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**Part 4. Examining Process****Chapter 19. Liability Determination****Section 17. Non-Filer Program****4.19.17 Non-Filer Program**

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**4.19.17.1 (11-10-2006)  
Non-filer Program**

1. The Non-filer Strategy was developed at the request of the Executive Committee. Outreach/communication actions are being implemented to bring non-filers into compliance.
2. The National Non-Filer strategy is directly aligned with the Service's effort to identify non-compliant taxpayers and design methods to encourage their compliance.
3. The non-filer customer creates one of the most significant compliance issues facing our system of taxation.
4. Under the non-filer strategy, non-filers are being encouraged to come forward voluntarily and file delinquent tax returns.
  - The Multi-functional Non-filer Assistance Program was developed to meet this challenge.
  - Non-filers who voluntarily come forward, have only legal source income, file an accurate tax return and pay their tax will not be referred for criminal prosecution for failure to file.
5. The campus examination branches participate in the Non-filer Assistance Program either:
  - Directly under the guidelines in the IRM or
  - By providing support for Area Offices in their Non-filer Assistance Program efforts.

**4.19.17.1.1 (11-10-2006)  
Non-filer Coordination**

1. Examination will coordinate with and provide assistance to other functional areas in conducting non-filer investigations.
2. Examination will work closely with Collections and Customer Service to ensure an effective outreach program.

**Note:**

The Examination Non-filer Program is supplemented by the Multi-Functional Refund Hold Handbook.

#### **4.19.17.1.1.1 (11-10-2006) Non-Filer Inventory**

1. The Operations Manager, Examination or designated employee at each campus examination branch secures non-filer cases for investigation by Examination.
2. The Operations Manager, Examination establishes the priority of cases to be selected based on the availability of cases identified through the Collection Inventory and assigned projects.
3. The Operations Manager, Examination or designated employee coordinates with the Collection Division to establish a periodic review of the:
  1. Referral procedures regarding referral criteria,
  2. Volume of potential inventory, etc. from CFf (Collection Function-field) to campus examination.

#### **4.19.17.1.1.2 (11-10-2006) Non-Filer Case Screening**

1. Establish a case file for selected cases as follows:
  1. The folder will include the various research prints, i.e. IMFOL, INOLE, IRPTRO, 1.10, "Commissioner of Internal Revenue Correspondence, etc., with Form 3198 properly notated and attached.
  2. The case file will be assigned to a Correspondence Examination group for further case building, research, and taxpayer contact actions.
  3. The case file will be assigned to a Correspondence Examination Group for further case building, research and taxpayer contact actions.
2. Reminders for examiners when selecting cases:
  1. You may only have one or two tax periods in your package.
  2. See IRM 4.19.17.1.2.1 to ensure all appropriate tax periods are addressed.
  3. If you select a year, make sure to check all prior years or related SSNs to ensure the return did not post somewhere else.
  4. When working non-filer cases you may select some years and not others. Follow the procedures above, under non-select, for years you will not be selecting.
  5. If selecting a case, and there is a TC 140 on the module and no TC 595, input a TC 595. This will satisfy the Delinquency.
3. Do not select cases if any of the following apply.
  - A. Taxpayer filed with spouse.
  - B. Little or no tax due .
  - C. Taxpayer filed under another SSN.
  - D. Taxpayer is in combat zone.

- E. TC 59X is in module, (exception is TC 592).
- F. TC 150 DLN is in the module.
- G. TC 290/300 is in the module.
- H. TC 520 Taxpayer is deceased.
- I. TC 977/976/610 is in the module.

#### **4.19.17.1.1.3 (11-10-2006) Fraud Referrals**

1. Refer to IRM 25.1, Fraud, for additional information.
2. Non-filer cases should have sufficient information after the initial screening and case building process for you to determine if the known facts indicate potential fraud. If it appears that fraud may be present,
  1. Discuss the case with the group manager and if appropriate, the Campus Fraud Coordinator.
  2. When firm indications of fraud exist, do not contact the non-filer or solicit the delinquent tax return(s).
3. Items to consider when evaluating a potential case:
  - A. History of non-filing -- Multiple non-filed years providing a pattern of behavior.
  - B. Repeated contacts by the Service -- History of contacts by service personnel for failure to file.
  - C. Indications that the non-filer had knowledge of filing requirements (i.e., professional with an advanced education, person who works directly in the tax field).
  - D. Age of taxpayer.
  - E. A large number of cash transactions (i.e., purchases by cash, cash deposits as evidenced by CTRs in the case file).
  - F. Indications of significant unreported income (i.e., substantial interest and dividends earned, investments in IRA accounts, stock and bond transactions, high mortgage interest paid) per Information Return Processing (IRP) or Taxpayer Delinquency Investigation (TDI) documents.
  - G. Non-filer/Non-filer frivolous correspondence and
  - H. Frivolous returns.
4. Refer to the Law Enforcement Manual IV for criteria to use when considering submission of a criminal fraud referral.
5. Fraud must be proven by clear and convincing evidence and the statutory notice asserting the fraud penalty must be reviewed by Area Office Counsel.
6. Upon receiving civil referrals (and criminal referrals reclassified as civil) returned from CID, complete the investigation and attempt to secure the non-filers return(s).
  - When the examination is completed, contact the Fraud Coordinator to discuss final facts prior to asserting the civil fraud penalty, fraudulent failure to file penalty or closing without a penalty.

- In these cases, the government has the burden to prove that the taxpayer acted in a fraudulent manner.
7. In prosecuted non-filer cases under IRC Sec. 7203 returned for civil settlement, the judgement is not collateral estoppel to allow the automatic assertion of the civil fraud penalty.
    - Evidence in the civil investigation should be developed to support the assertion of the fraudulent failure to file penalty for years after 1988 and the fraud penalty for years prior to 1989.
    - Area Office Counsel must approve the non-assertion of the civil fraud penalty in these cases.
  8. Refer delinquent returns secured by Examination that have substantial understatements of income and/or substantial overstatements of deductions to Criminal Investigation if it is determined that there are firm indications of fraud.

#### **4.19.17.1.1.4 (11-10-2006) Refund Hold (RH) Program**

1. Refer to multifunctional IRM 25.12 and LEM 25.12, Delinquent Return and Refund Hold Program, for specific processing information.
2. The service holds individual income tax refunds, Debtor Master File offsets and credit elects when a current return is filed with a refund and the account has at least one module within the six years prior to the refund hold which:
  - A. Is in Taxpayer Delinquency Status 03, or
  - B. Is assigned to ASFR, or
  - C. Has an OPEN AIMS RECORD with an unresolved TC 420/424 and the return is not posted.

#### **4.19.17.1.1.5 (11-10-2006) Refund Hold (RH) Program Coordinator**

1. Compliance Services Examination Operations must designate functional Refund Hold Coordinators (RHC).
  - A. The RHC is responsible for implementing the instructions in this document and communication with the Headquarters Program Analyst with responsibility for the Refund Hold Program.
  - B. RHCs coordinate with the Office of Appeals and/or Area Counsel to determine the status and history of RH cases in Appeals.
  - C. RHCs support the program within their assigned area of responsibility and ensure timely movement of cases.

#### **4.19.17.1.1.6 (11-10-2006) IDRS Processing Output**

1. Refund hold account information is passed from Master File to IDRS for processing and analysis. A Control D report, LE62740Z, is created weekly to alert Examination Operations of the Refund Hold cases in their inventory.
2. Exam is responsible for weekly review of the report to identify cases assigned to their functional area and determining whether the refund should be released or applied to a proposed liability.

#### **4.19.17.1.2 (11-10-2006) Non-Filer Case Processing**

1. Generally, the examiner will initiate contact with the non-filer by mail.
2. In some cases the initial contact may be by telephone to the taxpayers residence.

**Note:**

Do NOT attempt contact with the non-filer before 8:00 AM. or after 9:00 PM as prescribed by the Fair Debt Collections Act.

3. If the initial contact with the non-filer is by telephone, attempt to obtain as much information as possible to arrive at a substantially correct tax assessment.
  1. At a minimum, obtain the following information during an initial telephone interview.
  2. Ensure information is obtained on the amounts and sources of both income and expenses/deductions:

IF	THEN
The taxpayer is self-employed	<ul style="list-style-type: none"> <li>• establish the cost of goods sold,</li> <li>• gross profit margin,</li> <li>• ordinary operating expenses</li> <li>• name and addresses of principal suppliers, and</li> <li>• method of payment.</li> </ul>
The non-filer had employees	<ul style="list-style-type: none"> <li>• Were employment tax returns filed?</li> <li>• Were Forms 1099 filed?</li> <li>• What was the method of payment?</li> </ul>
The information concerning personal expenses are received	<ul style="list-style-type: none"> <li>• What is the location of the residence?</li> <li>• Renting?</li> <li>• Own?</li> <li>• Number of family members?</li> <li>• Autos owned?</li> </ul>

4. Develop Filing Status and dependent information. Establish the reasons for non-filing by asking specific and direct questions. For example:
  - Why were the returns not filed?
  - Did you know that you were required to file returns?

**Note:**

The non-filer should provide reasons that would establish reasonable cause for failure to file.

5. During the first telephone contact, explain to the non-filer that:

1. He/she is under examination due to failure to file tax returns.
2. They should have previously received a copy of Publication 1, Your Rights as a Taxpayer.
3. If the taxpayer indicates that Publication 1 was not received, advise the taxpayer of his/her rights and provide a copy of Publication 1 to the taxpayer by mail.
4. Request that the non-filer file all delinquent returns without regard to the number of years or tax periods involved.
5. Set a firm date for the non-filer to send in his/her returns.
6. Use the case history sheet to record actions taken in locating the non-filer and/or securing the return(s).
7. If the non-filer raises the question of criminal prosecution,
  - State that you are conducting a civil investigation of the tax liability and
  - Have no authority to grant immunity.

However, the services voluntary disclosure practice is that taxpayers will not be referred for criminal investigation for failure to file if they:

- A. File accurate returns with an income tax examiner.
- B. Have only legal source income (i.e., no part of the income was earned from activity which is illegal under federal or state law).
- C. Make payment (or a bona fide arrangement to pay).

#### 8. Verification of IRP Documents --

- If the non-filer states that he/she did not receive income reported on a filed information report, check Bad Payor List, and attempt to verify the information report through third party contacts.
  - If the payor appears on the list, no verification can be obtained, the third party cannot be located, has ceased to operate, has not retained records from which verification can be derived, or other circumstances suggest that the information report is not reliable or accurate, do not include the income item in the non-filers income.
  - If, however, the information report can be verified, the income item should be included in the non-filers income.
9. If the non-filer is cooperative and is unable to file all required returns for the enforcement period, the examiner will determine the substantially correct tax liability based upon the non-filers records.
    - Utilize oral evidence,
    - Income/expense ratios,
    - Third party sources and
    - Other relevant data in preparing an examination report if the non-filers records are missing or not made available for examination.

#### **4.19.17.1.2.1 (11-10-2006) Delinquent Returns--Enforcement of Filing Requirements**

1. Policy Statement P-5-133 provides guidelines for the extent of retroactive enforcement in delinquency cases.
  - Policy Statement P-5-133 provides that enforcement should not extend beyond six years, but there are instances where longer or shorter periods may be enforced.
  - The six year period is the last six prior tax periods.
2. Factors to consider in determining whether shorter or longer periods should be enforced are:
  - A. Prior history of noncompliance.
  - B. Existence of income from illegal sources
  - C. Effect on voluntary compliance.
  - D. Anticipated revenue in relation to the time and effort required to determine the tax due.
  - E. Special circumstances existing in the case of a particular taxpayer and available information.
3. Group manager approval is required for all enforcement activity that is less than or exceeds the six year period.
  - However, group manager approval is not needed if the non-filer voluntarily files returns beyond the established enforcement period.
  - The case file is documented with the facts and reasons for deviating from Policy Statement P-5-133.

#### **4.19.17.1.2.2 (11-10-2006) Conducting Compliance Checks**

1. Cases should be researched to establish compliance for filing requirements based on income verification and to determine selection for examination. Research all related SSN's and prior years filing history
2. Check IMFOLE for entity information and IMFOLI for filing history
3. Check SUPOL and IRPTR for all related non-filer years to determine sources of income. Do not consider:
  - Duplicate or rollover items,
  - Bad payer information, or
  - Items where the payer's name is missing, incorrect, or incomplete.
4. Determine potential liability and taxable income by:
  1. Income minus standard deduction,
  2. Minus standard deduction,
  3. Minus personal exemptions for the appropriate tax year.
  4. Refer to tax tables for the delinquent year to determine tax.

#### **Note:**

Any cases below tolerance may be worked if compliance will be enhanced.

5. Process under SFR procedures.

#### **4.19.17.1.2.3 (11-10-2006) Auditing Standards--Non-Filer Returns**

1. The objective of the non-filer strategy is to bring non-filers back into the tax system by securing a substantially correct delinquent return.
2. The focus of non-filer examinations is the non-filers tax liability as a whole rather than the considerations of individual income and expense issues.
3. While this focus differs from the objective of traditional Examination activities, non-filer cases should meet the expectations expressed in the Auditing Standards.
4. The following discussion in (5) through (9) is intended to clarify how individual auditing standards should be interpreted for non-filer cases at Campuses. Auditing standards not discussed here should be interpreted following the guidelines in the General Examination IRM:
  5. **Standard #1 -- Consideration of Large, Unusual or Questionable Items (LUQs):**
    - Returns secured from the taxpayer are reviewed for the presence of LUQs.
    - Such items are deemed appropriate if the non-filers responses resolve the examiners questions and are consistent with other available information, even if no records are inspected.
    - In-depth review of the non-filers books and records should be limited to material items where the non-filers responses do not adequately resolve the issue.
  6. **Standard #2 -- Probes for Unreported Income:**
    - Review all known facts to determine the reasonableness of known income and the potential for additional unreported income.
    - Additional information sources include, but are not limited to Statistics of Information (SOI) Bulletin data, Bureau of Labor Statistics (BLS), any third party information, oral testimony, etc.
    - If the scope of the probe is beyond the capability of the Correspondence Examination examiner (e.g., self employment cash business), refer the case to the Classification Unit for possible transfer to the field.
  7. **Standard #3 -- Examination Depth and Records Examined:**
    - The known facts in the case and results of any non-filer contacts and correspondence will determine the depth and scope of the examination.
    - In most cases the examiners inquiries and documentation analysis should be considered adequate auditing techniques when examining a secured delinquent return.
    - Issues should not be overly developed; the examiner should rely on oral testimony and other corroborating data rather than on-line by line documentation.
    - The work papers should document the examiners efforts made to secure documentation if attempts to do so were unsuccessful.
  8. **Standard #4 -- Penalties Properly Considered:**

- Every effort should be made to apply penalties in a fair and consistent manner.
- The case file should fully document the consideration, assertion or non-assertion, and computation of all appropriate penalties.
- Determine why the taxpayer did not timely comply with filing requirements.
- Reasonable cause should be applied consistently and fully documented in the work papers.

**9. Standard #5 -- Work papers Support Conclusions:**

- Delinquent returns that are accepted as prepared by the non-filer still require work papers to support the conclusion that the returns are substantially correct.
- The work papers should establish an audit trail and justify estimates and acceptance of oral testimony.
- In unagreed cases take particular care to document contact (or attempts at contact including telephone and correspondence) with the taxpayer and the calculation of taxable income.

**4.19.17.1.2.4 (11-10-2006)  
AIMS Controls**

1. Cases are established on AIMS for each tax year as follows:

- A. Transaction Code (TC) 424.
- B. Source Code 24. Source code 25 for HINF
- C. Employee group code (EGC) 1XXX/2XXX/5XXX
- D. Organization Code 1XXX/2XXX/5XXX.
- E. Master File Tax (MFT) 30.
- F. Status Code 06/08.
- G. Primary business code (PBC)
- H. Area office Code.
- I. Use Push Code  
021 (Substitute for return),  
036 (Substitute for return-Computer generated), or  
037 (Potential CI referral/non-filer).  
A push code must be used to establish the case on AIMS in order to hold the TC 424 at Master file until the TC 150 posts.

**Note:**

Push code 021 and 037 will allow the posting of TC 424 at master file, even if there is not a TC 150 posted and will hold the skeletal record on AIMS for 26 months. Push code 36 will automatically generate TC 150 and TC 595 and is preferred instead of push code 021.

- J. Project code 156 (Known non-filer), 437 (High Income non-filer) or other appropriate non-filer project code.
- K. The filing status must be single or married filing separate. The entity must first be corrected, if using push code 36.

## L. Use appropriate Activity Code

**4.19.17.1.3 (11-10-2006)**  
**Substitute for Return**

1. Internal Revenue Code Section (IRC) 6212 authorizes the Service to send a notice of deficiency when a taxpayer appears to have a filing requirement but does not comply by voluntarily filing a tax return.
2. The SFR Program and its automated version (ASFR) were developed to deal with taxpayers who have not filed tax returns voluntarily and for whom income information is available to substantiate a significant income tax liability.
3. The Automated Substitute for Return Program (ASFR) processes cases meeting criteria established at the national level. The cases are systemically selected during initial case analysis.
4. Return delinquencies that do not meet ASFR criteria (see ADP Document 6209 for select code criteria) must be manually processed such as accounts with:
  - Open balances due,
  - Indications of self employment, and
  - Non-employee compensation exceeds 30% of total income.
5. Substitute for Return (SFR) procedures should be used for non-filers for whom compliance check reveals income information is available to substantiate a significant income tax liability.
6. See IRM 4.19.1.9.2.2, Conducting Compliance Checks, for information.
7. Two letters are issued to the taxpayer, a 30-day letter and a 90-day letter.
  - These letters request the taxpayer file a return or explain why they are not required to file.
  - The letters include a list of income information reported to the Service and the proposed tax assessment which shows how the Service will assess tax if no return is secured.
8. If a return is not received by the end of the 90-day period, the account defaults and an assessment is made.
9. The deficiency is assessed when the taxpayer does not file a petition to Tax court.
10. When the taxpayer has petitioned the Tax Court, no assessment should be made while the case is in litigation without the concurrence of the Area Office Counsel office assigned to the case.
11. If compliance check reveals deficiency potential for Campus examination, initiate SFR procedures.
12. If compliance check reveals deficiency potential for area office examination, cases should be transshipped to the appropriate area office as provided for under Campus/ area office agreement.

**4.19.17.1.3.1 (11-10-2006)**  
**Substitute For Return Procedures**

1. The examination begins when compliance check reveals filing delinquencies with potential for tax assessment.

2. Cases selected for SFR procedures should be controlled on IDRS with appropriate activity codes
3. Initial case folder will contain:
  - A. Form 3198 stapled to inside left of case file folder.
  - B. Compliance check information on fact of filing stapled to inside left under Form 3198.
  - C. Labels (cross through any labels showing an incorrect address).
  - D. Letters and information to be sent to the taxpayer (copy of 30/90 day letter.)
  - E. Form 5600, Statutory Notice Worksheet, if case is going 90 days (include reports, current ENMOD and AMDIS prints).
  - F. Form 5564, Notice of Deficiency Waiver.
  - G. History sheet of actions.
  - H. File copies of taxpayer letters and correspondence/telephone communications in date order with most current date on top.
  - I. Examination workpapers.
  - J. IDRS transcripts, research, IRP transcripts, any pertinent information.
  - K. Form 6754, Classification Checklist.
  - L. RTVUE, original return, amended return, or photocopy of return. Form 5546, Examination Return Charge out, or AMDIS print.
  - M. Current TXMOD or IMFOLT
  - N. AMDISA and ENMOD prints
  - O. Copy of dummy SFR 1040. If push code 036 was used to establish TC 150, a dummy 1040 SFR is not required.
4. Substitutes for Returns (SFR) are established as follows:
  - A. Prepare a dummy/SFR for each tax period.
  - B. Use a current year tax form for each dummy/SFR.
  - C. Cross out the tax period and write the SFR tax period in red using YYYYMM format.
  - D. Using the non-filers name from Master File, enter a bracket in front of the last name in red.
  - E. Use the non-filers correct social security number.
  - F. Use either single or married filing separate filing Status for each dummy/SFR. For married filing separate, show the spouses name and SSN (if available). DO NOT use joint filing Status.
  - G. Use the current date as the received date in MMDDYYYY format.
  - H. Code the entity with a "P" code (partial entity) in red above the first name area. No address will be entered on dummy SFRs. (Forms 2363, Master File Entity Change, must be used to update addresses to Master File.)

- I. Allow exemptions for 65 or over, if applicable.
  - J. Enter Return Processing Codes L (dummy return) and K (delinquent return statute cleared) to the right of line 23 on form 1040 in red.
  - K. Write "Exam/SFR" across the top margin of the return in red.
  - L. Enter Computer Condition Code (CCC) 3 in the filing Status block of the return. This generates a TC 570 to prevent prepaid credits from being refunded erroneously.
5. If push code 036 was used, the TC 150 DLN will establish automatically, and the above steps, in (4) above are not required. Use the following procedures to post an IMF SFR using AM 424 Push Code 036:
- A. Check master file using INOLES or IMFOLE to verify that the name line is for a period equal to or earlier than the tax period being input and that the name line is for a non-joint filing status
  - B. If all name lines are for a subsequent tax period, prepare Form 2363 to change the name line to the earliest tax period and filing status being established.
  - C. If the name line relating to the year being processed reflects filing status married filing joint, prepare Form 2363 to change the name line to married filing separate or single. Make sure the filing status is equal to or prior to the earliest tax period being established.
  - D. If the case is not on AIMS, establish the tax period by using Push Code 036 and CC AM424.
  - E. If case is on AIMS, correct the Push code to 036 via CC AM424.
  - F. There is no "Dummy SFR" to submit to Submission Processing when Push code 36 is used, in the top margin of Form 5344, write " Original Return - SFR."
  - G. Place an IMFOLT in the case file in lieu of a tax return and notate "EXAM SFR" across the top margin of the IMFOLT.
6. Issue 30-day letter including report of Individual Income Tax Examination Changes.
7. Complete Form 13496 with a live signature or computer facsimile signature when the 30 day letter is sent to the taxpayer. See IRM 20.1.2.1.4
8. Compute proposed tax as single or married filing separate status based on last return taxpayer filed.
9. Prepare Form 3198, Special Handling Notice, to advise AIMS/closing of any changes to the Master File name, address or filing status.
10. Returns submitted must have the taxpayer's signature.
11. All years for the same non-filer are kept together.
12. Hand-carry the returns to the Receipt and Control Unit at the Campus.
13. The Receipt and Control Unit process the returns within six days of receipt (12 days during peak periods) using the correct Document Locator Number (DLN) for dummy/ SFRs.

#### **4.19.17.1.3.2 (11-10-2006) Non-Filer Penalties**

1. Do not waive penalties in non-filer cases without reasonable cause. IRM 20.1 Penalty Handbook will provide assistance and should be used as a resource guide for the assertion or non-assertion of penalties and correct calculations of appropriate penalties in non-filer cases.
2. Form 3198, Special Handling Notice, reflects what penalties are to be assessed when the case is forwarded to AIMS as both partial or final assessments. Indicate if the failure to pay penalty is to be assessed and the date to start the failure to pay penalty computation on the Form 3198. Compute the failure to file penalty in accordance with IRM 20.1.

**Note:**

Compute the failure to pay penalty on both delinquent returns and IRC Sec. 6020(a) returns from the due date of the return. The failure to pay penalty cannot be assessed on unagreed cases closed after the Notice of Deficiency defaults.

3. Penalties to be considered on secured delinquent returns and IRC Sec. 6020(a) returns are:
  - A. Failure to File Penalty (IRC Sec. 6651(a)(1)).
  - B. Estimated Tax Penalty (IRC Sec. 6654 or IRC Sec. 6655).
  - C. Failure to Pay Penalty (IRC Sec. 6651(a)(2)).
  - D. Fraudulent Failure to File (IRC Sec. 6651(f)).
  - E. Accuracy Penalty (IRC Sec. 6662(a)).
4. SFR (IRC 6020 (b)) return must be prepared before penalty can be considered.
5. See IRM 20.1.2.1.4 for specific procedure regarding penalties and IRC 6020(b).
6. Penalties to be considered if no return is filed and the case is closed through deficiency procedures are.
  - A. Failure to File Penalty (IRC Sec. 6651(a)(1)).
  - B. Estimated Tax Penalty (IRC Sec. 6654 or IRC Sec. 6655).
  - C. Failure to Pay Penalty (IRC Sec. 6651(a)(2))

**Note:**

Not for IRC Sec. 6020(b) returns prepared for returns due before July 31, 1996 (without regard to any extension to file). SFR (IRC Sec. 6020(b)) return must be prepared before penalty can be considered.

7. The burden of proof is on the Government to establish fraud.
  - When imposing the fraud penalty on a taxpayer, propose the negligence penalty as an alternative position.
  - The burden of proof must be met with regard to the negligence penalty.
8. The burden of proof is on the Government to establish fraudulent failure to file.
  - This penalty can only be asserted for years after 1988 where there is clear and convincing evidence that the failure to file was done fraudulently.
  - If the fraudulent failure to file penalty is proposed, the failure to file penalty should be proposed as an alternative issue.

- Area Office Counsel must review the case before issuance of the statutory notice of deficiency in unagreed cases if the fraudulent failure to file penalty is being proposed.
  - See (9) below for cases where the income tax liability has been resolved.
9. When the tax liability has been resolved, the failure to file and failure to pay penalty are applied unless the non-filer had reasonable cause. The work papers should fully document that reasonable cause was considered and the reason it was/was not established.
10. When the non-filer disagrees with the reasonable cause determination for failure to file or the assertion of the fraudulent failure to file penalty, the non-filers appeal rights are:

TYPE	ACTION
NO RETURN SUBMITTED -- UNAGREED	<ul style="list-style-type: none"> <li>• In unagreed deficiency cases, the fraudulent failure to file and failure to file/pay penalties are subject to pre-assessment appeal to the Tax Court.</li> <li>• The penalty is proposed on the examiners report with the deficiencies.</li> <li>• The statutory notices of deficiency will show both the income tax deficiencies and additions to tax (including the failure to file penalty).</li> </ul>
RETURN SECURED OR NON-FILER SIGNS THE EXAMINER'S REPORT (IRC Sec. 6020(a) CASES) --	<ul style="list-style-type: none"> <li>• In agreed or no change cases, the non-filer can request a meeting with the group manager and a pre-assessment conference with Office of Appeals on the failure to pay/file and the fraudulent failure to file penalties.</li> <li>• The non-filer cannot appeal the failure to pay/file and the fraudulent failure to file penalties without a related deficiency to the Tax Court.</li> <li>• In these cases where the non-filer disagrees with Examination's penalty determination: ?????</li> </ul>
FAILURE TO PAY/ FILE PENALTY --	<ul style="list-style-type: none"> <li>• Request that the non-filer provide the examiner a written statement requesting an Appeals conference stating reasons for failure to file.</li> <li>• These cases should be forwarded to the Office of Appeals</li> </ul>
FRAUDULENT FAILURE TO FILE --	<ul style="list-style-type: none"> <li>• Issue Letter 2777(DO) with the examination report to the non-filer.</li> <li>• Requests for Appeals conference should be forwarded to the Office of Appeals.</li> </ul>

**4.19.17.1.3.3 (11-10-2006)  
Penalty Appeals**

1. If the non-filer requests an Appeals Conference on the assertion of failure to file/pay penalties or fraudulent failure file penalty in no change or agreed cases, indicate on the Form 3198 not to assess the applicable penalties when the delinquent return is being posted or examination report is being assessed.
2. Close the case to Appeals following normal procedures after the delinquent return or TC 150 SUB has posted to Master File.
3. Appeals will assert the penalty if applicable.

#### **4.19.17.1.4 (11-10-2006)**

##### **Closing SFR Cases**

1. This section provides instructions for Campus examination employees to process and close non-filer cases for secured return, agreed, unagreed and no filing requirement situations.

#### **4.19.17.1.4.1 (11-10-2006)**

##### **Secured Delinquent Returns--Dummy/SFRs Not Processed**

1. Verify the return is properly completed, write in red Process as Original Return, Exam is Retaining Original and date stamp the return.
2. If penalties are not to be assessed because of reasonable cause criteria, enter a computer condition code on the return. The condition code for not assessing penalties are contained in the ADP 6209 Handbook.
3. If one or more of the delinquent return(s) shows a refund, special procedures apply if the returns are accepted as filed.
4. The processing of the returns must be cycled to process the balance due returns first.
  - A. Attach Form 6469, Expedite Processing Cycle, to the balance due years.
  - B. Instruct Receipt and Control on the Form 3198, Special Handling Notice, to process balance due returns first using cycling procedures.
  - C. Forward copy of the returns to Receipt and Control for processing.

#### **4.19.17.1.4.2 (11-10-2006)**

##### **Secured Delinquent Returns -- Dummy/SFR Processed**

1. Secured delinquent returns in non-filer cases are processed by Examination.
2. If a dummy/SFR was previously processed and a Transaction Code (TC) 150 has posted, the delinquent return cannot be forwarded to the Campus for processing.
3. The amount of tax shown on the return and any applicable penalties will be assessed by Examination.

#### **4.19.17.1.4.3 (11-10-2006)**

##### **Substantially Correct Secured Delinquent Returns -- Dummy/SFR Processed**

1. If you receive substantially correct delinquent returns where a dummy/SFR has been processed, verify:
  - A. That the name on the return is the correct name for the tax period.
  - B. That the name for the non-filer matches the social security number and that the spouses name matches the social security number for the spouse.
  - C. That the address on the return is the correct address. If the address is incorrect, the non-filer should be asked to line through the address shown and

enter the correct address.

- D. Check the math on the return for accuracy. If the return is in error, the non-filer should be asked to correct the return or the corrections should be made in an examination report.
- E. Form 4137, Social Security and Medicare Tax on Unreported Tip Income, is present if a taxpayer has unreported tip income.
  1. For tax years prior to 199012, math verify the Form 4137 and Schedule U, ensuring that the Schedule U only contains the name and SSN of the taxpayer whose SSA account is being adjusted. Detach the Schedule U and staple it to the Form 3198.
  2. Examination must send the Schedule U to the campus separately, where it then is sent to SSA.
  3. For tax years 199012 and subsequent, notate on the Form 3198, Unreported Tip Income Case.
2. Date stamp the return copy and mark the return "Process as Original, Exam is retaining Original" .
  1. Before submission to Receipt and Control, a current MFTRA or IMFOL (less than 60 days old) is to be obtained.
  2. If the TC 150 of 0.00 has not been posted, the return is to be held in the group or Receipt and Control until it has posted.
3. Forward the original tax return, with work papers, to AIMS for assessment of the amount of tax on the return and the applicable penalties.
  - If the return shows a refund barred by the statute of limitations, send a 105(C) Letter.
  - Otherwise, indicate on the Form 4700, Examination Work papers, which letter is to be issued. Form 3198, Special Handling Notice, will be attached to the return and notated Secured Delinquent Return Assessment Required -- No Change Examination.
  - Additionally, the Form 3198 must identify the applicable penalties to be assessed. Close the examination using Disposal Code 08.
  - Disposal Code 08 is necessary to allow for accurate computations of interest and penalties (by computer).
  - A current MFTRA transcript verifying the Dummy/SFR TC 150 has been posted must be attached to the copy of the return.

#### **4.19.17.1.4.4 (11-10-2006)**

#### **Delinquent Return Secured With Reported Tax or Reasonable Cause in Question -- Dummy/SFR Processed**

1. If the dummy TC 150 SUB procedures are used, partial assessments are made in situations where the secured delinquent return is in question and the examination cannot be closed within three days of receipt.
2. In addition, if the non-filer is appealing the delinquency penalties on the basis of reasonable cause, partial assessment for the tax will also need to be made.
3. Forward a copy of the tax return to AIMS for assessment of the amount of tax on the return and applicable penalties.
  - A. Attach Form 3198, Special Handling Notice, to the copy of the return and notate Secured Delinquent Return, Partial Assessment Required and indicate

whether or not to assess delinquency penalty.

- B. A current MFTRA transcript or IMFOL verifying dummy/SFR TC 150 has been posted, must be attached to the copy of the return
4. If the delinquent return shows a refund, decide upon case file information whether to hold the refund and work the case following category A claim procedures.
  5. The Form 3198 should state "claim case" : Hold Refund--enter a 2 in item seven (Hold Codes) of the Form 5344, to stop Master File notices and to prevent excess credits from refunding.
  6. After the assessment of the tax and penalties, AIMS will return a copy of Form 5344, Examination Closing Record, showing the assessments (should be stapled to the original return). The original return will remain in the case file.
  7. When the examination is closed, the case file will reflect that the delinquent return was No Change, Agreed, or Unagreed. Claims procedures must be followed in cases where a refund was held and the refund was partially or fully disallowed.
  8. Reports written on non-filer cases will follow directions in the Report Writing Guide.
  9. The starting point for the tax liability will be the tax shown on the secured delinquent returns. The report will reflect
    - Additional tax assessments,
    - Changes to prepayment credits, and
    - Applicable penalties.
    - If the examination results in a No Change, Form 4700 Examination Work papers, will reflect which letter is to be issued.

#### **4.19.17.1.5 (11-10-2006)**

##### **Closing the Examination When No Return is Secured**

1. When no return is secured on an assigned non-filer case close the examination either by:
  - Agreed closure,
  - Unagreed closure,
  - No return due, or
  - Unable to locate.

#### **4.19.17.1.5.1 (11-10-2006)**

##### **Agreed Closure -- IRC Sec. 6020(a)**

1. If the non-filer does not provide a delinquent return, propose all adjustments, tax, and penalties on an income tax change report (Form 1902-B or Form 4549/4549EZ).
2. If the non-filer agrees with the report:
  - The report becomes a return filed by the Service under IRC Sec. 6020(a).
  - Form 3198, Special Handling Notice, will be attached to the case with notation IRC Sec. 6020(a)
  - Return--Close Disposal Code 08.

- If a dummy/SFR has not been processed follow the procedures to establish an entity on Master File.
3. AIMS must process the report either as a partial or final assessment based on Form 3198, Examination Special Handling, instructions.
    - If a partial assessment is requested, prepare an examination report using the report instead of a return.
    - The signature date will be used as the Return Received Date.
  4. If a final assessment is requested, follow the procedures in the IRM for final assessments.
  5. Include in the examiners report:
    - A. Failure to file,
    - B. Fraudulent failure to file,
    - C. Fraud,
    - D. Negligence and estimated tax penalties when applicable.
    - E. The failure to pay penalty must be computed by AIMS, based on the information on the Form 3198.

#### **4.19.17.1.5.2 (11-10-2006) Unagreed Closure**

1. If a cooperative non-filer is unable to provide a delinquent return, propose all adjustments, tax and penalties on an income tax change report (Form 1902-B or Form 4549/4549EZ).
  - If this non-filer does not agree with the proposed assessment, close the case as "Unagreed."
  - The AIMS project code will be changed to Project Code 154, Substitute for Return unless the non-filer is a Selection Code 438, High Income non-filer (Project Code 437).
2. If the non-filer does not respond to our actions and continues to be uncooperative, obtain managerial involvement/approval prior to issuance of a 30-day letter.
  - After consulting with the manager, also prepare an income tax change report reflecting all adjustments, tax, and penalties.
  - Close this case as an unagreed.
  - Change the AIMS Project Code to 154, Substitute for Return unless the non-filer is a Selection Code 438, High Income non-filer (Project Code 437).
3. Provide the non-filer a copy of the unagreed report reflecting tax and applicable penalties.
  - Prepare the unagreed report using the Report Writing Guide.
  - The non-filer can request a conference with the Office of Appeals to review the proposed deficiency during closing and after receipt of 30-day letter.
  - If the non-filer requests an Appeals conference, close the case file to AIMS for processing to the respective Appeals Office serving the Campus.
4. If the non-filer is uncooperative, issue a 90-day Notice of Deficiency letter.

#### 5. Refund years --

- A notice of deficiency should not be issued for years where the non-filer refuses to file a return or sign a waiver prepared as a return and the known information indicates the non-filer is due a refund for that year.
- Known information should include consideration of external source (comparative year analyses, third party information, statistical data) to ensure that the potential refund year reflects the non-filers substantially correct taxable income.

In these cases the examiner should:

- A. Issue Letter 2770, Refund Invitation Letter, advising the non-filer to file a return/claim for the refund year. Send this letter at the same time the 30-day letter is issued.
  - B. If the non-filer does not submit a delinquent return within 30 days, close the case.
  - C. If the refund year has been established on AIMS, prepare Form 3198 to inform AIMS to close the case for the year using Disposal Code 41.
  - D. Close any balance due years using Notice of Deficiency Procedures.
6. Delinquent Returns Received After Notice of Deficiency is Issued -- Situations where the non-filer submits a delinquent return after the notice of deficiency has been issued are handled as follows (unless the taxpayer has petitioned the tax court, in which case no assessment should be made while the case is in litigation without the concurrence of the Area Office Counsel Office assigned to the case) :
- A. If the Service accepts the figures shown on the return as substantially correct, the amount on the return is assessed pursuant to Section 301.6211-1(a) of the regulations and the case closed. A revised report supplementing the notice of deficiency does not need to be issued even if the amount of tax shown on the return differs from the amount on the notice.
  - B. If the Service does not accept the figures on the return as substantially correct, the amount of tax on the return is immediately assessed as a partial agreement. A revised report supplementing the notice of deficiency should be sent to the non-filer.

#### **4.19.17.1.5.3 (11-10-2006)**

##### **No Return Secured -- No Filing Requirement/Little or No Tax Due**

1. There may be instances of an assigned non-filer case where the non-filer has no filing requirement or the tax liability cannot be determined.
  1. If the case is fully established on AIMS, close using Disposal Code (DC) 36, No Return Filed.
  2. If there is only a 424 skeletal record on AIMS, delete the skeletal AIMS record with command AM424D. Form 3198, Special Handling Notice, is to be notated No return filed, taxpayer not liable this period or little or no tax due. Obtain group manager approval of the closure.
  3. File work papers behind the DC 36 or 424D request.
  4. If the non-filer case includes some years where returns are secured and other years where a return is not due, place all work papers in the case file for the most current year where a return was secured.

#### **4.19.17.1.5.4 (11-10-2006)**

##### **Unable to Locate**

1. If the initial correspondence on a Non-Filer case comes back undeliverable, the same research procedures will apply as in IRM 4.19.1.4.13, Undeliverable.
2. In addition, send postal tracers to the local post office to obtain forwarding address. Information on how to send postal tracers can be found in IRM 5.1.18, Locating Taxpayers.
3. If a new address is secured, reissue the correspondence to the new address.
4. If no new address is secured, close case in accordance with instructions per IRM 4.10.2.8.6, Undeliverable Mail Procedures.

#### **4.19.17.1.6 (11-10-2006)**

##### **Special Processing for Non-Filer Cases**

1. This section provides special processing policy and procedural guidelines and specific IRM and Handbook references for the processing of:
  - Non-filer cases including command codes,
  - Posted dummy/SFRs,
  - Requests for partial assessments (secured return),
  - Agreed closure (no return secured),
  - Unagreed closure (no return secured),
  - Final closing and
  - Processing dummy/SFR requests.

#### **4.19.17.1.6.1 (11-10-2006)**

##### **Processing of Cases if DUMMY/SFRs Have Been Posted**

1. Special procedures are needed for the processing area to process original returns and deficiencies on non-filer cases if dummy/SFRs have been processed.
  1. If returns are secured, they should be assessed on Master File using TC 300.
  2. If the examination results in additional deficiencies, the processing area will make additional assessments of TC 300 for the additional amounts.
  3. Penalties will be addressed on each assessment.
2. If the closing of one year will result in a refund and other years are open which will result in a deficiency, AIMS should use cycling procedures to:
  1. Close the deficiency years first, and
  2. Then close the refund years.

#### **4.19.17.1.6.2 (11-10-2006)**

##### **Return Secured -- Partial Assessment Requested**

1. Use partial assessment procedures to assess the secured delinquent return if
  - A dummy TC 150 has posted, and
  - The examination is continuing or

- The non-filer is appealing the reasonable cause determination.
2. The case will be identified with a Form 3198, Special Handling Notice, notated "Secured Delinquent Return -- Partial Assessment Required " and whether or not to assess the penalties.
  3. Verify that the Transaction Code (TC) 150 has been posted. If not, send the case back to the group noting TC 150 has not been posted.
  4. Before the case is sent to AIMS, ensure that the return information is correct.
    1. Compare the name, address, and filing Status on the return against Master File.
    2. If different, prepare and enclose a Form 2363, Master File Entity Change.
  5. Prepare a Form 3177, Notice of Action for Entry on Master File to request that a TC 971 Action Code (AC) 13 with a Return Received Date be input for all secured delinquent returns or signed agreement in lieu of a return that have a dummy/SFR TC 150 posted.

**Note:**

The TC 971 with AC 13 indicates that the taxpayer has filed a return or signed an agreement instead of a return and is in Examination. Master File computes the Assessment Statute Expiration Date (ASED) based on the return received or signature date.

6. AIMS must process the delinquent return and penalties using current assessment procedures.
7. Do not make an entry in item 06, Interest to Date, enter disposal code 08 in item 13.
8. The following line items must be taken from the return and entered on the Form 5344, Examination Closing Record, using the appropriate Reference/Transaction codes
  - A. Adjusted Gross Income
  - B. Taxable Income Self Employment Income
  - C. Withholding Credits (Estimated Tax payments should not be included since payments are already posted to Master file)
  - D. Excess FICA
  - E. Tax Liability
  - F. Earned Income Credit
9. AIMS must enter the appropriate penalty amounts on Form 5344, Examination Closing Record based on information provided by the examiner on Form 3198, Special Handling Notice.
  - A. The Estimated Tax Penalty (TC 170) will be computed by the examiner
  - B. The Failure to File Penalty (TC 160) will be computed by the examiner
  - C. The Failure to Pay Penalty (TC 270) will not be computed by the examiner
10. Forward a copy of the completed Form 5344, Examination Closing Record, to the group after the partial assessment has been input.

**4.19.17.1.6.3 (11-10-2006)**

## Final Closing

1. Previous Partial Assessment -- If a partial assessment was made, follow the procedures below based on the results of the examination.

### Note:

If a TC 971 Action Code 13 was previously input, a Priority Code of 1 must be used to override the duplicate return freeze.

2. Additional assessment -- Process the case using current final closing procedures. Since the Failure To Pay penalty (FTP) was manually assessed on the partial assessment, it must be addressed on each subsequent adjustment. The AIMS, examiner must
  1. Compute additional FTP on the partial assessment using COMPAF from the 23C date to the 23C date of this assessment on the unpaid amount of the partial assessment.
  2. The result of the COMPAF must be entered as a TC 270, even if the result is zero.
3. No change -- Process the case using current final closing procedures. The AIMS examiner will:
  1. Compute additional FTP on the partial assessment using COMPAF from the 23C date to the 23C date of this assessment.
  2. The result of the COMPAF must be entered as a TC 270, even if the result is zero.
4. No prior assessment - The case will be identified with a Form 3198, Special Handling Notice, notated "Secured Delinquent Return/Signed Report--Assessment Required."
  - A. Process the case as a final closure using appropriate closing procedures.
  - B. Input the TC 971 the same cycle as the final closure.

### Note:

If the TC 971 is input before the final closure, it causes a duplicate filing condition, issues a weekly update record and requires that a Priority Code of 1 to be input.

#### 4.19.17.1.6.4 (11-10-2006) Form 5344, Item 34, Adjustment Amount

1. If the case file is being maintained in AIMS for posting of a TC 150 for a secured delinquent return, Item 34, Adjustment Amount, must be completed by AIMS.
2. No information is to be entered in this item for tax years where a TC 150 SUB has been input.

#### 4.19.17.1.7 (11-10-2006) Non-Examined Satisfied TDIs

1. AIMS closure --
  - A. Full record -- use disposal in the table below.
  - B. Skeletal record -- Use AM424D using Form 3177, Notice of Action for Entry on Master File.

Non-Examined Disposal	AIMS Disposal Code	Master TC	File CC
No Return Filed --Taxpayer not liable this period, little or no tax due (P-5-133)	36	590	52
Return previously filed	37	594	58
Return previously filed -- Taxpayer filed as spouse on a joint return	38	594	59
No return filed -- Taxpayer no longer liable (deceased)	39	591	50
No return filed -- Taxpayer unable to locate	40	593	57
No return filed -- Taxpayer due a refund	41	590	53
Return filed -- Unable to locate taxpayer	42		

**Note:**

Inputting the above disposal codes will automatically generate the above transaction and closing codes.

2. File the non-examined case file with the last year that is examined. Or if no years were examined, retain the non-examined case file in the Processing Unit Disposal Code 33 file or other site in searchable order for one year per IRM.
3. Do not transfer credit balances to Excess Collections. Credits will be computer transferred after the three year statute expiration if no return posts to the account.

**4.19.17.1.8 (11-10-2006)****Closing Letters**

1. If the case is closed without an examination report, one of the following letters are to be issued:
  - A. Letter 2769, No Change, is to be issued when the examination results in a delinquent return being accepted as filed and the non-filer did not have reasonable cause for his/her failure to file. Indicate on Form 4700, Examination Work papers, that AIMS is to issue Letter 2769.
  - B. Issue Letter 2778, No Change Delinquency Penalty Not Charged, when the examination results in a delinquent return being accepted as filed and no penalty being asserted. Indicate on Form 4700, Examination Work papers, that AIMS is to issue Letter 2778.
2. Do not issue No Change letters on cases where refund statute of limitation has expired
3. Beginning July 2003, AIMS weekly processing will extract Examination cases which have been closed "no change" and meets specific criteria. The program will generate no change closing Letter 3581 (SC/CG) to be sent out to each taxpayer and POA of record.
  - A. The program will select only those accounts where the status closed date (status 90) is after the prior processing date, disposal code is equal to 02, and the organization code is within the range of 5000 to 5399.
  - B. ARP2440 Weekly Exam No Change Letter List and ARP2441 Weekly Exam No Change Letter Summary will be generated, printed and available on EONS. ARP2440 will list all no change letters generated for that week. ARP2441 will contain summary counts of letters sent.
  - C. The letters will be mailed from the National Print sites.

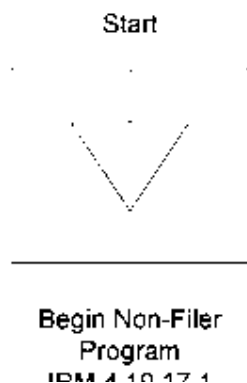
**4.19.17.1.9 (11-10-2006)**  
**Refund Statute Expired Cases**

1. Certified notice of claim disallowance must be issued when delinquent returns are received with refunds barred by statute of limitations.
2. Issue Letter 105C.
3. Prepare and process Form 8758, Excess Collection Additions, to transfer the expired credits to the excess collections file.

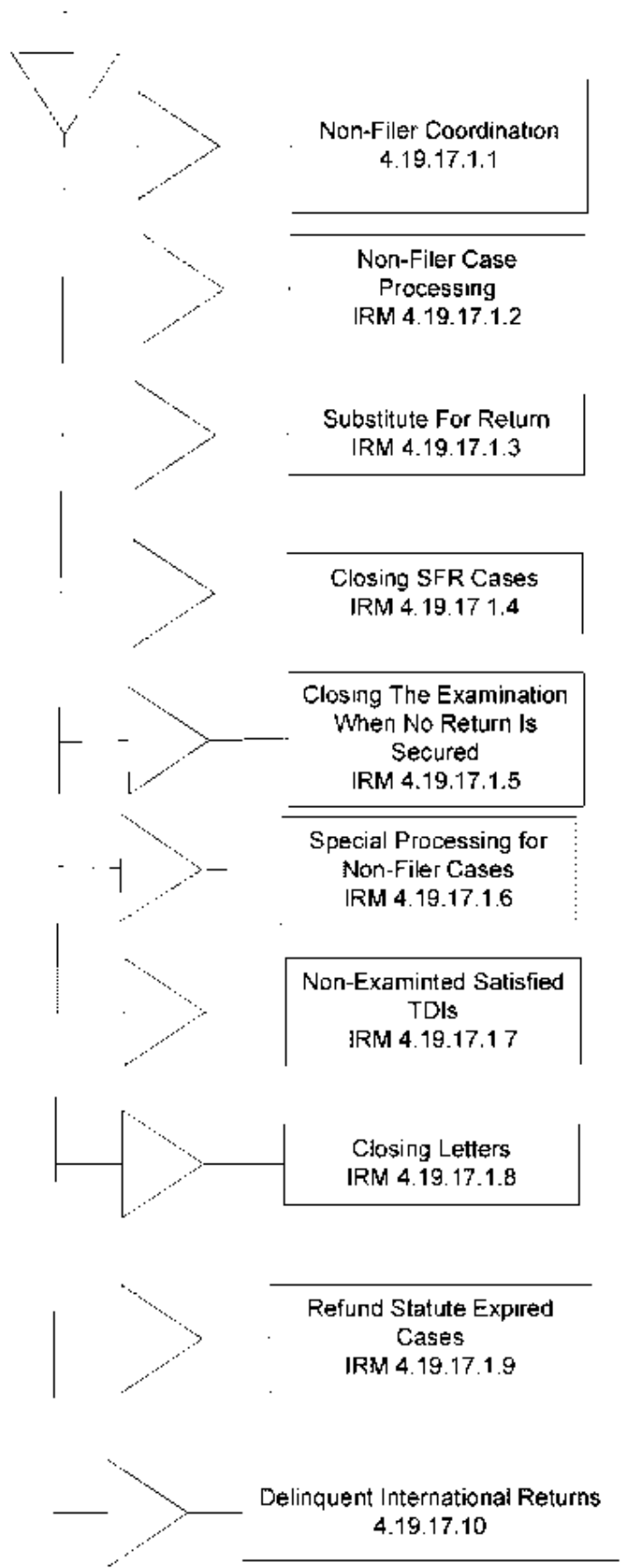
**4.19.17.1.10 (11-10-2006)**  
**Delinquent International Returns**

1. If, during an examination, the delinquency of a return under the jurisdiction of International is uncovered, attempt to secure the delinquent return.
  1. If the taxpayer refuses to file the delinquent return, or if a substantial amount of time will be requested to secure the return, Form 5346, Examination Information Report, will be forwarded to the Assistant Commissioner (International) Attention: Chief, Planning and Special Programs (SB:IN:C:E:62).
  2. Also advise on Form 5346 if the taxpayer contends he/she is not legally liable for filing the return and whether such liability is an issue.
  3. If the return is secured, it should be filed with the Philadelphia Campus under existing manual procedures.
2. International has jurisdiction over U.S. income tax returns with a foreign address or where either the taxpayer or the principal books and records are located outside the United States.
  - A. Returns with a foreign address include Puerto Rico, Virgin Islands, Guam, American Samoa, and the Northern Marianas.
  - B. Returns with APO/FPO (Army Post Office/Fleet Post Office) are under the jurisdiction of International.
  - C. Returns having the principal books and records located outside the United States include Form 1040 with a claimed foreign income exclusion or deduction (2555 attached), Form 1040NR (Non Resident Alien) and Form 1120F, SU Income Tax Return of a Foreign Corporation.
  - D. Except as noted above, all returns with a U.S. address are under the jurisdiction of the area office where the principal books and records of the taxpayers are maintained.

**Exhibit 4.19.17-1 (11-10-2006)**  
**Non-Filer Work Process**



**Program  
IRM 4.19.17.1**



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