

Department
of the
Treasury

Internal
Revenue
Service

Office of
Chief Counsel

Notice

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October 17, 2001

Assessment of the Section
6651(f) Fraudulent Failure
Subject: to File Penalty
Upon incorporation
Cancellation Date: into CCDM

Purpose:

This notice advises Counsel attorneys of the necessity, in appropriate circumstances, to assess immediately all or a portion of the section 6651(f) fraudulent failure to file penalty, rather than follow deficiency procedures.

Summary:

The Revenue Reconciliation Act of 1989, effective for years beginning after December 31, 1988, made changes to the traditional fraud penalty. This change requires the Service to assess and collect the section 6651(f) fraudulent failure to file penalty, in certain circumstances, before the taxpayer can judicially contest that assessment.

Discussion:

Section 7721(a) of the Revenue Reconciliation Act of 1989, P.L. 101-239 (RRA 1989), modified and recodified the traditional fraud penalty as section 6663. In accordance with the RRA 1989 modification, the traditional fraud penalty only applies to situations where a taxpayer files a fraudulent return. Section 6664(b). In order to retain a penalty for the failure to file a return with intent to evade tax, Congress added section 6651(f), which generally has an impact equal to the traditional fraud penalty, i.e., rising to a rate of 75% after a five month delinquency.

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The administration of the section 6651(f) penalty, however, differs from the administration of the traditional fraud penalty because the section 6651(f) penalty follows the section 6665 procedural rules for assessing the section 6651 delinquency penalty. Section 6665(a) provides the general rule that the deficiency procedures applicable to income, estate, gift and certain excise taxes are equally applicable to additions to tax imposed by Chapter 68. Section 6665(b) excludes additions to tax under section 6651 from this general rule. The section 6665(b) exclusion, however, is limited in that it does not apply to that portion of the section 6651 addition to tax which is attributable to a deficiency in tax described in section 6211. Thus, the time for assessment of the section 6651 delinquency penalty differs depending upon whether the penalty is based upon a tax liability reflected on the return or upon a deficiency (with or without a filed return). When a taxpayer files a delinquent return, the Service must assess the delinquency penalty under section 6651 based upon the tax shown on the return. For the amount of the delinquency that is attributable to a deficiency (as defined in section 6211), however, the penalty is administered in the same manner as the deficiency, with a notice of deficiency and an opportunity for pre-assessment judicial review. See section 6665(a) and (b)(1). Therefore, where the section 6651(f) fraud penalty applies to a delinquency followed by a filed return showing a tax liability, the Service should assess the penalty immediately in the same manner as the usual delinquency penalty since the penalty is not calculated upon a deficiency. If the late filed return is incorrect, the section 6651(f) penalty amount attributable to the tax shown on the return is immediately assessable, while the part of the penalty attributable to the deficiency is subject to the deficiency procedures.

The assessment procedures are not optional and the Service may not include a fraud delinquency penalty which is not attributable to a deficiency in a deficiency notice. Not only is a deficiency notice for this amount not authorized by sections 6211 and 6665, the period of limitations for the assessment of such amount would not be suspended by the issuance of the notice. Section 6503(a), which ordinarily protects the Service when issuing a notice of deficiency, only applies “in respect of any deficiency as defined in section 6211. . . .” Since this amount cannot constitute a deficiency, the statute would not be suspended and, if the penalty is not assessed, could expire. Cf. Bennett v. Commissioner, 30 T.C. 114 (1958), acq. 1958-2 C.B. 3 (nonfraudulent delinquent return begins running of statute of limitations even though original failure to file was fraudulent). Thus, in reviewing notices of deficiency, Counsel attorneys should ensure that the notice includes only those amounts attributable to deficiencies.

Several cases have been brought to our attention in which the statutory notices erroneously included the section 6651(f) fraudulent failure to file penalty based, wholly or partly, on the tax shown on taxpayers’ returns. The erroneous inclusion of the penalty in the deficiency notice was not discovered until after the statute of limitations expired. For this reason, attorneys should review their dockets to determine if there are any cases in which a notice of deficiency incorrectly includes a fraudulent failure to file penalty based on the tax shown on a taxpayer’s return. In the future, attorneys who review statutory notices or who receive cases for answer should confirm that any fraudulent failure to file penalty included in the notice of deficiency is attributable to a deficiency in tax, not to the tax shown on the

taxpayer's return.

If a notice of deficiency includes a fraudulent failure to file penalty based on the tax shown on the taxpayer's return and the statute of limitations on assessment is still open, the Service should be advised to take the steps necessary to ensure that the assessment is made prior to the expiration of the statute of limitations, computed without regard to the issuance of the notice of deficiency. Further, in such cases, if the case has not been answered, Counsel should concede in the answer that the notice of deficiency improperly includes a fraudulent failure to file penalty that is not within the jurisdiction of the court. If the answer has already been filed, Counsel should file an amendment to answer, together with any required motion for leave, that concedes that a fraudulent failure to file penalty was improperly included in the notice of deficiency.

Questions regarding this Notice should be addressed to Branch 2 of the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division), at (202) 622-4940.

/s/
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(Procedure and Administration)