

# 15 IRS, Penalties, and Audits

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## IRS Contact Information

Website	www.irs.gov
Website assistance*	www.irs.gov/uac/Navigate-IRSGov
Telephone assistance: Individuals	1-800-829-1040
Businesses	1-800-829-4933
TDD (hearing impaired)	1-800-829-4059
Forms and publications	1-800-829-3676
Electronic products and services support	1-866-255-0654
Practitioner Priority Service®**	1-866-860-4259

\* The IRS website help desk allows email or online chat with a representative for website issues. Or call 1-800-876-1715 for assistance.

\*\* The Practitioner Priority Service® is for practitioners working with taxpayers and having a valid third party authorization.

## Taxpayer Advocate Service

The Taxpayer Advocate Service is set up to help with problems that have not been resolved through normal channels or when undue hardship or adverse impacts from IRS actions are imminent. The taxpayer can request that an IRS employee complete Form 911 over the phone.

- Form 911, *Request for Taxpayer Advocate Service Assistance*
- IRS Pub. 1546, *The Taxpayer Advocate Service of the IRS*
- Phone: 1-877-777-4778; TDD 1-800-829-4059

## Refund Inquiries

To inquire about the status of a taxpayer's refund, gather the taxpayer's SSN, filing status, and exact refund amount. Go to [www.irs.gov](http://www.irs.gov), then follow the link to "Where's My Refund?" To check the status of the taxpayer's refund online, wait at least:

- 24 hours after acknowledgement of an electronically filed return, or
- Four weeks after mailing a paper return.

Only call the IRS at 1-800-829-1954 if it has been at least 21 days from electronic filing or more than six weeks from mailing a paper return.

## ■ New for 2015 ■

- **PTIN fee.** Effective November 1, 2015 the fee for new PTIN applications and renewals is \$50. See *Preparer Tax Identification Number*, page 15-2.
- **Taxpayer representation.** Beginning in 2016, attorneys, CPAs and EAs are the only tax professionals with unlimited representation rights. Tax preparers with an AFSP—Record of Completion will have limited representation rights. PTIN holders without an AFSP—Record of Completion will only be permitted to prepare tax returns. See *Taxpayer representation*, page 15-9.

## Filing and Extended Due Dates

Form Number	Return Due Date	Extension
Form 1040: Individual*	15th day of fourth month following close of tax year.	Form 4868 extends deadline six months.
Form 1065: Partnership and LLC	15th day of fourth month following close of tax year.	Form 7004 extends deadline five months.
Forms 1120 and 1120S: Corporation	15th day of third month following close of tax year.	Form 7004 extends deadline six months.
Form 1041: Estates	15th day of fourth month following close of tax year.	Form 7004 extends deadline five months.
Form 1041: Trusts		
Form 706: Estates	Nine months after date of decedent's death.	Form 4768 extends deadline six months.
Form 709: Gift Tax	April 15th following year of gift.	Form 4868 extends deadline six months.

\* For military exceptions, see *Extensions and Deferrals*, Tab 14.

**Due date.** If the due date falls on a Saturday, Sunday, or legal holiday, the due date is delayed until the next business day.

**Penalties and interest.** Filing an extension does not extend the time to pay the tax. Interest and/or penalties could apply to amounts due, but not paid, by the regular due date.

## Overpayment/Underpayment Interest Rates

2015 Interest Rates—Compounded Daily				
	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.
Individuals—Overpayments and Underpayments	3%	3%	3%	3%
Corporate Overpayment \$10,000 or Less	2%	2%	2%	2%
Corporate Overpayment Portion Exceeding \$10,000	0.5%	0.5%	0.5%	0.5%
Corporate Underpayment \$100,000 or Less	3%	3%	3%	3%
Corporate Underpayment Greater Than \$100,000	5%	5%	5%	5%

## Taxpayer Penalties

Reason	Amount	IRC §
Failure to file	<ul style="list-style-type: none"> <li>5% of unpaid balance per month—maximum 25%.</li> <li>More than 60 days late—the smaller of \$135 or 100% of tax due on return.</li> <li>No penalty if the taxpayer is due a refund.</li> <li>Failure to file penalty is reduced by failure to pay penalty if both apply.</li> </ul>	6651(a)(1) 6651(c)(1)
	<b>\$205 (HR 644 enacted 2/24/16)</b>	
Failure to pay	<ul style="list-style-type: none"> <li>0.5% of unpaid balance per month—maximum 25%.</li> <li>0.25% of unpaid balance per month during term of installment agreement.</li> </ul>	6651(a)(2) 6651(h)
Fraudulent failure to file	<ul style="list-style-type: none"> <li>15% of unpaid balance per month—maximum 75%.</li> </ul>	6651(f)
Underpayment of estimated tax—individuals and corporations	<ul style="list-style-type: none"> <li>See <i>Individuals Overpayment/Underpayment Interest Rates</i>, page 15-1.</li> </ul>	6654 6655
Accuracy related penalty	20% of underpayment due to: <ul style="list-style-type: none"> <li>Negligence—includes failure to make a reasonable attempt to comply or intentional disregard.</li> <li>Substantial understatement of tax—more than the greater of 10% of the actual amount due or \$5,000.</li> <li>Substantial valuation misstatement.</li> </ul>	6662
Fraud	75% of understatement due to fraud.	6663
Failure to file correct information returns (penalty assessed per information return) *	<ul style="list-style-type: none"> <li>\$50 if correctly filed within 30 days—maximum \$500,000 per year (\$175,000 for small business).</li> <li>\$100 if filed more than 30 days after due date but before August 1—maximum \$1,500,000 (\$500,000 for small business).</li> <li>\$250 if filed after August 1 or not filed at all—maximum \$3,000,000 (\$1,000,000 for small business).</li> </ul>	6721
Failure to furnish correct payee statements *	At least \$500 per payee statement with no maximum penalty.	6722
Tax evasion	Willful attempt to evade tax is a felony. Maximum fine of \$250,000 (\$500,000 for a corporation) and/or up to five years in prison.	7201
Failure to collect or pay over tax	Willful failure to collect, account for, and pay over tax is a felony. Maximum fine of \$250,000 (\$500,000 for a corporation) and/or five years in prison.	7202
Perjury and fraud	Knowingly filing or helping in the filing of a false return or aiding in fraud is a felony. Maximum fine is \$250,000 (\$500,000 for a corporation) and/or up to three years in prison.	7206
Earned income credit claimed even though taxpayer is not eligible	Error due to reckless or intentional disregard of the EIC rules. <ul style="list-style-type: none"> <li>Taxpayer is not allowed to take the credit for two years, even if eligible.</li> </ul>	32(k)
	Error due to fraud. <ul style="list-style-type: none"> <li>Taxpayer is not allowed to take the credit for 10 years, even if eligible.</li> </ul>	

\* Increased penalty amount for returns filed after December 31, 2015.

**Note:** "Reasonable cause" will mitigate the noncriminal penalties listed above.

**Reasonable cause.** Reasonable cause is based on all the facts and circumstances in each situation. Any reason that establishes the taxpayer exercised ordinary business care and prudence, but nevertheless failed to comply with the tax law, may be considered for penalty relief.

## Income Tax Return Preparer Penalties

Penalties Imposed for	Amount of Penalty	IRC §
Understatement of tax caused by an unreasonable position taken on the tax return by the preparer.	The greater of \$1,000 per return or 50% of the income derived from the return to which the penalty was imposed.	6694(a)
Understatement of tax caused by the preparer's reckless or intentional disregard of the rules or regulations.	The greater of \$5,000 per return or 50% of the income derived from the return to which the penalty was imposed.	6694(b)
Failure to furnish a copy of the return to the taxpayer.	\$50 per return. Maximum \$25,000 per year.	6695(a)
Endorsing or negotiating the taxpayer's refund check.	\$500 per check.	6695(f)
Failure to sign the return.	\$50 per return. Maximum \$25,000 per year.	6695(b)
Failure to furnish the identifying number of the preparer on the return.	\$50 per return. Maximum \$25,000 per year.	6695(c)
Failure to retain a copy of a return for three years or maintain a list of names and ID numbers of the taxpayers for whom the returns were prepared.	\$50 per return. Maximum \$25,000 per year.	6695(d)
Failure to be diligent in determining eligibility for EIC.	\$500 per return. <b>\$505 (Rev. Proc. 2016-11)</b>	6695(g)
Disclosure or use of information by the preparer of the return without the taxpayer's consent.	\$1,000 per offense and/or up to one year in prison.	7216

**Due diligence—Earned Income Credit.** Paid preparers must meet four due diligence requirements, including attaching Form 8867, *Paid Preparer's Earned Income Credit Checklist*, to the return for tax returns claiming the EIC. Failure to comply can result in a penalty of \$500 per failure. See *Earned Income Credit*, page 11-7. **\$505**

## Preparer Tax Identification Number

A preparer tax identification number (PTIN) is used by a paid tax preparer in place of his or her SSN when signing returns.

**PTIN requirement.** The IRS requires all tax return preparers, including attorneys, CPAs, and enrolled agents, to use PTINs on tax returns. All tax return preparers are required to obtain a PTIN and pay a user fee through the online application system. The PTIN must be renewed annually.

Access to the online sign-up system is available at [www.irs.gov/taxpros](http://www.irs.gov/taxpros). Effective November 1, 2015, the fee is \$50 for both new applications and renewals. Of the \$50, the IRS will collect \$33 as a user fee and \$17 will go to a third-party vendor.

**Tax return preparer.** For purposes of PTIN registration, a tax return preparer is an individual who, for compensation, prepares or assists in preparing, all or substantially all of a federal tax return or claim for refund. All enrolled agents must have a PTIN.

## Treasury Inspector General for Tax Administration

The Treasury Inspector General for Tax Administration (TIGTA) provides independent oversight of IRS activities. The purpose of the TIGTA is to protect the IRS from corruption from both internal and external sources. Investigations involve issues such as unauthorized use of taxpayer information by IRS employees, threats against IRS employees, attempts to bribe IRS employees, and witness tampering. To report allegations such as misconduct by IRS employees, fraud by outside contractors, or suspected impersonation of IRS personnel, call 1-800-366-4484; website: [www.treas.gov/tigta](http://www.treas.gov/tigta)

## Statutes of Limitation

### Cross References

- IRS Pub. 1035, *Extending the Tax Assessment Period*
- IRC §6501, *Limitations on assessment and collection*
- IRC §6502, *Collection after assessment*
- IRC §6511, *Limitations on credit or refund*

### Related Topics

- Return Due Date—Extensions, page 3-8

### Military Exceptions

The deadline extension provision extends the statutes of limitation for filing a claim for credit or refund of any tax, assessment of any tax by the IRS, and any collection by the IRS of any tax due for any qualified military personnel. See *U.S. Armed Forces Personnel*, Tab 14.

### Date Considered Filed

**Early filing.** Returns and payments filed before the due date are considered to be filed on the due date.

**Late filing.** Returns and payments filed after the due date are considered to be filed on the date received by the IRS.

**Mailbox rule.** If a document or payment has a timely postmark, the document or payment is considered to be filed on time even though it is received by the IRS at a later date.

In order for the mailbox rule to take effect, the document or payment must be received by the IRS. Other than direct proof of actual delivery, proof of proper use of registered or certified mail is the exclusive means to establish prima facie evidence of delivery of a document to the IRS. No other evidence of a postmark or of mailing will be prima facie evidence of delivery or raise a presumption that the document was delivered. [Reg. §301.7502-1(e)]

**Private postmark.** If a taxpayer uses a private delivery service designated by the IRS to mail their return, the postmark date generally is the date the private delivery service records in its database or marks on the mailing label. The private delivery service can tell the taxpayer how to get proof of the date. Designated private delivery services are offered by Federal Express and United Parcel Service.

**Deposits made by the Electronic Federal Tax Payment System (EFTPS).** Deposits must be initiated by 8 p.m. ET at least one calendar day before the deposit due date to be considered timely. For more information, see *How to Deposit*, page 23-3, *Deluxe Edition/Small Business Edition*.

### Assessment

Any additional tax must be assessed within three years after a return is filed. The three year assessment period applies to both the IRS and the taxpayer, such as when a taxpayer files an amended return to pay additional tax. (Ltr. Rul. 201052003)

The rule applies regardless of whether the return was filed on time. See *Date Considered Filed*, above. See exceptions, next column.



### Exceptions to Three-Year Limit

IRC §6501(c)(1,2)	False or willful attempt to evade tax	If a taxpayer files a false or fraudulent return, or files a return with the intent to evade tax, there is no statute of limitations.
IRC §6501(c)(3)	Failure to file	If a taxpayer fails to file a return, collection proceedings may be undertaken without assessment and at any time.
IRC §6501(c)(4)	Extension by agreement	A taxpayer may enter into an agreement with the IRS to extend the statute of limitations for assessment.
IRC §6501(e)(1)	Substantial omission	If the taxpayer omits income in excess of 25% of gross income reported on the return, the assessment period is extended to six years.

### Collection

After assessment of tax, collection activity must begin within 10 years after the date of assessment. The 10-year period may be extended in certain situations or by agreement between the parties.

### Claim for Refund

A claim for refund must be made within three years from the time the original return was considered filed or two years from the time the tax was paid, whichever is later. See *Date Considered Filed*, previous column.

## Penalty for Underpayment of Estimated Tax

### Cross References

- Form 2210, *Underpayment of Estimated Tax by Individuals, Estates, and Trusts*
- IRS Pub. 505, *Tax Withholding and Estimated Tax*
- IRC §6404, *Abatements*



### Related Topics

- Estimated Tax, page 18-4, *Deluxe Edition/Small Business Edition*

### 2016 Estimated Payment Dates for Individuals

Installment	Tax Period Covered	Due Date
First	January 1 to March 31, 2016	April 18, 2016
Second	April 1 to May 31, 2016	June 15, 2016
Third	June 1 to August 31, 2016	September 15, 2016
Fourth	September 1 to December 31, 2016	January 17, 2017*

\* Underpayment penalty for fourth installment does not apply if the 2016 return is filed and balance paid by February 1, 2017. **Note:** It may be advantageous to pay the fourth period installment of estimated taxes for state by December 31, 2016, in order to deduct the amount as an itemized deduction for 2016.

### Estimated Tax Penalty for 2015

**Safe harbor.** An estimated tax penalty will not apply if either of the following amounts is paid through withholding or estimated tax payments for 2015.

- 1) At least 90% of the tax shown on the 2015 tax return, or
- 2) 100% of the tax shown on the 2014 return (110% if 2014 AGI was greater than \$150,000/\$75,000 MFS).

An estimated tax penalty for tax year 2015 will not apply if:

- The balance due on the individual's 2015 tax return is less than \$1,000,

*continued on next page*

- The taxpayer was a U.S. citizen and had no tax liability in 2014 for a tax year that covered 12 months.

**Farmers and fishermen.** Only one estimated payment is required if two-thirds of the taxpayer's gross income for 2014 or 2015 is from farming or fishing. The due date of the estimated payment for tax year 2015 is January 15, 2016, and the required payment is two-thirds of the tax liability for the year. Due dates for the first three installments do not apply.

**Exception:** No estimated payment is required if the 2015 tax return is filed and the balance due paid by March 1, 2016. See *Income Averaging for Farmers and Fishermen*, page 5-26, for more information about farmers and fishermen.

**U.S. Armed Forces personnel.** Taxpayers who qualify may not be subject to penalty. See *Extensions and Deferrals*, Tab 14.

## Joint Return to Separate

If a married couple filed a joint tax return in 2014, but are filing separate returns in 2015, for purposes of avoiding the penalty for underpayment, tax must be allocated between the spouses.

Compute the tax that each spouse would have paid for 2014 using the same filing status as 2015. Then multiply the tax on the joint return by the following fraction.

$$\frac{\text{Tax payable by each spouse on a separate return}}{\text{Total tax payable by both spouses on separate returns}}$$

**Example:** Ray and Jane filed a joint return for 2014 showing taxable income of \$49,000 and tax of \$6,446. Of the \$49,000 of taxable income, \$41,000 was allocable to Ray, and \$8,000 was allocable to Jane. The couple divorces in 2015, and each uses the Single filing status for the 2015 tax year. For purposes of determining any underpayment of estimated tax, the taxpayers' shares of 2014 tax are computed as follows.

	Taxable Income	Tax
2014 tax based on single rate: Ray.....	\$41,000	= \$6,113
Jane.....	\$ 8,000	= 803
	Total	\$6,916

Ray's share of 2014 tax:  $\$6,113 \div \$6,916 = 88.39\%$ .  $\$6,446 \times .8839 = \$5,698$ .

If a couple filed separate returns in 2014 (either MFS or two Single returns), but are filing MFJ in 2015, combine the income and tax of each on the 2014 return to determine the applicable estimated tax rules for 2015. [Reg. §1.6654-2(e)(3)]

## Form 2210, Underpayment of Estimated Tax by Individuals, Estates, and Trusts

The underpayment penalty is computed on Form 2210. If an underpayment penalty is due, enter the amount of the penalty on line 79, Form 1040, but do not file Form 2210 unless one of the following exceptions applies.

- The taxpayer requests a penalty waiver,
- The annualized income installment method is chosen, or
- The choice is made to treat federal tax withholding as paid at the time withheld instead of paid evenly throughout the year.

**Waiver of penalty.** The IRS will waive the penalty for underpayment of estimated tax if:

- In 2015 the taxpayer received excess advance payment of the PTC and the taxpayer is current with filing and payment obligations,
- In 2014 or 2015 the taxpayer retired after age 62 or became disabled, and the underpayment was due to a reasonable cause, or
- The underpayment was due to a casualty, disaster, or other unusual circumstance, and it would be unfair to impose the penalty.

**Requesting a waiver.** Part II, Form 2210, *Underpayment of Estimated Tax by Individuals, Estates, and Trusts*, contains checkboxes and



instructions for requesting a waiver of the underpayment penalty. File Form 2210 with the tax return and include a statement explaining the reasons for requesting the waiver. The IRS will review the information and decide whether to grant the waiver.

**Annualized income installment method.** Under the regular installment method, required payments may be determined by multiplying annual estimated tax due by 25%. However, if income is not received evenly throughout the year, using the annualized income installment method may reduce the underpayment penalty. The annualized installment method is computed on Schedule AI, Form 2210.

**Example:** Brad is in the business of providing tax practitioners with high-quality research materials. All of Brad's income for 2015 is derived in the last three months of the year. Because he has no income for the first nine months of the year, Brad makes no estimated tax payments until January 15, 2016. If Brad were to file his 2015 Form 1040 without electing the annualized income installment method, the IRS would use the regular installment method that assumes his income was earned evenly throughout the year and would assess a penalty for underpayment of estimated tax. Instead, Brad files Form 2210 with his tax return and chooses the annualized income installment method. Because Brad's income was attributed to the final payment period in the year, and he made the payment before the final estimated payment due date, no underpayment penalty will be assessed.



**Withholding dates.** Federal income tax withholding is considered to be withheld evenly throughout the year. Underpayment is computed by taking the entire withholding for the year and applying one-fourth of that amount to each installment period.

**Exception:** Actual dates tax was withheld can be used in the computation of underpayment of estimated tax. Form 2210 must be filed to make this choice. This choice can be beneficial if a larger amount of tax was withheld early in the tax year.

**Planning Tip:** If a taxpayer is behind on estimated tax payments for the year, and the taxpayer is an employee, withholding may be accelerated toward the end of the year to make up the difference. The withholding will be considered to have been paid evenly throughout the year.

## Directing Payments

Under the "voluntary payment rule," when a taxpayer has an outstanding tax liability and makes a payment, the IRS will usually honor a taxpayer's specific written direction to apply the payment to minimize interest, penalties, or other collection actions. If the taxpayer does not provide specific written direction, the IRS will apply the payments in a way that best serves the IRS' interests.

## Taxpayer Unable to Pay

### Cross References

- Form 1127, *Application for Extension of Time for Payment of Tax Due to Undue Hardship*
- Form 9465, *Installment Agreement Request*
- IRS Pub. 594, *The IRS Collection Process*

### Related Topics

- Business Deductions, Tab 8
- Guide to an IRS Audit, page 32-2, *Small Business Edition*

### File the Tax Return on Time

Missing the tax return due date (including extensions) makes the taxpayer subject to late filing penalties, which can be as much

## Amended Returns

as 25% of the tax due on the return. The tax return can be filed without payment and the IRS will send the taxpayer a bill for tax owed plus penalties and interest. The taxpayer should pay as much as possible with a timely filed return to reduce the late-payment penalty and interest charges.

**Credit card or loan.** The interest rate and fees charged by a credit card company or other lender may be lower than the interest and penalties charged by the IRS. The interest is generally not tax deductible.

### Additional Time to Pay

Tax payment alternatives that can extend the time to pay:

- Request an extension from IRS to pay within 60 to 120 days of April 15,
- Apply for a 6-month extension due to undue hardship, or
- File for an installment agreement to make monthly payments.

**Form 9465, Installment Agreement Request.** A taxpayer requesting a monthly installment plan should file Form 9465, *Installment Agreement Request*, or apply online at [www.irs.gov/Individuals/Online-Payment-Agreement-Application](http://www.irs.gov/Individuals/Online-Payment-Agreement-Application). The following individuals are eligible to use Form 9465.

- Owe income tax on Form 1040,
- Is or may be responsible for a Trust Fund Recovery Penalty, or
- Owes employment taxes related to a sole proprietor business that is no longer in operation.

**Installment agreement.** If the tax can be paid in 120 days, the taxpayer should not file for an installment agreement. The fees for the installment method are \$120 if payment is made by check, money order, credit card, or payroll deduction, or \$52 if made by direct debit. For a summary of options, see *Tax Payment Alternatives* chart, below.

### Tax Payment Alternatives

Alternative	Terms	Process
Taxpayer agrees to pay in full within 120 days of April 15.	Interest will accrue, no penalties will be assessed.	Call 1-800-829-1040 to request this method.
6-month extension due to undue hardship.	Interest will accrue, no penalties will be assessed.	File Form 1127, <i>Application for Extension of Time for Payment of Tax Due to Undue Hardship</i> , by April 15. The requirements to qualify for this method are strict.
3-year installment agreement (\$10,000 or less).	Interest will accrue, late payment penalties may be assessed, application fee must be remitted.	File Form 9465, <i>Installment Agreement Request</i> , or apply online (cannot be turned down if conditions met).
6-year installment agreement (\$25,000 or less).	Interest will accrue, late payment penalties may be assessed, application fee must be remitted.	File Form 9465, <i>Installment Agreement Request</i> , or apply online.
6-year installment agreement (more than \$25,000 but not more than \$50,000 owed).	Interest will accrue, late payment penalties may be assessed, application fee must be remitted, must agree to an electronic funds transfer agreement.	File Form 9465, <i>Installment Agreement Request</i> , or apply online.
6-year installment agreement (more than \$50,000 owed).	Interest will accrue, late payment penalties may be assessed, application fee must be remitted.	File Form 9465, <i>Installment Agreement Request</i> , and Form 433-F, <i>Collection Information Statement</i> .

### Cross References

- Form 1040X, *Amended U.S. Individual Income Tax Return*
- Form 1045, *Application for Tentative Refund*
- IRS Pub. 556, *Examination of Returns, Appeal Rights, and Claims for Refund*

### Related Topics

- Prior year tax rate schedules, page 2-13
- Change in Accounting Method, page 8-23
- Net Operating Loss (NOL), page 8-16



### Filing Claim for Refund

A claim for refund must be filed within three years from the date the original return was filed or within two years from the date the tax was paid, whichever is later. Returns filed before the due date are considered filed on the due date. Extended returns filed before the extended due date are considered filed on the date received. A refund claim for a return filed late must be filed within three years from the date the return was due (including extensions).

**Note:** The time limit for filing a claim for refund can be suspended for certain people who are physically or mentally unable to manage their financial affairs. [IRC § 6511(h)]

**Bad debt or worthless security.** The filing period is extended to seven years from the due date of filing the return for the tax year in which the debt or security became worthless.

**Foreign tax credit or deduction.** To claim or change a foreign tax credit or deduction for foreign taxes, the period is extended to 10 years from the due date of the return (without regard to any extension).

**Loss or credit carryback.** A claim of refund based on the carryback of a net operating loss (NOL), unused general business credit, or section 1256 contracts loss must be filed within three years after the due date (including extensions) for the tax year of the NOL, capital loss, or unused credit. See *Net Operating Loss*, page 8-16.

### Form 1040X, Amended U.S. Individual Income Tax Return

Form 1040X is the taxpayer's new tax return, changing the original return to include the new information.

Form 1040X is used for:

- Correcting income, deductions, credits, or other items incorrectly reported on an original return.
- Changing the taxpayer's filing status. **Note:** A change from a joint return to a separate return after the due date is not allowed.
- Making certain elections after the prescribed deadline for filing. (Regulation §§301.9100-1 through -3)
- Changing amounts previously adjusted by the IRS.
- Filing for a refund based on an NOL or unused credit. **Note:** Form 1045, *Application for Tentative Refund*, may be used if the claim is filed within one year after the year in which the loss or credit arose. See *Form 1045, Application for Tentative Refund*, page 15-6.

**Accounting method change.** Once an accounting method is chosen on an original return, the method cannot be changed by filing Form 1040X, even if the tax year is not closed. See *Change in Accounting Method*, page 8-23, for more information on change in accounting method.

**Filing an amended return after divorce.** The IRS may accept a claim for refund filed by a divorced taxpayer on Form 1040X

with respect to a prior-year joint return if the amended return is signed by only one of the spouses. Such refund will be issued in the name of the taxpayer who filed Form 1040X. However, the amount of the individual taxpayer's refund will be determined by recomputing the taxpayer's share of the joint liability and subtracting that amount from the taxpayer's contributions toward the joint liability using the IRS allocation method based on separate return liability amounts. (Rev. Rul. 80-8, amplified by Rev. Rul. 86-57)

**Where to file an amended return.** If a taxpayer is filing an amended return because of any of the situations listed below, use the corresponding address.

If the taxpayer is filing Form 1040X:	Then mail Form 1040X and attachments to:
In response to a notice the taxpayer received from the IRS	The address shown in the notice
Because the taxpayer received a reimbursement for a hurricane related loss	Department of the Treasury, Internal Revenue Service, Austin, TX 73301-0255
With Form 1040NR of 1040NR-EZ	Department of the Treasury, Internal Revenue Service, Austin, TX 73301-0215

If none of these situations apply, mail the return based on the taxpayer's state to the designated IRS Service Center for returns with no payment. See *Where to File*, page 16-1.

### Form 1045, Application for Tentative Refund

Form 1045 may be used instead of Form 1040X by an individual, an estate, or trust to apply for a refund that is attributable to:

- An NOL,
- Carryback of an unused general business credit,
- Carryback of a net section 1256 contracts loss, or
- Overpayment of tax due to a claim of right adjustment under IRC section 1341(b)(1). This occurs when an amount in excess of \$3,000 is subtracted from prior year taxable income under claim of right rules, and the decrease in tax exceeds the tax imposed for that year.

**Multiple years.** Form 1045 may be used to apply for a refund attributable to several years of adjustments. For example, if an NOL is being carried back three years, computations for all three years may be reported on one Form 1045.

**Quick refund.** The IRS will process Form 1045 within 90 days from the later of (1) the date the completed Form 1045 was filed, or (2) the last day of the month that includes the due date (including extensions) for filing the income tax return [or, for a claim of right adjustment, the date of the overpayment under IRC section 1341(b)(1)].

**When to file.** Form 1045 must be filed within one year after the end of the year in which an NOL, unused credit, a net section 1256 contracts loss, or claim of right adjustment arose. If the deadline for filing Form 1045 has passed, Form 1040X may be used to apply for a refund.

**Self-employment tax.** Self-employment tax may not be adjusted based on any carryback reported on Form 1045.

**Additional Medicare tax.** Additional Medicare tax may not be adjusted based on any carryback reported on Form 1045.

## IRS Audits

### Cross References

- Form 2848, *Power of Attorney and Declaration of Representative*
- Form 8919, *Uncollected Social Security and Medicare Tax on Wages*
- IRS Pub. 1, *Your Rights as a Taxpayer*

- IRS Pub. 556, *Examination of Returns, Appeal Rights, and Claims for Refund*
- IRS Circular 230, *Regulations Governing Practice before the Internal Revenue Service*



### Related Topics

- Hobby Loss Rules, page 5-19
- Business Use of Home, page 5-12
- Independent Contractor vs. Employee, page 5-21
- Business Deductions, Tab 8
- Business Audit Strategies, Tab 32, *Small Business Edition*

### Selection of Returns for Examination

**Computer scoring.** A computer program called the Discriminant Inventory Function System (DIF) assigns a numeric score to each individual and some corporate tax returns after they have been processed. A return may be selected for audit due to a high score under the DIF system.

**Search for unreported income.** The IRS performs matching functions to reconcile information reported on Forms 1099 and W-2 with information reported on the taxpayer's return. If income reported by the taxpayer does not meet or exceed amounts reported to the IRS, the taxpayer will receive either a bill for tax on the difference or an audit notice.

**Worker reclassification efforts.** The IRS conducts joint employment audits with state tax agencies to determine whether workers classified as independent contractors are in fact employees. One initiative looks at employers who issue both a W-2 and a 1099 to the same employee in the same year, while a second examines employers issuing more than five 1099-MISC forms exceeding \$25,000 each to contractors with no other source of income.

For more information on reclassification, see *Voluntary Classification Settlement Program*, page 5-23.

**Reporting uncollected Social Security and Medicare wages.** Taxpayers who disagree with classification as an independent contractor are able to file Form 8919, *Uncollected Social Security and Medicare Tax on Wages*, to inform the IRS of the potential misclassification. See *Independent Contractor vs. Employee*, page 5-21, for classification criteria.

**Other sources.** A tax return may be selected as a result of information received from other sources on potential noncompliance with the tax laws or inaccurate filing. This information can come from sources, including newspapers, public records and individuals. The information is evaluated for reliability and accuracy before it is used for the basis of an examination.

### Schedule C, Profit or Loss From Business

Issues associated with sole proprietorships are common audit triggers. The IRS has several approaches to achieve an increase in income tax, as well as the assessment of SE tax.

**Unreported income.** There is a relatively high potential for unreported income from cash transactions with sole proprietorships. The IRS will examine the taxpayer's bank records to detect deposits that are unaccounted for, compare revenue and expenses of similar businesses, and in some cases will perform a "lifestyle" audit to reconstruct income based on changes in the sole proprietor's net worth based on valuation of assets.

**Losses.** Significant losses reported on Schedule C, or losses continuing over two or more years, may increase the chance of audit. If the IRS is successful in reclassifying an activity as a hobby instead of a for-profit business, losses will be disallowed. See *Hobby Loss Rules*, page 5-19, and *Activities Not Engaged in For Profit*, page 32-8, *Small Business Edition*. Another common target is to

reclassify business expenses as nondeductible start-up costs. See *Start-Up/Organization Costs*, page 8-18.

**Bartering.** The FMV of products and services received through bartering can be considered business income if the products or services rendered are associated with the sole proprietorship. If the sole proprietor trades through a barter exchange program, the program will issue Form 1099-B, *Proceeds from Broker and Barter Exchange Transactions*.

## IRS Audits

**IRS notice (CP) or letter (LTR).** The IRS will send a notice or letter if:

- The taxpayer has a balance due.
- The taxpayer is due a larger or smaller refund.
- The IRS has questions about the tax return.
- The IRS needs to verify the taxpayer's identity.
- The IRS needs additional information.
- The IRS changed the taxpayer's tax return.
- The IRS is notifying the taxpayer of processing delays.

Go to [www.irs.gov/Individuals/Understanding-Your-IRS-Notice-or-Letter](http://www.irs.gov/Individuals/Understanding-Your-IRS-Notice-or-Letter) to find the listing of IRS notices and letters. Common notices and letters are listed in the chart below.

CP or LTR	Description
CP01	Identify theft claim verified.
CP05	Refund is being held while the tax return is reviewed.
CP14	Inform taxpayer of unpaid taxes.
CP14H	Inform taxpayer of unpaid shared responsibility payment.
CP32	Replacement check has been sent.
CP45	Unable to apply overpayment to estimated tax as requested.
CP49	All or part of refund used to pay tax debt.
CP59	No tax return on file.
CP79A	Two year ban from claiming Earned Income Credit.
CP90	Notice of intent to levy for unpaid taxes.
CP91	Notice of intent to levy up to 15% of Social Security benefits.
CP92	State tax refund was levied for unpaid taxes.
CP166	Monthly payment not processed due to insufficient funds.
CP180/CP181	Tax return is missing a schedule or form.
CP231	Refund or credit payment was returned. Current address needs to be updated.
CP501	Reminder of balance due.
CP521	Reminder that an installment payment is due.
CP523	Intent to terminate installment agreement. Payment due immediately.
CP2000	Notice of proposed changes to the tax return.
LT2030	Notice or proposed changes to Form 1120 or Form 1041.
CP2566	No tax return received so IRS calculated tax return based on third party reporting.


**Soft notice.** The IRS issues the Automated Underreporter (AUR) Notice CP 2057 to certain taxpayers with apparent underreported income. The form informs the taxpayer of an apparent discrepancy and instructs them to file a Form 1040X, *Amended U.S. Individual Income Tax Return*, if the information on the notice is correct.

**Examination by mail.** The IRS sends the taxpayer Notice CP 2000 to disclose proposed changes. The taxpayer typically has 30 days to respond and can either agree to all proposals, partially agree to the proposals, or dispute all proposed changes.

The taxpayer is allowed to sign an authorization that enables another party to represent him or her in connection with the

Notice CP 2000. The authorization is part of Notice CP 2000, and a separate power of attorney is not required.

**Field audit.** The revenue agent will send a letter to the taxpayer requesting that the taxpayer phone the agent. At that time, the date, location, and agenda for the first meeting will be set. The taxpayer has the right to request that the examination take place at a reasonable time and place that is convenient for both the taxpayer and the IRS.


 **Author's Comment:** Based on the author's experience in working with the IRS, it appears that agents on a field audit may be under unofficial pressure to close an examination with additional tax payable by the taxpayer. Even a small adjustment in tax is preferable to the agent than a "no change." A no change exam might indicate either the agent missed something or was not aggressive enough. If the agent uncovers an overpayment in tax, he or she might inform the representative to file a claim for refund instead of making the adjustment as part of the audit report.



## Audit Strategy

The best way to prepare for an audit is to put oneself into the auditor's shoes. The representative should take the perspective that he or she is auditing the client's return and is looking for anything possible to increase the client's tax liability on the return.


Conduct a pre-audit interview with the client. Ask tough questions and "throw out" any questionable deductions. Make sure that any issue raised during an audit is something that has already been discussed with the client. If the pre-audit interview is performed properly, the actual audit will be more comfortable for the client and/or representative, and the client will be prepared for any negative adjustments. Proper preparation will create the situation where the representative will know what will happen during the audit interview.

 **Author's Comment:** The stronger the taxpayer's documentation for the return, and the more accurate the return is as originally filed, the more likely auditors are to allow otherwise nondeductible items. If the taxpayer's records are not complete or accurate, the auditor can allow certain undocumented expenses based on professional judgment. When conducting the audit representation, keep in mind the overall result. For instance, one may not want to argue whether certain, smaller, well documented items are deductible if the auditor is willing to allow another, larger, less documented item.

**Audit video.** The IRS has created a video web page to assist taxpayers preparing for a small business audit. Go to the IRS website at [www.irsvideos.gov/audit](http://www.irsvideos.gov/audit).

## Requesting a Different Auditor

A taxpayer or taxpayer's representative has the right to request a different auditor if the current one seems uncooperative, too busy, or too inexperienced to properly consider the issues under examination. The request should be made to the auditor's supervisor by phone or in writing and should include a detailed explanation of the reasons for the request.

 **Author's Comment:** Any comments made to an IRS employee that could be interpreted as a threat against the employee will be taken seriously and fully investigated. Advise clients not to joke around with IRS employees during an examination.

## Repeat Examinations

If a return was examined for the same items in either of the two previous years, and no change was proposed to the tax liability, contact the IRS immediately and the examination will likely be discontinued. This policy is in accordance with IRC section 7605(b)

of the Internal Revenue Code, which states that no taxpayer shall be subjected to “unnecessary examinations.”

## Appeals Process

The function of the Appeals Division of the IRS is to settle cases in order to reduce the number of cases proceeding to court.



Following an audit, the report of an examiner recommends one of four determinations.

- 1) Acceptance of the return as filed and closing of the case,
- 2) Assertion of a deficiency or additional tax,
- 3) Allowance of an overassessment, with or without a refund claim, or
- 4) Denial of a claim for refund that is determined to be without merit.

**No change letter.** If the return is accepted as filed, the IRS will issue a “no change letter,” and no further action by the taxpayer is required.

**30-day letter.** In an unagreed case, the IRS will issue a “30-day letter” (also known as a “preliminary letter”). The 30-day letter states the proposed changes and is accompanied by a copy of the examiner’s report. The taxpayer is given the option of agreeing with the proposed changes and is also given information about protesting and appealing the results of the audit. If the taxpayer does not respond to the letter within 30 days, a statutory Notice of Deficiency (90-day letter) will be issued. If the taxpayer submits a protest within 30 days, the IRS will postpone issuance of the Notice of Deficiency.

**90-day letter.** A statutory Notice of Deficiency allows the taxpayer 90 days to file a petition to the Tax Court (150 days if the taxpayer is outside the United States).

## Tax Court

**Petition to Tax Court.** Upon receipt of a Statutory Notice of Deficiency (90-day letter), the taxpayer has 90 days to petition Tax Court or pay the tax and file a claim for refund. If the taxpayer takes no action, the amount will be assessed and no appeal is available.

When a Tax Court petition is received within the IRS, the representative will receive a call from Appeals to try to settle the case before it goes to the Tax Court. If a petition is not timely filed, the proposed tax will be assessed, and a bill will be sent by the IRS. In that case, the taxpayer will be prohibited from taking the case to the Tax Court or otherwise appealing the case.

**Small case procedure.** If the disputed amount is \$50,000 or less, the taxpayer can request the case be heard under the small case procedure. This procedure is less formal than the general procedure. Cases decided under the small case procedure may not be appealed.

## Appeals/Court Options for Taxpayer

IRS issues	Option
30-day letter as result of examination	<i>Option 1.</i> Request a meeting with IRS Appeals Division. The 30-day letter will provide contact information.
	<i>Option 2.</i> Take no action and wait for the IRS to issue a 90-day Notice of Deficiency. A request may be made for the IRS to issue the Notice of Deficiency so the taxpayer can proceed to court.
	<i>Option 3.</i> Pay the tax.
IRS issues Statutory Notice of Deficiency (90-day letter)	<i>Option 1.</i> The taxpayer can petition Tax Court within 90 days. A petition cannot be filed until receipt of the 90-day letter.
	<i>Option 2.</i> The taxpayer can pay the tax then file a claim for a refund. This keeps the case open.
	<i>Option 3.</i> If the taxpayer takes no action, the tax is assessed and an appeal is not allowed.

## Appeals/Court Options for Taxpayer continued

<b>Taxpayer petitions Tax Court</b>	If the taxpayer disputes the Tax Court decision, the taxpayer may file an appeal with the U.S. Court of Appeals. No appeal is allowed if the case was heard under the Small Case Procedures.
<b>U.S. District Court/Court of Federal Claims (after IRS rejects taxpayer’s claim for refund)</b>	If the taxpayer paid the tax assessed with a 90-day letter, files a claim for a refund, and the IRS rejects the claim, the taxpayer can take the case to U.S. District Court or Court of Federal Claims. The taxpayer has two years from the rejection of the refund claim to sue. The taxpayer must wait to file the suit either until the claim is rejected by the IRS or six months after the claim was filed.
<b>U.S. Court of Appeals</b>	If the taxpayer disputes the findings of the Tax Court, the U.S. District Court, or the Court of Federal Claims, the taxpayer may file with the U.S. Court of Appeals.
<b>United States Supreme Court</b>	If the U.S. Court of Appeals finds against the taxpayer, the U.S. Supreme Court is the next step. The U.S. Supreme Court chooses which cases to hear.

## Annual Filing Season Program

### Cross References

- [www.irs.gov/Tax-Professionals/Annual-Filing-Season-Program](http://www.irs.gov/Tax-Professionals/Annual-Filing-Season-Program), *Annual Filing Season Program*
- Circular 230, *Regulations Governing Practice before the Internal Revenue Service*



### Related Topics

- What’s New, Tab 1

The Annual Filing Season Program (AFSP) is a voluntary program geared toward non-credentialed tax return preparers. AFSP participants are included in a public database of return preparers on the IRS website. The directory includes the credentials and qualifications of all qualified federal tax return preparers.

### AFSP Requirements

In order to receive the AFSP—Record of Completion and be included in the IRS public directory, tax preparers must complete a certain number of continuing education hours annually by December 31. Preparers must have a valid PTIN and consent to specific practice obligations in subpart B and section 10.51 of Treasury Department Circular No. 230.

**Non-exempt.** Non-exempt tax return preparers must complete 18 hours of continuing education annually. The hours need to include the six hour Annual Federal Tax Refresher (AFTR) course, 10 hours of federal tax law topics, and two hours of ethics.

**Exempt.** Exempt tax return preparers are exempt from the 6-hour AFTR course, but must complete 15 hours of continuing education annually, including 10 hours of federal tax law topics, three hours of federal tax law updates, and two hours of ethics.

### Continuing Education (CE) Requirements

Preparer Classification	AFTR Course	Federal Tax Law	Ethics	Federal Tax Law Updates	Total CE hours
Non-exempt	6	10	2		18
Exempt*		10	2	3	15

\* A credentialed preparer who elects to participate in the AFSP must meet the same requirements as preparers in the exempt category.



**Exempt individuals.** The following individuals are exempt from taking the AFTR course to obtain the AFSP—Record of Completion.

- Anyone who passed the Registered Tax Return Preparer (RTRP) test between November 2011 and January 2013.
- Established state-based return preparer program participants currently with testing requirements (California, Oregon, Maryland).
- Special Enrollment Exam (SEE) Part I test passers within past two years.
- VITA volunteers with active PTINs.
- Other accredited tax-focused credential holders.
- CPAs, enrolled agents, attorneys, enrolled retirement plan agents, and enrolled actuaries.

**Taxpayer representation.** Beginning in 2016:

- PTIN holders without an AFSP—Record of Completion or without other professional credentials will not be able to represent clients before the IRS.
- PTIN holders with an AFSP—Record of Completion have limited representation rights, meaning they can represent clients whose returns they prepared and signed, but only before revenue agents and similar IRS employees.

Attorneys, CPAs, and enrolled agents continue to have unlimited representation rights. Any return preparer who represents a taxpayer before the IRS is subject to Circular 230.

## Practice Before the IRS

### Cross References

- Form 2848, *Power of Attorney and Declaration of Representative*
- Form 8821, *Tax Information Authorization*
- IRS Pub. 947, *Practice Before the IRS and Power of Attorney*
- Circular 230, *Regulations Governing Practice before the Internal Revenue Service*

### Related Topics

- Business Audit Strategies, Tab 32, *Small Business Edition*

### Practice Before the IRS

Practice before the IRS is covered by Circular 230 and includes all matters relating to any of the following.

- Communicating with the IRS for a taxpayer regarding the taxpayer's rights, privileges, or liabilities under laws and regulations administered by the IRS.
- Representing a taxpayer at conferences, hearings, or meetings with the IRS.
- Preparing or filing documents, including tax returns, with the IRS for a taxpayer.
- Providing a client with written advice on one or more federal matters.

Any individual may for compensation prepare or assist with the preparation of a tax return or claim for refund, appear as a witness for the taxpayer before the IRS, or furnishing information at the request of the IRS.

**Who can practice before the IRS.** Any individual who is authorized to practice must be designated as the taxpayer's representative by filing a written declaration, typically Form 2848, *Power of Attorney and Declaration of Representative*. The following individuals are authorized to practice before the IRS.

- Attorneys.
- Certified public accountants (CPAs).
- Enrolled agents (EAs).
- Enrolled retirement plan agents.
- Enrolled actuaries.
- Other representatives include:
  - An individual.
  - An immediate family member.
  - A corporate officer.
  - A general partner.
  - A full-time employee.
  - A fiduciary.

- Unenrolled return preparers (for the return they prepared) who hold an AFSP—Record of Completion for the tax return year and year the examination is conducted.

### Who cannot practice before the IRS:

- Individuals who are not eligible or who have lost the privilege.
- Corporations, associations, partnerships, and other persons who are not individuals.



**Rules of practice.** Circular 230 sets forth standards of professional conduct for practice before the IRS. Individuals have a duty to perform certain acts, are restricted from performing other acts, and cannot engage in disreputable conduct. Violations of the regulations, which may affect a practitioner's ability to practice before the IRS, and items of incompetence and disreputable conduct are described in Subpart C, Circular 230.

**Performance as a notary.** A practitioner who is a notary public and is employed as counsel, attorney, or agent in a matter before the IRS, or has a material interest in the matter, cannot engage in any notary activities related to that matter.

### Authorizing a Representative

A representative is an individual who acts in place of the taxpayer in dealings with the IRS. If authorization is not limited, the representative generally can perform all acts that taxpayer can, except negotiating a check. The authority granted to enrolled retirement plan agents, enrolled actuaries, and unenrolled return preparers are limited. Authorization includes, signing consents extending time to assess or collect tax, signing a closing agreement, and executing waivers agreeing to a tax adjustment. The representative may not sign the taxpayer's tax return unless permitted by regulations and specifically authorized in the power of attorney.

**Limited representation.** Representation by enrolled retirement plan agents and enrolled actuaries are limited to certain Internal Revenue Code sections that related to their area of expertise. For unenrolled return preparers, see *Taxpayer representation*, previous column.

**Form 2848, Power of Attorney and Declaration of Representative.** Form 2848 authorizes a person to represent a taxpayer before the IRS. The power of attorney (POA) authorizes the representative to perform any and all acts the taxpayer can perform, such as signing consents extending the time to assess tax, recording the interview, or executing waivers agreeing to a tax adjustment.

**Revocation of POA or withdrawal of representative.** If the taxpayer wants to revoke an existing POA and does not wish to name a new representative, or a representative wants to withdraw from representation, mail a copy of the previously-executed POA to the IRS using the *Where to File* chart, page 16-1, or to the IRS office handling the matter. Write the term "REVOKE" or "WITHDRAW," whichever is applicable, across the top of the first page and include a current signature and date below the annotation. The revocation or withdrawal may also be faxed to the Service Center at the number shown in the Instructions for Form 1040.

If a copy of the POA is not available, see the instructions for Form 2848, *Power of Attorney and Declaration of Representative*, for information about how to revoke or withdraw the POA.

**Central Authorization File number.** The representative must have a Centralized Authorization File (CAF) number, which is a nine digit number assigned to the representative and used for all the representative's audits. If a CAF number has not been previously assigned, write "None" as the CAF number on line 2, Form 2848. The IRS will issue a CAF number directly to the representative. The representative then uses the assigned CAF number on all future powers of attorney.

## Disclosure of Tax Return Information

### Cross References

- IRC §7216, *Disclosure or use of information by preparers of returns*
- Rev. Proc. 2013-14
- Rev. Proc. 2013-19



### Related Topics

- Form 1040, *U.S. Individual Income Tax Return 2015*, page 3-1

### Disclosure or Use of Tax Return Information

Preparer penalties may apply if the tax return preparer discloses or uses information obtained from a client's return without the taxpayer's consent. Criminal penalties apply for tax return preparers who knowingly or recklessly disclose or use tax return information for a purpose other than preparing a tax return.

### Tax Return Information

Tax return information is any information on the return, including a taxpayer's name, address, and Social Security number, which is furnished in connection with the preparation of a tax return. It includes information that the taxpayer furnishes and information furnished by a third party. Tax return information includes information the tax return preparer derives or generates in connection with the preparation of the tax return.

### Taxpayer Consent

Unless specifically authorized, a tax return preparer may not disclose or use a taxpayer's tax return information prior to obtaining a written consent from the taxpayer. The consent must be knowing and voluntary. See *Permissible disclosures or uses without consent of the taxpayer*, next column.

**Form and content of taxpayer consent.** A consent to disclose or use tax return information must satisfy the following requirements.

- It must include the names of the tax return preparer and the taxpayer.
- It must identify the intended purpose of the disclosure and the specific recipient of the disclosure.
- It must specify the tax return information to be disclosed or used.
- It must be signed and dated by the taxpayer.

If the consent is furnished on paper, the sheets must be 8½ inches by 11 inches or larger. All the text must pertain solely to the disclosure or use, and the text must be in at least 12-point type.

**Language of consent.** Except for substituting the preparer's name where "we" or "our" is used, when the consent is for the disclosure of tax return information in a context other than tax preparation or auxiliary services, the consent must contain the following statements in the following sequence.

Federal law requires this consent form be provided to you. Unless authorized by law, we cannot disclose, your tax return information to third parties for purposes other than the preparation and filing of your tax return without your consent. If you consent to the disclosure of your tax return information, federal law may not protect your tax return information from further use or distribution.

You are not required to complete this form to engage our tax return preparation services. If we obtain your signature on this form by conditioning our tax return preparation services on your consent, your consent will not be valid. If

you agree to the disclosure of your tax return information, your consent is valid for the amount of time that you specify.

If you do not specify the duration of your consent, your consent is valid for one year from the date of signature.

If you believe your tax return information has been disclosed or used improperly in a manner unauthorized by law or without your permission, you may contact the Treasury Inspector General for Tax Administration (TIGTA) by telephone at 1-800-366-4484 or by email at [complaints@tigta.treas.gov](mailto:complaints@tigta.treas.gov).

**Duration of consent.** Unless the consent document specifies differently, the consent to the disclosure or use of tax information will be effective for a period of one year from the date the taxpayer signed the consent.

**Permissible disclosures or uses without consent of the taxpayer.** Specific situations, such as disclosures to the IRS or by court order, do not require the consent of the taxpayer. (Reg. §301.7216-2)

For access to *Consent to Release Information* in printable format, see *Tools for Tax Pros* inside the front cover.

## IRS Collection Process

### Cross References

- Form 656-B, *Offer in Compromise Booklet*
- Form 843, *Claim for Refund and Request for Abatement*
- IRS Pub. 1, *Your Rights as a Taxpayer*
- IRS Pub. 594, *The IRS Collection Process*
- IRC §6334, *Property exempt from levy*

### Related Topics

- Foreclosures, Repossessions, Cancellation of Debt, Tab 14
- Trust Fund Recovery Penalty, page 23-7, *Deluxe Edition/Small Business Edition*



### Taxpayer Bill of Rights

IRS Pub. 1, *Your Rights as a Taxpayer*, includes the Taxpayer Bill of Rights and will be sent to taxpayers when they receive IRS notices on issues ranging from audits to collections.

### Payment Options

If the taxpayer owes money and agrees with the amount, see *Taxpayer Unable to Pay*, page 15-4, and *Offers in Compromise*, page 15-11.

### Federal Tax Liens

Liens give the IRS a legal claim to the taxpayer's property as security for payment of the tax debt. The lien arises when:

- The tax is assessed,
- The IRS sends a Notice and Demand for Payment, a bill that tells how much is owed, and
- The taxpayer does not fully pay the debt within 10 days after notification.

### IRS Levies

A levy is a legal seizure of property to satisfy a tax debt. The levy usually takes place after the following three requirements are met.

- The tax is assessed, and a Notice and Demand for Payment is sent to the taxpayer,
- The tax is not paid,
- The IRS sends a Final Notice of Intent to Levy and Notice of Your Right to a Hearing at least 30 days before the levy.

**Appealing the filing of a lien or levy.** The taxpayer may ask an IRS manager to review the case, or may request a Collection Due Process (CDP) hearing with the Office of Appeals, by filing a request for a hearing with the office listed on the notice. The taxpayer must file the request for an appeal within 30 days of the date listed on the notice.

Requesting a CDP hearing will suspend the lien or levy actions while the hearing is pending.

**Disqualified employment tax levy (DETL).** A DETL gives the IRS the ability to enforce collection action against repeat employment tax offenders without a pre-levy CDP hearing. A DETL situation can exist if a CDP hearing has been requested, but not yet heard, and additional employment taxes have accrued.

**Property exempt from levy:**

- Apparel and school books as are necessary for the taxpayer or members of the family.
- Furniture and personal effects of the household up to \$9,120 (for 2016).
- Unemployment benefits.
- Workers' compensation.
- Certain service-connected disability payments.
- Public assistance payments.
- Judgments for support of minor children.
- Business property up to \$4,560 (for 2016).

**Retirement accounts.** Even if state law claims that funds in a taxpayer's retirement accounts are immune from the claims of creditors, the IRS will allow a levy on the accounts.



**To Submit an Offer**

- Complete Form 656, *Offer in Compromise*,
- Complete Form 433-A (OIC), *Collection Information Statement for Wage Earners and Self-Employed Individuals*, or Form 433-B (OIC), *Collection Information Statement of Businesses*,
- Submit the nonrefundable \$186 application fee, unless low-income certification is met, and
- Submit the nonrefundable initial offer payment, unless low-income certification is met.

**Select a payment option.** The initial payment will vary based on the offer and the payment option selected.

**Lump-sum cash.** Submit an initial payment of 20% of the total offer amount. After acceptance, the remaining balance of the offer must be paid in five or fewer payments.

**Periodic payment.** Submit an initial payment of the first month's installment. After acceptance, the remaining balance must be paid in six to 24 months.

**Low-income certification.** The low-income certification guidelines are included on Form 656.

**Doubt as to liability.** Doubt as to liability exists if there is a genuine dispute as to the existence or amount of the correct tax debt. Doubt as to liability does not exist if the tax debt has been established by a final court decision or judgment or if the tax debt is based on current law. A taxpayer wishing to file a doubt as to liability OIC must complete Form 656-L, *Offer in Compromise (Doubt as to Liability)*. The amount of the offer should be based on what the taxpayer believes is the correct amount of tax debt.

**Offer in Compromise (OIC)**

**Cross References**

- Form 656-B, *Offer in Compromise Booklet*
- Form 656-L, *Offer in Compromise (Doubt as to Liability)*
- IRS Pub. 594, *The IRS Collection Process*
- IRS Notice 2006-68
- IRC §7122, *Compromises*

**Related Topics**

- Foreclosures, Repossessions, Cancellation of Debt, Tab 14

**Summary of an Offer in Compromise (OIC)**

An OIC is an offer made by a taxpayer to settle a tax liability for less than the full amount owed. It is a legitimate option if the taxpayer can't pay the full tax liability, or doing so creates a financial hardship. Facts and circumstances considered include:

- Ability to pay.
- Income.
- Expenses.
- Asset equity.

The IRS will usually approve an OIC when the amount offered represents the most the IRS can expect to collect within a reasonable period of time. The ultimate goal is a compromise that suits the best interests of the taxpayer and the IRS. Submitting an offer application does not ensure that the IRS will accept the offer. It begins a process of evaluation and verification. Generally, the IRS will not accept an offer if the tax debt can be paid in full via an installment agreement or lump sum.

**Eligibility**

Before the IRS can consider an offer, the taxpayer must be current with all filing and payment requirements and cannot be in an open bankruptcy proceeding.

**Evaluation Process**

While the offer is being evaluated:

- The nonrefundable payments and fees will be applied to the tax liability (the taxpayer can designate how the payments are applied),
- A Notice of Federal Tax Lien may be filed,
- Penalties and interest will continue to accrue,
- Individual shared responsibility payments are not subject to penalties,
- Other collection activities are suspended,
- The legal assessment and collection period is extended,
- All required payments associated with the offer must be made,
- If the periodic payment plan option was selected, the monthly payments must be made unless low-income certification is met,
- Continue to timely file and pay all required tax returns, estimated tax payments, and federal tax payments,
- Existing installment agreement payments are not required to be made, and
- The offer is automatically accepted if the IRS does not make a determination within two years of the IRS receipt date.

**Relief from Joint and Several Liability on Joint Returns**

**Cross References**

- Form 8379, *Injured Spouse Allocation*
- Form 8857, *Request for Innocent Spouse Relief*
- IRS Pub. 971, *Innocent Spouse Relief*
- Rev. Proc. 2013-34
- IRC §6015, *Relief from joint and several liability on joint return*



**Related Topics**

- Married Filing Separately (MFS), page 3-10
- Community Property, Tab 14

## Innocent Spouse

When a joint tax return is filed, both taxpayers are jointly and individually liable for the tax and any interest or penalty due on the return, even if they later divorce. This is true even if a divorce decree states that a former spouse will be responsible for any amounts due on a previously-filed joint return. One spouse may be held responsible for payment of all tax due even if all the income was earned by the other spouse.

Types of relief available to married individuals who filed joint returns are:

- Innocent spouse relief.
- Separation of liability relief.
- Equitable relief.
- Relief from liability arising from community property law.

**When to file.** File Form 8857, *Request for Innocent Spouse Relief*, requesting relief from joint liability as soon as the taxpayer becomes aware of a tax liability for which the taxpayer believes only the spouse or former spouse should be held responsible.

Generally Form 8857 must be filed no later than two years after the first IRS attempt to collect the tax. See exceptions, below, for different deadlines that apply.

**Exception for equitable relief.** A request for equitable relief must be filed within the:

- 10-year statute of limitations under IRC section 6502 for collection of tax, or
  - 2- or 3-year statute of limitations under IRC section 6511 for credit or refund of tax.
- (Rev. Proc. 2013-34)



**Exception for relief based on community property laws.** A request for relief based on community property laws must be filed no later than six months before the expiration of the period of limitations on assessment (including extensions) against the spouse or former spouse for the tax year relief is being requested.

**Innocent spouse relief.** An innocent spouse seeking relief from joint tax liability must meet all the following conditions.

- 1) The tax must be based on a joint return for the year for which relief is sought,
- 2) The return must have understated tax due to erroneous items of the taxpayer's spouse,
- 3) The spouse seeking relief did not know of the understated tax, and
- 4) It would be unfair to hold the spouse seeking relief liable for the understated tax.

**Understated tax.** Tax is understated if the IRS determines that the total tax should be more than the amount actually shown on the return.

**Separation of liability relief.** Separation of liability relief allocates the understated tax between the taxpayer and spouse or former spouse. The understated tax allocated to the taxpayer is generally the amount the taxpayer is responsible for. To qualify the taxpayer must be widowed or the taxpayer and spouse:

- Are now divorced,
- Are now legally separated, or
- Have lived apart at all times during the 12-month period prior to the date Form 8857 is filed.

**Exception:** If, at the time the taxpayer signed the return, he or she knew about any item that resulted in all or part of the understated tax, then the request will not apply to that part of the understated tax.

**Equitable relief.** If the taxpayer seeking relief does not qualify for innocent spouse relief or relief by separation of liability, the taxpayer may still be eligible for equitable relief. Under equitable relief, the taxpayer may be relieved of liability for underpayment

of tax, as well as understated tax, unlike the other provisions where relief may be granted only for understated tax.

Equitable relief may be allowed if both of the following conditions are met.

- The taxpayer has an understated tax or an underpaid tax, and
- The IRS determines it would be unfair to hold the taxpayer liable for the understated or underpaid tax.

Equitable relief is the only type of relief available for an underpaid tax.

**Equitable relief guidance.** Under certain conditions, the IRS will make streamlined relief determinations and give greater deference to factors that may increase the likelihood of a requesting spouse gaining equitable relief. (Rev. Proc. 2013-34)



**Underpaid tax.** An underpaid tax is tax that is properly shown on the return but has not yet been paid.

**Conditions.** Additional conditions for obtaining equitable relief include:

- The taxpayer is not eligible for any other type of relief.
- The taxpayer has not paid the tax.
- The taxpayer and spouse or former spouse did not transfer assets to one another as part of a fraudulent scheme.
- The taxpayer and spouse or former spouse did not transfer property for the main purpose of avoiding the payment of tax.
- The taxpayer did not file or fail to file the return with the intent to commit fraud.
- The income tax liability for which relief is sought is attributable to the taxpayer's spouse or former spouse, with certain exceptions.

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**Court Case:** The court granted petitioning spouse equitable relief under IRC section 6015(c) with respect to unpaid tax liability. Though the petitioner and her son were the sole signatories on the bank account for the business producing the liability, and she made all deposits to that account, petitioner asserted she did not control the account. The petitioner's physically abusive husband controlled the account through fear and intimidation of the petitioner. The petitioner argued she was not allowed any involvement in the finances of the business or preparation and filing of the tax returns. She asserted her husband forged her signature on the returns. The Tax Court agreed to both arguments and assigned all liability to the husband. (*Wilson*, T.C. Memo 2007-127)

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**Community property laws.** Taxpayers who are married and live in a community property state must generally follow community property laws when filing a tax return. However, community property laws are not taken into account in determining whether an item belongs to the taxpayer or spouse or former spouse for purposes of requesting any relief from liability.

## Injured Spouse

An injured spouse is a taxpayer who files a joint return and all or part of a refund is, or is expected to be, applied against debts of the other spouse. The following debts apply for this purpose.

- Past-due federal tax.
- Child or spousal support.
- Federal non-tax debt (such as a student loan).
- State income tax.
- State unemployment compensation debts.

**Form 8379, Injured Spouse Allocation.** File Form 8379 if:

- 1) The injured spouse is not legally obligated to pay the past due amount, and
- 2) The injured spouse meets any of the following conditions:
  - a) The injured spouse made and reported tax payments, such as federal income tax withholding or estimated tax payments.

- b) The injured spouse had earned income, such as wages, salaries, or self-employment income and claimed the Earned Income Credit or the Additional Child Tax Credit.
- c) The injured spouse claimed a refundable tax credit, such as the Health Coverage Tax Credit or refundable credit for a prior year minimum tax.

**Exception:** If the main home of the injured spouse was in a community property state, the spouse may file Form 8379 if only item (1) above applies. See *Community property states*, below.

**Filing.** Form 8379 may be filed with the tax return. If the return was already filed, send Form 8379 by itself to the IRS center for the place the injured spouse lived when the return was filed. Attach a copy of all Forms W-2, and W-2G for both spouses, and any Forms 1099 showing federal income tax withholding.

**Allocation.** Part III, Form 8379 lists income and withholding amounts shown on the joint return, amounts allocated to the injured spouse, and amounts allocated to the other spouse. The IRS will figure the amount of any refund due the injured spouse.

**Community property states.** For guidance on the amount of an overpayment that may offset a spouse's separate tax liability, refer to the Revenue Ruling corresponding to the taxpayer's residency.

AZ or WI .....	Rev. Rul. 2004-71	NM, NV, or WA..	Rev. Rul. 2004-73
CA, ID, or LA.....	Rev. Rul. 2004-72	TX .....	Rev. Rul. 2004-74

## Electronic Filing

### Cross References

- Form 8453, *U.S. Individual Income Tax Transmittal for an IRS e-file Return*
- Form 8878, *IRS e-file Signature Authorization for Form 4868 or Form 2350*
- Form 8879, *IRS e-file Signature Authorization*
- Form 8944, *Preparer e-file Hardship Waiver Request*
- Form 8948, *Preparer Explanation for Not Filing Electronically*
- IRS Pub. 1220, *Specifications for Electronic Filing of Forms 1097, 1098, 1099, 3921, 3922, 5498, and W-2G*
- IRS Pub. 1345, *Handbook for Authorized IRS e-file Providers of Individual Income Tax Returns*
- IRS Pub. 3112, *IRS e-file Application and Participation*
- IRS Pub. 3823, *Employment Tax e-file System Implementation and User Guide*

### Related Topics

- Monitoring of Authorized IRS e-file Providers, page 32-13, *Small Business Edition*



### e-File Requirement for Tax Return Preparers

Specified tax return preparers who reasonably expect to file 11 or more covered returns in a calendar year are required to e-file returns.

**Covered tax return.** A covered tax return is a return for an individual, trust, or estate.

**Reasonably expect to file.** Reasonably expect to file means the estimated number of covered returns that the tax return preparer expects to prepare and file. File means submitted to the IRS on the taxpayers behalf either electronically or in non-electronic (paper) form. See *Applying to Become an e-File Provider*, next column.

**Exception:** For specific circumstances, tax preparers can apply for a hardship waiver by filing Form 8944, *Preparer e-file Hardship Waiver Request*. A return preparer receiving a hardship waiver

must file Form 8948, *Preparer Explanation for Not Filing Electronically*, with each paper-filed return.

**Explanation for not e-filing.** Tax preparers required to e-file must furnish Form 8948 for taxpayers who file by paper. The reason for paper filing must be identified on Form 8948.

Returns filed by paper solely because the returns are not eligible for e-file do not require Form 8948. See *Individual Returns Not Eligible for e-File*, below.



### Applying to Become an e-File Provider

A tax practitioner uses the IRS e-file application at [www.irs.gov](http://www.irs.gov) to apply to become an e-file provider. The application process may take up to 45 days. The e-file application includes setting up an IRS e-services account, providing the necessary information, and passing a suitability check. In setting up the account, practitioners who want to e-file for a client should select ERO. A fingerprint card is required for any principal who is not an attorney, CPA, EA, officer of a publically traded corporation, or bonded bank official. Call 866-255-0654 to request a fingerprint card.

### Electronic Return Originators (EROs)

Tax preparers who offer electronic filing to their clients generally function as Electronic Return Originators (EROs). An ERO originates the electronic submission of a return after the taxpayer authorizes the filing of the return via IRS e-file.

**ERO responsibilities.** The ERO has a variety of responsibilities, including, but not limited to the following.

- Timely originating the electronic submission of returns.
- Submitting any required supporting paper documents to the IRS.
- Providing copies to taxpayers.
- Retaining records and making records available to the IRS.
- Accepting returns only from taxpayers and providers.
- Having only one EFIN for the same firm for use at one location, unless the IRS issued more than one EFIN to the firm for the same location.

**Record retention.** EROs must retain the following material until the end of the calendar year in which a return was filed.

- A copy of signed Form 8453, any supporting documents that are not included in the electronic return data.
- Copies of Forms W-2, W-2G, and 1099-R.
- A copy of signed IRS e-file consent to disclosure forms.
- A copy of the electronic portion of the return that can be converted into an electronic transmission that the IRS can process.
- The acknowledgement file for IRS accepted returns.

**Forms 8878 and 8879.** These must be retained for three years from the due date of the return or the IRS received date, whichever is later.

**Scanning.** The EROs may store an electronic image of all paper records they are required to retain for IRS e-file. This includes Forms W-2, 1099-R, and Forms 8878 and 8879. See Revenue Procedure 97-22, *Retention of Books and Records*, for information about standards for an electronic storage system.

### Individual Returns Not Eligible for e-File

Returns that cannot be e-filed with the IRS include amended returns, fiscal year returns, returns containing forms or schedules that cannot be processed electronically by the IRS, and returns with tax years ending prior to December 31, 2012. In addition, returns with Taxpayer Identification Numbers (TINs) within the range of 900-00-0000 through 999-99-9999.

**Exception:** Certain Adoption (ATINs) and Individual (ITINs) within the range noted above may be accepted.

## Timely Filing

An electronically filed return is not considered filed until the electronic portion of the return has been acknowledged by the IRS. However, if the return is successfully transmitted on or before the due date, and the provider complies with the requirements for signing the return, the return will be considered timely filed. The practitioner has the responsibility to ensure that a return accepted for electronic filing before the deadline is submitted to the IRS before the deadline.

**Rejected returns.** If an electronically filed return is rejected by the IRS, the ERO must take reasonable steps to notify the taxpayer within 24 hours. The ERO must provide the taxpayer with the reject codes accompanied by an explanation. If the taxpayer chooses to file a paper return, or if the electronic return cannot be accepted for processing by the IRS, a paper return must be filed. In order to be considered timely filed, the paper return must be filed by the later of the due date of the return or 10 calendar days after the date the IRS gives notification that the electronic portion of the return is rejected.



## Signing an Electronic Return—Individuals

**Signature options.** Taxpayers may sign electronic returns one of two ways.

- 1) Self-select PIN.** The taxpayer enters a personal identification number (PIN) directly into the electronic return (using the practitioner's keyboard). When using a self-select PIN, signature documents are not required. However, the taxpayer must provide prior-year AGI for use by the IRS to authenticate the taxpayer.
- 2) Practitioner PIN.** Form 8879, *IRS e-file Signature Authorization*, authorizes an ERO to enter a taxpayer's PIN on an electronic return. The taxpayer must sign and date Form 8879 and return the completed Form 8879 to the ERO in person, by mail, private delivery service, fax, email, or a website prior to the return being transmitted to the IRS. The practitioner must retain Form 8879 for three years from the return due date or the IRS received date, whichever is later, but the form is not required to be sent in unless requested by the IRS.

**Stockpiling of returns.** Stockpiling is waiting more than three calendar days to submit returns to the IRS after the preparer has all necessary information for origination. Collecting tax returns prior to the startup of IRS e-file is not stockpiling. However, preparers must advise taxpayers that returns cannot be transmitted prior to the startup date.

**Tax return changes require new signature.** If a declaration has already been signed by a client, and a correction is made on the return, a new signature is required if the correct amounts differ by more than either \$50 to total income or AGI, or \$14 to total tax, federal income tax withheld, refund, or amount owed.

**Form 8453, U.S. Individual Income Tax Transmittal for an IRS e-file Return.** Form 8453 is used when submitting by paper certain forms and documents supporting a tax return filed electronically. See the instructions for Form 8453 for a complete list of documents eligible for submission.



## Corporations, Partnerships, Estates, and Trusts

Corporations, partnerships, estates, and trusts can generally e-file income tax returns with related forms, schedules, and attachments, as well as extensions, employment tax, and other information returns.

**Ineligible to e-file.** Returns and extensions meeting certain conditions cannot be currently e-filed. See IRS Pub. 4164, *Modernized e-File (MeF) Guide for Software Developers and Transmitters*, for current exclusions.

**Required e-filers.** Certain entities are required to e-file their returns. However, these entities can request a waiver of the requirements.

### Mandatory e-Filing for Corporations

Return Type	Asset Size	Annual Return Filings <sup>2</sup>
1120, 1120S, 990, amended returns <sup>1</sup>	\$10 million and over	250 or more
990-PF	All, regardless of asset size	250 or more

<sup>1</sup> Entities amending an original return that was required to be e-filed must e-file the amended return unless an approved waiver was obtained.

<sup>2</sup> Annual return filings mean corporations that file 250 or more federal returns a year, including excise tax, employment tax, and information returns such as Forms W-2 and 1099.

### Mandatory e-Filing for Partnerships

Return Type	Number of Partners
Form 1065, 1065-B, amended returns <sup>1</sup>	More than 100 partners (Schedules K-1)

<sup>1</sup> Entities amending an original return that was required to be e-filed must e-file the amended return unless an approved waiver was obtained.

**Penalties.** If a taxpayer fails to e-file an income tax return when required to do so by regulations, the IRS may determine that the taxpayer failed to file the return. The taxpayer then becomes subject to IRC section 6651 additions to tax, typically resulting in monetary penalties on the amount of underpayment. Additionally, any return not in compliance with the e-filing requirement will be considered to not have been timely filed, rendering any elections invalid.

**Waivers from required e-filing.** Waivers are available for entities where a specific situation precludes them from meeting the e-file requirement due to technology constraints or where compliance with the requirements would result in undue financial burden.

## Signing an Electronic Return

### Signing e-Filed Business and Trust Returns

Return Type	Pin Method	Signature Method	Required Retention by Practitioner
1120	Complete Form 8879-C and do not file with return.	Complete Form 8453-C and e-file with return.	Three years from the later of date of filing or due date.
1120-S	Complete Form 8879-S and do not file with return.	Complete Form 8453-S and e-file with return.	Three years from the later of date of filing or due date.
1065	Complete Form 8879-PE and do not file with return.	Complete Form 8453-PE and e-file with return.	Three years from the later of date of filing or due date.
1041	Complete Form 8879-F and do not file with return.	Complete Form 8453-F and mail to IRS within three business days of return acceptance.	Form 8879-F, three years from the later of date of filing or due date.

~ End ~