



Internal Revenue Service

DEPARTMENT OF THE TREASURY

LB&I Process Unit

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| Unit Name | Erroneous Claim for Refund or Credit Penalty | |
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|-----------------------|--------------------------------------|
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| Book | LB&I Penalties Procedures (Domestic) |
| Chapter | Erroneous Claim for Refund or Credit |

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Process Overview

Erroneous Claim for Refund or Credit Penalty

Congress enacted IRC 6676 to allow penalties for erroneous tax refund or tax credit claims. The penalty may be imposed on a taxpayer filing an original return, an amended return, a claim, or any other form or writing that contends the taxpayer made an overpayment of tax. In the “Protecting Americans from Tax Hikes (PATH) Act of 2015,” Congress amended IRC 6676 in three key ways: to remove the exception for erroneously claimed earned income credits, to change the “reasonable basis” exception to “reasonable cause,” and to revise the definition of underpayment under IRC 6664. This revised definition of underpayment allows refundable credits to reduce the amount for “tax shown on the return” below zero in calculating the underpayment amount.

Under IRC 6676, a 20 percent penalty may be imposed against the “excessive amount” of a claim for refund or credit. An excessive amount is the portion that exceeds the allowable amount of the claim. In other words, the excessive amount is the disallowed portion of the claim for refund or credit. The penalty typically applies to the not yet refunded/non-deficiency amount determined to be the excessive amount of the claim. However, it can be imposed when there is a deficiency under IRC 6211, which is subject to deficiency procedures. For example, a penalty may be imposed when there is a “frozen refund,” a situation where a taxpayer has claimed a refund on an original return, but it has not yet been refunded or credited to the taxpayer (as explained in IRM 20.1.5.18.4.) When an excessive amount depends on the determination of a deficiency, the penalty is subject to deficiency procedures.

IRC 6676 complements the IRC 6662 accuracy-related penalty. The IRC 6662 penalty applies only where an underpayment arises. The IRC 6676 erroneous claim for refund or credit penalty does not apply where an underpayment arises or if the IRC 6662, 6662A or 6663 penalties apply. For example, the erroneous claim for refund or credit penalty does not apply if a claim has been erroneously paid, but the IRC 6662 accuracy-related penalty would still apply.

The law provides an exemption from the erroneous claims penalty if the excessive amount is due to reasonable cause. Under the prior law, the penalty did not apply if there was a “reasonable basis for the excessive amount.” Any excessive amount attributable to noneconomic substance transactions described in IRC 6662(b)(6) are treated as lacking reasonable cause.

To guard against the possibility of a barred assessment, the Service should generally treat the erroneous claim for refund or credit penalty as if it has a three-year limitations period running from the date the claim for refund or credit was filed. If more than three years has run, contact local counsel for guidance.

Detailed Explanation of the Process

Erroneous Claim for Refund or Credit Penalty

Analysis

To calculate the amount of an underpayment, the Service treats the amount of a frozen refund as collected without assessment. Therefore, generally with frozen refunds, there is no underpayment. When there is no underpayment, no accuracy-related or fraud penalties will apply. In these cases, the excessive amount of the refund claim is part of a deficiency, and the erroneous claim penalty is therefore subject to deficiency procedures.

In all other cases where the excessive amount is not part of a deficiency, the erroneous claim for refund or credit penalty is assessable without following deficiency procedures.

The reasonable basis exception applies only to claims filed before December 18, 2015. To meet the reasonable basis standard, a taxpayer must reasonably base a claim on one or more of the authorities set forth in Treas. Reg. 1.6662-4(d)(3)(iii). The authorities include, but are not limited to, the Internal Revenue Code and related Treasury regulations, revenue rulings and procedures, tax treaties, etc. The reasonable cause and good faith exception in Treas. Reg. 1.6662-3(b)(3) does not apply. Any transaction that lacks economic substance (as described in IRC 6662(b)(6)) and results in an excessive claim amount shall not be treated as having a reasonable basis.

A claim that cannot be substantiated, is without basis in fact, or is not supported by adequate books and records will fail to satisfy the reasonable basis standard. An excessive claim which results from an honest mistake or error may have a reasonable basis when all facts and circumstances are considered.

For claims filed on or after December 18, 2015, a reasonable cause exception applies. The reasonable cause standard considers all pertinent fact and circumstances, including whether the taxpayer exercised ordinary business care and prudence in light of the nature of the tax benefit, the issue's complexity, and the sophistication of the taxpayer.

Process Applicability

Erroneous Claim for Refund or Credit Penalty

For an erroneous claim for refund or credit penalty to apply, the taxpayer must have filed a claim or an amended return. An erroneous claim may also arise from an originally filed return or any other form or writing, that shows there is an overpayment of tax for a particular tax year. For the refund or credit penalty to apply, all or a portion of the claim must be disallowed.

| Criteria | Resources |
|---|--|
| <p>An amended return or a claim filed under IRC 6676. This may include:</p> <ul style="list-style-type: none"> ▪ Any of the following forms: <ul style="list-style-type: none"> - Form 1120X – Amended U.S. Corporation Income Tax Return, - Form 1040X – Amended U.S. Individual Income Tax Return, - Form 843 – Claim for Refund and Request for Abatement. ▪ Any other filing that would constitute a “claim for refund or credit” of income tax under IRC 6676 such as: <ul style="list-style-type: none"> - Affirmative issues (defined in Step 3 of Process Steps on page 12 of this Process Unit). <p>Coordinate with Counsel if a protective claim or informal claim (a claim not made on the correct form) is involved. Note: The refund must be “frozen” and not have been already issued to the taxpayer.</p> | |
| <p>The claim for refund or credit must have been for an excessive amount. The “excessive amount” is the amount of the claim for refund or credit that exceeds the amount allowable for the year.</p> | <ul style="list-style-type: none"> ▪ IRC 6676(b) - Excessive Amount Defined |

Process Applicability (cont'd)

| Erroneous Claim for Refund or Credit Penalty | |
|---|---|
| Criteria | Resources |
| <p>The claim for refund or credit was filed before December 18, 2015. If the claim for refund or credit was filed before this day, does the taxpayer have a reasonable basis for the claim? If a reasonable basis exists, the erroneous claim for refund or credit penalty may not apply.</p> <p>A claim that is merely arguable or colorable will not meet the reasonable basis standard. A claim that a taxpayer reasonably bases on one or more of the authorities set forth in Treas. Reg. 1.6662-4(d)(3)(iii) will generally satisfy the reasonable basis standard. Any excessive amount that is attributable to a transaction lacking economic substance or is otherwise described in IRC 6662(b)(6), shall not be treated as having a reasonable basis.</p> <p>Generally, a claim that is without basis in fact, that is not supported by adequate books and records, or that cannot be substantiated will not satisfy the reasonable basis standard. An excessive claim resulting from an honest factual error that is reasonable in light of the facts and circumstances, such as an isolated computational or transcription error, is generally not inconsistent with reasonable basis.</p> | <ul style="list-style-type: none"> ▪ Treas. Reg. 1.6662-3(b)(3) - Reasonable Basis Defined |
| <p>The claim for refund or credit was filed on or after December 18, 2015. If the claim for refund or credit was filed on or after this day, does the taxpayer have a reasonable cause for making the claim? Reasonable cause considers if the taxpayer exercised ordinary business care and prudence. Reliance on professional tax advice does not necessarily demonstrate reasonable cause. Reasonable cause is a subjective standard that takes into account the extent of the taxpayer's effort to assess its proper tax liability. A reasonable cause analysis takes into account all relevant facts and circumstances, including the taxpayer's knowledge and sophistication, issue complexity, and the nature of the tax benefit.</p> | <ul style="list-style-type: none"> ▪ Treas. Reg. 1.6664-4 - Reasonable Cause |

Summary of Process Steps

Erroneous Claim for Refund or Credit Penalty

Process Steps

Calculating the claim for refund or credit penalty.

Step 1

Determine whether the case file includes an amended return or claim for refund or credit.

Step 2

Determine if any portion of the refund for the claim or refund or credit was frozen by the IRS and not issued.

Step 3

Determine if a claim was submitted during examination of which any portion was disallowed.

Step 4

Determine if an “excessive amount” exists.

Summary of Process Steps (cont'd)

Erroneous Claim for Refund or Credit Penalty

Process Steps

| | |
|------------------------|--|
| Step 5 | Determine the statute of limitations. |
| Step 6 | Determine whether reasonable basis (for claims filed before December 18, 2015) or reasonable cause exception (for claims filed on or after December 18, 2015) is applicable. |
| Step 7 | Determine whether deficiency or non-deficiency procedures are applicable. |

Step 1: Determine if Case Involves Claim for Refund or Credit

Erroneous Claim for Refund or Credit Penalty

Step 1

Determine whether the case file includes an amended return or a claim for refund or credit.

| Considerations | Resources |
|--|---|
| <p>The case must involve a claim for refund or credit. This may include:</p> <ul style="list-style-type: none">▪ Form 1040X, <i>Amended U.S. Individual Income Tax Return</i>,▪ Form 1120X, <i>Amended U.S. Corporation Income Tax Return</i>, or▪ Form 843, <i>Claim for Refund and Request for Abatement</i>. <p>This penalty only applies to income taxes. It does not apply to employment taxes, excise taxes, or estate and gift taxes.</p> | <ul style="list-style-type: none">▪ IRM 20.1.5.18.3 - Penalty Assertion |

Step 2: Determine if the Refund Was Issued

Erroneous Claim for Refund or Credit Penalty

Step 2

Determine if any portion of the refund for the claim for refund or credit was frozen by the IRS and not issued.

| Considerations | Resources |
|--|---|
| <p>The refund amount cannot have been paid out. At least a portion of the claim amount must not have been refunded or credited to the taxpayer. If the refund has already been paid out, this may result in an underpayment. In the case of an underpayment, determine whether an erroneous claim for refund or credit may be imposed, such as when there is a frozen refund. If not, a penalty may be imposed under IRC 6662 (Imposition of Accuracy-Related Penalty on Underpayments) or 6663 (Imposition of Fraud Penalty).</p> | <ul style="list-style-type: none">▪ IRM 20.1.5.18(7) - IRC 6676, Erroneous Claim for Refund or Credit Penalty |

Step 3: Determine if Any of the Claim Is Disallowed

Erroneous Claim for Refund or Credit Penalty

Step 3

Was a claim submitted during examination of which any portion was disallowed?

| Considerations | Resources |
|---|-----------|
| <p>This penalty may also apply to any other filing which may constitute a “claim for credit or refund” of income tax under IRC Section 6676 such as an affirmative issue, an informal claim or a protective claim.</p> <p>Affirmative issue is issue information that is a taxpayer favorable adjustment supplied by the taxpayer during an examination that could result in either a decrease to taxpayer’s taxable income or an increase to allowable credits.</p> <p>Informal claims are submitted on a non-standard form or by some other means (such as a written request) if the required elements of a claim are identified.</p> <p>Protective claims may be formal claims, informal claims or amended returns for credit or refund normally based on expected changes in a current regulation, pending legislation or current litigation. These claims are filed to protect the taxpayer’s right to recover internal revenue tax before the expiration of the statute of limitations.</p> | |

Step 4: Determine if an “Excessive Amount” Exists

Erroneous Claim for Refund or Credit Penalty

Step 4

Determine if an “excessive amount” exists.

| Considerations | Resources |
|---|--|
| <p>The “excessive amount” subject to the penalty is the amount of the claim that exceeds the amount allowed.</p> <p>When a taxpayer makes a claim for refund or credit for an excessive amount, IRC 6676 imposes a penalty of 20 percent on the excessive amount. For example, if the claimed amount is \$100,000, but only \$30,000 of the claim is allowed, \$70,000 is the excessive amount; the resulting penalty is \$14,000 (20 percent of \$70,000).</p> | <ul style="list-style-type: none">▪ IRM 20.1.5.18(5) - <i>Excessive Amount</i>▪ IRC 6676(b) - <i>Excessive Amount</i> |

Step 5: Determine if the Statute Is Still Open

Erroneous Claim for Refund or Credit Penalty

Step 5

Determine the statute of limitations.

| Considerations | Resources |
|--|--|
| <p>To guard against the possibility of a barred assessment, the Service should generally treat the erroneous claim for refund or credit penalty as if it has a three-year limitations period running from the date the claim for refund or credit was filed. If more than three years has run, agents should contact local counsel for guidance.</p> <p>Use Form 872-EC to extend the period for assessment of the section 6676 penalty. The period for assessment may also be extended by the effect of a Form 872 applicable to the tax reportable on the original return, but the period for a tax deficiency and for assessment of the 6676 penalty should be separately controlled.</p> | <ul style="list-style-type: none">▪ IRM 20.1.5.18.2 - <i>Statute Consideration</i> |

Step 6: Determine if an Exception Applies

Erroneous Claim for Refund or Credit Penalty

Step 6

Determine whether reasonable basis (for claims filed before December 18, 2015) or reasonable cause exception (for claims filed on or after December 18, 2015) applies.

| Considerations | Resources |
|---|---|
| <p>"Reasonable basis" is a relatively high standard of tax reporting that is not satisfied by a return position that is merely arguable or that is merely a colorable (plausible) claim. It is generally satisfied by a return position that is reasonably based on one of the authorities that can be used as substantial authority to avoid the substantial understatement penalty under IRC 6662(d).</p> <p>Note: The reasonable basis standard only applies to claims filed before December 18, 2015.</p> <p>For claims filed on or after December 18, 2015, a reasonable cause standard applies. Reasonable cause considers if the taxpayer exercised ordinary business care and prudence. "Reasonable cause" differs from reasonable basis in that it is determined based on all pertinent facts and circumstances. It is generally granted when the taxpayer exercised ordinary business care and prudence in determining his or her tax obligations but nevertheless failed to comply with those obligations.</p> | <ul style="list-style-type: none"> ▪ IRM 20.1.5.18(9) – (12) |

Step 7: Determine if Deficiency or Non-deficiency Procedures Apply

Erroneous Claim for Refund or Credit Penalty

Step 7

Determine whether deficiency or non-deficiency procedures apply.

| Considerations | Resources |
|---|---|
| <p><u>Deficiency Procedures</u></p> <p>An erroneous claim for refund or credit penalty is subject to deficiency procedures in situations where the determination of liability for the penalty is dependent on the determination of a deficiency. When an erroneous claim for refund or credit penalty is subject to deficiency procedures, it will be included on the examination report with the excessive amount as part of a deficiency. Since the PATH Act reversed <i>Rand v. Commissioner</i>, 141 T.C. 376 (2013), and allowed refundable credits to reduce the amount of tax shown on a return below zero when calculating an underpayment, there is only one situation where there would be a deficiency but not an underpayment, and that is in cases when the taxpayer makes an erroneous claim for refund or credit of a refundable credit on an original return and the refund is frozen. The disallowed refundable credit will result in a deficiency, but because the refund is frozen there will be no underpayment. However, there will still be a deficiency because disallowed refundable credits give rise to a deficiency.</p> | <ul style="list-style-type: none"> ▪ IRM 20.1.5.18.4 - <i>Case Procedures With Deficiency Procedures</i> |

Step 7: Determine if Deficiency or Non-deficiency Procedures Apply (cont'd)

Erroneous Claim for Refund or Credit Penalty

[Step 7](#)

| Considerations | Resources |
|---|--|
| <p><u>Non-Deficiency Procedures</u></p> <p>In all other cases in which the erroneous claim for refund or credit penalty applies, the penalty does not depend on the existence of a deficiency and is therefore assessable without following deficiency procedures.</p> <p>When the penalty is NOT subject to deficiency procedures, use Form 8278, <i>Assessment and Abatement of Miscellaneous Civil Penalties</i>. Form 8278 is used for the computation and assessment of miscellaneous penalties that are not subject to deficiency procedures.</p> | <ul style="list-style-type: none"> ▪ IRM 20.1.5.18.5 - <i>Case Procedures Without Deficiency Procedures</i> |

Exceptions

Erroneous Claim for Refund or Credit Penalty

Description

Reasonable cause criteria apply to an erroneous claim for refund or credit penalty when the claim was filed on or after December 18, 2015.

The erroneous claim for refund or credit penalty shall not apply if there is reasonable cause (reasonable basis for claims filed before December 18, 2015) for the claimed tax treatment. See Treas. Reg. Section 1.6662-3(b)(3) for the definition of reasonable basis.

If a taxpayer entered into a transaction after March 30, 2010, any excessive amount that is attributable to a transaction described in IRC Section 6662(b)(6) will not be treated as having reasonable cause (reasonable basis if the claim was filed before December 18, 2015) under IRC Section 6676(c).

Definitions

Erroneous Claim for Refund or Credit Penalty

Description

- Excessive Amount - The amount of the claim that exceeds the amount allowed.
- Frozen Refund - Situation where a taxpayer has claimed a refund on an original income tax return, but the amount has not yet been credited or refunded to the taxpayer.

Other Considerations / Impact to Audit

| Erroneous Claim for Refund or Credit Penalty | |
|--|---|
| Considerations | Resources |
| <p>No stacking with accuracy related or fraud penalties. The erroneous claim for refund or credit penalty does not apply to any portion of the disallowed amount of the claim for refund or credit that is subject to the following penalties:</p> <ul style="list-style-type: none"> ▪ IRC 6662 – Accuracy Related Penalty, ▪ IRC 6662A – Accuracy-Related Penalty on Understatements with Respect to Reportable Transactions, ▪ IRC 6663 – Fraud Penalty. | <ul style="list-style-type: none"> ▪ IRM 20.1.5.18.3.1 - <i>Coordination With Other Penalties</i> |
| <p>Imposition of an erroneous claim for refund or credit penalty on identity theft perpetrator:</p> <ul style="list-style-type: none"> ▪ An erroneous claim for refund or credit penalty can be asserted against perpetrators of identity theft who, without authority, use a third party's identifying information to file a return(s) or claim(s) for refund or credit. | <ul style="list-style-type: none"> ▪ IRM 20.1.5.18.1 - <i>Imposition of IRC 6676 Penalty on Identity Theft Perpetrator</i> |
| <ul style="list-style-type: none"> ▪ For non-deficiency procedures, Form 8278, <i>Assessment and Abatement of Miscellaneous Civil Penalties</i> is used for erroneous claim for refund or credit penalty cases except for Married Filing Jointly (MFJ) income tax return claims. The erroneous claim for refund or credit penalty is assessed on MFT 55 for IMF and MFT 13 for BMF with PRN 565 using Form 8278. ▪ Form 3870, <i>Request for Adjustment</i>, is used when asserting the erroneous claim for refund or credit penalty on MFJ income tax returns. The penalty "related" case for MFJ income tax return claims must be assessed on MFT 30 with PRN 687. Do not use Form 8278 for MFJ penalty cases. | <ul style="list-style-type: none"> ▪ IRM 20.1.5.18.6 - <i>Non-deficiency "Related" Case File for Disallowed Claims</i> |

Index of Referenced Resources

Erroneous Claim for Refund or Credit Penalty

IRC 6662 – *Imposition of Accuracy-Related Penalty on Underpayments*

IRC 6662A – *Imposition of Accuracy-Related Penalty on Understatements with Respect to Reportable Transactions*

IRC 6663 – *Imposition of Fraud Penalty*

IRC 6676 – *Erroneous Claim for Refund or Credit*

Treas. Reg. 1.6662-3(b)(3) – Reasonable Basis

Treas. Reg. 1.6662-4(d) – Substantial Authority

Treas. Reg. 1.6664-4 – Reasonable Cause

IRM 20.1.5.18 – *IRC 6676, Erroneous Claim for Refund or Credit Penalty*

Training and Additional Resources

| Erroneous Claim for Refund or Credit Penalty | |
|---|---|
| Type of Resource | Description(s) |
| Saba Meeting Sessions | <ul style="list-style-type: none">▪ Penalties IPG Community Meeting - 2014-11▪ Penalties IPG Community Meeting - 2015-04 |

Glossary of Terms and Acronyms

| Term/Acronym | Definition |
|--------------|--------------------------|
| BMF | Business Master File |
| IMF | Individual Master File |
| MFJ | Married Filing Jointly |
| MFT | Master File Tax |
| PRN | Penalty Reference Number |

Index of Related Practice Units

| Associated UIL(s) | Related Practice Unit |
|-------------------|-----------------------|
| | None at this time. |