



MANUAL TRANSMITTAL

Department of the Treasury
Internal Revenue Service

4.25.7

SEPTEMBER 4, 2024

EFFECTIVE DATE

(09-04-2024)

PURPOSE

- (1) This transmits revised IRM 4.25.7, Estate and Gift Tax, Estate and Gift Tax Penalty and Fraud Procedures.

MATERIAL CHANGES

- (1) IRM 4.25.7.1.5 bullets were deleted and condensed references.
- (2) IRM 4.25.7.2 paragraph (8) was deleted.
- (3) IRM 4.25.7.2 paragraph (9) was deleted.
- (4) IRM 4.25.7.4(1) added IRC 6695 link.
- (5) IRM 4.25.7.4(6) changed “completed in group” to “closed from group”.
- (6) IRM 4.25.7.4(23)(f) The words “group secretary” were changed to the broader term “administrative staff”.
- (7) IRM 4.25.7.5 bullet list was condensed.
- (8) The second sentence in IRM 4.25.7.6.1 paragraph (4) was deleted.
- (9) IRM 4.25.7.6.1 paragraph (5) was deleted. The information is contained in IRM 4.11.55.5.
- (10) IRM 4.25.7.6.2 paragraph (3) was deleted. The information is contained in IRM 4.11.55.5
- (11) IRM 4.25.7.6.2 paragraph (4) was deleted. The information is contained in IRM 4.11.55.5
- (12) IRM 4.25.7.6.2 paragraph (5) was deleted. The information is contained in IRM 4.11.55.5
- (13) IRM 4.25.7.6.2 paragraph (6) was deleted. The information is contained in IRM 4.11.55.5
- (14) IRM 4.25.7.7.1 paragraph (4) was deleted. The information is contained in IRM 25.1.1.4.
- (15) IRM 4.25.7.7.1 paragraph (5) was deleted. The information is contained in IRM 25.1.1.4.
- (16) IRM 4.25.7.7.1 paragraph (6) was deleted. The information is contained in IRM 25.1.1.4.
- (17) IRM 4.25.7.7.1 paragraph (7) was deleted. The information is contained in IRM 25.1.1.4.
- (18) IRM 4.25.7.7.1 paragraph (8) was deleted. The information is contained in IRM 25.1.1.4.
- (19) IRM 4.25.7.7.1 paragraph (9) was deleted. The information is contained in IRM 25.1.1.4.
- (20) IRM 4.25.7.7.2 paragraph (2) was deleted.
- (21) IRM 4.25.7.7.3.1 paragraph (2) was deleted. The information is contained in IRM 25.1.3.
- (22) IRM 4.25.7.7.3.1 paragraph (3) was deleted. The information is contained in IRM 25.1.3.
- (23) IRM 4.25.7.7.3.1 paragraph (4) was deleted. The information is contained in IRM 25.1.3.

- (24) IRM 4.25.7.7.3.1 paragraph (5) was deleted. The information is contained in IRM 25.1.3.
- (25) IRM 4.25.7.7.3.1 paragraph (6) was deleted. The information is contained in IRM 25.1.3.
- (26) IRM 4.25.7.7.3.1 paragraph (7) was deleted. The information is contained in IRM 25.1.3.
- (27) IRM 4.25.7.7.3.1 paragraph (8) was deleted. The information is contained in IRM 25.1.3.
- (28) IRM 4.25.7.7.4.1 paragraph (1) was deleted. The information is contained in IRM 20.1.2.3.7.5
- (29) IRM 4.25.7.7.4.1 paragraph (2) was deleted. The information is contained in IRM 20.1.2.3.7.5
- (30) IRM 4.25.7.7.4.1 paragraph (3) was deleted. The information is contained in IRM 20.1.2.3.7.5
- (31) IRM 4.25.7.8(1) paragraph (a) was deleted.
- (32) IRM 4.25.7.8(1) paragraph (b) was deleted and added to IRM 4.25.7.8.1.
- (33) Editorial changes have been made throughout this IRM. Website addresses, legal references, and IRM references were reviewed and updated as necessary.

EFFECT ON OTHER DOCUMENTS

IRM 4.25.7 dated June 14, 2021 is superseded.

AUDIENCE

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4.25.7

Estate and Gift Tax Penalty and Fraud Procedures

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4.25.7.1
(07-23-2018)
Program Scope and Objectives

- (1) **General Overview** - This IRM provides information about estate and gift related penalties and procedures.
- (2) **Purpose** - This IRM explains Estate and Gift penalty analysis and assessment responsibilities so that managers, senior-level officials and estate, gift and generation-skipping transfer tax return examiners will be better equipped to prepare and submit accurate and appropriate penalty assessments.
- (3) **Audience** - This IRM is for Estate and Gift Specialty Tax managers, examiners and personnel at the campus who process estate, gift and generation-skipping transfer tax returns, refunds and claims.
- (4) **Policy Owner** - Director, Examination - Specialty Policy is responsible for the administration, procedures and updates related to the technical guidance and information processing steps and methods specific to Estate and Gift Tax examiner responsibilities, IRM subsections, and forms created for the examination of returns and claims.
- (5) **Program Owner** - Director, Examination - Specialty Examination owns Estate and Gift Tax Examination.
- (6) **Primary Stakeholders** - Advisory Collections, Appeals, Counsel, Estate and Gift Tax Workload Selection and Delivery (WSD), Specialty Examination, and SB/SE Examination Quality & Technical Support are the primary stakeholders for this IRM.

4.25.7.1.1
(07-23-2018)
Background

- (1) This section provides policies and procedures relating to estate and gift tax program specific penalty analysis, managerial approval, assessment and abatement.

4.25.7.1.2
(06-14-2021)
Authority

- (1) Every function in the IRS has a role in proper penalty administration. It is essential that each function conducts its operations with an emphasis on promoting voluntary compliance. Appropriate business reviews should be conducted to ensure consistency with Policy Statement 20-1. IRM 1.2.1.12.1, Policy Statement 20-1 (Formerly P-1-18), provides guidance relating to the use of penalties to encourage voluntary compliance.
- (2) Estate and gift tax examiners and managers assigned to examine and oversee the examination of estate and gift tax returns and issues are responsible for complying with servicewide policies and authorities set forth in IRM 1.2.1.5, Policy Statements for the Examining Process.
- (3) Examination of estate and gift tax returns should be conducted in a manner that will promote public confidence as stated in the Mission of the IRS. See IRM 1.2.1.2.1, Policy Statement 1-1, Mission of the IRS.
- (4) Section 3504 of P.L. 106-206 requires the IRS to include an explanation of the examination and collection process, as well as information about assistance from the Taxpayer Advocate with any first report/notice of proposed deficiency. Pub 3498, The Examination Process, will be used for this purpose.
- (5) The following Internal Revenue Code sections authorize the penalties most frequently assessed and abated by Estate and Gift tax examiners:
 - IRC 6651, Failure to File and Failure to Pay Penalty

- IRC 6694, Understatement of Taxpayer's Liability by Tax Return Preparer
- IRC 6695, Other Assessable Penalties With Respect to the Preparation of Tax Returns for Other Persons
- IRC 6701, Penalties for Aiding and Abetting Understatement of Tax Liability
- IRC 6713, Disclosure or Use of Information by Preparers of Returns
- IRC 6721, Failure to File Correct Information Returns
- IRC 6722, Failure to Furnish Correct Payee Statements
- IRC 6723, Failure to Comply with other Information Reporting Requirements

4.25.7.1.3 (07-16-2020)

Program Objectives and Review

- (1) The National Quality Review System (NQRS) is a web-based review system used by Estate and Gift Tax Policy, Estate and Gift Tax Examination Management and Estate and Gift Tax Quality Measures and Analysis (QMA) to generate and review reports analyzing national quality performance based upon standardized quality attributes set forth in Document 12499, Estate and Gift Tax Examination Embedded Quality Job Aid. NQRS report data is compiled by QMA on a quarterly basis, but **ad hoc** reports may be obtained monthly. The use of NQRS is explained in additional detail in IRM 4.25.1.11, Manager Embedded Quality Review and Specialty Exam National Embedded Quality Review Programs.
- (2) Operational Reviews and related NQRS reports are conducted by Territory Managers and the Chief of Estate and Gift to measure national adherence to quality standards and managerial performance and/or oversight.
- (3) Customer (i.e. taxpayer) satisfaction reports are generated by SB/SE Operation Support Research on a quarterly basis. These reports provide masked taxpayer narratives that are responsive to a pre-defined set of survey questions. The quarterly survey reports are to be used to identify areas for examination quality improvement.
- (4) Frequent Front-line manager reviews are conducted under the Examination Quality Review System (EQRS), with the frequency based on annual personnel requirements.

4.25.7.1.4 (07-16-2020)

Terms/Definitions/ Acronyms

- (1) The following table sets forth acronyms used in this IRM:

Term	Acronym
Criminal Investigation	CI
Document Locator Number	DLN
Estate and Gift Tax Embedded Quality Review System	EQRS or EQ
Estate and Gift Tax Exam Process and Documentation	EPD
Estate and Gift Tax Notebook Job Aid	Notebook
Failure to File Penalty	FTF

Term	Acronym
Failure to Pay Penalty	FTP
Fraud Technical Advisor	FTA
Generation-Skipping Transfer Tax	GSTT
Issue Management System	IMS
National Quality Review System (NQRS)	NQRS or NQ
Office of Professional Responsibility	OPR
Plan to Close Meeting	PTC
Source Code	SC
Special Agent	SA
Special Agent in Charge (CI)	SAC
Supervisory Special Agent	SSA
Substitute for a Return	SFR
Return Preparer Coordinator	RPC
Workload Selection and Delivery	WSD

4.25.7.1.5
(09-04-2024)

Related Resources

- (1) The Estate and Gift Tax program is required to follow all servicewide examination procedures and those set forth in SB/SE examining process IRM. The following IRM subsections provide additional information relating to the processing, classification and examination of Estate and Gift Tax program returns and claims:
 - IRM 4.25.1 through 4.25.14
 - IRM 4.10.8, Examining Process, Examination of Returns, Report Writing
 - IRM 4.10.6, Examining Process, Examination of Returns, Penalty Considerations
 - IRM 20.1, Penalty Handbook
- (2) Document 12499, Estate and Gift Tax Examination Embedded Quality Job Aid, is issued by Estate and Gift Tax Policy, and is relied upon for the application and interpretation of the quality attributes. The job aid includes complete instructions, definitions, and examples of how cases should be evaluated.
- (3) The *Penalties Knowledge Management Base* is owned and maintained by the Office of Servicewide Penalties, and provides guidance, resources and information for all employees that consider the assessment and/or abatement of civil penalties.

4.25.7.2
(07-16-2020)

**Assessing or Abating
Penalties in Estate and
Gift Tax Cases**

- (1) Consider the applicability and non-applicability of penalties in every case and document consideration of penalties whenever an examination adjustment results in a deficiency. The case file workpapers should contain fully developed facts supporting the application or non-application of penalties. A consideration of penalties should be made any time an adjustment that results in a deficiency is made to the return. Any penalty consideration will be made based on the merits of that particular issue, i.e., the imposition of the penalty provision will not be the subject of bargaining in order to achieve agreement on the case. Documentation should include the procedures used, information obtained, and conclusions reached in deciding whether to recommend applicable penalties. Penalties should not be asserted without an explanation. See Commissioner's Policy Statement 20-1, IRM 1.2.1.12.1. See also, IRM 20.1.1.2, Purpose of Penalties
- (2) Any assertion of a penalty must be reflected in the workpapers, report recommendations, and on the Form 3198, Special Handling Notice for Examination Case Processing. Document the consideration, assertion, or non-assertion and computation of all applicable penalties using the case specific mandatory lead sheet, and applicable worksheets, or lead sheets.
- (3) The examiner should verify the case transcripts to determine whether the service center assessed or abated penalties prior to an examination of the return. The amount and applicability of previously assessed penalties should be verified by the examiner using the Estate and Gift Notebook Job Aid (Notebook) as the amount of the applicable penalty may change as a result of recommended adjustments. See IRM 4.25.6, Report Writing Guide for Estate and Gift Tax Examinations.
- (4) If a case is in Status 10 (assigned but not yet opened by an examiner) or Status 12 (opened by an examiner), any request for penalty abatement must be handled by the examiner to whom the case is assigned.
 - a. If the request is submitted to Estate and Gift Operations at the Campus (Campus), a secure mail notification of the abatement request will be transmitted to the field group manager responsible for such case.
 - b. Even if there are no other issues, the case cannot be surveyed after assignment. It must be made the subject of an examination, limited to the penalty abatement request.
 - c. Under no circumstances will a request be made by the examiner to the Campus for consideration of the penalty for returns assigned to the field.
 - d. Conversely, if a case is no longer assigned to a field group, then any request for abatement must be referred to the Supervisory Attorney, Estate and Gift Tax (Campus) for consideration.
 - e. The taxpayer may agree to the tax adjustment, but may not agree to the penalty adjustment. In situations where the taxpayer does not agree to the penalty adjustment the examiner should follow the appropriate 30-day or 90-day unagreed procedures set forth in IRM 4.25.10, Case Closing Procedures.
- (5) If a case has been assigned to a group (Status 10) and not yet to an examiner, the group manager will assign the case if a request for abatement of any penalty is in the file or is received to associate with the file.
- (6) If a return is selected for examination, the examiner will determine whether or not to reassert a penalty if:

- a. The Campus clearly erred as a matter of law in its decision to abate a penalty, or
- b. The fact situation was not as represented to the Campus.

Note: In the interest of taxpayer relations, care should be taken to ensure that either (a) or (b) applies before reversing the decision of the Campus.

(7) Penalties should be verified or calculated in Notebook. See IRM 4.25.6.

- a. There are rules for computing the amount of the underpayment for the accuracy-related and fraud penalties. Under the computational method explained in IRM 4.25.6, Notebook will calculate the portion of an underpayment subject to the current penalty and tax rates.

(8) When submitting cases for closure, (including substitute for return and non-filer project cases) verify that all appropriate penalties have been considered, correctly assessed, and documented in the case file and on case closing documents.

- a. The Form 3198 should clearly indicate any determination to not assess penalties or to abate previously assessed penalties. This is particularly necessary when penalties might otherwise be automatically assessed. For example, an examiner should include a written statement at the bottom indicating that the decision not to assess a Failure to Pay penalty on substitute for return or non-filer project cases was intentional. If appropriate, provide additional instructions on Form 3198. This will help avoid the inadvertent assessment of penalties that later require the Field to contact the Campus to remove or abate penalties.
- b. For additional case closing procedures including, issues regarding penalties, refer to IRM 4.25.10, Case Closing Procedures.

4.25.7.2.1
(07-16-2020)
Reasonable Cause

- (1) While not all penalty abatement is based on reasonable cause, it is a commonly raised defense in estate and gift tax cases. The taxpayer may raise several other defenses to the assertion of penalties including, but not limited to statutory and regulatory exceptions, administrative waivers, or corrections of Service error. See IRM 20.1.1.3.3.1, Statutory and Regulatory Exceptions, IRM 20.1.1.3.3.2, Administrative Waivers, and IRM 20.1.1.3.4, Corrections of Service Error for additional information. Examiners may use the Reasonable Cause Lead Sheet to document their analysis of the reasonable cause defense.
- (2) Reliance on a preparer's advice may satisfy the IRC 6664(c) reasonable cause exception to any accuracy-related penalty. See 26 CFR 1.664-4(c). Advice includes any communication setting forth an analysis or conclusion by a person other than the taxpayer, and on which the taxpayer relied in preparing the return. Advice does not have to be in any particular form. The reasonable cause and good faith exception may be satisfied if the taxpayer reasonably relied on advice that was based upon an objectively reasonable, factual or legal assumption. The Penalty Handbook provides additional information relating to a finding of reasonable cause. See IRM 20.1.5.7.1, Reasonable Cause and IRM 20.1.1.3.2, Reasonable Cause.
 - a. In addition, the taxpayer's representation of reasonable cause or justification must be reflected in written format, preferably given under the

penalty of perjury. If a taxpayer makes an oral or unsigned request for penalty relief, see IRM 20.1.1.3.1, Unsigned or Oral Requests for Penalty Relief.

- (3) Reasonable cause criteria include but are not limited to the following:
 - a. Unavoidable postal delays (See IRC 7502)
 - b. The taxpayer's timely filing of a return with the wrong IRS office (See IRC 6091)
 - c. The taxpayer's reliance on the erroneous advice of an IRS officer or employee
 - d. The death or serious illness of the taxpayer (executor) or a member of his immediate family. See *United States v. Boyle*, 469 U.S. 241 (1985)
 - e. The taxpayer's unavoidable absence
 - f. Destruction by casualty of the taxpayer's records or place of business
 - g. Failure of the IRS to furnish the taxpayer with the necessary forms in a timely fashion
 - h. The inability of an IRS representative to meet with the taxpayer when the taxpayer makes a timely visit to an IRS office in an attempt to secure information or aid in preparation of a return
- (4) When penalties are not asserted due to reliance on a third party, the examiner should document the case file by updating their workpapers or the Reasonable Cause Lead Sheet with the additional facts, analysis, and conclusions reached regarding the reasonable cause exception.
 - a. If an accuracy-related penalty is not asserted due to reliance on advice, the penalty workpapers in the case file must document that the advisor was contacted to confirm that the advice was provided and that the standard for the reasonable cause exception was met. See IRM 20.1.5.7, Penalty Relief and IRM 20.1.1.3.2, Reasonable Cause.
 - b. If the preparer of the return was not the person who prepared or provided the advice, contact with both individuals may be necessary.

4.25.7.3
(07-16-2020)
**Immediate Supervisor
Approval for
Assessment of Penalties**

- (1) IRC 6751(b), Approval of Assessment states, in general, that no penalty under the IRC shall be assessed unless the **initial** determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination or such higher level official as the Secretary may designate. See IRM 20.1.1.2.3, Approval Prerequisite to Penalty Assessments and IRM 20.1.1.2.3.1, Timing of Supervisory Approval. The examiner should also document all managerial involvement regarding penalties in the Form 9984, Case Activity Record. See IRM 4.10.9.8.6.2, Penalties: Supervisory Approval.

4.25.7.4
(09-04-2024)
**Return Preparer
Penalties**

- (1) The purpose of proposing and assessing penalties on return preparers, pursuant to IRC 6694 and IRC 6695, is to increase voluntary compliance. When examining a return prepared by a tax return preparer, it is an examiner's responsibility to ensure that the identification and conduct provisions of the Code are followed. If the provisions are not followed, it is the examiner's responsibility to assert the penalties. During every examination, examiners should determine whether return preparer violations exist. This determination will be made based on oral testimony or statements and/or written evidence during the examination process.

- (2) IRM 20.1.6, Preparer and Promoter Penalties, provides servicewide policy and procedures for the administration of return preparer penalties, promoter penalties, and material advisor penalties.
- (3) Prior to pursuing the return preparer penalty or penalties, examiners must obtain the immediate supervisor's approval and engage in a Workload Selection and Delivery (WSD) Appraiser/Return Preparer Coordinator consultation. The contact information is available on the Estate and Gift Tax intranet page.
- (4) Return preparer case referrals are also routed to examiners through WSD. See IRM 4.25.3.10.2.8, Return Preparer Referrals, for an explanation of the WSD Return Preparer Coordinator's role and responsibilities.
- (5) Statute of Limitations: The statute of limitations on assessment for IRC 6694(a) and IRC 6695 expires three years from the date the related return or claim for refund was filed. See IRC 6696(d). See IRM 20.1.12.4, Statute of Limitations and IRM 20.1.6.18, Statute of Limitations.
 - There is no statute of limitations on assessment for IRC 6694(b), IRC 6700, and IRC 6701 penalties.
 - There is no statute of limitations on actions to enjoin preparers or promoters under IRC 7407 or IRC 7408.

Note: Extending the statute on a taxpayer's return with a Form 872, Consent to Extend the Time to Assess Tax, does not extend the statute for the return preparer penalty case. See Form 872-D, Consent to Extend the Time on Assessment of Tax Return Preparer Penalty.

- (6) No return preparer penalty will be proposed until the estate or gift tax examination is closed at the group level. If the estate or gift tax case is unagreed, the examiner may pursue the preparer penalty after the unagreed estate or gift tax case is submitted at the group level. The determination and settlement of the estate or gift tax examination will always proceed without regard to the return preparer penalty issue.

Note: The requirement that the underlying estate or gift tax case be closed may affect the decision whether to initiate a return preparer investigation. Also, note that IRC 6694(d) provides that the IRC 6694 penalty must be abated where there is a final administrative determination or final judicial determination that there was no understatement of liability.

- (7) Each estate or gift tax examination is **separate and distinct from the return preparer penalty case** relating to the estate or gift tax examination. Examiners will not propose or discuss conduct or identification penalties in the presence of the taxpayer.
- (8) A comprehensive interview with the taxpayer during the underlying examination is the method used to identify misconduct by a tax return preparer. During the interview process, the examiner should pose questions to the taxpayer regarding the return preparation to assist in determining whether a preparer penalty is applicable. The pursuit of a return preparer penalty should not be specifically discussed in the presence of the taxpayer. Some examples of questions are listed below:
 - Did you meet with the preparer?

- Did you complete a questionnaire and/or have a face-to-face meeting with the preparer?
 - What documentation was provided to the preparer?
 - Did you receive a copy of the prepared return?
 - Was the preparer compensated?
- (9) While examiners are required to ask basic interview questions, crucial information may be provided in the responses to the follow-up questions. The questions that the examiner asks of the preparer are important to determine if any misconduct transpired during the return preparation. If the preparer is also the representative, the examiner should ask follow up questions about:
- What was discussed in your interview with the taxpayer?
 - What documentation was provided to prepare the return?
 - What authorities were relied upon?
 - Was a copy of the return provided to the taxpayer?
 - Are you aware of any errors, omissions or mistakes on the return under examination?
 - Were you compensated?
- (10) Representatives will often review the return and the taxpayer client's records prior to the interview. If there is an error, they will probably know in advance. While representatives are not required to disclose the error, they may reveal the information to establish their credibility. As you continue to work your case, the extent of the representative's knowledge will become apparent.
- (11) While it is not appropriate to discuss a preparer penalty issue with the taxpayer, the interview with the taxpayer may help to establish a factual background used in developing a separate preparer penalty case. When interviewing the taxpayer or preparer ask if any other services have been provided by the preparer's firm and how long the preparer has been preparing returns for the taxpayer. These questions will give the examiner an idea of the extent of the preparer's knowledge regarding the taxpayer's financial situation/status and alert the examiner as to the applicability of penalties. A tax return preparer who has been providing estate planning services may be more knowledgeable than a preparer who has not been providing any other services.
- Example:** Did they prepare previous gift tax returns, or did they prepare Form 706, U.S. Estate Tax Return, for the predeceased spouse?
- (12) The examiner should document the case file following the conversation with the taxpayer and/or Power of Attorney (POA). While each examiner has their own interview style, examiners should be consistent in the documentation of the facts. Use of the examination lead sheets, workpapers and Activity Record should ensure consistency in documentation.

Note: All information on the return preparer's activities and the applicability of any penalties relating to the return preparer should be separated from the taxpayer's case file. A return preparer penalty case file should be created and the taxpayer's answers to these inquiries as well as a separate activity record should be included in this case file and not included in the taxpayer's case file.

Caution: Do not include any information about the return preparer's conduct gathered from other sources or conclusions about the assertion or non-

assertion of the preparer penalty in the underlying case file. The taxpayer's case file should only reflect the fact that the required inquiries on the return preparer issues were completed.

- (13) A preparer penalty determination action is an individual federal tax matter of the preparer. As with any individual tax matter, an examiner may disclose federal tax information to that individual (the preparer in this instance), in accordance with IRC 6103(e)(1)(A)(i) or to the preparer's representative (also known as an "attorney in fact"), as permitted by IRC 6103(e)(6).
 - a. Return preparer penalty case files may include copies of tax returns or portions of tax returns prepared by the preparer who is being considered for the penalty. The case files may also include other information taken from examination case files, including workpapers and transcripts of account of the taxpayers whose returns were prepared by the preparer, as well as information received directly from the preparer.
 - b. Information taken from the returns or copies of returns prepared by the preparer and information from the examination files related to such returns may be incorporated into the return preparer penalty case file. Such information may be disclosed to the preparer or representative if the information relates to the resolution of the penalty issue. See IRC 6103(h)(4). These disclosures may be made by the examiner during the penalty determination or subsequent tax administration activity.
 - c. Remember that an examiner may disclose information about the prepared returns because that information relates to the penalty determination, not because the preparer prepared the return or may have had a representative to represent the taxpayer. If there is any information in the return preparer penalty case file that does not relate to the penalty determination, such as the taxpayer's current address or current employer, that information may not be disclosed to the preparer or the preparer's representative.
 - d. If the return preparer penalty case file includes information that would seriously impair federal tax administration if disclosed, that information must be withheld by the examiner's manager in accordance with the manager's authority to withhold information in accordance with IRC 6103(e)(7). See Delegation Order 11-2.
- (14) Obtain approval to pursue the penalty by:
 - a. Preparing Form 5809, Preparer Penalty Case Control Card.
 - b. Form 5809 must remain in the Return Preparer Penalty Case File.
 - c. If the Estate and Gift group manager does not approve, the examiner should not pursue the penalty issue.
 - d. If the Estate and Gift group manager approves Form 5809 then the manager must obtain additional approval of the WSD Return Preparer Coordinator (RPC).
 - e. The manager must forward the Penalty Lead Sheet to the WSD RPC electronically or by fax.
- (15) Opening A Return Preparer Penalty Case File:
 - a. The examiner establishes ERCS control using Form 5809 as the ERCS input document. These cases are not controlled on AIMS. In addition to the information concerning the preparer, record the relevant information from the taxpayer's tax return on Form 5809. Use of this document

allows the establishment of the non-AIMS case on ERCS for purposes of time application and is a means of keeping a manual record of penalty action on the Preparer. Use the return preparer's TIN and name to prepare the Form 5809.

Note: Form 5345-D, Examination Request-ERCS (Examination Returns Control System) Users, is NOT used to establish a preparer penalty on ERCS.

- b. Most of these penalty cases will derive from Form 706 or Form 709, United States Gift (and Generation - Skipping Transfer) Tax Return, selected for audit. Some cases may come from the Campus because the cases involve a questionable tax practitioner. If cases are sent from the Campus in this manner, source code 49 should be used only for the primary return (estate or gift tax return) selected as part of the Program Action Case (PAC) client sample originating from the Campus. If multi-year cases are developed in the Campus for delivery to the field groups, only the primary return should reflect source code 49.
- c. Aging reason code 49 should be added to all return preparer program returns including the primary and multiple-year returns.
- d. Establish a separate ERCS record for each client/year/proposed penalty combination (if establishing a separate case, with one or more penalties against the same preparer, establish a different ERCS record) using the following guidelines: Record the SSN or EIN of the preparer in the TIN field; Record the Preparer's Name in the name field; Record the tax period of the client's return in the tax period field; in the statute field, record the statute of the client's return. P2 penalties should be assigned an alpha statute of "XX", and in the Activity Code (ActCd) field, record one of the following codes:

Activity Code	IRC	MFT
ActCd 501	Section 6694(a) penalty	MFT P1
ActCd 502	Section 6694(b) penalty	MFT P2
ActCd 503	Section 6695(f) penalty	MFT P3
ActCd 504	Section 6695(a), (b), (c), (d), or (e) penalties	MFT P4
ActCd 505	Section 7407 injunctions	MFT P5

Note: Use Activity Code 828 (Indirect Exam Time) for closing the Return Preparer Penalty Case File when the only time charged is for unsuccessful attempts to locate the preparer.

- e. Place a copy of the signed Penalty Lead Sheet in the return preparer penalty case file.
- (16) If the remaining assessment statute of limitations is greater than 365 days then proceed to paragraph (17). There must be a minimum of 12 months (365 days) remaining on the statute at the date when the case reaches the Office of Appeals. See IRM 25.6.23.7.1, Minimum Time Remaining on ASERD. Guidance for reviewing and extending the return preparer penalty assessment statute is provided in IRM 20.1.6.18, Statute of Limitations.

- (17) To charge time to the preparer penalty case, use one of the penalty specific SAIN codes available in IMS. See IRM 4.25.1.8.5, Standard Audit Index Number (SAIN) Codes.
- (18) Forward a copy of the completed Form 5809 (Copy B) to the RPC at the start of the penalty investigation.
- (19) Contact preparer and conduct comprehensive interview - Use Letter 4523, Preparer Contact Letter, to contact the return preparer to schedule the initial appointment (include Pub 1).
- (20) If preparer penalties are not warranted, proceed by using the following instructions:
 - a. Close the case no change. The group manager will review the return preparer penalty case file and document concurrence.
 - b. The examiner will prepare Letter 1120, No Change- Preparer's Penalty, mail the original to the preparer and include a copy in the case file. Show only the last four digits of the taxpayer's identification number.
 - c. The examiner will complete Form 5809.
 - d. The examiner will note on the Penalty Lead Sheet that the case is being closed No Change.
 - e. The group will update ERCS to Status 41 and forward the case, marked "Closed No Change," to the RPC for review. The RPC will extract pertinent information from the file to be retained for at least one year. The balance of the no-change case file does not need to be retained.
- (21) If preparer penalties are warranted, proceed by using the following instructions:
 - a. The preparer should be afforded an opportunity to meet with the group manager to resolve the issues.
 - b. Document the actions taken on Form 4665, Report Transmittal, if the preparer does not agree with the penalty proposal.
 - c. If penalties are being proposed during a conference with the preparer, the examiner provides the preparer with Form 5816, Report of Tax Return Preparer Penalty Case, and Form 886-A, Explanation of Items.
 - d. When penalties are based on many different prepared returns, attach a list of client names, SSNs, EINs and tax periods. Use a separate form for each year return combination.
 - e. If penalties are being proposed via mail, send Letter 1125, Transmittal of Examination Report; Form 5816; Form 886-A; Pub 5, Your Appeal Rights and How to Prepare a Protest if You Do Not Agree; and Pub 594, The IRS Collection Process.
- (22) If this is an agreed case, proceed using the following instructions:
 - a. Preparer signs Form 5816. Solicit payment from preparer and if the preparer pays, prepare Form 3244-A, Payment Posting Voucher – Examination.
 - b. Complete Form 8278, Assessment and Abatement of Miscellaneous Civil Penalties.
 - c. When more than one penalty under different IRC sections will be assessed against the same preparer for the same period, complete a separate Form 8278 for each penalty.

- d. Attach Form 3198, to each case file, identifying it as a return preparer penalty case in the "Other" section and referencing the applicable IRC section.
 - e. Notify the RPC of the potential penalty case and upload the required case information to IMS in a separate case file.
 - f. The group secretary or clerk will update the return preparer case on ERCS to Status 41 and use Form 3210 to mail the case for normal closing through Centralized Case Processing (CCP).
 - g. Notify the RPC via secure e-mail of the final results.
- (23) If this is an unagreed case and the remaining assessment statute is greater than 365 days when received by Appeals, proceed using the following instructions:
- a. The examiner provides the preparer with: Letter 1125, Form 5816, with the bottom part of the form removed; Form 886-A, Pub 594, and Pub 5.
 - b. The case then goes into suspense for 30 days, during which time the preparer may agree or protest.
 - c. If the response is agreed or there is no response, process as an agreed case.
 - d. If the preparer submits a pre-assessment protest (written) within 30 days, the case file will be reviewed for adequacy of the protest, development of the issue(s) and managerial involvement.
 - e. The examiner will prepare an assessment document, Form 8278. When more than one penalty under different IRC sections will be assessed against the same preparer for the same period, complete a separate Form 8278 for each penalty.
 - f. The administrative staff will then update ERCS to Status 41 and forward the case marked UNAGREED, to the RPC for review.
- Note:** Appeals and Unagreed Closings: If the taxpayer's examination case is unagreed, the unagreed preparer penalty case file cannot be submitted to Appeals before the tax examination case file.
- Note:** An unagreed preparer penalty case file cannot be submitted to Appeals for pre-assessment consideration if there is less than 365 days remaining on the assessment statute of limitations. There must be a minimum time of 12 months (365 days) remaining on the ASER at the date when the case reaches the Office of Appeals. See IRM 25.6.23.7.1, Minimum Time Remaining on ASER. Form 872-D is used to extend the original statute in a preparer penalty investigation. If the statute is not extended and there is shorter than 365 days remaining on the assessment statute, proceed to paragraph (25).
- g. After review, CCP updates ERCS to Status 21 and forwards the case through Technical Services to Appeals (use Form 3210).
- (24) If this is an unagreed case and the remaining assessment statute is shorter than 365 days, request the statute extension from the preparer:
- The statute on a return preparer penalty case under IRC 6694(a) and IRC 6695 can be extended using Form 872-D, Consent to Extend the Time on Assessment of Tax Return Preparer Penalty. See Rev. Rul. 78-245.

- Use Letter 907-P, Return Preparer Penalty Statute Extension Request to send Form 872-D to the preparer.
- A transcript of the return on which the preparer penalty is based should be included in the case file for accurate monitoring of the expiration date.
- Since the case is unagreed, regular unagreed case closing procedures should be followed. See IRM 4.25.10.7.

Note: There must be a minimum time of 12 months (365 days) remaining on ASER at the date when the case reaches the Office of Appeals. See IRM 25.6.23.7.1 Minimum Time Remaining on ASER.

- (25) If the extension is requested and the preparer does not agree to extend the statute, follow the instructions below.

- Send the preparer a Form 5816 with the bottom part of the report removed along with an explanation of the reason for the quick assessment and a discussion of the preparer's Appeals rights.

Note: Letter 1125 is NOT sent to the preparer.

- Forward to the RPC a copy of Form 5816 along with a completed Form 8278 and Form 2859, Request for Quick or Prompt Assessment.
- Annotate Form 3198 with "Quick Assessment" on the Other line in the Expedite section.
- CCP will direct immediate assessment of the penalty.
- The Return Preparer Penalty Case File should be forwarded to the Return Preparer Coordinator when completed.
- Upon request, the preparer will be provided the same Appeals rights post-assessment as would have been provided if the request for Appeals consideration were received before the assessment.

- (26) Referral to the Director of the Office of Professional Responsibility: The Office of Professional Responsibility (OPR) exercises jurisdiction over Attorneys, CPAs, Enrolled Agents, Enrolled Actuaries, Enrolled Retirement Plan Agents, and Appraisers. Examiners should exercise discretion in making referrals of specific cases. In matters involving non-willful conduct, a referral should only be made when it can be established that the preparer has a pattern of failing to meet the required standards of Circular 230. An isolated instance in which a penalty may apply should not, in and of itself, require a referral unless willful conduct is involved. Accordingly, the imposition of penalties under IRC 6694(a) and IRC 6695(a) through IRC 6695(e) should not automatically generate a referral to the Director of OPR. See IRM 4.11.55.5.1, Referral to Office of Professional Responsibility (OPR). Referrals of asserted IRC 6694(a) and/or IRC 6695(a) through (g) penalties to OPR should be based on a pattern of behavior or penalties across multiple taxpayers, tax issues or tax years. See IRM 4.11.55.5.1, Referral to Office of Professional Responsibility (OPR).

- a. When making a referral to OPR, examiners will prepare Form 8484, Suspected Practitioner Misconduct Report for the Office of Professional Responsibility, and obtain signature approval of their manager and send the completed Form 8484 to the Office of Professional Responsibility. See Form 8484, Suspected Practitioner Misconduct Report for the Office of Professional Responsibility, for fax and e-mail contact information.

- (27) In cases in which a referral is not prepared but was considered, a comment should be made on the Examination Planning and Work Paper Index and/or the Penalty Lead Sheet explaining why the referral was not made.
- (28) An explanation of the required forms and letter preparation for return preparer cases is located in IRM 20.1.6, Preparer and Promoter Penalties.

4.25.7.5
(09-04-2024)

Appraiser Penalties

- (1) Section 1219 of the Pension Protection Act of 2006 added IRC 6695A, Substantial and Gross Valuation Misstatements Attributable to Incorrect Appraisals. This penalty provision allows the IRS to impose a penalty against a person if the following elements are met:
 - 1. the person prepares an appraisal of the value of property;
 - 2. the person knew or reasonably should have known that the appraisal would be used in connection with a return or a claim for refund; and
 - 3. the claimed value of the property on a return or claim for refund which is based on the appraisal results in a substantial valuation misstatement (within the meaning of IRC 6662(e)), a substantial estate or gift tax valuation understatement (within the meaning of IRC 6662(g)), or a gross valuation misstatement (within the meaning of IRC 6662(h)), with respect to such property.
- (2) An IRC 6695A appraiser penalty case must be conducted as a separate and distinct case from the related estate or gift tax examination. During the related gift or estate tax examination, the examiner should evaluate the facts and circumstances to determine whether or not an IRC 6695A appraiser penalty case should be opened. Appraiser penalties must not be discussed with the taxpayer, the preparer, or the taxpayer's authorized Power of Attorney. An IRC 6695A penalty against an appraiser will not be proposed until the related tax examination is completed at the group level. The appraiser penalty case can proceed when the related tax examination case is closed agreed, closed no response after default, or is in Appeals or Tax Court.
- (3) Prior to pursuing the appraiser penalty, examiners must obtain the immediate supervisor's approval and engage in an Appraiser/Return Preparer Coordinator consultation by contacting the WSD Appraiser/Return Preparer Coordinator. The contact information is available on the Estate and Gift Tax intranet page.
- (4) Appraiser penalty referrals are also routed to examiners through Estate and Gift Tax Workload Selection and Delivery (WSD). See IRM 4.25.3.10.2.8, Return Preparer Referrals for an explanation of the WSD Return Appraiser/Preparer Coordinator's role and responsibilities.
- (5) IRM 20.1.12, Penalties Applicable to Incorrect Appraisals, provides servicewide policy and procedure for the administration of penalties for incorrect appraisals.

4.25.7.6
(09-04-2024)

Referrals to SBSE Lead Development Center and OPR

- (1) This section provides guidance and procedures for Referrals to SBSE Lead Development Center (LDC) and Office of Professional Responsibility (OPR).

4.25.7.6.1

(09-04-2024)

Referrals to SBSE Lead Development Center

- (1) The LDC *LDC website*, acts as the national clearing house to identify and deter individuals from promoting abusive tax schemes and/or preparing abusive returns. The LDC evaluates and develops information from both internal and external referral sources.
- (2) The LDC also evaluates leads on appraisers who may have contributed to valuation misstatements or who may have participated in a scheme involving valuation issues. In certain cases, appraisers may be subject to the aiding and abetting penalty under IRC 6701. A referral must be prepared and submitted to the SBSE Lead Development Center if, in making determinations regarding the appropriate value of assets for estate and gift tax purposes, the appraiser's methodology and accuracy of appraisal(s) suggests aiding and abetting under IRC 6701.
- (3) If an examiner identifies a new or unique abusive promotion or transaction during an examination, the case will be discussed with the group manager and a decision by the group manager should be made regarding whether a LDC referral is warranted.
- (4) LDC Referrals are made by sending Form 14242, Report Suspected Abusive Tax Promotions or Preparers. See *LDC website*.
- (5) Examiners should not take any action that would begin the actual promoter investigation prior to the authorization of the investigation by the LDC. Examiners preparing referrals are allowed to conduct only enough research to submit the referral to the LDC.
- (6) Examiners making referrals to the LDC should charge time to activity code 593000 for activity under IRC 6701 or activity code 594000 for activity under IRC 6700.
- (7) SBSE Lead Development has an extensive abusive tax website which was created to assist employees conducting promoter investigations and the related participant examinations. Its web pages describe specific tax schemes, provide job aids, and include contact information for further assistance. IRM 4.32, Abusive Transactions, discusses procedures for cross-functional development of abusive tax schemes and promoter cases. IRM 5.20.1, Abusive Tax Avoidance Transaction Program, discusses SB/SE Collection's cross-functional role working abusive tax avoidance collection issues.

4.25.7.6.2

(09-04-2024)

Referrals to OPR

- (1) OPR is responsible for reviewing, investigating, and resolving alleged violations of the professional standards of competence, conduct, and integrity by tax practitioners who represent taxpayers before the IRS. OPR identifies and resolves alleged violations of the applicable professional standards enumerated by Treasury Department *Circular 230*, Regulations Governing Practice before the Internal Revenue Service.
- (2) Please see IRM 4.11.55.5, Referrals, for information on the procedures for referrals of practitioner or appraiser misconduct.

4.25.7.7

(09-04-2024)

Fraud

- (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 estate, gift and generation-skipping transfer 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 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.
- (3) IRM 25.1, Fraud Handbook, provides detailed guidance in identifying indicators of fraud, and establishes processes for developing those indicators into referrals to Criminal Investigation or recommendations to assert a fraud penalty, where appropriate. In addition, the Penalty Approval Lead Sheet and Fraud Development Lead Sheet, found in Notebook, should be used to document the group manager's involvement and examiner's analysis and case actions. See IRM 20.1.1.2.3, Approval Prerequisite to Penalty Assessments and IRM 20.1.1.2.3.1, Timing of Supervisory Approval.

4.25.7.7.1
(09-04-2024)

**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. The discovery and development of fraud are the result of effective investigative techniques. Techniques employed by compliance employees should be designed to disclose not only errors in accounting and application of tax law, but also irregularities that indicate the possibility of fraud and taxpayer intent. Examples of fraud indicators can be found in IRM 25.1.2.3, Indicators of Fraud. Some common indicators of fraud in estate and gift tax cases include but are not limited to:
- Significant unreported asset(s) or gift(s)
 - Non-filed return(s) or indications of willful failure to file returns (see IRC 6651(f) and IRM 20.1.2.3.7.5, Fraudulent Failure to File –IRC 6651(f))
 - Significant undervaluation
 - Substantial overstatement of deductions or claiming fictitious deductions
 - False statement about a material fact involved in the examination
 - Attempts to hinder the examination. For example, failure to answer pertinent questions, repeated cancellations of appointments, refusal to provide records, threatening potential witnesses, including the examiner, or assaulting the examiner.
 - Failure to follow the advice of accountant or attorney
 - Failure to make full disclosure of relevant facts to the accountant
 - Destruction of books and records, especially if just after examination was started
 - Transfer of assets for purposes of concealment, or diversion of funds and/or assets by executors, trustees or fiduciaries, and/or use of secret bank accounts

- (3) At the first indication of possible fraud, the examiner should follow IRM 25.1.2.2, Fraud Development Procedures.

4.25.7.7.2
(09-04-2024)

Firm Indicators 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. See IRM 25.1.1.4, Indicators of Fraud vs. Affirmative Acts of Fraud.
- (2) 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 FTA 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.
- (3) When the group manager, FTA, 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.
- (4) 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 FTA to ensure complete development of the facts to support assertion of the civil fraud penalty.
- (5) If the case warrants a criminal referral, the examiner will prepare Form 2797, Referral Report of Potential Criminal Fraud Cases.
- (6) A criminal fraud referral to Criminal Investigation is warranted if firm indicators of fraud/willfulness exist, and criminal criteria are met. If affirmative acts of fraud/willfulness exist, then the examiner will refer the case through the Fraud Technical Advisor (FTA) to Criminal Investigation (CI) using Form 2797. The FTA is available to assist in determining if firm indications of fraud/willfulness are present, criminal criteria have been met, etc. See IRM 25.1.3, Criminal Referrals.

4.25.7.7.3
(07-16-2020)
**Criminal Fraud
Procedures**

- (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 estate and gift tax examiners when developing criminal fraud cases:
- IRC 7202, Willful Failure to Collect or Pay Over Taxes
 - IRC 7203, Willful Failure to File Return, Supply Information or Pay Tax
 - IRC 7206, Fraud and False Statements
 - IRC 7212, Attempts to Interfere with Administration of Internal Revenue Laws
 - IRC 7512, Separate Accounting for Certain Collected Taxes
- (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 taxpayer. 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. CI or the FTA 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 TCs 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 examination activity on the case. If agreement to either continue the suspension or to resume the examination activity on the case cannot be reached at the group or territory level, the issue will be decided at the Chief 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 IRS 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.
- (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 FTA.

4.25.7.7.3.1
(09-04-2024)

Criminal Fraud Referrals

- (1) Cases are referred to CI by using Form 2797. The FTA is available to assist the examiner with the preparation of the referral. See IRM 25.1.3 for additional instructions.

4.25.7.7.3.2
(07-16-2020)

**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 FTA. The FTA 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 SC "18" (Accepted by CI) and maintain controls and responsibilities of the civil case. See IRM 25.1.3.5, Accepted Criminal Referrals.
- (2) The accepted fraud case can be resolved by CI in two ways:
 1. CI refers the case to Department of Justice (DOJ).
 2. CI determines to not pursue criminal prosecution, discontinues their involvement, and returns the case to the examiner for civil settlement.

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

4.25.7.7.3.3
(07-16-2020)

**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 FTA and the group manager to determine if civil fraud development will continue. Either the case will remain in SC "17" (civil fraud development) or the examiner will update the case back to SC "12". In either situation, if the examiner discovers new badges of fraud, they will discuss with the FTA to determine whether to submit a new referral to CI.

4.25.7.7.3.4
(06-14-2021)

**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 paragraph (5) in IRM 25.1.3.5. The FTA may be included in these conferences. The quarterly conferences apply to both types of cases, administrative and grand jury. See IRM 25.1.4.4.4, Required Communications, and IRM 25.1.5.4, Cooperating Grand Jury Examiner/Revenue Officer Procedures.

4.25.7.7.3.5
(06-14-2021)

**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. The examiner will discuss the case with the FTA and manager to determine if the civil fraud penalty will be pursued. The examiner will update the case to the appropriate status code "17" or "12" and continue with development of the civil case.

4.25.7.7.4
(07-16-2020)

Civil Fraud Procedures

- (1) A civil fraud penalty case may be developed based on facts and circumstances of a civil examination or result from a Criminal Investigation (CI) initiated case. 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. Specific guidance on fraud indicators and the development of fraud may be found in IRM 25.1.1, Overview/Definitions IRM 25.1.2, Recognizing and Developing Fraud and IRM 25.1.6, Civil Fraud.
 - a. Upon concurrence of the group manager and FTA, cases being developed for civil fraud, including write-up and review of the civil fraud penalty and/or the fraudulent failure to file penalty, should be updated on AIMS to status code 17 (Fraud Development), via Form 11661, Fraud Development Recommendation - Examination.

- b. Area Counsel must approve the civil fraud penalty before the issuance of a Statutory Notice of Deficiency (90-day letter).
 - c. In cases where fraud was considered and the civil fraud penalty is not being recommended, the examiner must explain in the work papers why the penalty was not asserted.
- (2) 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).
- (3) 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 FTA. See IRM 25.1.6.2, Procedures.
- (4) Recommendations for imposing the civil fraud penalty must receive careful scrutiny to make certain that such penalties are asserted only in appropriate cases. The IRS 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 25.1.1.2.2, Requirements of Proof, or IRM 25.1.6.1, Overview.

- (5) The following code sections are the most common used by estate and gift tax examiners when developing civil fraud cases:
 - a. IRC 6663, Imposition of Fraud Penalty (civil fraud)
 - b. IRC 6651, Failure to File Tax Return or Pay Tax (6651(f), Increase in penalty for fraudulent failure to file)
- (6) 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.”
- (7) When the group manager, FTA, and examiner agree to pursue the civil fraud penalty on a civil examination, the case will remain in SC “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 SC “12”, and complete the examination.
- (8) The final examination report will reflect the civil fraud penalties applied to the appropriate adjustments.
- (9) Cases returned from CI after criminal prosecution or discontinuance of the criminal investigation will be completed as a civil resolution by the referring examiner. 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.
- (1) IRM 20.1.5.16.2, Penalty Assertion, provides specific procedures for assertion of the civil fraud penalty under IRC 6663. See IRM 20.1.2.3.7.5, Fraudulent Failure to File - IRC 6651(f), for additional information regarding restrictions on the assertion of the civil fraud penalty with respect to the fraudulent failure to file penalty.

4.25.7.7.4.1
(09-04-2024)
**Civil Fraud Penalty
Rates**

4.25.7.7.4.2
(06-14-2021)
**Civil Resolution of
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, FTA, 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 SC "17" when the case is returned for civil resolution. The case will be updated to SC "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 25.1.6.4, Evidence of Fraud, for additional information.
- (5) For civil resolution of a criminal prosecution case, the examiner should calculate the proper amount of 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.

4.25.7.7.5
(07-16-2020)
**Fraud Source Codes and
Case Closure
Procedures**

- (1) Update the case to source 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 source code "12" for the completion of the examination.
- (2) Update the case to source code "18" when a case is accepted by CI after a criminal fraud referral is made. The accepted criminal referral case will remain in source code "18" until the criminal investigation is concluded or until the case is referred to DOJ.
- (3) While in source code "17" or source code "18", cycle time will be excluded from monthly "aging" reports to management. As AIMS and ERCS include data from all cases, a manual reconciliation to the aging reports will exclude source 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 on the appropriate line of Form 5344, Examination Closing Record, (see IRM 4.38.1.7.3.1.45, Organization and Responsibilities, Item 38: Fraud) to ensure capture of the penalty on AIMS the following:
 - "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,

Note: Form 3198 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, e.g., "IRC 6663".

4.25.7.8
(09-04-2024)
**Form 8971 and
Schedule(s) A —
Information Return
Related Penalties**

- (1) The information return penalties discussed in this IRM are for information returns defined under IRC 6724(d), or 26 CFR 301.6721-1(g) and 26 CFR 301.6722-1(d). There are two potential penalties applicable to the late or incomplete filing of the Form 8971 and Schedule(s) A. For guidance in reviewing the filing requirements, timeliness, and completeness of a Form 8971 and related Schedule(s) A, see: *Instructions for Form 8971 Information Regarding Beneficiaries Acquiring Property From a Decedent and Schedule A*.
- (2) IRM 20.1.7.8, Failure to File Correct Information Returns, IRC 6721 provides Servicewide policy and procedures for the assessment or abatement of the IRC 6721 penalty. The IRC 6721 failure to file an information return applies to a Form 8971 filed with the IRS if there is a failure to:
 - a. File timely
 - b. Include all the information required to be shown on the form or schedule
 - c. Include correct information, or
 - d. File a correct supplemental form and/or schedule by the due date, when required
- (3) IRM 20.1.7.9, Failure to Furnish Correct Payee Statements, IRC 6722 provides Servicewide policy and procedures for the assessment or abatement of the IRC 6722 penalty. The IRC 6722 failure to file a correct payee statement applies to the filing for the Form 8971 related Schedule(s) A.
- (4) The time spent reviewing books and records to determine if taxpayers are in compliance with various filing requirements is charged to the key/primary Form 706 case. If the examiner determines that these miscellaneous penalties should be considered as a separate case, the time spent related to the penalty case from that point forward should be established as a separate case and charged to Activity Code 506, Other Penalties - Form 8278.