IRM PROCEDURAL UPDATE

DATE: 06/17/2026

NUMBER: sbse-20-0626-0643

SUBJECT: Automatic Exemption From Penalty Administrative Relief (AEP)

AFFECTED IRM(s)/SUBSECTION(s): 20.1.1

CHANGE(s):

IRM 20.1.1.3.3.2.5, Automatic Exemption from Penalty Administrative Relief: added subsection for penalty relief instructions.

(1) Automatic Exemption from Penalty (AEP) officially replaces First Time Abate (FTA) for all eligible original returns due January 1, 2027, and after. AEP is administrative relief that is granted at original return processing. To qualify, the eligible original return must be filed within the required timeframe and meet the criteria demonstrating a compliance history of filing and paying on time. When these conditions are met, Master File systemically prevents the assessment of applicable penalties. Under certain circumstances, AEP may be granted manually. See IRM 20.1.1.3.3.2.6, Manually Grant Automatic Exemption from Penalty- IRS Error.

(2) The transition from FTA to the new AEP will begin in Summer 2026, starting with 2025 tax year and 2026 quarterly original returns. AEP will then continue for all subsequent tax periods.

(3) FTA is still available for tax year 2024 and quarterly 2025 returns and earlier. It is also available for those tax year 2025 and quarterly 2026 returns that did not receive AEP consideration during the transition year. However, for eligible returns with original return due dates on or after January 1, 2027, FTA is no longer available.

(4) Since AEP begins in Summer 2026, not all 2025 tax year and 2026 quarterly returns will receive AEP consideration. Taxpayers that receive notice of penalty assessment may contact the IRS to request FTA if they believe they have a timely compliance history.

(5) AEP prevents the assessment of the following penalties:

- Failure to File (FTF) under IRC 6651(a)(1), IRC 6698(a)(1), or IRC 6699(a)(1),
- Failure to Pay (FTP) under IRC 6651(a)(2) and/or IRC 6651(a)(3), and
- Failure to Deposit (FTD) under IRC 6656

(6) **AEP applies to these eligible returns:**

- Form 1040, U.S. Individual Income Tax Return

- Form 1065, U.S. Return of Partnership Income
- Form 1120, U.S. Corporation Income Tax Return
- Form 1120-S, U.S. Income Tax Return for an S Corporation
- Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return
- Form 941, Employer's Quarterly Federal Tax Return
- Form 943, Employer's Annual Tax Return for Agriculture Employees
- Form 944, Employer's Annual Tax Return
- Form 945, Annual Return of Withheld Federal Income Tax
- Form CT-1, Employer's Annual Railroad Retirement Tax Return

Note: Forms CT-1 are eligible but are NOT programmed to systemically receive application of AEP at posting of the original return. Taxpayers may contact the IRS for manual consideration of this relief either orally or in writing. See IRM 20.1.1.3.3.2.6, Manually Grant Automatic Exemption from Penalty- IRS Error.

(7) An eligible return must be filed within three years of the original return due date to receive AEP consideration.

Example: 1) An original 2025 return (with an original return due date of 04/15/2026) was received April 10, 2028, from Taxpayer A. The return is processed and systemically considered for AEP.

Example: 2) An original 2025 return from Taxpayer B wasn't received until June 27, 2029. The original return due date was 04/15/2026, and the taxpayer had an extension to file until 10/15/2026. Since the original return was received more than three years past the **original** return due date, Taxpayer B's return is not eligible for AEP.

Example: 3) An original 2024 return from Taxpayer C was received on 02/01/2028, which is within three years of the original return due date of 04/15/2025. The return is sent for processing but is not eligible for AEP consideration because only returns for the 2025 tax year (and 2026 quarters for employment returns) and after can be considered. The taxpayer may request First Time Abate.

Example: 4) An original 2026 second quarter Form 941 from Taxpayer D was received on the original return due date of July 30, 2026, showing a balance due that would result in a FTP and/or FTD penalty. The return is processed and systemically considered for AEP.

(8) **Criteria demonstrating a compliance history of filing and paying on time** are met for the **prior three years** (or **12 consecutive quarters**) if:

- The same return type, as the original return, was filed for each year or quarter (or records show there was no requirement to file), **and**

- Either no penalty (except the estimated tax penalty) was assessed **#** for $1.00 or more **#, or** a penalty was assessed, but then abated for reasonable cause or IRS error, and **not** for AEP, First Time Abate (FTA), or tolerance, **and**
- The additional criteria shown below in (8) are met for employment tax returns only.

(9) Employment tax returns **must** meet all criteria shown above in paragraph (7) along with the criteria shown below:

- The return hasn't received four or more failure to deposit (FTD) penalty waivers (Waiver Code 24 and/or 25) in the prior three years (or 12 consecutive quarters), See IRM 20.1.4.3, Restrictions on Assessments, criteria. (Waiver codes can be found in (CC) BMFOL definer R with the literal FTD PEN WAIVER CD.), **and**
- The FTD penalty on the current return was NOT because of Electronic Federal Tax Payment System (EFTPS) avoidance.

Note: Consider both MFTs 01 and 14 together if Forms 941 and Forms 944 were filed for different tax periods during the prior three years (or 12 consecutive quarters) when evaluating the compliance history of filing and paying on time. (For example: IRS records show a Form 944 was filed for the 2023 tax year, and Forms 941 filed for all quarters of 2024 and 2025. MFTs 01 and 14 are considered together for the compliance history evaluation.)

(10) For a jointly filed return, both the primary and secondary TINs, and both MFTs 30 and 31, must meet the criteria demonstrating a compliance history of filing and paying on time.

(11) During original return processing, Master File determines whether AEP applies. It grants AEP when an unreversed TC 971 with Action Code 995 is present on modules, for that return type (MFT), for the prior three years (or 12 consecutive quarters).

(12) During original return processing, Master File will **NOT** grant AEP if one of the three prior year modules (or 12 consecutive quarters):

- Has a TC 972 A/C 995 (reversing the TC 971 A/C 995), or
- Does NOT contain the TC 971 A/C 995 at all, or
- Has an unreversed TC 971 A/C 996 (showing AEP or prior FTA was granted)

(13) Modules with Substitute for Returns (SFRs) and/or returns completed per IRC 6020(b) procedures (agreed or unagreed) are not considered compliant and should not reflect an unreversed TC 971 A/C 995.

(14) When AEP is granted, Master File will:

- Post a TC 971 A/C 996 showing the module received AEP. The penalty type and amount are recorded in the MISC field. **IMF** modules display FTF penalty amounts in the first 10 digits of the MISC field, and the FTP amount in the second 10

digits. **BMF** modules display a separate TC 971 A/C 996 for each penalty not assessed and will show the penalty type and amount in each MISC field, and

- Systemically prevent the assessment of the FTF, FTP and/or FTD penalty on the module, and
- Post a TC 971 A/C 996 on the secondary TIN for Married Filing Joint returns, and
- Issue the normal routine settlement notice. The notice will exclude any FTF, FTP, and/or FTD penalty amount in the balance due, and
- Issue a separate notice (CP95/CP95(SP) for IMF) and (CP195B/CP895B for BMF) explaining to the taxpayer that AEP was granted and no penalties were assessed.

(15) A posted (unreversed) TC 971 A/C 996 will prevent future FTF, FTP, and/or FTD penalty accruals or assessments on that module. For example, when using the IDRS command code (CC) INTST to provide an outstanding account balance, the display will show $0.00 for accrued, assessed, and total FTP penalty.

Note: Master File will prevent posting of manual adjustments containing FTF, FTP, or FTD penalty assessments when an unreversed TC 971 A/C 996 is on the module.

(16) Although the TC 971 A/C 996 prevents future accruals and assessments on the module for the FTF, FTP, and FTD penalty, other penalty types may be assessed when applicable. Interest is charged on the unpaid balance and continues to accrue until the balance is fully paid.

(17) Once the TC 971 A/C 996 posts to the module, Master File will not consider that return eligible for AEP until three more consecutive years (or 12 consecutive quarters) of a history of timely filing and payment (i.e. TC 971 A/C 995) is established.

(18) Taxpayers can identify when AEP was granted on their return by viewing their online account transcript, which will reflect an unreversed TC 971 A/C 996. Taxpayers may also rely on the CP95, CP95(SP), CP195B, or CP895(b) notice they received when AEP was applied to their return.

(19) If the eligible qualified return didn't receive AEP due to an IRS error, see IRM 20.1.1.3.3.2.6, Manually Grant Automatic Exemption from Penalty- IRS Error.

(20) If AEP is not granted at posting of the original return, normal routine settlement notices are issued and the balance due will include the applicable penalty assessment. The option to submit a request for penalty relief due to reasonable cause is available. See IRM 20.1.1.3.2, Reasonable Cause.

Note: If a penalty is abated for reasonable cause, and no other penalties are showing on the module, the module will reflect as compliant, and Master File should post a subsequent TC 971 A/C 995.

IRM 20.1.1.3.3.2.6, Manually Grant Automatic Exemption from Penalty - IRS Error: added subsection for penalty relief instructions.

(1) Automatic Exemption from Penalty (AEP) may be granted manually **only** when an IRS error prevented an otherwise qualified and eligible return from receiving the non-assessment of penalties when the original return posted. Once it's determined AEP was not granted due to IRS error, whether it was discovered through internal actions or taxpayer contact, manually grant AEP. Circumstances include:

- System or programming limitations that prevented the return from receiving AEP at posting.
- The original return posting to an incorrect TIN or tax period.
- A math error that wasn't properly identified during processing.

(2) The following examples support application of manual AEP relief:

Example: 1) An original Form CT-1 was filed late and meets all AEP criteria. However, due to programming limitations, the return didn't receive the systemic non-assessment of penalties at posting. In this situation, AEP may be granted manually.

Example: 2) The taxpayer attached Schedule B to their 2026 second-quarter Form 941, which showed unpaid tax. Prior to processing, the Schedule B was detached from the return. As the return completed processing, an FTD penalty was assessed, and AEP wasn't granted because the Schedule B must be present with the return. The Schedule B was later located and determined to be valid and complete. Because the Schedule B was originally filed with the Form 941 and was detached through no fault of the taxpayer, AEP should be manually considered and granted if applicable.

Example: 3) Taxpayer A filed a late 2025 Form 1040 showing unpaid tax. However, a 2025 return filed by Taxpayer B erroneously posted to Taxpayer A's 2025 module under Taxpayer A's TIN. The incorrect posting of Taxpayer B's return prevented the systemic application of AEP for Taxpayer A. The return filed by Taxpayer B was later removed and processed to the correct TIN, and the 2025 module was adjusted to reflect the correct information for Taxpayer A. Although FTF and FTP penalties would normally apply due to the unpaid tax, Taxpayer A's original return is eligible and qualifies for AEP. Because this resulted from IRS error, AEP should be granted manually for Taxpayer A.

Note: The IRS should proactively grant AEP relief when an error is identified and corrected without taxpayer contact, as well as when a taxpayer calls or writes to report the error and request relief.

(3) ***Additional Rule when manually considering AEP for Late Filed Returns:*** For late-filed eligible returns, an additional requirement applies to ensure the relief isn't granted more often than allowed.

Caution: *Do not manually grant AEP if a module for the same MFT:*

1) *Has an unreversed TC 971 A/C 996 in the* **prior three tax years**, or

2) *Has an unreversed TC 971 A/C 996 in the* **subsequent three tax years**

Example: A late-filed 2025 Form CT-1 is received 04/10/2029. The return is eligible and meets criteria for AEP. There is no unreversed TC 971 A/C 996 in any of the prior three years (2022, 2023, 2024); However, since this is a late filed return, the subsequent three years (2026, 2027, 2028) must also be checked. Research shows an unreversed TC 971 A/C 996 dated 06/30/2028 on the 2027 module. AEP cannot be manually granted for the late-filed 2025 Form CT-1.

(4) **When manually granting the Automatic Exemption from Penalty, and the penalty has already been assessed:**

- Ensure the eligible return qualifies to receive the relief per IRM 20.1.1.3.3.2.5, **Automatic Exemption from Penalty Administrative Relief**, and
- Input an adjustment with a TC 161, 271, or 181 to remove the applicable FTF, FTP, and/or FTD penalty. **Use PRC 043**, and
- Use CC FRM77 to input the TC 971 A/C 996. For IMF modules showing Married Filing Joint, also input the TC 971 A/C 996 to the secondary TIN and cross reference the primary TIN. The TC 971 A/C 996 prevents the accrual/assessment of the FTF, FTP and/or FTD penalty on that module.

(5) **When manually granting the AEP, and a penalty has NOT yet been assessed, or is only showing as accrued:**

- Ensure the eligible return qualifies to receive the relief, and
- Use CC FRM77 to input the TC 971 A/C 996. For IMF modules showing Married Filing Joint, also input the TC 971 A/C 996 to the secondary TIN and cross reference the primary TIN, and
- Allow the TC 971 A/C 996 to post prior to input of any additional tax adjustment, and do not manually assess a FTF, FTP, and/or FTD penalty with the adjustment. The TC 971 A/C 996 prevents the accrual/assessment of those penalties on the module.

(6) If AEP was granted but later found not to apply, it must be manually reversed. To do this, reverse **TC 971 A/C 996 by manually inputting TC 972 A/C 996 using CC FRM 77**. Once posted, the TC 972 A/C 996 will prompt Master File to compute the FTF, FTP and/or FTD

penalty normally. See IRM 20.1.1.3.3.2.5 paragraph (15), Automatic Exemption from Penalty Relief. Take the following actions:

- **IMF -** Manually input a TC 972 A/C 996 via CC FRM77 to reverse the AEP indicator. For IMF modules, only one TC 972 A/C 996 is needed since Master File only generates one TC 971 A/C 996 when one or both the FTF/FTP penalties weren't assessed. MISC field information is not needed. For Married Filing Joint returns, input the TC 972 A/C 996 reversal to the secondary TIN and cross reference the primary TIN.
- **BMF -** Manually input TC 972 A/C 996 via CC FRM77 to reverse the AEP indicator. If the module contains multiple TCs 971 A/C 996 entries with MISC Fields posted, review the posting dates for each TC 971 A/C 996. If all entries have the same date (as is typically the case because they should post at return settlement on the same date), only one TC 972 A/C 996 is needed. The TC 972 A/C 996 must reflect the posting date of the TC 971 A/C 996 entries. If the TCs 971 A/C 996 have different dates, input a separate TC 972 A/C 996 for each date. MISC field information is not needed.

(7) When a TC 972 A/C 996 posts to the module, it reverses the TC 971 A/C 996. As a result, the FTF, FTP, and/or FTD will no longer be suppressed. Master File will then systemically compute the applicable penalties for that module using:

- The return's original or extended due date for the FTF penalty
- The original return due date for the FTP penalty
- The applicable deposit requirements for the FTD penalty

(8) Do not attempt to assess the FTF, FTP and/or FTD penalty on a module with an unreversed TC 971 A/C 996. The adjustment will not post because the AEP relief will not allow assessment of the penalties.