

**Office of Chief Counsel
Internal Revenue Service
memorandum**

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subject: Penalty for aiding and abetting understatements of income tax

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

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LAW AND ANALYSIS

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Section 6701 imposes a penalty on a person who aids or abets another person in the understatement of that person's tax liability. It states:

Any person—

(1) who aids or assists in, procures, or advises with respect to, the preparation or presentation of any portion of a return, affidavit, claim or other document,
(2) who knows (or has reason to believe) that such portion will be used in connection with any material matter arising under the internal revenue laws,
and

(3) who knows that such portion (if so used) would result in an understatement of the liability for tax of another person,

shall pay a penalty with respect to each such document in the amount determined under subsection (b).

The penalty amount under subsection (b) is \$1,000 and, if the return, affidavit, claim or other document pertains to the tax liability of corporation, the amount is \$10,000.

The structure of section 6701 requires the Service to identify what documents the person liable for the penalty helped prepare or present, and which also meet the criteria set out in section 6701(a)(2) and (3). Mitchell v. United States, 977 F.2d 1318, 1321-22 (9th Cir. 1992). Section 6701(a)(1) requires that the person or entity to be penalized must "aid[] or assist[] in, procure[], or advise[] with respect to the preparation or presentation of any portion of a return, affidavit, claim or other document." Mitchell, 977 F.2d at 1322. Penalties are imposed with respect to each document identified in section 6701(a)(1) that further meets the criteria under paragraphs (2) and (3) of subsection (a). Mitchell, 977 F.2d at 1322; Berger v. United States, 1997 U.S. Dist. LEXIS 6297, 19 (D. Conn. 1997) ("... the statute plainly imposes a penalty as to each document through which the plaintiff aided or assisted in the understatement of a tax liability.").

³ Note that the Service would also need to comply with section 6751(b)(1) before assessing the section 6701 penalty. The immediate supervisor of the revenue agent who initially recommended pursuing the penalty would need to approve the penalty in writing.

in Mitchell v. United States, 977 F.2d 1318 (9th Cir. 1992). Mitchell, a tax shelter organizer, had reviewed and signed tax returns for an S corporation and K-1 forms for each of the shareholders which showed their purported shares of deductions and credits. Although Mitchell clearly aided in the preparation or presentation of the S corporation returns, the court found that section 6701(a)(1) was satisfied with respect to other documents as well.

Mitchell's aiding also pertains to portions of all 34 investors' individual tax returns, because each investor incorporates the tax information contained on the Form K-1 supplied by Mitchell into his or her U.S. individual tax returns. Thus, Mitchell aided in the preparation or presentation of documents that relate to the returns of 35 persons.

Mitchell, 977 F.2d at 1322.

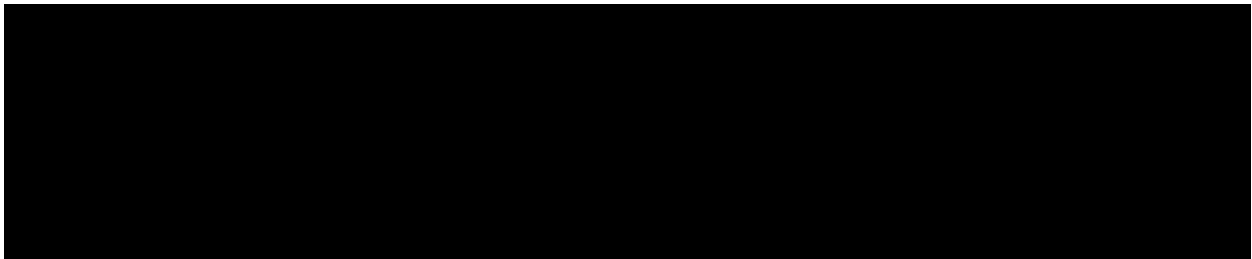
The opinion in Berger v. United States, *supra*,

In Berger, the government sought to impose a penalty under section 6701 based solely upon the plaintiff's filing of false Forms 5300. "Application for Determination for Employee Benefit Plan." Each form related to a separate corporation that claimed tax benefits for more than one year in reliance on a false Form 5300. The court held that the section 6701 penalty was limited by the number of false Forms 5300 prepared and was not calculated by the number of tax years affected. Berger, 1997 U.S. Dist. LEXIS 6297, at 20. That holding was correct,

. "[T]he conduct allegedly warranting imposition of a section 6701 penalty was the plaintiff's alleged falsification of the forms 5300." Id.

The legislative history to section 6701 states that the penalty was intended to apply as a civil counterpart to the criminal penalty on aiding or assisting in the preparation or presentation of false or fraudulent on returns or other documents. S. Rep. No. 97-494, at 1022 (1982). Section 7206(2) is the criminal penalty applicable to a person who willfully "aids or assists in, or procures, counsels, or advises the preparation or presentation . . . of a return, affidavit, claim, or other document . . ." This language is virtually the same as in section 6701(a)(1). Courts have applied the criminal penalty to all participants in a scheme which results in the filing of a false return, whether or not those parties actually prepare it. United States v. Hooks, 848 F.2d 785, 791 (7th Cir. 1988).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS



[REDACTED]

[REDACTED]

[REDACTED]

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