



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

SMALL BUSINESS/SELF-EMPLOYED DIVISION

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MEMORANDUM FOR LB&I AND SB/SE EXAMINATION AND APPEALS PERSONNEL

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SUBJECT: Updated Interim Guidance on IRC Section 6707A Penalty

The Small Business Jobs Act of 2010 changed the way the section 6707A penalty amount is calculated. Under amended section 6707A, the penalty is "75 percent of the decrease in tax shown on the return as a result of" the reportable transaction or the decrease in tax "which would have resulted from such transaction if such transaction were respected for federal tax purposes." The amended penalty amount is also subject to maximum and minimum penalty amounts. The maximum penalty, in the case of a listed transaction, is \$100,000 for a natural person and \$200,000 for all other taxpayers and, in the case of a non-listed reportable transaction, is \$10,000 for a natural person and \$50,000 for all other taxpayers. The minimum penalty for both listed transactions and non-listed reportable transactions is \$5,000 for a natural person and \$10,000 for all other taxpayers, including pass-through entities such as partnerships and S corporations.

The attachments to this memo provide updated interim guidance to reflect this amendment. In addition, the attached processing guidelines change how Appeals and compliance personnel will handle cases that are appealed. Significantly, for cases that are appealed, Appeals will be responsible for protecting the statute of limitations and making arrangements for assessments, as appropriate.

Please direct suggestions, questions, comments, and concerns about section 6707A to Alice Ronk, Attorney-Advisor to the Director, Abusive Transactions and Technical

Issues, SB/SE; Samantha Hunt, Domestic Penalties Technical Advisor, Pre-Filing and Technical Guidance, Office of Tax Shelter Analysis, LB&I; or John O'Leary, Appeals Officer/Technical Guidance Coordinator.

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Effect on Other Documents: The procedures and technical guidance will be incorporated into proposed IRM 4.32.4, *Types of ATAT Issues* by September 12, 2012.

Attachments (2)

cc: [www.irs.gov](http://www.irs.gov)

## ATTACHMENT 1

### PROCEDURES FOR PROCESSING AND IMPOSING THE AMENDED SECTION 6707A PENALTY

#### A. INTRODUCTION

1. This attachment provides procedures for processing and imposing the section 6707A penalty. These procedures are being incorporated into a newly created Internal Revenue Manual Section 4.32.4.
2. Section 6707A provides a monetary penalty for the failure to include on any return, including an amended return, or statement, any information required to be disclosed under section 6011 and associated regulations regarding “reportable transactions” as defined in Treas. Reg. section 1.6011-4(b). The section 6707A penalty is in addition to any other penalty that may be imposed, and applies without regard to whether the transaction ultimately results in an understatement of tax.
3. Unlike most other penalties, the section 6707A penalty contains no reasonable cause exception. Also, unlike most other penalties, the section 6707A penalty allows the Commissioner (or his delegate) to rescind the imposition of the penalty with respect to non-listed reportable transactions if it would promote compliance with the tax laws and effective tax administration. The penalty cannot be rescinded with respect to a listed transaction.
4. The determination of whether the section 6707A penalty applies can impact the determination of the section 6662A penalty (“Reportable Transaction Understatement”), which was added by section 812 of the American Jobs Creation Act of 2004 (AJCA). Technical and Procedural Guidance for the section 6662A penalty was incorporated into IRM 20.1.5 published July 1, 2008.
5. Technical information about the section 6707A penalty, including how to identify reportable transactions, the grounds for imposing the penalty, and the period of limitations, is contained in the associated “Updated Technical Guidance” attachment. For additional information, including templates and letters, please refer to the section 6707A penalty link on the AJCA Penalties website at <http://mysbse.web.irs.gov/exam/tip/ajca/default.aspx>

#### B. PENALTY COMPUTATION

1. Prior to enactment of the Small Business Jobs Act of 2010, the amount of the section 6707A penalty was unrelated to the tax impact of the reportable transaction that gave rise to the penalty, and ranged from \$10,000 to \$200,000 depending on the type of transaction and taxpayer involved.

2. The Small Business Jobs Act of 2010 amended the section 6707A penalty and is retroactive to penalties assessed after December 31, 2006. The application of the section 6707A penalty remains unchanged; only the calculation of the penalty amount was amended.
3. As amended, subject to the maximum and minimum limits, the penalty is 75 percent of the decrease in tax shown on the return as a result of the reportable transaction (or which would have resulted from such transaction if such transaction were respected for Federal tax purposes).
  - a. The maximum penalty in the case of a listed transaction is \$100,000 for a natural person and \$200,000 for all other taxpayers. In the case of a non-listed reportable transaction, the maximum penalty is \$10,000 for a natural person and \$50,000 for all other taxpayers.
  - b. The minimum penalty for both listed transactions and non-listed reportable transactions is \$5,000 for a natural person and \$10,000 for all other taxpayers.
4. Married Filing Joint Taxpayers
  - a. To determine whether the section 6707A penalty applies to a married couple filing a joint return, refer to the August 4, 2010 Memorandum from the Director, Examination, which is available on the ATTI website.
  - b. If only one spouse has participated in a reportable transaction (i.e., only one spouse is subject to the section 6707A penalty), the agent should propose the penalty against the participant-spouse. The agent should:
    - i. Determine the decrease in tax shown on the return as a result of such transaction (or which would have resulted from such transaction if such transaction were respected for Federal tax purposes) and determine the penalty amount under section 6707A(b)(1).
    - ii. Apply the minimum and maximum provisions of section 6707A(b)(2) and (3).
  - c. If both spouses participated in a reportable transaction (i.e., both spouses are subject to the section 6707A penalty), the agent should propose the penalty against each spouse. NOTE: The agent should open separate section 6707A cases for the husband and wife. The agent should then:
    - i. Determine the decrease in tax shown on the return as a result of such transaction (or which would have resulted from such transaction if such transaction were respected for Federal tax purposes) and determine the penalty under section 6707A(b)(1).
    - ii. Allocate the penalty determined under paragraph (i) 50% to each spouse, unless the taxpayers provide clear evidence supporting an alternative allocation (i.e., the taxpayers provide a K-1 indicating ownership percentage).

- iii. Apply the minimum and maximum provisions of section 6707A(b)(2) and (3) to each spouse separately.
- iv. If the proposed section 6707A penalty is being assessed against both husband and spouse two (2) penalty case files should be established, one for each spouse. This will allow Appeals to control the assessment of the penalty against each spouse by establishing separate Work Unit Numbers (WUNOs), decide the applicability of the penalty against each individual spouse as well as the allocation of the penalty.

### **C. ADMINISTRATIVE ISSUES**

1. Penalty cases involving a potential section 6707A penalty should be established as penalty investigations on Examination Returns Control System (ERCS) and include the appropriate project and tracking codes. Refer to the ATTI website or the LB&I Office of Tax Shelter Analysis (OTSA) website for the proper tracking codes.
2. Complete Form 5345-D, *Examination Request-ERCS* (for each spouse under the respective TIN, if applicable), to put the investigation on ERCS, check the box "Control Penalty Investigation," use Source Code 99, and use penalty MFT P5 with activity code 505 which will automatically populate the case as a P5 on the ERCS database. An agent's time will be charged to Activity Code 505 on their 4502, *Exam Technical Time Report*, reports. This case is created and tracked on ERCS as a P5 case along with its statute controls. It will not be on the AIMS database. For IDRS (CFOL) records, cases are not P5 but are referred to as MFT13 for entity and MFT55 for an individual. Input the IDRS MFT code 13 or 55 on documents to include Form 8278, Form 3198 and Form 3244A.
3. If SB/SE or LB&I are involved in a concurrent examination with TE/GE, then the penalty case file will be assigned to the SB/SE or LB&I agent. For example, a TE/GE agent would analyze and write-up whether a transaction is substantially similar to a listed transaction and the SB/SE or LB&I agent would analyze the following: whether the taxpayer had a duty to disclose the transaction under Treas. Reg. section 1.6011-4; whether the taxpayer had complied with the applicable disclosure requirement and whether section 6707A was effective for the year(s) at issue.
4. The section 6707A penalty may be imposed even if an income tax examination results in no change in tax liability or if no income tax examination is opened, as long as sufficient evidence is obtained to support the conclusion that the taxpayer participated in a reportable transaction, had a duty to disclose that participation, and failed to properly disclose. There must also be sufficient factual information to support the calculation of the penalty amount.

5. When a section 6707A penalty is developed in conjunction with an income tax examination, the agent does **not** need to conclude the income tax examination before issuing the 30-day letter for the section 6707A penalty, provided all relevant facts to support the penalty are established. Likewise, an agent also does **not** need to conclude the section 6707A penalty investigation before issuing the 30-day letter for the income tax examination. In other words, the agent should not arbitrarily hold one case to allow the other case to “catch up.” If the timing is appropriate for the income tax and §6707A penalty cases, the 30-day letters for both can be issued at the same time.
6. Report Generating System (RGS) can be used to calculate the tax deficiency attributable to the reportable transaction, which then can be used to compute the penalty for cases involving individuals and C corporations only. This method can be used if an income examination is ongoing to substantiate the tax benefit for section 6707A purposes only. Indicate this in the remarks area. RGS cannot generate the actual penalty report. A manual Form 4549A will need to be completed using a supportive workpaper justifying the penalty amount. Because flow-through entities have no “tax benefits” associated with a reportable transaction, they are subject to the minimum penalty, which is \$10,000 for non-individual taxpayers. This flat penalty applicable to flow-through entities does not need to be calculated on RGS.
7. Although not required, agents can use RGS to store and backup documents and workpapers associated with the section 6707A penalty case file. RGS uses the generic workcenter for Form 8278, *Assessment and Abatement of Miscellaneous Civil Penalties*, penalty cases. See the RGS instructions posted to the §6707A link on the ATTI website for additional information.

#### **D. OPENING A SECTION 6707A INVESTIGATION**

1. *Opening Letter*: If a section 6707A penalty is being considered without an associated income tax examination, an opening letter should be sent by the examining agent. If the section 6707A penalty is being considered as part of an income tax examination, a separate opening letter for the section 6707A penalty is not required. An opening letter is posted at the section 6707A penalty link on the ATTI website.
2. *Power of Attorney* (NOTE: These procedures have changed): In general, when a taxpayer authorizes an individual to represent the taxpayer with respect to a particular form, the representation also covers any penalties related to the form. Thus, the section 6707A penalty is covered when the taxpayer authorizes the individual to represent the taxpayer in connection with the Form 8886. Similarly, if the Form 8886 is included or should have been included with a Form 1040, 1120 or any other tax return, an authorization with respect to that tax return will also authorize the representative for the section 6707A penalty. Agents need to obtain a Form 2848 that refers to “civil penalties,” “section 6707A penalty,” or similar language **only** when the Form

8886 was or should have been filed without being attached to a return (i.e. when a transaction has been listed after the taxpayer filed he or her return and the Form 8886 is required to be filed with OTSA separate from the tax return).

3. Where married spouses file a joint Form 1040, each spouse can be separately liable for the section 6707A penalty. Accordingly, the agent should have a valid, separate Form 2848 that covers the section 6707A penalty for each spouse.

## **E. STATUTE OF LIMITATIONS**

### **1. Overview**

- a. In general, the 30-day letter for the penalty case should be issued with at least 9 months remaining on the period of limitations on assessment. This will allow sufficient time for the taxpayer to respond to the 30-day letter and the agent to send the case to Appeals with sufficient time remaining on the period of limitations on assessment. This also allows time for Appeals to consider and assess the penalty as appropriate. If the 30-day letter cannot be issued with at least 9 months remaining on the period of limitations, the agent should request an extension of the time to make the assessment from the taxpayer on Form 872, *Consent to Extend the Time to Assess Tax*. If the taxpayer refuses to extend the statute and all relevant facts to support the penalty are established, proceed to assessment (as described in Section M, paragraph 3) and offer the taxpayer post-assessment Appeals consideration. See Section N, paragraph 7.
- b. The application of IRC section 6501 in the context of the section 6707A penalty depends on whether disclosure is required with a return. A period of limitations on assessment for the section 6707A penalty applies when disclosure is required with a return and begins to run from the date the disclosure is required. Under the current version of the section 6011 regulations, disclosure of a reportable transaction on Form 8886, *Reportable Transaction Disclosure Statement*, is not always made with the taxpayer's return. In contrast, when a disclosure is not required with a return, the limitations period does not apply to assessment of the section 6707A penalty.
- c. Because the section 6707A penalty can be assessed at entity level (distinct from the shareholder or partner level), the limitations period for assessing the penalty against an S corporation or partnership depends on when the entity was required to disclose its participation and is not controlled by the associated shareholder's or partner's statute.
- d. If the penalty is developed along with the determination of a deficiency with respect to the reportable transaction and a statutory notice of deficiency is issued, the penalty needs to be assessed within the three-year period discussed above (unless an exception applies). While issuance of a statutory notice of deficiency suspends the time to assess a deficiency during the 90-day period to file a petition with the

Tax Court, while the case is before the Tax Court, and an additional 60 days after the court's decision is final, these suspension rules do **not** apply to the time to assess the section 6707A penalty because the penalty is not part of the deficiency and is not subject to the deficiency procedures.

2. Period of Limitations Where Disclosure Is Required With Return
  - a. *General period of limitations*: When the Form 8886 is required to be filed with a return, the assessment of the section 6707A penalty for a failure to timely and/or properly disclose a reportable transaction generally must be made within three years of the date of filing the underlying return pursuant to section 6501, *Limitations on Assessment and Collection*.
  - b. *Exception for listed transactions*: For listed transactions only, section 6501(c)(10) provides additional time to make an assessment of the penalty if the disclosure is not made with the return. Section 6501(c)(10) provides that the period to assess tax with respect to a listed transaction the taxpayer failed to disclose in accordance with section 6011 shall not expire before one year after the earlier of (i) the date the taxpayer provides the information required under section 6011, or (ii) the date that a material advisor meets the requirements of section 6112. After first following the instructions in *General Procedures Applicable to All Reportable Transactions* below, see Rev. Proc. 2005-26, 2005-17 C.B. 965, for further guidance on section 6501(c)(10) and consult Counsel to determine the applicability of this provision.
3. Disclosure Required Without A Return: Treas. Reg. section 1.6011-4(e)(2)(i) requires taxpayers to file a disclosure with OTSA within 90 calendar days of the date that a transaction is listed or identified as a transaction of interest (TOI) by the Service, if the taxpayer participated in the transaction and reported tax benefits from it on a previously filed return for which the period for assessing tax remains open. In this situation, the regulations require that the disclosure be filed without a return. Because the return on which the taxpayer took the tax benefits of the transaction was already filed and at the time of filing there was no requirement to make the disclosure, the three-year period for assessing tax on a return is not the appropriate limit of the period within which to assess the penalty for failing to file a stand-alone statement. In this situation, no limitations period to assess the section 6707A penalty should apply. Despite no period applying, agents should be sure to avoid undue delay in making an assessment.
4. General Procedures Applicable to all Reportable Transactions
  - a. A determination regarding the application of the section 6707A penalty should be made within the three-year period (if disclosure is required



with the return), if possible, to avoid questions about whether the limitations period is open.

- b. Where it is not possible to complete an appropriate investigation within the three-year period, an agent should try to obtain the taxpayer's consent to extend the period of limitations (see *Form 872* discussion in section E., paragraph 5). Even if the agent believes an exception to the three-year period may be warranted, the agent should nonetheless try to obtain the taxpayer's consent to extend the period of limitations.
  - c. If a taxpayer refuses to extend the period of limitations on assessment and the case is sufficiently developed to assess the section 6707A penalty, assess the penalty.
  - d. If the taxpayer refuses to extend the period of limitations on assessment for a case involving a listed transaction, and the case is not sufficiently developed to assess the penalty, the agent should consult with Counsel to determine whether the period in which to assess (the tax and the penalty) is extended under section 6501(c)(10).
  - e. If the taxpayer refuses to extend the period of limitations on assessment, the agent may also consult with Counsel, as necessary, to determine whether any other exceptions to the normal period of limitations apply.
5. *Form 872*
- a. The *Form 872* for the underlying income tax does not extend the period of limitations for assessment of the section 6707A penalty unless the form includes specific language addressing the penalty.
  - b. The following language is approved for use on the *Form 872*: "Without otherwise limiting the applicability of this agreement, this agreement also extends the expiration date identified in paragraph (1) above to the period of limitations for assessing any penalty pursuant to section 6707A, Penalty For Failure to Include Reportable Transaction Information with the Return, with respect to the taxpayers, kind of tax, and tax periods identified above."
  - c. A separate *Form 872*, apart from the income tax case(s), should be obtained from the taxpayer(s) using the language from 5.b., above for the section 6707A penalty.
  - d. The section 6707A penalty is not assessed as a joint and several liability; it can be individually applied to each spouse who jointly files a *Form 1040* provided each meets the legal criteria for the penalty. For these cases, the agent should request that each spouse sign a separate *Form 872* that has the explicit language from the preceding bullet. The agent does not need a *Form 872* from a spouse for whom the agent is not considering a section 6707A penalty.
  - e. To extend the period of limitations for a partnership potentially subject to a section 6707A penalty, the *Form 872* should be signed by the General Partner and not the Tax Matters Partner. Because there is no

line on the Form 872 for a General Partner to sign, the agent should strike through the words "Corporate Name" and write in "Partnership Name" and strike through "Corporate Officer" and substitute "General Partner."

- f. If the taxpayer extends the statute of limitations with respect to the section 6707A penalty, ERCS should be updated to reflect the new statute date. The agent will need to request a P5 print from the secretary to validate that the statute has been updated in the ERCS system.

#### **F. SEEKING COUNSEL ASSISTANCE**

1. When seeking legal advice regarding the application of section 6707A, the agent or Senior Compliance Analyst should consult with his or her IMT Counsel if an IMT is active for the reportable transaction or Area Counsel.
2. The IMT Counsel or Area Counsel will consult with the subject-matter experts in Counsel, as necessary.

#### **G. DEVELOPMENT OF THE PENALTY CASE FILE - OVERVIEW**

1. The agent must develop a case file that contains all relevant documents and other evidence that demonstrates that the transaction was a reportable transaction. Minimum required documents and information are listed in Sections H. and I., but other documents may be required depending on the case (*e.g.*, transactional documents, emails, other correspondence, opinions about whether the transaction is a reportable transaction, or promotional material). In addition, where applicable, include any evidence about why a disclosure is deficient, including the Form 8886 and any other evidence about the time or manner of filing the Form 8886. Finally, ensure that the case file contains copies of all documents demonstrating that the required procedures have been followed.
2. No Reasonable Cause Exception: The statute provides no reasonable cause or other good faith exception to the penalty, and an agent must fully develop the relevant facts and must process the penalty as described in this interim guidance whenever a section 6707A penalty investigation indicates that the penalty legally applies. Reasonable cause may be a factor considered in requests for rescission of non-listed reportable transactions but the presence of reasonable cause and good faith will not necessarily be determinative of whether the Commissioner or his delegate grants rescission.
3. Potential Rescission Requests: Agents handling a section 6707A penalty investigation related to a non-listed reportable transaction should attempt to document facts related to any potential rescission request as explained in Sections I. and O.

4. Because the section 6707A penalty is not a partnership item, there is no difference between a TEFRA partnership and a non-TEFRA partnership for purposes of imposing the penalty for failure to disclose a reportable transaction. Specifically, this penalty is not subject to the TEFRA procedures because the TEFRA procedures apply only to partnership items (items under subtitle A of the Code), and penalties that "relate to an adjustment" of such partnership items. See section 6221.

When starting examination activities related to a section 6707A penalty, all agents should contact OTSA to determine whether a Form 8886 was filed with OTSA and the date and tax year of such filing. An agent should be prepared to provide OTSA with the taxpayer's name, TIN, year or years of interest, type of transaction, and whether the disclosure was incomplete or not attached to the return. Contacts at OTSA are listed at the following website: <http://lmsb.irs.gov/hq/pftg/otsa/KeyPrograms/Disclosures.asp>. LB&I examiners when placing a tax return under examination that has a Form 8886 attached must contact OTSA under certain conditions. Refer to IRM 4.32.2.3.3.1.2(3) for further information.

5. The agent must order the original return if the original return is the only method available to confirm whether the Form 8886 disclosure was filed with the return. Request the original paper filed income tax return using Form 5345D and Source Code 45, use alpha statute code "FF" if the statute date has expired or is due to expire within 180 days. When received make a copy of the original return for the case file and attach the Form 5345D to the return. The group secretary will transfer the return on ERCS to CCP in status 51 with Disposal Code 45 and ship to CCP for closure. If the return was electronically filed a graphic image of the return can be requested by the group secretary with command code TRPRT. If the return was filed through Modernized E-File a PDF file of the return can be requested through your AIMS/ERCS staff.
6. If no Form 8886 was filed by the taxpayer and there is sufficient basis to demonstrate that the taxpayer was involved in a reportable transaction under Treas. Reg. section 1.6011-4, then the required disclosure obligation has not been met.
7. Once an agent determines that a taxpayer either has failed to properly disclose a reportable transaction (whether listed or non-listed) on Form 8886 or has not timely filed the Form 8886 (or the required duplicate), the agent prepares a separate case file for the penalty investigation. Agents handling a section 6707A penalty investigation related to a non-listed reportable transaction should attempt to document facts related to any potential rescission request as explained below.

#### **H. PENALTY CASE FILE — ALL REPORTABLE TRANSACTIONS**

The section 6707A penalty case file should include the following:

1. Documents describing the transaction(s) for which disclosure is required and an explanation of the category of reportable transaction (e.g., listed transaction, confidential transaction, transaction with contractual protection, loss transaction, transaction with significant book-tax difference, transaction involving an asset with a brief holding period, or transaction of interest).
2. Statement of facts and explanation of the agent's rationale for concluding that the taxpayer participated in a reportable transaction.
3. Statement of whether the taxpayer filed a Form 8886.
  - a. If a Form 8886 was filed, statement of facts and explanation of agent's rationale for concluding that the form was deficient.
  - b. If the Form 8886 was not timely filed, include a statement of facts and explanation as to why the agent determined the filing was not timely.
4. P5 ERCS Printout.
5. Opening letter, if one was required.
6. Form 2848.
7. Form 872.
8. 30-day letter ( L4143) or the "Notice of Assessment and Post Assessment Appeals Rights" letter.
9. Signed Form 895, Notice of Statute Expiration, which should be attached to the front of the section 6707A case file.
10. Information on associated flow-through entities (e.g., Form K-1).
11. Other information necessary to identify related cases.
12. Copy of the associated income tax return that gave rise to the disclosure obligation, if applicable (i.e., where disclosure was required with the tax return).
13. Penalty calculation, including detailed computation schedules.
14. Section 6707A Case Overview and Record of Approval.
15. Completed Form 8278, *Assessment and Abatement of Miscellaneous Civil Penalties*. **Please ensure that you are using the most current Form 8278, which can be found at <http://publish.no.irs.gov/catlg.html>.** The appropriate Penalty Reference Number (PRN) to use on Form 8278 for the section 6707A penalty is 648. On page 1, complete column (c) and (d). Also

complete page 8 listing the underlying income tax return reference. The Form 8278 must be signed by the agent and manager.

#### **I. PENALTY CASE FILE—NON-LISTED TRANSACTIONS ONLY**

1. For non-listed reportable transactions, in addition to the information required in section H., include any available information on the presence or absence of the following factors from Treas. Reg. section 301.6707A-1 that relate to a potential rescission request.
  - a. The person, upon becoming aware of the failure to disclose or report a reportable transaction, properly filed a complete and proper, albeit untimely, Form 8886 (or any successor form), as applicable.
  - b. The failure to properly disclose was due to an unintentional mistake of fact that existed despite the person's reasonable attempts to ascertain the correct facts with respect to the transaction.
  - c. The person has an established history of properly disclosing other reportable transactions and complying with other tax laws, including compliance with any requests made under section 6112, if applicable.
  - d. The person demonstrates that the failure to include on any return or statement any information required to be disclosed under section 6011 arose from events beyond the person's control.
  - e. The person cooperates with the Service by providing timely information with respect to the transaction at issue that the Commissioner (or the Commissioner's delegate) may request in consideration of the rescission request.
  - f. Assessment of the penalty would weigh against equity and good conscience, including whether the person demonstrates that there was reasonable cause for, and the person acted in good faith with respect to, the failure to timely file or to include on any return any information required to be disclosed under section 6011. An important factor in determining reasonable cause and good faith is the extent of the taxpayer's efforts to ensure that persons who prepared the taxpayer's return were informed of the taxpayer's participation in the reportable transactions.
2. **NOTE: The absence of factors weighs against rescission, so agents should document negative findings. Consult Treas. Reg. section 1.6707A-1 (d) (or future guidance) for further details.**

#### **J. PENALTY APPROVAL**

1. The agent submits the file to his or her immediate supervisor for written approval of the imposition of the penalty before any report is issued to taxpayer. A "*Case Overview and Record of Approval of §6707A Penalty*" form that may be used for this purpose is posted at the section 6707A penalty link on the ATTI website.

2. If approved, the immediate supervisor records and dates his or her approval on the *Case Overview and Record of Approval of §6707A Penalty* form and forwards the file to the SB/SE or LB&I Territory Manager. In the case of a penalty, the amount of which is determined under section 6707A(b)(2) (i.e., the proposed penalty is the maximum penalty allowable under section 6707A), the immediate supervisor should forward the file to the SB/SE Area Director or the LB&I Director of Field Operations for approval. If the penalty is not approved, the immediate supervisor will return the case to the agent for further development or other action.
3. If the Territory Manager (Area Director or Director of Field Operations, as appropriate) approves the penalty, the file, including the record of approval, will be returned to the agent. Then the agent will issue only one report with L4143 allowing 30 days for taxpayer to agree or protest.
4. The section 6707A penalty has **no** reasonable cause exception. The penalty must be developed wherever it appears legally applicable.

**K. ISSUING THE SECTION 6707A 30-DAY LETTER (L-4143)**

1. The report to assert the section 6707A penalty cannot be prepared on RGS. (As noted previously, an agent can use RGS to calculate the deficiency attributable to the reportable transaction and then compute the penalty amount for individuals and C corporations and may use RGS to store workpapers, but RGS is not able to produce the report.)
2. After the Territory Manager (Area Director or Director of Field Operations, as appropriate) approves assertion of the section 6707A penalty, the agent prepares and sends to the taxpayer the 30-day letter, L-4143, and encloses:
  - a. Form 4549A, *Income Tax Discrepancy Adjustments* (agents must manually prepare- listing type of tax as Form 8278 with IRC 6707A penalty and amount listed on page 2),
  - b. Form 870, *Waiver of Restrictions on Assessment & Collection of Deficiency in Tax & Acceptance of Overassessment*,
  - c. Form 886A, *Explanation of Items*,
  - d. Computation workpaper,
  - e. Publication 1, *Your Rights as a Taxpayer*,
  - f. Publication 5, *Your Appeal Rights and How To Prepare a Protest if You Don't Agree*, and
  - g. Publication 594, *The IRS Collection Process*.
3. An example of the 30-day letter is posted at the section 6707A penalty link on ATTI website.
4. The 30-day letter, L-4143, used for the section 6707A penalty informs taxpayers of Appeal rights, and specifies that the taxpayer must request review by Appeals within 30 days of the date of the notice.

5. In addition, this 30-day letter has been modified to explain that certain information contained in Publication 1 and Publication 5 is not applicable to the section 6707A penalty.
6. Where the taxpayer agrees with the proposed assessment, the agent should request the taxpayer's signature on a Form 870. Where taxpayer makes payment, see Section M, paragraph 1.b. for assessment information.

#### **L. ISSUING A NO-CHANGE LETTER**

1. If, after opening a section 6707A investigation and contacting the taxpayer, it is determined that no section 6707A penalty applies, the agent will issue a no-change letter specifically addressing this penalty. A section 6707A no-change letter is posted at the section 6707A penalty link on the ATTI website.
2. See closing instructions in Section Q.

#### **M. ASSESSMENT**

1. The 30-day report (also known as L4143), is issued with over 9 months remaining on statute and the taxpayer agrees or does not agree but does not request Appeals consideration
  - a. No agreement signed: For cases where the taxpayer does not timely request Appeals consideration, the agent will request assessment of the section 6707A penalty be done by Centralized Case Processing (CCP). The agent will complete Form 3198 and Form 8278 for the case file. The group secretary will transfer the case on ERCS to CCP with Status Code 51, Disposal Code 12 and the penalty amount. Special Instructions on Form 3198 should indicate for CCP to use the Form 8278 to process the assessment. CCP will input the assessment, close to Status Code 90 and ship to files.
  - b. Payment made: Where taxpayer makes payment, agent will immediately process payment using Form 3244A identifying the proper MFT as 13 or 55 and the penalty year, using TC 640 advance payment code.
    - i. Note: No penalty module exists until assessment is made. After agreed closure, where CCP makes the assessment, the payment will catch up to the module once it is created.
    - ii. Note: Interest charges will accrue only after the penalty has been assessed and the taxpayer has failed to remit payment in response to the Notice and Demand for Payment.
  - c. Agreed: Where taxpayer has agreed by signing Form 870, the agent will complete and sign Form 3198 and Form 8278 and will close the case with normal agreed closure using Disposal Code 03 to CCP with update to Status Code 51. Special Instructions on Form 3198 should indicate for CCP to use the Form 8278 to

- process the assessment. CCP will input the assessment, close to Status Code 90 and ship to files.
2. The 30-day report (also known as L4143) is issued and the taxpayer timely requests Appeals consideration:
    - a. For cases where a taxpayer timely requests Appeals' consideration, Appeals will request assessment through its Appeals Processing Services. See Section N, paragraph 6.
    - b. For instructions on the transmittal of the pre-assessment case from Exam to Appeals, see Section N, paragraph 3.
  3. Less than 9 months remaining on the statute of limitations and the agent cannot obtain a consent to extend the statute of limitations: The agent will assess using the quick assessment procedures outlined below. Until final case closure, the statute remains with the group.
    - a. Overview of quick assessment: For cases where less than 9 months remains on the statute of limitation and no extension can be secured, the agent should request via fax a quick assessment from the Centralized Case Processing (CCP) unit. Quick assessments will be worked by the assigned CCP Field Office Resource Team (FORT) within five business days of receipt in the FORT.
    - b. The agent must fax to CCP a copy of the Form 8278, along with a Form 3210.
    - c. The agent will receive an assessment ("23C) Document Locator Number (DLN) back in 2 weeks. The assessment DLN will be associated in IDRS under the MFT 55 (individual) or MFT 13 (entity) modules and the Transaction Code (TC) 240 Penalty Reference Number (PRN) 648 will post to master file in approximately 4 to 6 weeks.
    - d. Once CCP has made the assessment, the expiration of the statute of limitations on assessment is no longer an issue; however, the ERCS system will not reflect the fact that the statute has been protected (i.e., that the penalty already has been assessed). The group must monitor the receipt from the CCP of the Form 8278 and Form 3210 after the quick assessment (as described in subsection c above).
    - e. Once the 23C DLN is received, the group can use that number on the Form 8278 and close the case and ship to files.
    - f. Note: Taxpayers who were not offered pre-assessment Appeals consideration will be offered post-assessment Appeals consideration. Taxpayers who were offered pre-assessment Appeals consideration will not be offered post-assessment Appeals consideration regardless whether they took advantage of the pre-assessment Appeals opportunity.
    - g. **SPECIAL INSTRUCTIONS FOR FISCAL YEAR ASSESSMENTS:** If you are assessing a fiscal year penalty, include this instruction on the Form 3198, *Special Handling Notice For Examination Case Processing*: **"Please use ADJ54 NOT Form 2859 to process this penalty."** Fiscal year assessments take longer to process, so the



agent should received a copy of Form 3210 with the assessment (“23C”) DLN after approximately 3 weeks from the time that the agent has faxed the Form 8278 requesting assessment to the CCP. The agent must monitor IDRS (Integrated Data Retrieval System) for posting of the assessment, which should be reflected after 5-6 weeks.

- h. As soon as CCP makes the assessment, the expiration of the statute of limitations on assessment is no longer an issue; however, the ERCS system will not reflect the fact that the statute has been protected (i.e., that the penalty already has been assessed). The group must monitor the receipt from the CCP of the Form 8278 and Form 3210 (as noted in subsection g above).
- i. To request a quick assessment, the agent should alert the appropriate FORT manager and fax the documents listed below, including the Form 8278 signed by the manager and the Form 3198:

SB/SE: FORT Manager (Memphis, TN)  
 Phone: 901-786-7019  
 Fax: 901-786-7106 or 901-786-7105

LB&I: FORT Manager (Ogden, UT)  
 Phone: 801-620-2102  
 Fax: 801-620-2103

- j. The agent sends by facsimile the signed Form 8278 and Form 3198 to the FORT Manager with a cover sheet that requests that CCP confirm the assessment via fax by returning the Form 8278 along with a copy of the Form 3210 with the assessment (23C) DLN associated with the assessment.
- k. Upon completion of the quick assessment, the CCP will:
  - 1. Notate Form 8278 “Request Completed.”
  - 2. Fax a copy of Form 8278 including the Form 3210 with the assessment (23C) DLN back to the agent for association with the original case file to show that the assessment was completed. Once assessed, the expiration of the statute of limitations on assessment is no longer an issue.
- l. When there is a quick assessment the CP15/215 computer generated notice and demand letter (bill and explanation of the assessment) to the taxpayer is not generated. The quick assessment process uses Form 3552 Prompt Assessment Billing Assembly as the notice and demand to the taxpayer (bill and explanation of the assessment). See IRM 3.17.244.7.

- m. If the penalty relates to a non-listed reportable transaction, the agent also completes the section 6707A Penalty Rescission Checklist and forwards the copy of the penalty file and Appeals case file to LB&I:PFTG:JC for potential rescission request:

**Internal Revenue Service  
LB&I:PFTG:JC  
5338 Montgomery Blvd, NE  
MS4212:ALB:BH  
Albuquerque, NM 87109**

1. If the penalty relates to a non-listed reportable transaction and the taxpayer waives his/her rights to go to Appeals, has agreed in writing to the assessment of the penalty, and has agreed not to file or pursue a claim for refund or credit of the penalty, administratively or through litigation, other than by requesting rescission, then the agent also completes the section 6707A Penalty Rescission Checklist and forwards the copy of the penalty file to LB&I:PFTG:JC for potential rescission request.
2. Completion of the section 6707A Penalty Rescission Checklist:
  - i. All questions should be answered by the agent and LB&I:PFTG:JC. Attach information and documents that support responses.
    - Example 1 - In response to question 5 an IDRS 10 year history showing whether the taxpayer was in compliance with other tax laws, copies of other Forms 8886 filed and verification from OTSA of Forms 8886 filed should be attached.
    - Example 2 – Provide any information that would rebut any factors in favor of rescission. If the taxpayer did not cooperate during the examination or impeded the examination, the agent should provide details in the response to question 6.
    - Example 3 – Provide information/documents that support any factors in favor of rescission. If the agent has information/documents that show that the taxpayer's failure to file Form 8886 arose from events beyond the taxpayer's control, the agent should provide the information/documents in response to question 7.
  - ii. If there are workpapers in the case file that support the responses, then the agent may provide workpaper page references instead of the supporting information/documents.

3. If the penalty relates to a listed transaction and the taxpayer is a publicly traded company:
  - i. The agent also sends Form 8278 and attachments to OTSA. Contacts can be found at the OTSA website: [http://lmsb.stg.web.irs.gov/hq/pftg/otsa/Who\\_We\\_Are/contactusotsa.asp](http://lmsb.stg.web.irs.gov/hq/pftg/otsa/Who_We_Are/contactusotsa.asp)
  - ii. OTSA will review to ensure compliance with §6707A(e) (*i.e.*, disclosures to the Securities and Exchange Commission (SEC) where a taxpayer has an SEC reporting requirement and has participated in a listed transaction).
  
- n. Taxpayers who were not offered an opportunity to seek pre-assessment Appeals consideration (*i.e.*, taxpayers for whom the agent requested quick assessment) will be offered post-assessment Appeals consideration.
  1. When the agent faxes to CCP the request for a quick assessment, he or she will also mail to the taxpayer a “Notice of Assessment and of Post Assessment Appeal Rights” letter with copy of penalty report, calculations and any other items listed on the letter as attachments.
  2. If the taxpayer timely requests post-assessment Appeals consideration, the agent will transmit the case to Appeals using procedures in Section N, paragraph 7.
  3. If the taxpayer does not timely request post-assessment Appeals consideration and CCP has confirmed the assessment DLN, the case can be closed according the procedures in Section Q, paragraph 3.

#### **N. TIMELY APPEALS REQUEST**

1. To obtain Appeals consideration, the taxpayer must submit a timely written request (regardless of the total amount of the proposed assessment) in response to the 30-day letter or the post-assessment notice, and follow the standard protest procedures.
  - a. If the taxpayer’s protest is incomplete, the group manager should return it to the taxpayer and grant additional time to perfect the document.
  - b. If the protest contains information warranting further consideration, the group manager should return the case to the agent for further development. Cases returned for additional development should be considered priority work and given expedited consideration.
  - c. The group manager should attempt to discuss the disputed issues with the taxpayer (or the taxpayer’s representative) in an attempt to resolve the issues, obtain agreement, and limit taxpayer burden. If agreement cannot be reached, the case will be forwarded to Appeals as outlined in the steps below.

2. Upon receipt of a Protest, the agent:
  - a. Will consider the information contained therein and, if appropriate, reconsider the assertion of the penalty.
  - b. May make written comments in response to the Protest (see generally, IRM 4.23.10.17.4). If the agent prepares a rebuttal to the taxpayer's protest, the agent must send a copy of the rebuttal to the taxpayer.
  
3. Sending the Case to Appeals- **Pre-assessment** Appeals Consideration
  - a. **This portion of the procedures has changed significantly from the procedures in place prior to September 14, 2011.** Previously, while the section 6707A case was in Appeals, it remained in Status Code 12 in ERCS and jurisdiction for the penalty, including protecting relevant periods of limitations and seeking assessment, as required, remained with the agent. **Under these new procedures, when the case is transferred to Appeals, jurisdiction and case responsibility, including protecting the statute of limitations and submitting assessment documents, where appropriate, will be transferred to Appeals.**
  - b. Once an agent sends the taxpayer a 30-day letter and the taxpayer timely requests Appeals consideration in response to the letter, the agent should:
    - i. Prepare Form 3210, *Document Transmittal*. Form 3210 is used to track the transfer of the case to the Appeals Office as the section 6707A penalty is not controlled on the Automated Information Management System (AIMS).
    - ii. Prepare a Form 3198 listing PSP Status Code 41 and Disposal Code 07 Appeals. (Secretary or agent will retain a copy of this F3198. IMPORTANT: These status updates will not be performed by the group, and statuses will not be confirmed as transferred to appeals until the signed confirmation receipt of the Form 3210 comes back from Appeals, see more below)
    - iii. Ensure that the penalty case file contains all the documentation described in Sections H and I as well as a rebuttal to the taxpayer's protest, a copy of which should be provided to the taxpayer and his representative.
    - iv. Attach to the front of the section 6707A penalty case file a Form 895 - Notice of Statute Expiration with the correct information and signatures of the Revenue Agent and Team Manager.
    - v. Send the complete penalty file with Form 3210 to your local Appeals APS location via mail. Do not forward any RGS files. For additional information about where to send the file, please refer to the Appeals website at: <http://appeals.web.irs.gov/APS/caserouting.htm>
    - vi. Update the ERCS record to Suspense Type 203, "6707A Penalty Case In-Transit to Appeals". The ERCS record will remain in Status Code 12.
    - vii. Once the agent or group secretary receives a signed Form 3210 from Appeals, the group secretary should:

1. Update ERCS to Status Code 41, Disposal Code 07 and enter the penalty amount.
  2. Send a copy of the signed Form 3210 received from Appeals to your local AIMS/ERCS analyst to close the case to status 90 on ERCS. Appeals then has jurisdiction over the case, and is responsible for the statute, assessing the penalty, etc.
- viii. For RGS final closure: If the section 6707A penalty case has been worked using the RGS generic folder system and is live in inventory, the agent will move the case to the file server and the manager will send the case to archives and then delete it.
- c. Premature referral case return from Appeals and case reopening
- i. If the penalty case file is missing relevant information, Appeals will return the file as a premature referral and release jurisdiction to Compliance using established Appeals procedures using Form 3210 to return case to the field.
  - ii. The group secretary forwards a copy of the Form 3210 received from appeals to your AIMS/ERCS analyst to reopen case back from closed Status Code 90 into active exam group Status Code 12 and gives the case back to the examiner.
  - iii. Examiner will redevelop the case and then re-close to Appeals using the procedures listed above in 3b.
4. Appeals determines whether to sustain in full or in part the section 6707A penalty after considering the litigation hazards of whether the transaction is a listed or otherwise reportable transaction and whether the transaction was properly disclosed.
  5. Appeals recommends appropriate resolution based on the hazards and merits of the issues.
  6. Upon completion of Appeals consideration, the Appeals Officer will send the case files to Appeals Processing Services (APS) to assess the penalty as appropriate and close the case, ensuring the file includes the Appeals case memorandum, closing letter, and agreement form, if any.
  7. Sending the Case to Appeals- **Post-Assessment** Appeals Consideration
    - a. When there is less than 9 months remaining on the statute and the agent can not secure a consent to extend the period of limitation, the agent should request a quick assessment of the section 6707A penalty under the procedures described in Section M, paragraph 3, assuming sufficient facts exist to support imposition of the penalty.
    - b. At the time the agent submits the assessment documents, he or she must also send a letter notifying the taxpayer of the assessment and the ability

- to seek post-assessment Appeals consideration along with a copy of the report and computation of penalty allowing 30 days for response.
- c. A copy of the “Notice of Assessment and of Post-Assessment Appeals Rights” letter is posted on the ATTI website. The agent should ensure that a copy of this letter is included in the case file.
  - d. If the taxpayer submits a timely appeals request in response to the notification of assessment, the agent should:
    - i. Prepare Form 3210, *Document Transmittal*. Form 3210 is used to track the transfer of the case to the Appeals Office as the §6707A penalty is not controlled on the Automated Information Management System (AIMS). Prepare a Form 3198 listing PSP Status Code 41 and Disposal Code 07 Appeals. (Secretary or agent will retain a copy of this Form 3198. IMPORTANT: These status updates will not be performed by the group, and statutes will not be confirmed as transferred to Appeals until the signed confirmation receipt of the Form 3210 comes back from Appeals, see more below)
    - ii. Ensure that the penalty case file contains all the documentation described in Sections H and I as well as a rebuttal to the taxpayer’s protest, a copy of which should be provided to the taxpayer and his representative.
    - iii. Send the complete penalty file with Form 3210 to your local Appeals APS location via mail. Do not forward any RGS files. For additional information about where to send the file, please refer to the Appeals website at: <http://appeals.web.irs.gov/APS/caserouting.htm>
    - iv. Update the ERCS record to Suspense Type 203, “6707A Penalty Case In-Transit to Appeals”. The ERCS record will remain in Status Code 12.
    - v. Once the agent or group secretary receives a signed Form 3210 from Appeals, the group secretary should:
      - 1. Update ERCS to Status Code 41, Disposal Code 07 and enter the penalty amount.
      - 2. Send a copy of the signed Form 3210 received from appeals to your local AIMS/ERCS analyst to close the case to status 90 on ERCS. Appeals then has jurisdiction over the case, and is responsible for the statute, assessing the penalty, etc.
    - vi. If the section 6707A penalty case is on the RGS server, the agent will move it to the server and the manager will send it to archives and then delete it.
  - e. Premature referral case return from appeals and case reopening
    - i. If the penalty case file is missing relevant information, Appeals will return the file as a premature referral and release jurisdiction to Compliance using established Appeals procedures using Form 3210 to return case to the field.

- ii. The group secretary forwards a copy of the Form 3210 received from appeals to your AIMS/ERCS analyst to reopen case back from closed Status Code 90 into active exam group Status Code 12 and gives the case back to the examiner.
- iii. Examiner will redevelop the case and then re-close to Appeals using outlined Form 3210 shipping and Disposal Code 07 procedures listed above in 3b.

## **O. RESCISSION REQUEST**

1. Listed transactions are not eligible for rescission consideration.
2. Currently, a taxpayer may seek rescission only if (1) the Service did not offer an opportunity to go to Appeals prior to assessment of the penalty, (2) Appeals has concluded its consideration of the issue or (3) the taxpayer has, in writing, both waived its right to Appeals consideration and conceded the liability for the penalty.
3. The Deputy Commissioner for Services and Enforcement has been delegated the responsibility to determine for the Commissioner whether to rescind the penalty in part or in full.
4. The taxpayer must seek rescission within 30 days of notice and demand or full payment of the penalty, whichever is earlier.
5. The taxpayer must send the rescission request to LB&I:PFTG:JC for review.
6. After receiving the rescission request, LB&I:PFTG:JC may make a written request seeking additional information and documents relating to the transaction, such as marketing materials and tax opinions, from the person requesting rescission. Requested information must be submitted to LB&I:PFTG:JC within 30 days of the date of mailing of the request for additional information by LB&I:PFTG:JC.
7. LB&I:PFTG:JC may grant an extension of time for good cause to persons who request additional time within the 30-day period. A person's failure to provide the requested information within the applicable time period may weigh against rescission. Meritless claims of privilege may weigh against rescission.
8. Further, the examining revenue agent and other Service employee involved with the examination may be asked to review and comment on the rescission request.
9. LB&I:PFTG:JC will coordinate with Examination and Appeals.

10. LB&I:PFTG:JC will compile the rescission request package and forward a recommendation to the Service-wide Compliance Strategy Executive Steering Committee (SCS ESC) for review.
11. The rescission package will include:
  - a. Letters prepared for the Deputy Commissioner for Service and Enforcement to sign and send to the taxpayer.
  - b. Executive summary sheet that includes a short summary of the amount of the penalty, the basis for asserting the penalty (i.e., what type of transaction), the basis for the taxpayer's rescission request and recommendation.
  - c. Completed section 6707A Penalty Rescission Checklist and all attachments.
  - d. Copy of agent's case file.
  - e. Copy of Appeals Officer's case file, if applicable.
12. SCS ESC reviewers will review the rescission request package.
13. SCS ESC reviewers may request additional information from the taxpayer. See paragraph 6 above and Revenue Procedure 2007-21.
14. SCS ESC reviewers will present their rescission recommendation to the SCS ESC.
15. The SCS ESC will review the recommendation and, if it agrees, will forward it to the office of the Deputy Commissioner for Services and Enforcement to the attention of the Assistant Deputy Commissioner for Services and Enforcement.
16. If the Deputy Commissioner for Services and Enforcement agrees with the recommendation, he will sign the letter to the taxpayer that was prepared by LB&I:PFTG:JC.
  - a. The Deputy Commissioner's office will retain a copy of the signed letter and executive summary sheet, and send the original letter to the taxpayer.
  - b. The Deputy Commissioner's office will return the rescission package to LB&I:PFTG:JC and include a copy of the signed letter.
17. If the Deputy Commissioner's office does not agree with the recommendation or needs more information, it will contact LB&I:PFTG:JC.
18. LB&I:PFTG:JC will notify any function in the IRS that still has the taxpayer's return under consideration (e.g., Exam, Appeals, or Counsel) of the rescission request determination.



19. **The rescission determination is not reviewable by Appeals or by any court.**
20. ***Please note:*** Rev. Proc. 2007-21, 2007-9 C.B. 613, provides detailed information about how a taxpayer seeks rescission and what factors support a rescission request. See *also* Treas. Reg. section 1.6707A-1T(d).

**P. CONTINUATION OF THE INCOME TAX EXAMINATION AND SECTION 6662A CONSIDERATIONS**

1. In general, the income tax examination should not be delayed pending consideration of a rescission request. There are situations where the determination of whether the section 6707A penalty applies can affect the determination of whether the section 6662A penalty applies.
2. Section 6662A (“Reportable Transaction Understatement”) was added by section 812 of the AJCA and imposes a 20 percent penalty on an understatement resulting from a reportable transaction that is properly disclosed and a 30 percent penalty on an understatement resulting from a reportable transaction that is not properly disclosed. The section 6662A penalty will not be imposed if the taxpayer adequately disclosed the reportable transaction, and meets other criteria to establish reasonable cause and good faith.
3. If Appeals rejects the proposed assessment of a section 6707A penalty based on its determination that the transaction in question was not a reportable transaction, then the section 6662A penalty will not apply. If Appeals rejects the proposed section 6707A assessment based on its determination that the transaction was reportable but was properly disclosed, the section 6662A penalty will be reduced from 30 to 20 percent.
4. In addition, for purposes of section 6662A, a taxpayer is deemed to have properly disclosed the reportable transaction if the Commissioner has rescinded the section 6707A penalty with respect to the transaction. If the Commissioner rescinds the section 6707A penalty, the section 6662A penalty may not apply depending on whether the taxpayer meets the other criteria for relief under the reasonable cause and good faith provisions of section 6664. Therefore, the income tax case should not be closed until the rescission determination is made if (1) the agent proposes a section 6662A penalty with respect to the reportable transaction, (2) the taxpayer meets the substantial authority standard in section 6664(d)(2)(B), and (3) the taxpayer meets the reasonable belief standard in section 6664(d)(2)(C). If the section 6707A penalty is rescinded, the taxpayer is deemed to have properly disclosed the transaction and if the taxpayer met the criteria to demonstrate reasonable cause and good faith, the section 6662A penalty does not apply.
5. In contrast, where the results of the examination will not be affected by the Commissioner’s rescission determination (i.e., there is no proposed section 6662A penalty or the taxpayer would be liable for the penalty even if it had adequately disclosed because it failed to meet the other criteria to establish reasonable cause and good faith), the case should proceed and can be closed from the group without waiting for the conclusion of the rescission determination.

**Q. PENALTY CASE FILE CLOSURE**

1. Whether or not an agent has pursued a section 6707A penalty in connection with an income tax examination, the penalty case file will need to be closed in a particular fashion. Using these case closing procedures should ensure the closed case file can be secured from files using the DLN of the TC 240 PRN 648.
2. If the case has not been assessed (i.e., there was no request for a quick assessment) and taxpayer has not requested Appeals consideration, follow normal closing to CCP for assessment to be made using Form 8278. CCP will make assessment, close to Status Code 90 and ship to files. (See Section M *Assessment* that contains the Form 3198 instructions and group closing codes, i.e., Status Code CCP 51 with Disposal Code 03 for agreed cases and Disposal Code 12 for unagreed cases that are not appealed.)
3. If a section 6707A Penalty Was Assessed by the Group under the Quick Assessment Procedures:
  - a. Obtain a transcript after final posting of the taxpayer's account and identify the Document Locator Number (DLN) that is associated with Transaction Code (TC) 240 and Penalty Reference Number (PRN) 648. (If necessary, the agent can use the assessment ("23C") DLN provided on the Form 3210 when CCP confirmed the assessment.)
  - b. Place a Form 3198 on the case file. In the "Special Features" section, check the box for "Other Instructions" and include the following language: IRC section 6707A Penalty Case File – Associate with Penalty Assessment Under DLN" (and input the DLN identified from the transcript or 23C DLN in item 1). Use PSP Status Code 41 and Disposal Code 12 on Form 3198.
  - c. Attach a signed Form 895, *Notice of Statute Expiration*, on the front of the case file.
  - d. Ensure that the penalty case file includes the items identified in Sections H and I.
  - e. Send case to manager for review.
  - f. The group secretary will transfer the record in ERCS to Status Code 41, Disposal Code 12, and enter the penalty amount. (Please ensure the penalty amount is entered under the **penalty** amount and not erroneously entered into the **deficiency** amount.)
  - g. The group secretary will send an e-mail to your AIMS/ERCS analyst requesting the penalty record be closed to Status Code 90 on ERCS. The AIMS/ERCS analyst will update the Status Code to 42 and verify the assessment has been made prior to closing the ERCS record to Status Code 90.

- h. For RGS final closure: If the section 6707A penalty case has been worked using the RGS generic folder system and is live in inventory, the agent will move it to file server and the manager will send case to archives and then delete it.
- i. The group secretary will ship the case to files. The closed case must be associated with the DLN of the Quick Assessment with the Transaction Code 240 and Penalty Reference Number 648. The mailing of the closed case file must include a confirmation of receipt Form 3210 that the group retains for **three years**.

SB/SE closed case file is sent to:

Internal Revenue Service  
Cincinnati Service Center  
201 W Rivercenter Blvd Stop 2800-F  
Covington, KY 41011

LB&I closed cases send to:

IRS - Centralized Case Processing  
Scowcroft Building  
Mail Stop 4030  
1973 North Rulon White Boulevard  
Ogden, UT 84404

- 4. If No section 6707A Penalty Was Assessed but the Case was Established on ERCS: No change case.
  - a. Form 8278 – Penalty Assessment (Page 1) - Complete columns {c} & {d} for the applicable penalty amount of zero. The 3 digit reference code is 648. Complete page 8 referring to the income tax return. The Form must be signed by the agent and the group manager.
  - b. Attach Form 3198 indicating MFT 13 for an entity or MFT 55 for an individual, reflect the penalty amount as "\$0", report the time on the case to the penalty administrative file. Mark CCP Status Code 51 and Disposal Code 02. Under instructions insert directions for CCP to post a \$0 assessment, and for all workpapers to be kept with the closed case administrative file and filed with the Form 8278 DLN that will be assigned for TC 240 PRN 648.
  - c. Ensure that the case is flagged to note that a penalty was considered but not assessed.
  - d. The group secretary will transfer the ERCS record to CCP Status Code 51, Disposal Code 02 and ship to CCP..

- e. Follow normal closing procedures to Memphis Centralized Case Processing for SB/SE or Ogden Centralized Case Processing for LB&I. CCP establishes a TC 240 PRN 648 (noting that no penalty was assessed) and a DLN for the file. The file is stored like an audit file and can be retrieved if needed in the future using the DLN. CCP will close case to Status Code 90.
  
- f. If the taxpayer was contacted, the agent should prepare the undated 6707A no change letter with agent as contact and manager as signor and place in case file. Letter will then be signed, dated and mailed by manager as the case is closed to CCP for the zero posting. Manager will place the dated copy of the no-change letter in the case file and note on the back of F3198 that no letter should be sent by CCP.

## ATTACHMENT 2

### TECHNICAL GUIDANCE ON APPLYING THE IRC §6707A PENALTY

#### **I. INTRODUCTION**

This memorandum: (1) explains technical issues relating to the §6707A penalty which imposes a monetary penalty for failure to comply with the disclosure requirements of §6011 and the associated regulations; (2) provides information about the requirements of §6011 and the associated regulations; and (3) provides miscellaneous information to assist in developing the §6707A penalty cases.

This information is not a substitute for the guidance provided by Notice, Revenue Procedure, Regulation or any future guidance that may be issued. If you believe the §6707A penalty may apply to the transaction you are reviewing, you should consult the regulations and Counsel to determine whether the taxpayer is liable for the penalty. Information about the procedures for imposing the §6707A penalty are contained in the associated procedural guidance. For additional information, please refer to the IRC § 6707A penalty link on the AJCA Penalties website at <http://mysbse.web.irs.gov/exam/tip/ajca/default.aspx>.

#### **II. SECTION 6707A PENALTY**

##### **A. Overview**

Section 6707A provides a monetary penalty for the failure to include on any return or statement any information required to be disclosed under §6011 with respect to a reportable transaction. Under Treas. Reg. §1.6011-4, disclosure is required with respect to five (formerly six) types of “reportable transactions.” The §6707A penalty is in addition to any other penalty that may be imposed, and applies without regard to whether the transaction ultimately results in an understatement. It is a stand-alone penalty; it does not require an associated income tax examination.

The penalty previously was unrelated to the tax impact of the reportable transaction that gave rise to the penalty and ranged between \$10,000 and \$200,000 depending on the type of transaction and type of taxpayer involved. The Small Business Jobs Act of 2010 amended the Section 6707A penalty and is retroactive to penalties assessed after December 31, 2006. The application of the penalty remains unchanged; only the calculation of the penalty amount has been amended. Under the amendment, the penalty is “75 percent of the decrease in tax shown on the return” as a result of the reportable transaction or the decrease in tax “which would have resulted from such transaction if such transaction were respected for federal tax purposes” with the following maximum and minimum penalty amounts: The maximum penalty in the case of a listed transaction is \$100,000 for a natural person and \$200,000 for all other taxpayers and in the case of a non-listed reportable transaction is \$10,000 for a natural person and \$50,000 for all other taxpayers. The minimum penalty for both listed

transactions and non-listed reportable transactions is \$5,000 for a natural person and \$10,000 for all other taxpayers.

Section 6707A(e) further provides that taxpayers that are publicly traded companies (*i.e.*, those with SEC filing requirements under Sections 13 or 15 of the Securities and Exchange Act of 1934) are required to disclose their liability for §6707A penalties in public reports filed with the Securities and Exchange Commission. See Rev. Proc. 2005-51, 2005-2 C.B. 296, as well as Rev. Proc. 2007-25, 2007-12 C.B. 761, for additional information.

Unlike many other penalties, the §6707A penalty contains no reasonable cause exception. Also unlike most other penalties, §6707A allows the Commissioner to rescind the imposition of the penalty with respect to reportable non-listed transactions if it would promote compliance with the tax laws and effective tax administration. The penalty cannot be rescinded with respect to a listed transaction. A decision to rescind must be accompanied by a record describing the facts, reasons for the decision, and the amount rescinded. While a taxpayer may challenge, in Appeals and in court, the determination that it engaged in a reportable transaction or that it failed to timely and adequately disclose its participation in such a transaction, it cannot seek such review of the Commissioner's refusal to rescind penalty. See Rev. Proc. 2007-21, 2007-1 C.B. 613, for additional information on the rescission process. The IRS is required to submit an annual report to Congress summarizing the application of the §6707A penalty and the rescission provision.

## **B. When does Amended Section 6707A become effective?**

The amendment to Section 6707A applies to open cases, as well as any assessments made after December 31, 2006

## **C. Application of Section 6707A—in general**

### 1. Notice 2005-11

Notice 2005-11: informs taxpayers that the Treasury and IRS plan to issue new regulations under §6707A; and provides interim guidance on the imposition and rescission of penalties under §6707A. The Notice was superseded by Treasury Regulation 301.6707A-1.

The Temporary Regulation states that the Service will impose a penalty under §6707A with respect to each failure to timely and adequately disclose a reportable transaction as required by Section 6011 and the associated regulations. However, a taxpayer that fails to attach a reportable transaction disclosure statement to a return, including an amended return, and also fails to provide a copy of a required disclosure statement to the Office of Tax Shelter Analysis (OTSA), will only be subject to a single penalty under §6707A.

The following two examples from the Treasury Regulation illustrate the application of the §6707A penalty for failure to comply with the requirement to file a reportable transaction disclosure statement.

#### Example 1

Taxpayer T is required to attach a Form 8886, *Reportable Transaction Disclosure Statement*, to its return for the 2007 taxable year and to send a copy of the Form 8886 to OTSA at the time it files its return. Taxpayer T fails to attach the Form 8886 to its return and fails to send a copy of the Form 8886 to OTSA. Taxpayer T is subject to a single penalty under section 6707A for failure to disclose because Taxpayer T failed to comply with the disclosure requirements of section 6011. A penalty under section 6707A also would apply if Taxpayer T had failed to comply with only one of the two requirements.

#### Example 2

Same as Example 1, except that Taxpayer T also subsequently files an amended return for 2007 that reflects Taxpayer T's participation in the reportable transaction. Taxpayer T fails to attach a Form 8886 to the amended return as required by § 1.6011-4(e)(1). Taxpayer T is subject to an additional penalty under section 6707A for failing to disclose a reportable transaction.

2. A taxpayer generally cannot cure a failure to file a disclosure by filing a disclosure with an amended return.

Under the current regulations, filing an amended return with a disclosure will not cure the failure to file a disclosure with the original return unless the amended return is filed before the due date of the original return (whether extended or not).

#### Example:

Taxpayer's extended due date is August 15<sup>th</sup>. On June 1, he files a return but fails to include the required disclosure. On September 1 (i.e., after the due date of the return), he files an amended return with the disclosure. He is still liable for the penalty. It doesn't matter that he attempted to cure the problem or whether he attempted to do so before or after the IRS discovered his participation. If, however, Taxpayer filed the amended return before August 15<sup>th</sup>, the amended return would be considered a "superseding return" that is treated as the original return. Because this superseding return was filed with the required disclosure before the due date (as extended), taxpayer is not liable for the § 6707A penalty.



#### D. Application of Section 6707A—late filed returns

Notice 2005-11 provides that under §6707A, the penalty applies to each failure to provide a disclosure statement that is required to be attached to a return, including an amended return, filed after October 22, 2004 (with a copy sent to OTSA, if required), regardless of whether the original return was due on or before October 22, 2004.

The §6707A penalty will not be imposed until a taxpayer files a return and fails to provide the required disclosure statement. In other words, the §6707A penalty will not be imposed where a taxpayer has not yet filed a return—even if the due date for that return has already passed. Thus, the §6707A penalty will not be imposed where a taxpayer has failed to timely file a return (or required disclosure statement) but subsequently files a late return with the required disclosure statement.

### III. SECTION 6011 DISCLOSURE REQUIREMENTS

#### A. Overview of Disclosure Requirements

The application of the Section 6011 disclosure regulations requires that the taxpayer meet the definition of “participation” in a “reportable transaction” as those terms are defined in the relevant versions of the regulations, as well as other requirements of the applicable regulations described below. Whether a taxpayer was required to disclose under the Section 6011 regulations depends on what version of those regulations was in effect when the taxpayer entered into the transaction. The version of the regulations that applies to a transaction at the time the transaction was entered into by the taxpayer will remain applicable to the taxpayer, even if the regulations subsequently were modified. When the Section 6011 regulations do not impose a disclosure requirement, the Section 6707A penalty cannot apply. **Therefore, as explained more fully below, even if a taxpayer files a tax return after October 22, 2004, reflecting participation in a listed or non-listed reportable transaction and fails to file a Form 8886, he or she might not be subject to the Section 6707A penalty; further analysis is required before imposing the 6707A penalty.**

1. Returns filed on or before February 28, 2000: The disclosure regulations do not apply to any tax returns filed on or before February 28, 2000. See TD 8877 for more details.
2. Returns filed after February 28, 2000 and transactions entered into before January 1, 2001 (“Old rule”): The disclosure regulations initially applied to Federal **corporate** income tax returns filed after February 28, 2000. A listed transaction is not treated as a reportable transaction if it has affected the taxpayer’s Federal income tax liability as reported on any tax return filed on or

before February 28, 2000. A transaction may be an “other reportable transaction” only if it is entered into after February 28, 2000.

If a taxpayer entered into the transaction before 2001, it could be subject to the disclosure regulations *only* if it: (1) was a corporation and (2) the taxpayer reasonably estimated that the transaction would reduce the taxpayer's Federal income tax liability by more than \$1 million in any single taxable year or by a total of more than \$2 million for any combination of taxable years (the projected tax effect test – Section 1.6011-4T(b)(4)). See TD 8877, TD 8896, and TD 8961 for more details.

If a taxpayer entered into the transaction after February 28, 2000 and before 2001, it could be subject to the disclosure regulations *only* if it: (1) was a corporation and (2) the taxpayer reasonably estimated that the transaction would reduce the taxpayer's Federal income tax liability by more than \$1 million in any single taxable year or by a total of more than \$2 million for any combination of taxable years (the projected tax effect test – See former Section 1.6011-4T(b)(4)); TD 8877, TD 8896, and TD 8961 for more details.

1. Transactions entered into **on or after January 1, 2001 and before January 1, 2003: Taxpayer filed its return reporting the transaction on or before June 14, 2002:** If the taxpayer entered into the transaction on or after January 1, 2001 and filed its tax return reporting the transaction (i.e. reflecting the tax impact of *that* transaction) on or before June 14, 2002, the taxpayer was subject to the “old rule.” In other words, the taxpayer was subject to the disclosure rules only if it was a corporation and the transaction reduced the taxpayer's Federal income tax liability by the threshold amounts listed under the “old rule” above. See TD 9000; and TD 8877, TD 8896, and TD 8961 for more details.
2. Taxpayer filed its return reporting the transaction **after June 14, 2002:** If the taxpayer entered into the transaction on or after January 1, 2001 and did not file its tax return reporting the transaction (i.e. reflecting the tax impact of that transaction) on or before June 14, 2002, the taxpayer was subject to the disclosure rules if it was a corporation, individual, trust, partnership, or S corporation. However, taxpayers other than corporations were only subject to the disclosure rules with respect to listed transactions. Listed transactions no longer had to meet the projected tax effect test. See TD 9000 for more details.
3. Transactions entered into **on or after January 1, 2003:** All taxpayers who are required to file a tax return are subject to the disclosure rules with respect to all reportable transactions, including listed transactions. See TD 9017, TD 9046, TD 9108, TD 9295, and TD 9350 for more details.

## **B. How Does A Taxpayer Disclose a Reportable Transaction?**

Since March 2003, the Form 8886, *Reportable Transaction Disclosure Statement*, has been available to taxpayers for use as the disclosure statement required under §6011 and the regulations. Under the regulations issued prior to TD 9017, taxpayers did not have to use the Form 8886, but they had to disclose the information required under the regulations on a statement attached to their return. Under the current version of Treas. Reg. §1.6011-4(e), the Form 8886 must be attached to the taxpayer's tax return (or amended return) for each taxable year for which a taxpayer participates in a reportable transaction. In addition, when the taxpayer files its first Form 8886, a duplicate form must be sent to the Office of Tax Shelter Analysis (OTSA). Generally, a taxpayer should first file a Form 8886 beginning with the first year that it has participated in the reportable transaction. Thus, the requirement to file a duplicate Form 8886 should arise during the first year of participation in the reportable transaction. If, however, the taxpayer fails to file any Form 8886 in its first year of participation, the requirement to send a duplicate Form 8886 to OTSA will arise whenever the taxpayer first submits a Form 8886—regardless of how many years it has been engaged in the reportable transaction at issue. A failure to submit either filing is a failure to satisfy the disclosure requirements and results in liability under §6707A. There are special rules relating to the filing of a disclosure statement for transactions that become listed transactions or transactions of interest after the taxpayer has filed a return reflecting the taxpayer's participation in the transaction. In these situations, depending on which version of the regulation applies to the transaction, taxpayers may have to disclose with their next filed return and send a copy to OTSA or, under TD 9350, taxpayers may have to disclose to OTSA within 90 days after the date the transaction became a listed transaction or transaction of interest. If a taxpayer has entered into more than one reportable transaction, the taxpayer is required to meet the disclosure requirements with respect to each transaction; however, only one disclosure is made for substantially similar transactions.

### **C. Identifying Reportable Transactions**

#### **1. What is a Reportable Transaction?**

Treas. Reg. 1.6011-4(b) currently lists 5 types of reportable transactions. They are: (1) "listed transactions," (2) confidential transactions, (3) transactions with contractual protection, (4) loss transactions, and (5) transactions of interest. The definition of reportable transaction will vary greatly depending on which version of the regulations applies to the transaction, so it is imperative to look to the actual language of the regulations. For example, transactions with a significant book-tax difference were formerly a type of reportable transaction. Additionally, over time there have been exceptions to the reporting requirements contained in the regulations, such as the exception provided in Notice 2006-16. A list of transactions that taxpayers are not required to disclose is available on the OTSA Website ([lmsb.irs.gov/hq/pftg/otsa/exceptions-angel list.asp](http://lmsb.irs.gov/hq/pftg/otsa/exceptions-angel%20list.asp)).

## 2. Did the taxpayer participate in a Reportable Transaction?

When assessing whether §6707A applies, examiners must evaluate whether the taxpayer participated in a reportable transaction within the meaning of Treas. Reg. §1.6011-4(c). Again, this determination will vary based upon which version of the regulations is in effect for the transaction, so the actual language of the regulations must be consulted. Since TD 9046, the regulations have defined participation in slightly different ways depending upon the type of transaction involved. Examiners may encounter additional difficulties with the term “tax benefit” within the meaning of the regulation. For example, Treas. Reg. §1.6011-4(c)(3)(i)(B) states that a taxpayer participates in a confidential transaction if its tax return reflects a tax benefit from that transaction. It may be possible that certain transactions create tax benefits that occur in some years but not in others and would therefore require only intermittent disclosure. You should consult the regulations and Counsel if you believe that a provision may apply to the transaction you are reviewing.

## 3. Resources for Identifying Undisclosed Reportable Transactions

In working to identify undisclosed reportable transactions, it is essential that examiners become familiar with the various characteristics that are peculiar to tax shelters. They are outlined in the “Corporate Tax Shelter Check Sheet” which was developed to assist examiners in identifying corporate tax shelters and can be accessed on the OTSA Website under the link entitled “Tax Shelter Checksheet.”

Another resource to identify the characteristics of tax shelter transactions is an article by Michael Graetz, Professor of Law, Yale Law School, that is available at the OTSA Website, via the link entitled “Working a Tax Shelter Case.”

Information on a number of emerging issues with which examiners should become familiar is available on the OTSA Website using the link entitled “Emerging Issues.”

## **IV. MISCELLANEOUS CONSIDERATIONS**

### **A. Tax Accrual Workpapers**

Examiners must determine whether to request the taxpayer’s tax accrual workpapers. For instance, if the preliminary review of a return reveals the presence of a Form 8886 or other indications of a listed transaction(s), the examiner should consider immediately requesting the tax accrual workpapers.

For guidance in making this determination, examiners should refer to Announcement 2002-63, which sets forth the Service’s revised policy regarding when it will request, and, if necessary, issue a summons for tax accrual and other financial audit

workpapers. Examiners also should review IRM 4.20.10, Requesting Audit, Tax Accrual, or Tax Reconciliation Work Papers, and Frequently Asked Questions (FAQs). For more information, see the OTSA Website.