and IRC 6699 Partial Assessment Package*.

4.10.6.X.4

IRC 6698 and IRC 6699 Penalty Assessment

(1) IRC 6698 and IRC 6699 penalties are processed as partial assessments under the applicable tax module (Master File Tax (MFT) 02 or MFT 06) and tax year.

Note: IRC 6698 and IRC 6699 penalties have post-assessment appeal rights. See 4.10.6.X.6, *IRC 6698 and IRC 6699 Post-Assessment Appeal Rights*.

(2) The examiner must use Form 5344 to make the penalty assessment. When the assessment posts, it will be reflected as a TC 240 on the entity's tax module.

4.10.6.X.4.1

IRC 6698 and IRC 6699 Partial Assessment Package

(1) To submit a partial assessment for IRC 6698 or IRC 6699 penalties, the examiner must download and manually complete Form 5344 and Form 3198 following the procedures outlined in the *Job Aid - IRC 6698 & IRC 6699 Partial Assessment*.

Caution: Using RGS to generate Form 5344 or Form 3198 may cause erroneous codes to be included on the forms resulting in a rejected partial assessment or the taxpayer not receiving required notices under IRC 6303(a), *Notice and demand for tax*.

(2) The examiner must e-Fax Form 5344 and Form 3198 to Memphis CCP at 855-235-6795, noting in the subject line of the e-Fax cover sheet "Partial Assessment – IRC 66XX."

(3) Integrated Data Retrieval System (IDRS) should be monitored to ensure the penalty is properly assessed (TC 240).

(4) Once the partial assessment is processed, the examiner must save the acknowledged Form 5344 received from CCP in RGS Case File Documents (CFD) and ensure the file is named correctly (e.g., CLOSING – F5344 6698 Partial Assessment). See RGS File Naming Conventions Job Aid.

Caution: The case **cannot** close from the group prior to the IRC 6698 or IRC 6699 penalty posting to the tax module (MFT 02 or MFT 06). Therefore, the examiner should assess the applicable penalty as early in the examination as possible.

4.10.6.X.5

IRC 6698 and IRC 6699 Taxpayer Notification

(1) IRC 6751(a), *Computation of penalty included in notice*, requires each penalty notice to include the name of the penalty, applicable IRC section, and a computation of the penalty. IRC 6303(a) requires the IRS to give taxpayers notice of the amount due and demand payment within 60 days of assessment. Notice CP 162A, *Failure to File Form 1065, 1066 or 1120S*, and Notice CP 162B, *Failure to File Penalty/Missing Information Penalty*, provides the information required by IRC 6751(a) and IRC 6303(a) (See IRM 4.10.6.X.5(4) regarding issuance of these notices).

Caution: The examiner must verify the appropriate CP 162 notice was issued to the taxpayer prior to closing the case.

(2) Letter 6580, *IRC 6698 Penalty Notification*, and Letter 6581, *IRC 6699 Penalty Notification*, provides the taxpayer with the penalty information and the appeal rights

information.

(3) When the partial assessment is submitted to CCP, the examiner must issue Letter 6580 for IRC 6698 penalties or Letter 6581 for IRC 6699 penalties to the taxpayer, and include a copy of Pub 5, *Your Appeal Rights and How to Prepare a Protest if You Disagree*. When applicable, the examiner must also send a copy of the letter to the taxpayer's representative.

Note: The taxpayer should be given 14 days to respond to Letter 6580 or Letter 6581. If the taxpayer does not respond within the specified time, the examiner should close the case following the procedures in IRM 4.31.5.15, *Pass-through Entity Case Closing Procedures*, and IRM 4.31.9.11, *Case Disposition Procedures*.

(4) Examiners should advise taxpayers of the following:

- After the assessment is made, they will receive a systemically generated notice labeled Notice CP 162A or CP 162B (top right-hand corner) demanding payment. Generally, the taxpayers will have 8 weeks to pay the penalty in full.
- If the taxpayer does not pay the penalty in full, they will receive a notice of intent to levy labeled Notice CP 504B, *Business (BMF) Final Notice - Notice of Intent to Seize (Levy) Your Property or Rights to Property*, (top right-hand corner) and their case will then be sent to Collection.

4.10.6.X.6

IRC 6698 and IRC 6699 Post-Assessment Appeal Rights

(1) The taxpayer has post-assessment appeal rights for IRC 6698 and IRC 6699 penalties. After the penalty is assessed and the taxpayer receives notification (see IRM 4.10.6.X.5, *IRC 6698 and IRC 6699 Taxpayer Notification*), the taxpayer has an opportunity to:

- Pay the penalty in full, or
- Submit a formal written protest requesting a conference with the Independent Office of Appeals (Appeals) to challenge the examiner's findings.

(2) For additional guidance on IRC 6698 and IRC 6699 post-assessment appeal rights, see IRM 20.1.2.4.1(3) and IRM 20.1.2.6.4.1(3).

4.10.6.X.7

IRC 6698 and IRC 6699 Protested Penalties

(1) Prior to closing the case, the examiner must determine if the taxpayer will protest the IRC 6698 or IRC 6699 penalty. If the taxpayer intends to protest the penalty, the examiner must ensure the taxpayer submits a formal written protest. The examiner must document all actions on Form 9984, *Examining Officer's Activity Record*.

Note: The taxpayer may submit one protest for all unagreed issues, including the IRC 6698 or IRC 6699 penalty, even though it is not included on the audit report.

(2) Once the formal written protest is received, the examiner must determine if the protest is adequate. See Pub 5 for additional guidance regarding the adequacy of a formal written protest.

(3) Since the IRC 6698 or IRC 6699 penalty is not included on the audit report, the examiner must notate the following:

Form/Check Sheet	Action
Form 3198	Under Forward to Technical Services, check <i>Unagreed to Appeals</i>
Form 3198	Under Forward to Technical Services, check <i>Other</i> and include: "Protested IRC 66XX penalty in the amount of \$XXXX.XX. STAUP input on MM/DD/YYYY and expires on MM/DD/YYYY."
Electronic Case Receipt Check Sheet	Under Most Significant Issue and Dollar Amount, include: "Protested IRC 66XX penalty in the amount of \$XXXX.XX. STAUP input on MM/DD/YYYY and expires on MM/DD/YYYY."

This ensures Appeals is aware the taxpayer protested the IRC 6698 or IRC 6699 penalty and when the STAUP will expire. See IRM 4.10.6.X.8, *Pausing Notices and Collection Action for Appealed IRC 6698 and IRC 6699 Penalties*, for information on STAUP input.

Note: Appealed IRC 6698 and IRC 6699 cases are closed to Technical Services in Status 21.

4.10.6.X.8

Pausing Notices and Collection Action for Appealed IRC 6698 and IRC 6699 Penalties

(1) Examiners are responsible for ensuring a CC STAUP is input to prevent the issuance of collection notices/actions (e.g., Notice CP 504B and subsequent collection action(s)). See IRM 4.10.6.X.5(4)) when IRC 6698 and IRC 6699 penalties are appealed.

Caution: STAUP should not be input unless an adequate protest is received and the assessment (TC 240) has posted to TXMODA or BMFOLT. Inputting STAUP prior to the TC 240 date will pause the issuance of the notice and demand (e.g., Notice CP 162A, CP 162B, etc.), preventing the IRS from meeting the notice and demand requirements as prescribed in IRC 6303(a).

(2) Examiners should follow procedures in IRM 4.20.1.5, *Procedures for Suspension*

of Collection Actions, to have STAUP input.

(3) The examiner must monitor the STAUP using the following fields on TXMODA:

- Maximum Number of Cycles Delay (27) – Identifies the maximum number of cycles a notice can be delayed, and
- Balance of Cycles Delay (28) – Identifies the balance of cycles left that can be delayed.

(4) The examiner should extend the STAUP if either situation below exists:

- The case is in-process and the STAUP expires within 4 cycles (weeks).
- The audit is complete and the STAUP expires within 8 cycles (weeks) when closed from the group to Technical Services or Appeals.

Note: CCP has 20 days to input Form 3177 (see Exam Alerts #016, *Miscellaneous Information Data Retrieval System (IDRS) Inputs*). It is the examiner's responsibility to timely submit Form 3177 to CCP to ensure the STAUP does not expire.

(5) Generally, once the STAUP expires, all subsequent notices and/or collection action will resume.