Department of the Treasury **Internal Revenue Service** **Office of Chief Counsel**

Notice

CC-2018-006

June 6, 2018

Subject:	Section 6751(b) Compliance Issues for Penalties in Litigation	**Cancel Date**:	Upon incorporation into the CCDM

Purpose

This Notice advises Chief Counsel attorneys how to address compliance with section 6751(b) when handling penalties in litigation. To the extent that a case with a penalty has already progressed beyond a point where compliance with the requirements of this Notice is practical, Counsel attorneys should coordinate the case with Branch 1 or 2 of Procedure and Administration.

Background

Section 6751(b)(1) requires personal, written supervisory approval of the initial determination "of [a penalty] assessment." That section applies to all Title 26 penalties, except for penalties under sections 6651, 6654, and 6655 and penalties that are automatically calculated through electronic means.

In Graev v. Commissioner, 149 T.C. No. 23 (2017) (Graev III), the Tax Court partially adopted the holding of the Second Circuit in Chai v. Commissioner, 851 F.3d 190 (2d Cir. 2017). The Tax Court held that, in a deficiency case, the written supervisory approval must occur no later than the date the Internal Revenue Service mails the notice of deficiency or files an answer or amended answer asserting penalties. Id. at 221. In addition, the Tax Court held that part of the Service's burden of production for penalties under section 7491(c)[1] includes producing evidence of compliance with section 6751(b). The Tax Court declined to adopt the Second Circuit's holding that the Service has the burden of proof for compliance with section 6751(b).

[1] In any court proceeding, section 7491(c) imposes a burden of production on the Service with respect to the penalty liability of any individual. To meet his burden, the Commissioner must come forward with sufficient evidence indicating that it is appropriate to impose the relevant penalty. Higbee v. Commissioner, 116 T.C. 438, 446 (2001).

Distribute to:	Tax Litigation staff	Tax Litigation staff & Support personnel	
	X All Personnel	Electronic Reading Room	
Filename:	CC-2018-006	File copy in:	CC:FM:PFD

Litigating Guidelines

A. Burden of Production and Burden of Proof

The Tax Court in Graev III accepted the Second Circuit's holding in Chai to the extent it held that producing evidence of compliance with section 6751(b)(1) is part of the Service's burden of production under section 7491(c) in deficiency cases related to an individual's liability. Both the majority and Judge Holmes' concurring opinion questioned the Chai court's holding that producing evidence of compliance with section 6751(b)(1) is part of the Service's burden of proof in deficiency cases. The Graev III opinion does not adopt that aspect of the Second Circuit's holding in Chai.

Counsel attorneys should not dispute that compliance with section 6751(b)(1) is part of the Service's burden of production if section 7491(c) places the burden of production on the Service. Counsel attorneys should submit evidence of compliance with section 6751(b)(1) to satisfy the burden of production. In cases to which section 7491(c) does not apply because the taxpayer is not an individual, the Service does not have the burden of production. See Dynamo Holdings, L.P. v. Commissioner, 150 T.C. No. 10 (2018). Nonetheless, the best practice in these cases is to submit evidence of compliance with section 6751(b)(1) so that the burden issue does not need to be litigated at the circuit court level or does not arise in a subsequent CDP proceeding.

If there is no evidence sufficient to meet the burden of production, then Counsel attorneys should concede the penalty. If there is doubt as to whether the evidence is sufficient to show compliance with section 6751(b)(1), coordinate with Branch 1 or 2 of Procedure and Administration.

B. Compliance with Section 6751(b)(1)

1. *Deficiency Cases*

In any Tax Court deficiency case in which a penalty is at issue and is not excepted from supervisory approval under section 6751(b)(2), attorneys must submit evidence of compliance with section 6751(b)(1), even if the taxpayer does not raise the issue. The type of information that constitutes "evidence of compliance" is discussed in Section C. Attorneys should not argue that approval of a penalty appearing in a statutory notice of deficiency may be obtained from the Internal Revenue Service after the statutory notice is mailed.

If a penalty was not included in a statutory notice of deficiency, an attorney may raise a penalty in the answer or amended answer. The determination of whether to raise the penalty in an answer or amended answer should be made on a case-by-case basis in consultation with the attorney's immediate supervisor.

If an attorney raises a penalty in an answer or amended answer, the attorney's immediate supervisor must sign the answer or amended answer, and the answer or amended answer must identify the supervisor's signature as the written supervisory approval of the attorney's initial determination pursuant to section 6751(b)(1). A sample of an amendment to an answer in which a penalty is raised and compliance with section 6751(b)(1) is alleged is attached as Exhibit A.

If an attorney reviews a statutory notice of deficiency before it is issued and recommends that a penalty not currently in the statutory notice of deficiency should be included, the attorney should obtain approval from their immediate supervisor. The best practice is for the attorney to prepare, and the attorney's immediate supervisor to sign, a short separate memorandum to memorialize the initial penalty recommendation and approval. This separate memorandum should be provided to the examiner, and will constitute approval under section 6751(b). The separate memorandum should include a statement identifying the individual who made the initial determination, and a statement identifying the person who signs the memorandum as the immediate supervisor of the individual who made the initial determination.

The attorney should also advise the Service that the Service employee who receives the attorney's recommendation should document their acceptance of that recommendation and have their immediate supervisor personally approve, in writing, the acceptance of the recommendation.

2. *Collection Due Process (CDP) Cases*

Compliance with section 6751(b) must be evaluated in all CDP cases regardless of whether liability is at issue under section 6330(c)(2)(B). Where liability is not at issue, compliance with section 6751(b) must be verified by Appeals as part of its general responsibility to ensure compliance with required administrative procedures under section 6330(c)(1). See Blackburn v. Commissioner, 150 T.C. No. 9 (2018). However, if the penalty was the subject of a prior court proceeding that has collateral estoppel or res judicata effect, or the issue of section 6751(b) compliance is precluded by section 6330(c)(4), verification under section 6330(c)(1) is not required. See Chief Counsel Notice 2014-002. On the other hand, where liability is properly at issue under section 6330(c)(2)(B), compliance with section 6751(b) should be treated as part of the liability determination.

In a docketed CDP case, where liability is not at issue, the Tax Court reviews verification by Appeals for an abuse of discretion, and the Service does not have the burden of production under section 7491(c). Blackburn, slip. op. at 10 n. 4. If Appeals properly verified written supervisory approval and included necessary documentation in the administrative file, the assigned attorney should defend the verification, relying on the abuse of discretion standard.

If Appeals did not properly perform such verification, Counsel should obtain the documentary evidence necessary to establish compliance with section 6751(b) and submit this evidence to the court with a summary judgment motion or at trial. The administrative record may be supplemented with documentary evidence that Appeals failed to consider based on an exception to the record rule, including agency action not adequately explained in the record or the agency's failure to consider relevant factors. See Kreit Mechanical Associates, Inc. v. Commissioner, 137 T.C. 123, 131 (2011); see also Murphy v. Commissioner, 469 F.3d 27, 32 (1st Cir. 2006); Robinette v. Commissioner, 439 F.3d 455, 461 (8th Cir. 2006); Antioco v. Commissioner, T.C. Memo. 2013-35. If documentary evidence cannot be readily located, remand to Appeals may be appropriate for further investigation.

Where liability is properly at issue (such as when a liability determination is not precluded by judicial doctrines, section 6330(c)(2)(B) or section 6330(c)(4)), the Counsel attorney should decide whether the documentation in the file is sufficient for respondent to carry his burden of production in the same manner as in deficiency cases. See Graev III. If it is not sufficient, the attorney should obtain the additional documentary evidence needed.

Whether liability is or is not at issue, in cases where no documentary evidence of compliance can be located, and neither judicial doctrines nor section 6330(c)(4) bar judicial review of compliance, Counsel should concede the penalty.

3. *TEFRA Cases*

Attorneys should introduce evidence of compliance with section 6751(b)(1) in partnership-level TEFRA cases, regardless of whether it appears petitioners have raised the issue.

Evidence of compliance with section 6751(b)(1) should be submitted at the partnership-level proceeding where the penalties are at issue. For TEFRA cases, the approval of the penalty included in the notice of final partnership administrative adjustment (FPAA) must come before the FPAA is mailed to the tax matters partners of the partnership.[2] If the penalty is not included in the FPAA, the penalty may be raised upon answer (or amended answer) following the same procedures as in deficiency cases. Attorneys should argue that supervisory approval obtained at the partnership level (before the FPAA is mailed to the tax matters partner) is sufficient evidence of compliance with section 6751(b) in subsequent partner-level proceedings

If taxpayers bring a TEFRA proceeding in a district court or the Court of Federal Claims and a Counsel attorney determines that a penalty should be assessed and prepares a defense letter requesting that the Department of Justice raise a penalty in a counterclaim, the attorney's immediate supervisor must approve the penalty. Approval may be granted by having the attorney prepare, and the supervisor sign, the defense letter. The letter must expressly state that the supervisor's signature constitutes the written approval of the attorney's initial determination pursuant to section 6751(b)(1). The best practice is for the attorney to prepare, and the attorney's immediate supervisor to sign, a short separate memorandum memorializing the penalty approval.

4. *Refund Cases and Referrals to Department of Justice for Collection*

Attorneys who write defense letters to the Department of Justice in refund cases must address in the letter whether section 6751 applies and whether there was compliance with section 6751(b)(1),and make sure that any written approval is contained in the administrative file. If possible, the letter should identify the document constituting the written supervisory approval. Attorneys should also address whether the section 6751(b)(1) argument was raised in the administrative claim for refund. The variance doctrine may bar raising the issue for the first time in a refund suit. See generally Mallette Bros. Const. Co., Inc. v. United States, 695 F.2d 145, 155 (5th Cir. 1983). This is because all grounds upon which a taxpayer relies must be stated in the original claim for refund so as to apprise the Service of what to look into; the Service can then take the claim at face value and examine only those points to which attention has been necessarily directed. Id. Anything not raised at that time cannot be raised later in a suit for refund. Id.

Attorneys who refer penalty liabilities for collection to the Department of Justice must include the same information as specified above for refund suits.

[2] In Dynamo, the Tax Court acknowledged that compliance with section 6751(b) may be raised as a defense (by the taxpayer) in the partnership-level proceeding.

If the Department of Justice wishes to assert penalties as an offset to refund claims, attorneys should advise that section 6751(b)(1) is not applicable to an offset defense. This is because, under the principles of Lewis v. Reynolds, the United States can retain any amount that the Service could have assessed on audit. Lewis v. Reynolds, 284 U.S. 281 (1932). As a result, proof of compliance with section 6751(b)(1) is not an element of the United States' case-in-chief in these types of cases. Rather, a taxpayer must prove that he or she is entitled to a refund in the suit.

C. Evidence of Compliance with Section 6751(b)(1)

When working on a Tax Court case, a Counsel attorney should determine whether there is evidence of compliance with section 6751(b)(1) at the earliest opportunity, and no later than filing the pretrial memorandum.

If evidence of compliance exists, it can generally be introduced through stipulation or admitting into evidence a copy of the written supervisory approval. In lieu of testimony, Rule 803(6) of the Federal Rules of Evidence allows a party to submit evidence of the veracity of the approval. A certification that complies with Rule 902(11) of the Federal Rules of Evidence must also be prepared. Attorneys should notify the opposing party of the intent to admit the evidence of approval under Rule 803(6) no later than the 14-day exchange deadline and offer to make the certification available if the opposing party so requests. A motion filed with the court or a response to a court order that requests information about section 6751(b)(1) compliance should be sufficient to comply with the notice requirements of Rule 902(11), but a letter to opposing counsel should also suffice.

Where the relationship between the individual making the initial determination and the individual approving the penalty is not clear, evidence of the identity of the individual who made the initial determination and the identity of the immediate supervisor (or other designated person) who approved the penalty[3] should be included.

Section 6751(b)(1) permits approval of an individual's initial determination by a 'higher level official' other than an immediate supervisor if the Secretary designates the official to provide approval. A revision to the IRM designating such 'higher level officials' is being drafted and will be finalized soon.

Section 6751(b)(1) requires only personal approval in writing, not any particular form of signature or even any signature at all. See Deyo v. United States, 296 Fed. Appx. 157, 159 (2d Cir. 2008). For example, a note or email written by an immediate supervisor could suffice. It may also be possible to introduce sufficient evidence to allow the fact-finder to infer that the written approval existed at the relevant time, even if the written approval cannot be located now. See Fed. R. Evid 1004(a). If an attorney wishes to use that type of evidence, he or she must coordinate the case with the appropriate Division Counsel staff and with Branch 1 or 2 of Procedure and Administration.

[3] To prove that an individual's "immediate supervisor" approved the individual's "initial determination" when it is not evident from the written approval itself, it may be necessary to introduce supporting evidence (such as a declaration or explicit stipulations) that establishes the status of the person providing written approval as the immediate supervisor of the individual making the initial determination.

Generally, under current Service procedures, the administrative file should contain a penalty approval form. The particular form will depend on the penalty being asserted and the Operating Division asserting the penalty. Although not an exclusive list, the approval forms include: Form 300 (Civil Penalty Approval Form (Lead Sheet)); Form 8278 (Assessment and Abatement of Miscellaneous Civil Penalties); Form 4700 (for W&I/SBSE campus cases); Form 5772 (for TEGE cases); Form 5809 (for preparer penalty cases).

Existing procedures for documenting supervisory approval can be found in the IRM at: 20.1.1.2.3 (overview); 4.19.13.5.2 (overview); 20.1.5.1.4 (return-related penalties);[4] 20.1.6.1.1.2 (preparer penalties); and 20.1.12.6 (appraiser penalties).

D. No Evidence of Compliance

If a Counsel attorney cannot find evidence to establish compliance with section 6751(b)(1), and no exception under section 6751(b)(2) applies, the attorney must concede the penalty. The concession should be done at the earliest opportunity, which will typically be in the answer, and in all events at the very latest in the pretrial memorandum.

E. Exceptions to Section 6751(b)(1)

1. Penalties Under Sections 6651, 6654, and 6655 and Penalties that are Automatically Calculated Through Electronic Means

Section 6751(b)(2) provides that the general rule of section 6751(b)(1) does not apply to any addition to tax under section 6651, 6654, or 6655, nor to penalties that are "automatically calculated through electronic means." The reference to any addition to tax under section 6651 includes any addition to tax under any subsection of section 6651, such as the section 6651(a)(1) addition to tax for failure to file, the section 6651(a)(2) and (3) additions to tax for failure to pay, and the section 6651(f) addition to tax for fraudulent failure to file.

Penalties appearing in a statutory notice of deficiency as a result of programs such as the Automated Underreporter (AUR) and the Combined Annual Wage Reporting Automated programs will fall within the exception for penalties automatically calculated through electronic means if no one submits any response to the notice, such as a CP2000, proposing a penalty. However, if the taxpayer submits a response, written or otherwise, that challenges a proposed penalty, or the amount of tax to which a proposed penalty is attributable, then the immediate supervisor of the Service employee considering the response should provide written supervisory approval prior to the issuance of any statutory notice of deficiency that includes the penalty. A penalty is no longer automated once a Service employee makes an independent determination to pursue a penalty or to pursue adjustments to tax to which a penalty is attributable.

Chief Counsel Notice 2014-004 provides that when the proposal and the assessment of a section 6702 penalty is fully automated, written supervisory approval of the section 6702 penalty is not required. Section 6702 penalties determined by a Service employee, however, do not fall within the exception.

---

[4] Note that, for correspondence examination automation support (CEAS) cases, the manager must input a report generation software (RGS)/CEAS non-action notation to indicate concurrence with the penalty assertion. IRM 20.1.5.1.4.1(4). This notation, combined with other evidence regarding the individual who made the "initial determination," demonstrates compliance with section 6751(b)(1).

Counsel attorneys should coordinate with Branch 1 or 2 of Procedure and Administration any argument (not covered by an existing Chief Counsel Notice) that a particular penalty is automatically calculated through electronic means.

2. Section 6672 Is an Assessment of Tax Rather Than Penalty

Taxpayers have argued that compliance with section 6751(b)(1) is needed to impose the penalty under section 6672 for failing to collect and pay over taxes imposed by the Code. In those cases, Counsel attorneys should take the position that section 6751(b)(1) does not apply because section 6672, in substance, imposes a tax rather than a penalty. See United States v. Rozbruch, 28 F. Supp. 3d 256 (S.D.N.Y. 2014), aff'd on other grounds, 621 Fed. Appx. 77 (2d Cir. 2015). There may also be other taxes that taxpayers will contend are penalties. These arguments must be coordinated with Procedure and Administration and any other Associate Office that has responsibility for the tax involved.

3. Section 6673, Sanctions and Costs Awarded by Courts

Courts can award sanctions and costs under section 6673 for proceedings instituted primarily for delay, either *sua sponte* or at the request of the government. Section 6751(b)(1) should be inapplicable to a section 6673 penalty that the court imposes *sua sponte*, as there is no "initial determination" of a penalty assessment by a Service employee in that situation. Arguably, by moving the court to impose a section 6673 penalty, an attorney does not deprive the court of its power to impose the penalty if the attorney's immediate supervisor does not approve the penalty in writing.

Nonetheless, attorneys who make motions for section 6673 penalties should have their immediate supervisors approve them in writing. Attorneys who make an oral motion for section 6673 penalties at trial should document the fact that they made the oral motion and have that documentation approved, in writing, by their immediate supervisor at the earliest convenient time, even if it is after making the motion. For example, this can be accomplished in an email from the attorney to the immediate supervisor followed by a reply email from the immediate supervisor to the attorney that approves the penalty. Ideally, the approving email should state, "As your immediate supervisor, I approve your initial determination to seek assessment of a section 6673 penalty in the [INSERT NAME AND DOCKET NUMBER OF THE CASE]." Failure to do so may raise issues about the validity of the penalty.

4. Penalties in the Alternative

In some cases, there may be written supervisory approval of one penalty, but approval missing for penalties in the alternative to the one approved. In this situation, it may be possible to argue that approval of one penalty might function as approval of an alternative. Attorneys who encounter this situation must coordinate the case with Procedure and Administration.

F. Coordination with Procedure and Administration

Any questions regarding action in CDP cases should be directed to Branch 3 or 4 of Procedure and Administration.

Any questions regarding other section 6751(b)(1) issues should be directed to Branch 1 or 2 of Procedure and Administration. Any motions for summary judgment, pretrial memoranda or briefs addressing non-routine or important issues arising under section 6751(b)(1) should be coordinated with the appropriate branch.

If you have any questions regarding the matters discussed in this Notice, please contact Branch 1 or 2 of Procedure and Administration at (202) 317-6844 or (202) 317-6845.

/s/
Kathryn A. Zuba
Associate Chief Counsel
(Procedure & Administration)

Exhibit A

UNITED STATES TAX COURT

SAMPLE TAXPAYER(S),	)	
	)	
	)	
Petitioner(s),	)	
	)	
v.	)	Docket No. SAMPLE
	)	
COMMISSIONER OF INTERNAL REVENUE,	)	
	)	
Respondent.	)	

AMENDMENT TO ANSWER TO PETITION

RESPONDENT, in answer to the petition filed in the above-entitled case, further alleges as follows:

X. **FURTHER ANSWERING** the petition, respondent alleges:

a. [BACKGROUND FACTS]

b. That for [TAX YEAR X], [PENALTY/ADDITION TO TAX GROUND] as defined by [CODE SECTION] applies. Petitioner(s) are thus liable under [CODE SECTION] for the [PENALTY/ADDITION TO TAX].

c. After the filing of the petition in this case on [DATE], attorney for respondent [NAME OF ATTORNEY] made an initial determination to assert the [PENALTIES/ADDITIONS TO TAX SHOWN ABOVE] pursuant to section 6214(a) in this Amendment to Answer so that the Court may determine this amount. In accordance with I.R.C. § 6751(b)(1), this determination was personally approved, in writing, by [ATTORNEY NAME]'s immediate

supervisor, [SUPERVISOR'S NAME], by virtue of [SUPERVISOR'S NAME]'s signature on this pleading.

WHEREFORE, it is prayed:

That respondent's determinations, as set forth in this Amended Answer, be in all respects approved.

WILLIAM M. PAUL
Acting Chief Counsel
Internal Revenue Service

Date:_____ By: _____
ATTORNEY

By: _____
SUPERVISOR

OF COUNSEL:
NAME
Division Counsel
NAME
Area Counsel