



MANUAL TRANSMITTAL

Department of the Treasury
Internal Revenue Service

8.17.7

MARCH 31, 2014

EFFECTIVE DATE

(03-31-2014)

PURPOSE

- (1) This transmits a revised IRM 8.17.7, Penalties/Additions to Tax in Computations.

MATERIAL CHANGES

- (1) The following editorial changes were made in this IRM:
 - a. IRM 8.17.7.1.2: The wording "prior to" in paragraph (3)(a) changed to "on or before".
 - b. IRM 8.17.7.3.1, paragraph (1): Changed "filed" to "due".
 - c. IRM 8.17.7.4, paragraphs (6)(b) and (c): Changes made to clarify procedures.
 - d. IRM 8.17.7.9, paragraphs (4)(a) and (d): The wording "prior to" in the first sentence of paragraph (4)(a) changed to "on or before". Deleted the last sentence of paragraph (4)(a) and all of paragraph (4)(d) since IRC 6662 only applies to filed returns.

EFFECT ON OTHER DOCUMENTS

This supersedes IRM 8.17.7 dated 9/24/2013.

AUDIENCE

Appeals employees who prepare settlement computations involving penalties and/or additions to tax.

Lisa Zannitto
Acting Director, Policy, Quality and Case Support

8.17.7

Penalties/Additions to Tax in Computations

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(09-24-2013)

Settlements with Penalties and Additions to Tax

- (1) This subsection briefly discusses the various penalties and additions to tax that are included in settlement computations. These penalties and additions to the tax are generally considered by Appeals concurrently with the tax liability generating the penalty or addition to tax amounts.
- (2) For detailed information on these penalties and additions to tax, see IRM 20.1, *Penalty Handbook*.
- (3) The more common penalties and additions to the tax by Code section and kind of tax are summarized in the Penalty Reference Chart found in the exhibit. See Exhibit 8.17.7-2.
- (4) For useful information about penalty computations, click on the “Procedures and Resources” link on the Tax Computation Specialist (TCS) web site, and then see the “Penalty Information” folder.
 - This folder has a file with a very helpful chart which discusses whether certain penalties can be asserted on a deficiency determined in Appeals, depending on if the return was timely filed, late filed, or is a Substitute for Return (SFR) case.
 - The file also contains flow charts to assist in determining whether or not certain penalties can be asserted on a deficiency determined in Appeals.
- (5) References to an Appeals Officer (AO) within this IRM section include both an AO and an Appeals Team Case Leader (ATCL).

8.17.7.1.1

(09-24-2013)

When Tax Court Lacks Jurisdiction

- (1) The Tax Court does not have jurisdiction over certain underpayments of additions to tax or penalties.
- (2) When the Tax Court does not have jurisdiction, the additions (penalties) can be assessed directly. This should be done prior to issuance of the notice of deficiency. Penalties that are assessed are not included as part of the deficiency determined in the notice of deficiency.
- (3) In general, Tax Court has no jurisdiction over the following penalties.
 - **IRC 6651:** The IRC 6651 penalty (including the fraudulent failure to file penalty under IRC 6651(f)) where the penalty applies to tax shown on a **filed** return. Tax Court only has jurisdiction if the penalty is applicable to a deficiency.
 - **IRC 6652(b):** The IRC 6652(b) penalty.
 - **IRC 6654:** The IRC 6654 penalty when a tax return has been filed.
 - **IRC 6655:** The IRC 6655 penalty when a tax return has been filed.
 - **IRC 6656:** The IRC 6656 penalty where the penalty relates to the failure to deposit employment taxes withheld. (However, see IRC 7436 and IRM 8.7.16, *Appeals Employment Tax Procedures*, for information concerning IRC 7436 Notices of Determination).

Note: Tax Court does have jurisdiction over the IRC 6656 addition to tax when the addition relates to a deficiency due to the failure to withhold and deposit taxes pursuant to IRC 1441 and IRC 1442. (See IRM 20.1.4.11.5, *Deficiency Procedures Form 1042*, for additional information).

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- (4) The list in paragraph (3) above is not all inclusive. For more discussion of Tax Court jurisdiction, see the following IRM sections for additional information:
- IRM 8.17.4.3, *Adjustments Requested by AO Prior to Issuing Notice of Deficiency*
 - IRM 8.17.4.17, *Including Penalties/Additions to Tax in the Notice of Deficiency*
 - IRM 8.11.1, *Return Related Penalties in Appeals*
 - IRM 20.1.1.4.2, *Introduction and Penalty Relief, Deficiency Procedures*

8.17.7.1.2 (03-31-2014) **Items Impacting the Penalty Computations**

- (1) In most cases, penalty provisions of the code sections in effect for the loss year generating the carryback govern penalties applicable to carryback years, for deficiencies due to a carryback recapture.
- (2) Net operating loss carrybacks, capital loss carrybacks and all credit carrybacks cannot be used to reduce the underpayment subject to the penalty.
- (3) Prepayment credits and frozen refunds may impact the penalty computations:
- a. Prepayment credits are payments of tax such as withholding tax, estimated tax payments, etc., made on or before the due date of the return. Prepayment credits also include payments made on or before the due date for an unfiled return.
 - b. Prepayment credits do not include advance payments, cash bonds, or amounts applied from other tax liabilities subsequent to the due date of the return for which the penalty applies.
 - c. Payments and credits from a filed return that are neither applied to a tax liability nor refunded to the taxpayer are called “frozen refunds”, and may also impact the penalty computations.

8.17.7.2 (11-02-2007) **Penalties Repealed for Returns Due (Without Regard to Extensions) After 12/31/89**

- (1) The following penalties were repealed for returns due (without regard to extensions) after 12/31/89. For detailed information on preparing a settlement computation with any of these penalties, refer to the historical IRM 8.17.2 found on the Publishing web site at <http://publish.no.irs.gov>.
- a. Negligence Penalty, IRC 6653(a);
 - b. Fraud Penalty, IRC 6653(b);
 - c. Valuation Overstatement, IRC 6659;
 - d. Valuation Understatement (Estate and Gift), IRC 6660;
 - e. Substantial Understatement, IRC 6661.

8.17.7.3 (09-24-2013) **Failure to File, IRC 6651(a)(1)**

- (1) If a return is not timely filed, IRC 6651(a)(1) provides for a penalty of 5% if the failure is for not more than one month, with an additional 5% for each month or fraction thereof during which the failure continues, but not in excess of 25%.
- (2) The failure to file (FTF) penalty under IRC 6651(a)(1) applies to any delinquent return or substitute for return, except when the failure to file was due to reasonable cause and not willful neglect.
- (3) The FTF penalty is computed on the net amount due. The net amount due is the tax liability required to be shown on the return reduced by payments of tax on or before the date prescribed for payment and by the amount of allowable credits against the tax, which may be claimed on the return.

- a. If valid extensions of time to file have been granted, the FTF penalty is not applicable until the expiration of the extension and then only from that date on. An extension may be considered invalid if tax is not properly estimated. In these instances, the FTF penalty is computed from the original due date.
 - b. To arrive at the tax liability required to be shown on return, compute the revised tax liability of the case, excluding all net operating loss, capital loss and credit carrybacks.
 - c. All withholding credits are considered timely paid regardless of the posting date shown on the IDRS transcript. Additional withholding credits allowable are considered timely paid and are allowed as credits when computing the delinquency penalty.
 - d. Refundable credits such as earned income credit, additional child tax credit, first time homebuyer credit, etc:
 1. Are treated as payments when computing the FTF penalty.
 2. Adjustments made to change these credits are not included in the revised tax liability.
 3. Instead, when computing the FTF penalty with adjustments to these credits, the revised tax liability as determined in paragraph (b) above is reduced by the **allowable** amount of these refundable credits.
 4. The “allowable” amount of refundable credit is the total amount shown on the transcript increased or decreased by any adjustments made to the refundable credit in the Appeals tax computation.
- (4) The FTF penalty is generally computer generated by the Campus with respect to the liability shown on delinquent returns.
 - (5) Generally Appeals computations that assert the IRC 6651 penalty use the RGS penalty schedules or the TCS Excel penalty spreadsheets on the Technical Support SharePoint site, reached by a link on the TCS web site.
 - (6) Interest will be imposed on the FTF penalty as of the return due date (including extensions.) The Campus will normally compute interest. If the taxpayer wishes to make a payment, then an interest computation will be requested by the AO and included in the case file.
 - (7) Additional information on computing the FTF penalty can be found in IRM 20.1.2, *Failure To File/Failure To Pay Penalties*.

8.17.7.3.1
(03-31-2014)
**Minimum Failure to File
Penalty**

- (1) If the return is at least 60 days late, including extensions, a minimum FTF penalty applies:
 - For returns due (without regard to extensions) after 12/31/2008, the minimum penalty is the **lesser** of \$135 or 100 percent of the tax required to be shown on the return that was not paid on or before the due date.
 - For returns due (without regard to extensions) before 1/1/2009, the minimum penalty is the **lesser** of \$100 or 100 percent of the tax required to be shown on the return that was not paid on or before the due date.
- (2) In order for the minimum penalty to apply, there must be a net tax due. Withholding and other allowable credits as of the due date of the return must be less than the revised tax liability or tax required to be shown on the return.

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- (3) The minimum penalty applies only to income tax returns. It does not apply to employment tax, excise tax, gift tax, or estate tax returns.
- (4) When both the failure to pay (FTP) penalty and the minimum FTF penalty apply (income tax returns only), the minimum FTF penalty is not reduced by the amount of the FTP penalty.
- (5) See IRM 20.1.2.2.7.4, *Minimum Penalty*, for additional information.

8.17.7.3.2 (09-24-2013)

Coordination with Fraud Penalty

- (1) Effective for returns due after December 31, 1989 (determined without regard to extensions), the FTF and the fraud penalties may be asserted for the same tax year and against the same portion of the tax liability.
- (2) If the failure to file is due to fraud, the fraudulent failure to file penalty under IRC 6651(f) may be asserted rather than the regular FTF penalty under IRC 6651(a)(1).
- (3) See discussion of IRC 6651(f) in IRM 8.17.7.6.

8.17.7.3.3 (09-24-2013)

FTF Penalty With Concurrent FTP Penalty Assessment

- (1) IRC 6651(c)(1) provides that the penalty for filing late under IRC 6651(a)(1) is to be reduced by the **amount** of any penalty for paying late imposed under IRC 6651(a)(2) for any month or part of a month during which both penalties apply. The penalties are said to be running concurrently.
- (2) The above reduction does not reduce the total penalty for filing late below the minimum penalty, if applicable. See IRM 20.1.2.2.7.4, *Minimum Penalty*.
- (3) When both the IRC 6651(a)(1) FTF and IRC 6651(a)(2) FTP penalties apply to an original assessment, see example below of the computation of the FTF penalty that should be assessed by the Campus if the return is filed late:

Net Amount Due (Return due 4/15/2006 filed 12/2/2006)	\$500.00
Failure to Pay Penalty - \$500.00 x 1/2 of 1% for 8 months	20.00
Failure to File Penalty - \$500.00 x 5% per month for 5 months.	\$125.00
Less Failure to Pay Penalty for first 5 months.	<u>12.50</u>
Failure to File Penalty assessed by the Campus	\$112.50

- (4) If the taxpayer has filed a return late and an additional tax liability is determined:
 - a. Compute the FTF penalty at the total rate of 5% per month allowable under IRC 6651(a)(1).
 - b. Generally, the FTP penalty under IRC 6651(a)(2) can't be asserted on a subsequently determined tax deficiency when the taxpayer has filed a return.

Caution: If the Compliance report (RAR) or notice of deficiency has asserted the IRC 6651(a)(2) FTP penalty and the taxpayer filed a return, the AO or Counsel attorney will need to determine whether the FTP penalty should be sustained or eliminated.

- c. However, the IRC 6651(a)(2) FTP penalty may be assessed on the tax liability shown on the return when it was filed.
 - d. If an IRC 6651(a)(2) FTP penalty was assessed by the Campus on the tax per return, then the FTF penalty must be reduced by the amount of the FTP penalty assessed for any month or part of a month during which both penalties apply. See Exhibit 8.17.7-1 for an example.
- (5) Taxpayer has filed a return late - Computations for FTF penalty when the IRC 6651(a)(2) FTP penalty has been assessed:
- a. Generally the RGS penalty schedules or the TCS Excel penalty spreadsheets on the Technical Support SharePoint site are used for the IRC 6651 penalty computations.
 - b. **RGS Penalty Computations:**
 - Generally the IRC 6651(a)(2) FTP penalty can't be asserted on a subsequently determined tax deficiency when the taxpayer has filed a return. Therefore, the RGS user should not indicate that the IRC 6651(a)(2) FTP penalty applies on the RGS "Return Related Penalty Details" input screen. If an amount *is* entered on this input screen for the IRC 6651(a)(2) FTP penalty previously assessed, it won't be considered in the computation of the FTF penalty.
 - Therefore, the correct amount to enter into RGS for the previously assessed FTF penalty must include both the assessed FTF penalty and the concurrent IRC 6651(a)(2) FTP penalty assessed. This amount must be determined manually.
 - For an article that discusses how to compute the FTF penalty for late filed returns using RGS, click on the "Procedures and Resources" link on the TCS web site, and then see the "Penalty Information" folder.
 - c. **Excel Penalty Computation:**
 - The TCS Excel IRC 6651 penalty spreadsheet on the Technical Support SharePoint will reduce the FTF penalty amount by the amount of the IRC 6651(a)(2) FTP penalty previously assessed for any month or part of a month during which both penalties apply.
- (6) If the taxpayer has **not** filed a return and an additional tax liability is determined, see IRM 8.17.7.5 for SFR procedures for computing the FTF and FTP penalties.

8.17.7.4
(03-31-2014)
**Failure to Pay Penalty,
IRC 6651(a)(2) and IRC
6651(a)(3)**

- (1) The Failure to Pay (FTP) penalties apply to the balance of tax due and shown on returns, and to balances due where notice and demand is given. In general, the applicable FTP penalty should be assessed at one-half of 1% of the unpaid tax for the first month the penalty applies and an additional one-half of 1% for each additional or fraction of the month the tax is unpaid, not to exceed 25% of the tax.
- (2) IRC 6651(a)(2):

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- a. Computed from the date prescribed for payment of tax (determined with regard to any extension of time for payment.)
 - b. Generally, the failure to pay penalty is computed from the original due date of the return to the date the tax is paid.
- (3) IRC 6651(a)(3)
- a. The IRC 6651(a)(3) penalty generally applies to the following additional assessments:
 - A deficiency, or
 - An amendment to the original return, or
 - Tax assessed due to the a correction of a mathematical error as defined under IRC 6213(b)(1).
 - b. The IRC 6651(a)(3) penalty is assessed if payment is not made within 21 calendar days (or 10 business days if the balance due amount equals or exceeds \$100,000) of notice and demand.
- (4) These additions under IRC 6651(a)(2) and IRC 6651(a)(3) will generally be assessed automatically by the Campus.
- (5) However, if the addition under IRC 6651(a)(2) relates to a “substitute return” (SFR) prepared by the IRS under IRC 6020(b), the deficiency procedures have to be followed before an assessment can be made.
- (6) If the taxpayer has filed a return and an additional tax liability is determined:
- a. The IRC 6651(a)(2) failure to pay penalty generally can’t be asserted on a deficiency when the taxpayer filed a return. Therefore, the IRC 6651(a)(2) penalty should not be computed on the deficiency shown in the settlement computation when a return is filed by the taxpayer.
 - b. However, if the Compliance report (RAR) or statutory notice of deficiency has asserted IRC 6651(a)(2) and the taxpayer filed a return, the AO or Counsel attorney will need to determine whether the IRC 6651(a)(2) penalty should be sustained or conceded.
 - c. If the IRC 6651(a)(2) penalty is conceded, then the IRC 6651(a)(1) penalty asserted in the RAR or notice of deficiency will need to be recomputed.
 - d. If an IRC 6651(a)(2) penalty was assessed, see IRM 8.17.7.3.3 for information on how to recompute the IRC 6651(a)(1) penalty.
- (7) If the taxpayer has not filed a return and an additional tax liability is determined, see IRM 8.17.7.5 for SFR procedures for computing the FTP penalty.

8.17.7.4.1
(09-24-2013)

Failure to Pay Penalty and Notices of Levy - IRC 6651(d)

- (1) Notices of Levy: IRC 6651(d) increases the FTP penalty rate under IRC 6651(a)(2) or IRC 6651(a)(3) from one-half of one percent (.005) to one percent (.01) of the tax at the start of the month beginning after:
- 10 days after the date of notice of intent to levy [IRC 6331(d)], or
 - The day on which notice and demand for immediate payment is given in the case of jeopardy [IRC 6631(a)].

Note: The 1% penalty rate applies to all subsequent assessments on that module. However, once a module is fully paid, a later tax assessment will begin to accrue at the one-half of one percent rate.

- (2) These are the only two conditions (trigger dates) that allow for the FTP penalty rate increase to one percent. See IRM 20.1.2.2.8.1.1, *1 Percent Penalty Rate — IRC 6651(d)*, for more information.

8.17.7.4.2
(09-24-2013)
**Failure to Pay Penalty
and Installment
Agreement - IRC 6651(h)**

- (1) An individual's FTP penalty will be reduced to one quarter of one percent (.0025) for any month in which an installment payment agreement with the IRS is in effect, provided the individual timely filed (taking extensions into account) the return relating to the liability that is subject to the installment agreement.
- (2) This reduction does not apply if the 1% FTP penalty rate under IRC 6651(d) is in effect.
- (3) Termination of installment agreement
 - a. The one quarter of one percent rate ends following the month during which the installment agreement is terminated.
 - b. When an installment agreement is terminated, the basic penalty rate reverts to the rate in effect prior to the installment agreement beginning with the first penalty month that begins after the installment agreement is terminated.
- (4) See IRM 20.1.2.2.8.1.2, *1/4 Percent Penalty Rate — IRC 6651(h)*, for more detailed information.

8.17.7.5
(09-24-2013)
**Nonfilers : Substitute for
Return (SFR), IRC
6651(a)(1) and 6651(a)(2)**

- (1) If the taxpayer has not filed a return and an additional tax liability is determined:
 - a. IRC 6651(g) provides that for returns due (without regard to extension) after July 30, 1996, a taxpayer with a substitute for return (SFR) prepared by the IRS pursuant to IRC 6020(b) will be treated as a return filed by the taxpayer for purposes of determining the IRC 6651(a)(2) penalty.
 - b. Therefore, substitute for return (SFR) computations generally will include both a failure to file (FTF) penalty under IRC 6651(a)(1), and a failure to pay (FTP) penalty under IRC 6651(a)(2).

8.17.7.5.1
(09-24-2013)
**IRC 6651(a)(2) and IRC
6020(b) Returns**

- (1) Pursuant to IRC 6020(b), the IRS generally prepares a return when it determines that a taxpayer is liable for filing the tax return, but failed to do so after receiving notification from the IRS.
- (2) A valid return *must* have been prepared under IRC 6020(b) in order to assert the IRC 6651(a)(2) penalty on a nonfiler. The requirements of a valid IRC 6020(b) return are discussed in Treas. Reg. section 301.6020-1.
- (3) The requirements of a valid IRC 6020(b) return would include the following documents for each nonfiled tax period (known as the 6020(b) Certification package).
 - a. A properly completed and signed Form 13496, *IRC 6020(b) Certification*, dated on or after the date of the 30-day letter.
 - b. Form 4549 or Form 4549-A, signed by a duly authorized IRS employee.
 - c. Form 886-A, *Explanation of Items*.

Note: See IRM 4.19.17.1.2, *Form 13496 Certification Procedures*, for more information, including information about the electronic Form 13496.

8.17 Settlement Computations and Statutory Notices of Deficiency

- (4) The AO or Counsel must determine that SFR procedures were followed in order to sustain the FTP penalty asserted by Compliance. See discussion of steps they must take below:
 - a. Verify that the taxpayer did not file a return, and that there is a SFR TC 150 posting on the transcript.
 - b. Check the administrative file to see if the case file includes a 6020(b) Certification package.
 - c. Where no 6020(b) Certification package is included in the administrative file, the AO or Counsel attorney will need to review the file to determine whether there are documents that would meet the requirements of an IRC 6020(b) return, as outlined in Treas. Reg. section 301.6020-1. (Also see CC Notice 2003-019, as modified by CC Notice 2004-009.)
- (5) SFR's for employment and excise tax returns:
 - a. See IRM 8.7.16.16, *IRC 6020(b) Substitute for Return Case Processing*, for information about SFR returns prepared for employment tax cases.
 - b. See IRM 8.7.10.5, *Preparing an Excise Tax Return under IRC 6020(b)*, for information about SFR returns prepared for excise tax cases.

8.17.7.5.2 (09-24-2013) Failure to File and Failure to Pay Computations for SFR Returns

- (1) Since the IRC 6651(a)(1) failure to file (FTF) and IRC 6651(a)(2) failure to pay (FTP) penalties are asserted concurrently on substitute for returns, the amount of the FTF penalty must be reduced by the amount of the FTP penalty for any month or part of a month during which both penalties apply. See IRM 8.17.7.3.3 for additional information.
 - a. For simplicity purposes, RGS implements this reduction by reducing the 5 percent FTF penalty rate by the 0.5 percent penalty rate of the FTP penalty for any month during which both penalties apply. This results in an IRC 6651(a)(1) penalty rate of 4.5 percent a month (to a maximum of 22.5 percent) shown on the RGS IRC 6651 penalty computation schedule. The RGS IRC 6651 penalty computation schedule may be included in the settlement computation as long as the computations are accurate.
 - b. The TCS Excel IRC 6651 penalty spreadsheet on the Technical Support Sharepoint site will correctly reduce the IRC 6651(a)(1) penalty amount by the concurrent IRC 6651(a)(2) penalty amount.

Caution: If the taxpayer made payments after the due date of the return, the RGS IRC 6651 penalty computation schedule and the TCS IRC 6651 penalty Excel spreadsheet won't be accurate for the FTP penalty. This is because these penalty schedules won't consider any late payments in the FTP penalty computation. When there are late payments, these penalty schedules must be corrected or other schedules used.

- (2) **FTP Penalty is still accruing:** If the FTP penalty has not reached the maximum penalty of 25%, see procedures below:
 - a. Show the FTP penalty amount on Form 3610 (if prepared) or Form 5278, (or Form 4549, etc.) as an asterisk (*). An explanation should also be included to explain that the amount cannot be determined. Suggested sample language that can be used is "Amount to be determined" or "To be computed later."

Exception: In certain circumstances the FTP penalty may be computed at the maximum rate when the penalty is still accruing. An example is when Counsel or the AO determines that the FTP penalty should be computed at the maximum 25% rate because the maximum FTP penalty rate will be reached soon after the computations are prepared (usually within a month or two).

- b. Also include penalty computations in the settlement computation. The RGS or the TCS Excel IRC 6651 penalty schedules are generally used for this purpose, but other schedules may also be used.
 - c. Both the RGS and the TCS Excel IRC 6651 penalty schedules will show an amount for the FTP penalty even if the penalty is still accruing. This FTP amount does not need to be deleted from either the RGS or the TCS Excel penalty schedules and an asterisk inserted, because there is a paragraph on the penalty schedules underneath the computation that tells the taxpayer that the FTP penalty is still accruing.
 - d. If the RGS or TCS Excel schedules aren't used, then a similar paragraph must be included to notify the taxpayer that the FTP penalty is still accruing.
- (3) **FTP Penalty at the maximum amount:** If the IRC 6651(a)(2) penalty applies in a case at the maximum amount, either because the penalty has reached the maximum rate of 25% or because the tax has been paid in full, see procedures below:
- a. Compute the IRC 6651(a)(2) penalty and include on the settlement computation.
 - b. Also include penalty computations in the settlement computation. The RGS or the TCS Excel IRC 6651 penalty schedules are generally used for this purpose, but other schedules may also be used.

8.17.7.6
(09-24-2013)
**Fraudulent Failure to
File (FFTF), IRC 6651(f)**

- (1) IRC 6651(f) provides for an increase in the penalty rate for failure to file if the failure to file is fraudulent. The penalty rate is increased from 5 percent per month to 15 percent for each month or part of a month the return is late, and the maximum penalty is increased from 25 percent of the amount subject to IRC 6651(a)(1) to 75 percent of that amount.
- (2) The IRC 6651(f) fraudulent failure to file (FFTF) penalty is a counterpart of the IRC 6663 civil fraud penalty. The fraud components of the FFTF penalty and the civil fraud penalty are generally similar:
 - The civil fraud penalty requires an underpayment which is attributable to the willful and knowing intent to defraud.
 - The FFTF penalty requires that all or part of the tax required to be shown on the return was unpaid on the due date for payment.
- (3) The FFTF penalty and the IRC 6663 civil fraud penalty can be asserted on the same return, if failure to file is due to fraud and the taxpayer files a return with a deficiency attributable to fraud.
- (4) Additional information on the fraudulent failure to file penalty can be found in IRM 20.1.2, *Failure To File/Failure To Pay Penalties*.

8.17 Settlement Computations and Statutory Notices of Deficiency

8.17.7.7
(09-24-2013)

Failure to Report Tips, IRC 6652(b)

- (1) IRC 6652(b) provides for a penalty on employees for failure to report tips.
- (2) The IRC 6652(b) penalty is 50% of FICA tax on tip income that the employee failed to report to his or her employer. This penalty, though applicable to employment tax, is assessed and collected as a part of the taxpayer's income tax.
- (3) See IRM 20.1.10.3.2, *IRC 6652(b) Failure to Report Tips*, for additional information about the penalty computation.
- (4) See IRM 8.7.16.8, *Computations for Unreported Tip Income Cases*, for information on how to include the IRC 6652(b) penalty in a settlement computation.
- (5) See IRM 8.17.4.26, *Tip Income Cases*, and *FICA Tax Informational Notice*, for information about tip income cases and the IRC 6652(b) penalty when a notice of deficiency must be issued.

8.17.7.8
(09-24-2013)

Estimated Tax Penalties, IRC 6654 and IRC 6655

- (1) Taxpayers are generally required to pay income tax as income is earned. This is accomplished via withholding from income, or via estimated tax payments. Taxpayers who do not have sufficient amounts withheld, and who fail to make estimated tax payments as required by law, may be assessed a penalty under IRC 6654 or IRC 6655 for underpayment of estimated tax.
- (2) Although IRC 6654 and IRC 6655 penalties are generally computer generated by the Campus when the return is filed by the taxpayer, Compliance will sometimes assert or adjust these penalties. If an adjustment is made to the tax of an original return, after the return due date (including extensions) as a result of either an audit or the taxpayer filing an amended return, the penalty amount will generally not be adjusted.

Note: An estimated tax penalty cannot be asserted on a deficiency when the taxpayer has filed a return. An estimated tax penalty *can* be asserted in "Substitute for Return" cases.

- (3) For detailed information on all provisions covering estimated tax penalties, see IRM 20.1.3, *Estimated Tax Penalties*.

8.17.7.8.1
(09-24-2013)

IRC Section 6654 - Individuals

- (1) IRC 6654 provides for a penalty when individuals underpay any required installment(s) of estimated income tax liabilities reportable on Form 1040.
 - a. Taxpayers are required to make estimated tax payments if the tax that will be shown on their return (or, if no return is filed, their tax liability), minus tax amounts withheld from wages during the year, is \$1,000 or more.
 - b. "Tax shown on the return" is defined in the instructions for Form 2210. It's generally net tax reduced by net refundable credits listed for line 3 of Form 2210.
 - c. The required annual payment is generally based on the lesser of:
 - 1) A percentage of the tax shown on the original return or, if no return is filed, on the tax as determined or
 - 2) A percentage of the prior year's tax.

Note: Consult IRM 20.1.3 and/or the Form 2210 Instructions for the applicable percentages.

- d. The penalty rate is provided by IRC 6621. The period of underpayment runs from the due date of the installment to the lesser of the due date of the return or the date of payment.
- (2) For the purpose of asserting the penalty, tax is defined as income and self-employment tax less all credits allowed by Part IV, Subchapter A, Chapter 1, other than tax withheld from wages. Tax withheld is allowed as a payment of estimated tax.
- (3) RGS computations:
 - a. RGS will not show an amount on Form 5278 (or Form 4549/Form 4549-A) for IRC 6654 if the computed penalty is less than \$100.
 - b. The RGS Form 5278 (or Form 4549/Form 4549-A) that is generated without an IRC 6654 penalty when the penalty is less than \$100 can be used in the settlement computation.
 - c. If the AO or Counsel wants TCS to include the IRC 6654 penalty on the Form 5278 (or Form 4549/Form 4549-A) for amounts under \$100, they must specify this requirement in their work request to TCS.
- (4) See IRM 20.1.3.2, *IRC Section 6654 — Individual Taxpayers & Fiduciaries*, for more detailed information about IRC 6654.

8.17.7.8.2
(09-24-2013)
**IRC Section 6654 -
Estates and Trusts**

- (1) IRC 6654 provides for a penalty when estates and trusts (other than charitable trusts) underpay any required installment(s) of estimated income tax liabilities reportable on Form 1041 (U.S. Fiduciary Income Tax Return).
 - a. All estates and most trusts are required to make estimated tax payments in the same manner as individuals.
 - b. Generally, an estate or trust is required to pay estimated tax if it expects to owe, after credit for withholding, an amount greater than \$1,000.
- (2) Form 2210, *Underpayment of Estimated Tax by Individuals, Estates, and Trusts*, is used by the taxpayer to figure any penalty.
- (3) For information and exceptions when computing the estimated tax penalty for estates and trusts, consult the Code and Regulations. The following resources are also available:
 - IRM 20.1.3.2.1.1.6, *Determining the Required Annual Payment, Fiduciaries of Estates or Trusts*
 - Instructions for Form 2210
 - Form 1041-ES, *Estimated Income Tax for Estates and Trusts*
- (4) Charitable trusts and any private foundation organized as a trust, will be subject to the corporate estimated tax provisions under IRC 6655, rather than IRC 6654.

8.17.7.8.3
(09-24-2013)
**IRC Section 6655 -
Corporations & Others
Not Covered by IRC
Section 6654**

- (1) IRC 6655 imposes a penalty when a corporation (C or S), private foundation, private foundation organized as a trust, or tax exempt organization underpays estimated tax.
- (2) A corporation (or other entity subject to IRC 6655) must make estimated tax payments if its tax shown on the return (income tax minus credits) is \$500 or more. If the tax is less than \$500, no estimated tax payments are required and a penalty will not be assessed.

8.17 Settlement Computations and Statutory Notices of Deficiency

- (3) Since the law can be complex, it is best to consult the Code and Regulations if computation of this penalty is involved in a case. Also IRM 20.1.3.3. *IRC Section 6655 — Corporations & Others Not Covered by IRC Section 6654*, has very detailed information about IRC 6655.

8.17.7.9 (03-31-2014) Accuracy-Related Penalty, IRC 6662

- (1) IRC 6662 imposes an accuracy related penalty at the rate of 20% on the portion of any underpayment attributable to any of the following, for returns due after 12/31/89 (without regard to extensions):
- a. Negligence or disregard of rules or regulations. [IRC 6662(b)(1)]
 - b. Substantial understatement of income tax. [IRC 6662(b)(2)]
 - c. Substantial valuation misstatement under Chapter 1 of the IRC. [IRC 6662(b)(3)]
 - d. Substantial overstatement of pension liabilities. [IRC 6662(b)(4)]
 - e. Substantial estate or gift tax valuation understatement. [IRC 6662(b)(5)]
 - f. Transactions lacking economic substance. Applies for transactions entered into after 3/30/2010. [IRC 6662(b)(6)]
- (2) IRC 6662 imposes an accuracy related penalty at the rate of 40% on the portion of any underpayment attributable to any of the following:
- a. Gross valuation misstatements. Applies for returns due after 12/31/89. [IRC 6662(h)]
 - b. Nondisclosed noneconomic substance transactions. Applies for transactions entered into after 3/30/2010. [IRC 6662(i)]
 - c. Any undisclosed foreign financial asset understatement. Applies for tax years beginning after 3/18/2010. [IRC 6662(b)(7) and IRC 6662(j)]
- (3) The IRC 6662 penalty only applies to filed returns and does not apply to any portion of an underpayment that is subject to a fraud penalty.
- (4) The underpayment used to compute the IRC 6662 penalty is the deficiency attributable to IRC 6662 decreased (or increased) by changes to prepayment credits and decreased by frozen refunds:
- a. Prepayment credits are payments of tax such as withholding tax, estimated tax payments, etc., made on or before the due date of the return.
 - b. Prepayment credits do not include advance payments, cash bonds, or amounts applied from other tax liabilities subsequent to the due date of the return for which the penalty applies.
 - c. The deficiency attributable to IRC 6662 is decreased or increased by adjustments made in the settlement computation to prepayment credits:
 - 1) If prepayment credits are increased, then the computation of the penalty will decrease the deficiency attributable to IRC 6662 by the additional prepayment credits.
 - 2) If prepayment credits are decreased, then the computation of the penalty will increase the deficiency attributable to IRC 6662 by the amount of the adjustment to prepayment credits.
 - d. Payments and credits from a filed return that are neither applied to a tax liability nor refunded to the taxpayer are called "frozen refunds". The deficiency attributable to IRC 6662 is also reduced by a frozen refund.

- e. When computing the IRC 6662 penalty, RGS will reduce a deficiency by a frozen refund to get the underpayment subject to IRC 6662.

Note: For more information, click on the “Procedures and Resources” link on the Tax Computation Specialist (TCS) web site, and then see the “IRC 6662 Penalty and Frozen Refunds” folder. The folder contains Counsel memos on this topic, including a 2012 Counsel memo which discusses IRC 6664, and how to compute the IRC 6662 penalty when there are frozen refunds.

- (5) Net operating loss carrybacks, capital loss carrybacks and all credit carrybacks cannot be used to reduce the underpayment subject to the penalty.
- (6) Interest will accrue on the penalty from the due date of the return, including extensions.

8.17.7.9.1
(09-24-2013)
**Accuracy-Related
Penalty on
Understatements with
Respect to Reportable
Transactions, IRC 6662A**

- (1) IRC 6662A generally imposes an accuracy-related penalty on any reportable transaction understatement for tax years ending after October 22, 2004. The penalty applies to:
 - a. Any listed transaction (which is one category of reportable transactions); and
 - b. Any other reportable transaction if a significant purpose of the transaction is the avoidance or evasion of federal income tax.
- (2) The computation of the IRC 6662A penalty is:
 - a. 20 percent of the reportable transaction understatement where the reportable transaction was properly disclosed, and
 - b. 30 percent of the reportable transaction understatement where the transaction was **not** properly disclosed. (See IRM 20.1.5.15.1, *Adequate Disclosure and Rescission of IRC 6707A Impact on IRC 6662A*, for discussion of disclosure requirements.)
- (3) Due to the definition of “reportable transaction understatement,” the IRC 6662A penalty, unlike the IRC 6662 penalty, can apply even if there is no underpayment of tax on the taxpayer’s return. See IRM 20.1.5.15.2, *IRC 6662A, Accuracy-Related Penalty on Understatements with Respect to Reportable Transactions, Penalty Calculation*, for discussion of IRC 6662A penalty computations.
- (4) Coordination with other penalties:
 - a. IRC 6662A does not apply to any portion of an understatement on which a penalty is imposed under IRC 6663.
 - b. IRC 6662A does not apply to any portion of an understatement on which a gross valuation misstatement penalty under IRC 6662(h) is imposed.
 - c. IRC 6662A does not apply to any portion of an understatement on which an IRC 6662 penalty is imposed at the increased rates determined under IRC 6662(i) for nondisclosed, noneconomic substance transactions.

8.17.7.10
(09-24-2013)
Fraud Penalty, IRC 6663

- (1) IRC 6663 imposes a fraud penalty at the rate of 75% on the portion of any underpayment attributable to fraud for returns due after 12/31/89 (without regard to extensions). This penalty only applies to filed returns.

Note: The accuracy-related penalty, IRC 6662, cannot apply to any portion of an underpayment on which the fraud penalty is imposed.

8.17 Settlement Computations and Statutory Notices of Deficiency

- (2) IRC 6651(f) covers the fraud penalty that applies to failure to file cases.
- (3) On late filed returns the delinquency penalty under IRC 6651 and the fraud penalty under IRC 6663 can apply on the same return.
- (4) Net operating loss carrybacks, capital loss carrybacks and all credit carrybacks cannot be used to reduce the underpayment subject to the penalty.
- (5) The underpayment used to compute the IRC 6663 penalty is the deficiency attributable to IRC 6663 decreased (or increased) by changes to prepayment credits and decreased by frozen refunds:
 - a. The prepayment credit and frozen refund discussion in paragraph (5) of IRM 8.17.7.9 also applies to the IRC 6663 penalty.
 - b. When computing the IRC 6663 penalty, RGS will reduce a deficiency by a frozen refund to get the underpayment subject to IRC 6663.
- (6) Interest will accrue on the penalty from the due date of the return, including extensions.

Exhibit 8.17.7-1 (09-24-2013)
Computation of Failure to File Penalty After Tax Adjustment, with Previously Assessed Failure to Pay Penalty

Facts: The taxpayers filed their joint 2006 return on August 19, 2008. The tax liability on the return was \$4,062.00. The taxpayer had withholding of \$726.00, resulting in net tax due of \$3,336.00. FTF and FTP penalties were assessed by the Campus as shown below:

FTF Penalty Computation:

FTF : 3,336.00 x .05/month x 5 months	834.00
Less FTP for 5 months: 3,336.00 x .005/month x 5 months	83.40
FTF Penalty Assessed	750.60
FTP Penalty Assessed: 3,336.00 x .005/month x 17 months unpaid	283.56

Note: It may appear that the Campus computed the FTF penalty using a rate of .045 per month, since 3,336.00 x .045/month x 5 months = \$750.60. However, the actual computation is shown above.

The return was examined and an additional tax deficiency of \$1,500.00 was determined. The additional IRC 6651(a)(1) penalty would be \$375.00, computed as shown below:

Correct tax liability (4,026.00 + 1,500.00)	5,562.00
Less : prepayment credits	(726.00)
Net tax due	4,836.00
Penalty Rate	0.25
Penalty	1,209.00
Less FTP for the same number of months as FTF was assessed:	
(3,336.00 x .005 x 5 = 83.40)	83.40
Failure to file - IRC 6651(a)(1)	1,125.60
Less previously assessed FTF penalty	(750.60)
Additional failure to file penalty	375.00
	=====

Incorrect Method: If a penalty rate of .225 (.045 x 5) for IRC 6651(a)(1) was used, the following incorrect answer would result:

Net tax due	4,836.00
Penalty Rate	0.225
Penalty Amount	1,088.10
Less previously assessed FTF penalty	(750.60)
Incorrect amount of additional failure to file penalty	337.50
	=====

8.17 Settlement Computations and Statutory Notices of Deficiency

Exhibit 8.17.7-2 (09-24-2013)
Penalty Reference Chart

IRC 6651(a)(1)	<p>Failure to File 5% per month to 25% maximum. Based on correct tax liability less payments and credits allowable at due date of return.</p> <p>If the return is 60 days or more late, a minimum FTF penalty applies:</p> <p>Minimum penalty is lesser of \$135 or 100% of tax due on return.</p> <p>Minimum penalty is lesser of \$100 or 100% of tax due on return.</p> <p>Interest accrues from later of return due date or extended DD.</p>	<p>All years.</p> <p>Returns filed after 12/31/2008</p> <p>Returns filed before 1/1/2009</p>
IRC 6651(a)(2)	<p>Failure to Pay 0.5% per month not to exceed 25% in aggregate.</p> <p>Based on actual amount shown on return. Due date for payment is with regard to any extensions of time for payment.</p> <p>FTP applies for SFR returns.</p> <p>IRC 6651(d): See IRC 6651(d) and IRM 20.1.2.6 for certain situations where penalty is increased to 1%.</p> <p>IRC 6651(h): See IRC 6651(h) and IRM 20.1.2.8 for certain situations where penalty is decreased to .25%.</p>	<p>All years.</p>
IRC 6651(a)(3)	<p>Failure to Pay Additional Assessment upon Notice and Demand 0.5% per month not to exceed 25% in aggregate.</p> <p>Based on amount of additional assessment not paid on or before 21 calendar days from notice and demand (or 10 business days if amount of notice and demand equals or exceeds \$100,000).</p>	<p>All years.</p>
IRC 6651(f)	<p>Fraudulent Failure to File 15% per month up to maximum of 5 months, 75% maximum.</p>	<p>Returns due after 12/31/89, without regard to extensions.</p>

Exhibit 8.17.7-2 (Cont. 1) (09-24-2013)
Penalty Reference Chart

	<p>Amount of tax required to be shown on return reduced by tax timely paid and by credits which may be claimed on the day prescribed for payment of tax.</p> <p>IRC 6662 and/or IRC 6663 can apply with IRC 6651(f) as long as a return is filed.</p> <p>Carrybacks have no effect on penalty.</p>	
IRC 6652(b)	<p>Failure to Report Tips 50% of FICA tax on unreported tip income.</p>	Returns due after 12/31/86, without regard to extensions
IRC 6654	<p>Failure to Pay Estimated Tax – Individual, Estates and Trusts (See IRM 20.1.3.)</p>	
IRC 6655	<p>Failure to Pay Estimated Tax – Corporation (See IRM 20.1.3.)</p>	
IRC 6656	<p>Failure to Deposit (See IRM 20.1.4.)</p>	
IRC 6662 - 20%	<p>Accuracy-Related Penalty 20% of underpayment, applies to portion of understatement attributable to:</p> <ul style="list-style-type: none"> • Negligence • Substantial understatement • Valuation misstatement • Overstatement of pension liabilities • Estate/gift tax valuation understatement • Transactions lacking economic substance <p>Applies only if return has been filed.</p> <p>Not applicable to fraud items.</p>	<p>Returns due after 12/31/89, without regard to extensions.</p> <p>For transactions lacking economic substance, penalty applies for transactions entered into after 3/30/2010.</p>
IRC 6662 - 40%	<p>Accuracy-Related Penalty 40% of underpayment, applies to portion of understatement attributable to:</p> <ul style="list-style-type: none"> • Gross valuation misstatements. 	Applies for returns due after 12/31/89.

8.17 Settlement Computations and Statutory Notices of Deficiency

Exhibit 8.17.7-2 (Cont. 2) (09-24-2013)

Penalty Reference Chart

	<ul style="list-style-type: none"> • Nondisclosed noneconomic substance transactions. • Any undisclosed foreign financial asset understatement. <p>Applies only if return has been filed.</p> <p>Not applicable to fraud items.</p>	<p>Applies for transactions entered into after 3/30/2010.</p> <p>Applies for tax years beginning after 3/18/2010.</p>
IRC 6662A	<p>Accuracy-Related Penalty 20% of the reportable transaction understatement.</p> <p>Increased to 30% for any portion of any reportable transaction understatement where the transaction was not properly disclosed</p>	<p>Effective for taxable years ending after October 22, 2004.</p>
IRC 6663	<p>Fraud 75% of the underpayment attributable to fraud.</p> <p>Applies only if return filed.</p> <p>If no return filed, only IRC 6651(f) can apply.</p>	<p>Returns due after 12/31/89, without regard to extensions.</p>