

# STUDY UNIT ONE

## PRACTICE BEFORE THE IRS

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When a dispute or disagreement over tax issues arises, a taxpayer may have to appear before the IRS. Enrolled agents, CPAs, attorneys, and other individuals authorized to practice before the IRS may represent taxpayers. This study unit discusses the various individuals who may practice before the IRS, their standards of conduct, and other requirements of enrolled agents.

### 1.1 AUTHORITY TO PRACTICE

#### Rules of Practice

1. The rules governing practice before the Internal Revenue Service (IRS) appear in Treasury Department Circular 230, *Regulations Governing Practice before the Internal Revenue Service*.
  - a. We have reproduced Circular 230 as [Appendix A](#).

#### Practice before the IRS

2. Practice before the IRS is the presentation to the IRS, or any of its officers or employees, of any matter relating to a taxpayer's rights, privileges, or liabilities under laws or regulations administered by the IRS.
3. Practicing before the IRS includes
  - a. Communicating with the IRS for a taxpayer
  - b. Representing a taxpayer at conferences, hearings, or meetings with the IRS
  - c. Preparing necessary documents and filing them with the IRS for a taxpayer
  - d. Rendering written advice with respect to any entity, transaction, plan, or arrangement, or other plan or arrangement having a potential for tax avoidance or evasion
4. The following do **not** constitute practicing before the IRS:
  - a. Preparing a tax return, an amended return, or a claim for refund
  - b. Furnishing information upon request of the IRS
  - c. Appearing as a witness for the taxpayer

**Who May Practice**

5. Only authorized persons may practice before the IRS (i.e., practitioners).
- a. The following persons may practice before the IRS:
    - 1) Attorneys
      - a) An attorney is a member in good standing of the bar of the highest court of any state, possession, territory, commonwealth, or the District of Columbia.
    - 2) CPAs
      - a) A CPA who is not suspended from practice by the Office of Professional Responsibility and who is currently qualified to practice as a CPA in any state
    - 3) Enrolled agents
    - 4) Enrolled actuaries, for limited purposes listed under Sec. 10.3(d) of Circular 230
    - 5) Enrolled retirement plan agents, for limited purposes listed under Sec. 10.3(e) of Circular 230
    - 6) Annual Filing Season Program participants
      - a) The limited right to represent clients before the IRS is accorded to non-credentialed preparers only if they participate in the IRS Annual Filing Season Program (AFSP) and they must have prepared the return.
    - 7) Unenrolled individuals, if specifically permitted
    - 8) Appraisers

Type of Practice before the IRS	Types of Practitioners	Attorney, CPA, EA	AFSP Participants/ Others Specifically Allowed to Practice
	Allowed Practice before the IRS	Unlimited	Limited
	Preparation of Return or Claim for Refund	Sign returns and refunds when completed "all or substantially all" of a return or refund	Sign returns and refunds when completed "all or substantially all" of a return or refund
	Representation	1) Before anyone at the IRS 2) Examination and appeals 3) Any return or refund	1) Before IRS revenue agents, customer service representatives, and employees 2) During examination only 3) Return that tax return preparer signed him- or herself for the period under examination 4) Must participate in AFSP or be specifically permitted to practice
	Tax Advice	Unlimited including tax planning	Limited to return or refund preparation

**Attorney or CPA Requirements to Practice**

- b. To practice before the IRS, an attorney or a CPA must
  - 1) File a written declaration, for each party (s)he represents, that (s)he
    - a) Is qualified currently
    - b) Has been authorized to represent the party
  - 2) Not be suspended or disbarred

**Enrolled Agent**

- c. An enrolled agent is an individual, other than an attorney or a CPA, who is eligible, qualified, and certified as authorized to represent another in practice before the IRS.
  - 1) An enrolled agent may not appear in a representative capacity on behalf of any taxpayer unless the enrolled agent
    - a) Is recognized to practice before the IRS and
    - b) Presents satisfactory identification.
  - 2) Recognition must be evidenced when the enrolled agent appears for the initial meeting in the first office of the IRS in which (s)he represents the taxpayer.
    - a) A person will be recognized to practice before the IRS if (s)he meets the requirements set forth in Circular 230. Under Circular 230, an enrolled agent may represent a particular party upon filing a written declaration that (s)he
      - i) Is qualified currently and
      - ii) Has been authorized to represent the party.
- d. Only natural persons may be enrolled agents.
  - 1) U.S. citizenship is not required.
  - 2) Enrollment is available to, but not required of, attorneys and CPAs. They are automatically entitled to practice before the IRS.

**Eligibility to Become Enrolled**

- e. Eligible individuals must meet certain requirements for enrollment.
  - 1) **Conduct.** Enrollment is precluded by conduct that justifies suspension or disbarment from practice.
  - 2) **Exam.** A person who passes the IRS Special Enrollment Exam (also known as the Enrolled Agent or EA exam) may be enrolled.
  - 3) **IRS experience.** Past service in the IRS and technical experience are a basis for enrollment.
    - a) Factors considered are
      - i) Length (minimum of 5 continuous years), scope, and extent of employment
      - ii) Recommendation of the employing division's superior officer

**Application to Become Enrolled**

- f. A properly executed application for enrollment is necessary.
  - 1) **Temporary recognition** to practice may be granted to an applicant in unusual circumstances. The application must be regular on its face and properly executed.
    - a) It does not constitute a finding of eligibility or enrollment.
    - b) It may be withdrawn at any time.
  - 2) Consideration of the application may be conditioned on both
    - a) Filing additional information and
    - b) Submitting to written or oral examination under oath.
  - 3) An applicant may file a written appeal within 30 days after the receipt of a notice of denial.
  - 4) Enrollment card. Each approved applicant is issued an enrollment card.

**Eligibility of Non-Form 1040 Series Preparers to Represent Clients**

- g. Non-Form 1040 series preparers are individuals who certify that they do not prepare, or assist in the preparation of, any Form 1040 series tax return or claim for refund, except Form 1040-PR or Form 1040-SS, for compensation. Non-Form 1040 series preparers may
  - 1) Sign any tax return they prepare or assist in preparing
  - 2) Represent taxpayers before revenue agents, customer service representatives, or similar officers and employees of the IRS (including the Taxpayer Advocate Service) during an examination if the individual signed the tax return or claim for refund for the taxable year under examination

**Other Persons who may Practice before the IRS on a Limited Basis (AKA “limited practice”)**

- h. The IRS may authorize any person to represent another without enrollment. Individuals who are under suspension or disbarment from practice before the IRS may not engage in limited practice before the IRS. Listed below are situations in which representation by an individual without enrollment has been authorized:
  - 1) **Family.** An individual may represent, without compensation, an immediate family member.
  - 2) **Employee.** An employee may represent his or her regular, full-time employer.
  - 3) **Partnership.** A general partner or full-time partnership employee may represent the partnership.
  - 4) **Corporation.** An officer or a regular, full-time corporate employee may represent the corporation.
  - 5) **Fiduciary.** A trustee, a receiver, a guardian, an administrator, or an executor may represent the trust, receivership, guardianship, or estate.
  - 6) **Overseas.** An individual may provide representation to any individual or entity if the representation takes place outside the U.S.
  - 7) **Student Attorney/Student CPA.** A student can apply for permission to practice before the IRS by virtue of his or her status as a law student or CPA student under Sec. 10.7(d) of Circular 230.
  - 8) **Others.** An individual may be authorized by the Commissioner of the IRS to represent others in a particular matter.

**Who Is Subject to Regulations in Circular 230**

- 6. Any practitioner who for compensation prepares or assists with the preparation of all or substantially all of a tax return or claim for refund is subject to the duties and restrictions relating to practice, as well as subject to the sanctions for violation of the regulations in Circular 230.

**Who May Not Practice**

7. Unauthorized persons may not practice before the IRS.
  - a. A member of Congress may not practice before the IRS in connection with any matter for which (s)he directly or indirectly receives, agrees to receive, or seeks any compensation.
  - b. An officer or employee of the U.S. (legislative, executive, or judicial branch) or its agencies may not practice before the IRS, except as
    - 1) The representative of an immediate family member
    - 2) A personal fiduciary, such as trustee, receiver, guardian, administrator, or executor, representing the fiduciary entity or beneficiary
  - c. A state employee who investigates, passes upon, or otherwise deals with state tax matters may not practice before the IRS if (s)he may disclose information applicable to federal tax matters.
  - d. An individual convicted of any offense involving dishonesty or breach of trust may not practice before the IRS.

**Limited Practice**

8. Any practitioner who is an unenrolled return preparer (i.e., not a CPA, attorney, or EA) may only represent clients before revenue agents and customer service representatives (not appeals officers, revenue officers, or counsel) and may only represent clients for the tax return (s)he signed/prepared.

**Oversight of Practice**

9. The Commissioner of Internal Revenue or his or her delegate
  - a. Acts on applications for enrollment
  - b. Makes inquiries respecting matters under the commissioner's jurisdiction
  - c. Institutes and provides for the conduct of disciplinary proceedings relating to practitioners
  - d. Performs duties prescribed by the Secretary of the Treasury

**PTIN**

10. Any individual who for compensation prepares or assists with the preparation of all or substantially all of a federal tax return or claim for refund must have a Preparer Tax Identification Number (PTIN). Tax preparers can sign up for a PTIN online or by paper application.
  - a. The PTIN must be renewed annually.

## 1.2 CONDUCT OF PRACTICE

Rules for conduct of an attorney, a CPA, or an enrolled agent in practice before the IRS are provided in the applicable sections of Part 10 of Circular 230. Examples follow. Unless otherwise indicated, “practitioner” includes anyone preparing a tax return, e.g., an attorney, a CPA, or an EA.

### **Qualified**

1. The person representing a taxpayer before the IRS must be qualified, e.g., an EA.
  - a. The duty may not be delegated to an employee of the qualified practitioner.
  - b. A power of attorney or written authorization from the taxpayer is insufficient.

### **Declaration**

2. A written declaration that the representative is both qualified and authorized to represent the particular principal must be filed with the IRS.

### **Relying on Information Furnished by Clients**

3. A practitioner advising a client to take a position on a tax return, document, affidavit, or other paper submitted to the IRS, or preparing or signing a tax return as a preparer, generally may rely in good faith without verification upon information furnished by the client.
  - a. However, the preparer may not ignore the implications of the information.
  - b. The preparer must make **reasonable inquiries** if the information appears inaccurate or incomplete.
  - c. The preparer should make appropriate inquiries of the taxpayer about the existence of documentation for deductions.

### **Conflict of Interest**

4. According to Sec. 10.29 of Circular 230, a conflict of interest exists if
  - a. The representation of one client will adversely impact another client or
  - b. There is a significant risk that the representation of one or more clients will be materially limited by the practitioner’s responsibilities
    - 1) To another client,
    - 2) To a former client or a third person, or
    - 3) By a personal interest of the practitioner.
5. A practitioner may represent conflicting interests before the IRS only if
  - a. All directly affected parties provide informed, written consent at the time the existence of the conflict is known by the agent
    - 1) Written consent must be within 30 days of informed consent.
  - b. The representation is not prohibited by law
  - c. The practitioner reasonably believes that (s)he can provide competent and diligent representation to each client
6. Copies of the written consents must be retained by the practitioner for at least 36 months from the date of the conclusion of the representation of the affected clients, and the written consents must be provided to any officer or employee of the IRS on request.

7. The following are additional rules for conflict of interest:
- a. A former government employee who participated in a transaction may not represent or knowingly assist any party who is or was a specific party to that transaction.
  - b. A former IRS employee who participated in a matter administered by the IRS may not represent or assist anyone in the matter.
  - c. No agent may knowingly accept direct or indirect assistance from a former government employee such that 5.a. or 5.b. on the previous page would be violated.
  - d. Members of a former IRS employee's current firm, however, may represent or assist a specific party to such a matter if the former IRS employee is screened (isolated) such that (s)he does not assist in the representation.
  - e. A practitioner may not administer oaths or certify papers as a notary public in connection with matters in which (s)he is employed as agent for the taxpayer or in which (s)he may be in any way interested before the IRS.

### **Diligence**

8. Diligence must be exercised in preparing and in assisting in preparing, approving, and filing returns, documents, and other papers relating to IRS matters.
- a. Due diligence must also be exercised in determining the correctness of oral or written representations made by the practitioner to the Department of the Treasury and to clients.
  - b. Diligence is presumed if the practitioner
    - 1) Relies upon the work product of another person and
    - 2) Uses reasonable care in engaging, supervising, training, and evaluating the person.
  - c. If the practitioner engages a specialist, the focus is on engaging the specialist; when delegating to an employee, the focus is on training, supervising, and evaluating the employee.
  - d. A practitioner may not unreasonably delay the prompt disposition of any matter before the IRS.

### **Information**

9. Information or records properly and lawfully requested by a duly authorized officer or employee of the IRS must be promptly submitted.
- a. If reasonable basis exists for a good-faith belief that the information is privileged or that the request is not proper and lawful, the practitioner is excused from submitting the requested information.
  - b. A practitioner also is required to provide information about the identity of persons that (s)he reasonably believes may have possession or control of the requested information if the practitioner does not.
    - 1) This only requires that the practitioner make a reasonable inquiry of his or her client to determine this information and does not require independent verification of the client's statement.

**Assistance from a Suspended or Disbarred Practitioner**

10. A practitioner may not knowingly accept assistance (in practice before the IRS) from or give assistance to a person suspended or disbarred from practice before the IRS.

**Negotiating Client Refunds**

11. A practitioner must not negotiate, including by endorsement, any income tax refund check issued to a client.

**Client Noncompliance**

12. A practitioner who knows that a client has not complied with the revenue laws of the U.S. is required to promptly advise the client of noncompliance as well as the consequences of noncompliance under the Code and regulations.
- a. Circular 230 does not require the practitioner to notify the IRS or to advise the client to correct the error.

**Fees**

13. A practitioner may not charge an unconscionable fee in connection with any practice before the IRS.
- a. Published fees. If an agent publishes a fee schedule, (s)he must abide by it for the longer of a reasonable time or 30 days.
  - b. A practitioner may not charge a **contingent fee** in relation to any matter before the IRS except
    - 1) Examination of returns,
    - 2) Claim for credit or refund (interest and penalties), and
    - 3) Judicial proceedings.

**Return of Client Records**

14. A practitioner must return a client's records on request, regardless of any fee dispute.
- a. Records deemed returnable for purposes of this requirement are those records necessary for a client to comply with his or her federal tax obligations.
  - b. However, returns or other documents prepared by the practitioner that the practitioner is withholding pending payment of a fee are not included.



**Advertising**

## 15. Circular 230 allows advertising and solicitation.

- a. An enrolled agent may use the phrases
  - 1) “enrolled to practice before the Internal Revenue Service,”
  - 2) “enrolled to represent taxpayers before the Internal Revenue Service,”
  - 3) “admitted to practice before the Internal Revenue Service.”
    - a) A temporarily recognized person may not use the phrase.
    - b) An applicant is granted temporary recognition pending approval of application.
- b. Enrolled agents may not indicate an employer-employee relationship with the IRS or use the term “certified” while describing their professional designation.
- c. False, fraudulent, misleading, deceptive, or coercive statements or claims are not allowed. Claims must be subject to factual verification.
  - 1) A practitioner may advertise that practice is limited to certain areas, if true.
- d. Radio or television advertising must be recorded.
  - 1) A recording of the audio transmission must be retained.
- e. Copies of communications must be retained by the practitioner for at least 36 months from the date of the last transmission or use.
- f. Uninvited solicitation, direct or indirect, of employment in matters related to the IRS is not allowed if the solicitation violates federal or state law or other applicable rule.
  - 1) Mail solicitation designed for the general public is permissible.
  - 2) Mail solicitation for non-tax return services based on specific tax return circumstances unique to the recipient is not permissible.
  - 3) Making the availability of professional services known to other practitioners is allowed as long as the person or firm contacted is not a potential client.
- g. Fees. Each of the following may be advertised:
  - 1) Fixed fees for specific routine services
  - 2) A range of fees for particular services
  - 3) The fee for an initial consultation
  - 4) Hourly rates
  - 5) Availability of a written fee schedule
    - a) Refer to item 13.a. on the previous page.
- h. A practitioner may not assist or accept assistance from any person or entity that the practitioner knows has obtained clients in violation of Circular 230’s advertising and solicitation rules.

### 1.3 BEST PRACTICES FOR TAX ADVISORS

1. Tax advisors should provide clients with the highest quality representation concerning tax issues by adhering to best practices in providing advice and in preparing or assisting in the preparation of a submission to the IRS.
2. Best practices include four general elements:
  - a. Performing the steps needed to support the facts for a tax filing:
    - 1) Establish the facts, determine which facts are relevant, evaluate the reasonableness of any assumptions or representations, relate applicable law to the relevant facts, and arrive at a conclusion supported by the law and the facts.
  - b. Communicating clearly with the client about the terms of the engagement
  - c. Advising the client regarding the importance of the conclusions reached, including, for example, whether a taxpayer may avoid accuracy-related penalties under the Internal Revenue Code (IRC) if a taxpayer acts in reliance on the advice
  - d. Acting fairly and with integrity in practice before the IRS
3. Tax advisors must communicate the nature of any known errors or omissions, including any potential consequences under the Code or regulations.
4. Tax advisors with responsibility for overseeing a firm's practice of providing advice concerning federal tax issues or of preparing or assisting in the preparation of submissions to the IRS should take reasonable steps to ensure that the firm's procedures for all members, associates, and employees are consistent with the best practices.
5. If a representative is acting on behalf of an employer or any firm or other entity in connection with conduct subject to sanction, the Secretary of the Treasury may impose a monetary penalty on such employer, firm, or entity if it knew, or reasonably should have known, of such conduct. Such penalty shall not exceed the gross income derived (or to be derived) from the conduct giving rise to the penalty and may be in addition to, or in lieu of, any suspension, disbarment, or censure of the representative.

## 1.4 SUPERVISOR RESPONSIBILITY

### **Procedures to Ensure Compliance with Circular 230**

1. Any practitioner who has or shares principal authority and responsibility for overseeing a firm's practice of preparing tax returns, claims for refunds, or other documents for submission to the IRS must take reasonable steps to ensure that the firm has adequate procedures in effect for all members, associates, and employees for purposes of complying with Circular 230.
2. Any practitioner who has or shares this principal authority will be subject to discipline for failing to comply in certain circumstances.
  - a. The practitioner does not take reasonable steps to ensure that the firm has adequate procedures to comply with Circular 230, and one or more members, employees, or associates of the firm engage in a pattern or practice of noncompliance.
  - b. The practitioner knows or should know of a pattern or practice of noncompliance, and the practitioner fails to take prompt corrective action.
  - c. The practitioner is liable for such inaction if it is willful, reckless, or grossly incompetent.

### **Requirements for Written Tax Advice**

3. A practitioner may give written advice (including by means of electronic communication) concerning one or more federal tax matters subject to the requirements below:
  - a. When providing written advice about any federal tax matter, a practitioner must
    - 1) Base the advice on reasonable assumptions,
    - 2) Reasonably consider all relevant facts that are known or should be known, and
    - 3) Use reasonable efforts to identify and determine the relevant facts.
  - b. The advice cannot rely upon representations, statements, findings, or agreements that are unreasonable, i.e., are known to be incorrect, inconsistent, or incomplete.
  - c. The advice must not consider the possibility that a tax return will not be audited or a matter will not be raised during the audit in evaluating a federal tax matter.
  - d. When providing written advice, a practitioner may rely in good faith on the advice of another practitioner only if that advice is reasonable given all the facts and circumstances.
  - e. The practitioner cannot rely on the advice of a person who the practitioner knows or should know is not competent to provide the advice or has an unresolved conflict of interest.

## 1.5 SANCTIONS AND DISCIPLINARY PROCEEDINGS

Any practitioner, e.g., an attorney, a CPA, or an EA, may be censured (given public reprimand), suspended, or disbarred from practice before the IRS for willful violations of any of the regulations contained in Circular 230.

### **Censure, Suspend, Disbar**

1. The Secretary of the Treasury may censure, suspend, or disbar from practice before the IRS any practitioner, e.g., attorney, CPA, or enrolled agent, who
  - a. Is shown to be incompetent or disreputable
  - b. Refuses to comply with the rules and regulations relating to practice before the IRS
  - c. Willfully and knowingly, with intent to defraud, deceives, misleads, or threatens any client
2. The following is a brief list of incompetence and disreputable conduct for which a practitioner may be sanctioned under Circular 230 Sec. 10.50 that includes, but is not limited to
  - a. Conviction of any criminal offense under the federal tax laws.
  - b. Conviction of any criminal offense involving dishonesty or breach of trust.
  - c. Conviction of any felony under federal or state law for which the conduct involved renders the practitioner unfit to practice before the IRS.
  - d. Giving false or misleading information, or participating in any way in the giving of false or misleading information to the Department of the Treasury or any office or employee thereof, or to any tribunal authorized to pass upon federal tax matters, in connection with any matter pending or likely to be pending before them, knowing the information to be false or misleading.
  - e. Solicitation of employment as prohibited under Sec. 10.30, the use of false or misleading representations with intent to deceive a client or prospective client in order to procure employment, or intimating that the practitioner is able improperly to obtain special consideration or action from the IRS or any officer or employee thereof.
  - f. Willfully failing to make a federal tax return in violation of the federal tax law or willfully evading, attempting to evade, or participating in any way in evading or attempting to evade any assessment or payment of any federal tax.
  - g. Willfully assisting, counseling, encouraging a client or prospective client in violating, or suggesting to a client or prospective client to violate, any federal tax law, or knowingly counseling or suggesting to a client or prospective client an illegal plan to evade federal taxes or payment thereof.
  - h. Misappropriation of, or failure properly or promptly to remit, funds received from a client for the purpose of payment of taxes or other obligations due the United States.
  - i. Directly or indirectly attempting to influence, or offering or agreeing to attempt to influence, the official action of any officer or employee of the IRS by the use of threats, false accusations, duress, or coercion, by the offer of any special inducement or promise of an advantage or by the bestowing of any gift, favor, or thing of value.
  - j. Disbarment or suspension from practice as an attorney, certified public accountant, public accountant, or actuary by any duly constituted authority of any state, territory, or possession of the United States, including a commonwealth, or the District of Columbia, any federal court of record or any federal agency, body, or board.
  - k. Knowingly aiding and abetting another person to practice before the IRS during a period of suspension, disbarment, or ineligibility of such other person.

- l. Contemptuous conduct in connection with practice before the IRS, including the use of abusive language, making false accusations or statements, knowing them to be false, or circulating or publishing malicious or libelous matter.
  - m. Giving a false opinion, knowingly, recklessly, or through gross incompetence, including an opinion which is intentionally or recklessly misleading, or engaging in a pattern of providing incompetent opinions on questions arising under the federal tax laws.
  - n. Willfully failing to sign a tax return prepared by the practitioner when the practitioner's signature is required by federal tax laws unless the failure is due to reasonable cause and not due to willful neglect.
  - o. Willfully disclosing or otherwise using a tax return or tax return information in a manner not authorized by the Internal Revenue Code, contrary to the order of a court of competent jurisdiction, or contrary to the order of an administrative law judge in a proceeding instituted under Sec. 10.60.
  - p. Willfully failing to file, on magnetic or other electronic media, a tax return prepared by the practitioner when the practitioner is required to do so by the federal tax laws unless the failure is due to reasonable cause and not due to willful neglect.
  - q. Willfully preparing all or substantially all of, or signing, a tax return or claim for refund when the practitioner does not possess a current or otherwise valid PTIN or other prescribed identifying number.
  - r. Willfully representing a taxpayer before an officer or employee of the IRS unless the practitioner is authorized to do so pursuant to this part.
3. **Circular 230** lists conduct that may result in suspension or disbarment. A brief list of examples follows:
- a. Being convicted of an offense involving dishonesty or breach of trust
  - b. Providing false or misleading information to the Treasury Department, including the IRS
  - c. Negotiating a client's refund check or not promptly remitting a refund check
  - d. Circulating or publishing matter, related to practice before the IRS, deemed libelous or malicious; using abusive language
  - e. Forming or maintaining a partnership to practice tax law or accounting with a person suspended or disbarred from practice before the IRS
  - f. Violating a Circular 230 rule
  - g. Filing a complaint against IRS personnel if the practitioner knows the complaint to be false
  - h. Advancing an argument or claim that the practitioner knows is frivolous
  - i. Conviction of any felony involving conduct that renders the practitioner unfit to practice before the IRS
  - j. Attempting to influence the official action of any IRS employee by bestowing a gift, favor, or thing of value
  - k. Failing to electronically file when required to do so
  - l. Preparing all or substantially all of, or signing, a tax return without a PTIN
  - m. Unauthorized representation of a taxpayer before the IRS
  - n. Failing to remit funds from a client to the IRS for payment of tax or other obligations
  - o. Failing to make a federal tax return in violation of the federal tax laws
  - p. Intimating ability to obtain special consideration from the IRS
  - q. Instituting or maintaining proceedings primarily for delay

4. The commissioner may confer with a practitioner on allegations of misconduct whether or not a proceeding for suspension or disbarment has been instituted.

### **A Complaint Begins a Proceeding**

5. A proceeding is begun by filing a complaint that names the respondent and is signed by an authorized representative of the IRS.
  - a. The complaint should contain a clear and concise statement of the allegations that constitute the basis of the proceeding.
    - 1) It is sufficient if it fairly informs the respondent of the charges, such that (s)he can prepare a defense.
    - 2) It should also contain any recommended sanctions and a demand for an answer.

### **Service of Complaint**

- b. The complaint must be served on the practitioner by means of one of the following:
  - 1) Delivery in person
  - 2) Private delivery service
  - 3) Certified mail
  - 4) First-class mail, if the certified letter is not accepted by the practitioner

### **Compliance Opportunity**

6. A proceeding is not instituted until the complaint is received and until the practitioner is provided the opportunity to show or achieve compliance with all lawful requirements.

### **Consent to Suspension**

7. A practitioner may offer to consent to suspension to avoid institution of a suspension or disbarment proceeding. However, the IRS is not bound to accept the offer.

### **Complaint Response**

8. The practitioner must file an answer to the complaint in writing within the time specified.
  - a. The practitioner must have at least 30 days from the date of service to file the answer.
  - b. An extension may be granted if application is made to the Administrative Law Judge (ALJ).
  - c. If an answer to the complaint is not filed, the ALJ may
    - 1) Treat the respondent as if (s)he
      - a) Admitted each allegation and
      - b) Waived a hearing
    - 2) Not require proof by evidence at a hearing
    - 3) Decide against the respondent practitioner by default
  - d. The answer to the complaint must
    - 1) Contain a statement of facts that constitute the grounds for defense
    - 2) Admit or deny each allegation set forth in the complaint or state (s)he lacks sufficient information to form a belief
  - e. The practitioner may not
    - 1) Deny a material allegation that (s)he knows to be true
    - 2) State that (s)he lacks sufficient information to form a belief when (s)he has such information

- f. Special matters of defense must be affirmatively stated.
- g. Each allegation not denied is treated as
  - 1) Admitted and
  - 2) Proved.

### **Information Request**

- 9. The IRS may request, for suspension or disbarment, any person to provide information concerning violation of the rules and to testify at a proceeding.
  - a. A practitioner is required to honor the request unless, with a reasonable basis, (s)he believes in good faith and on reasonable grounds that the information is privileged.

### **Hearing**

- 10. An ALJ presides at hearings on complaints for sanctions. If either party, after due notice of a hearing has been sent, fails to appear, (s)he is treated as having waived the right to a hearing and the ALJ may enter a decision against him or her by default.
  - a. The hearing should occur within 180 days after the time for filing the answer.
  - b. Unless otherwise ordered by the ALJ, each party shall file and serve on the opposing party a prehearing memorandum identifying, in general,
    - 1) Exhibits,
    - 2) Witnesses,
    - 3) Depositions,
    - 4) Expert witnesses, and
    - 5) Undisputed facts.
  - c. A respondent may appear in person, be represented by a practitioner, or be represented by an attorney who has not filed a declaration to practice before the IRS.
    - 1) The representative need not be an enrolled agent.
  - d. Hearings must be stenographically recorded and transcribed.
  - e. Testimony of witnesses must be taken under oath or affirmation.
  - f. An ALJ does not necessarily follow rules of evidence applied in courts of law and equity.
    - 1) Evidence may be admitted in the form of depositions, exhibits, and proof of documents.
    - 2) The ALJ may exclude evidence that is irrelevant, immaterial, or repetitious.
  - g. If the sanction sought is censure or a suspension of less than 6 months, the standard of proof for Circular 230 proceedings is preponderance of the evidence. If the sanction sought is (1) a monetary penalty, (2) a suspension of 6 months or more, or (3) disbarment, the standard of proof is clear and convincing evidence.
  - h. The ALJ must allow the parties reasonable opportunity to submit proposed findings and conclusions and reasons supporting them.

**Appeal**

11. Either party may appeal the ALJ's decision to the Secretary of the Treasury within 30 days of its date.

**Notice of Censure, Suspension, or Disbarment**

12. The list of those receiving the issuance of a notice of censure, suspension, or disbarment from practice before the IRS includes
- a. IRS employees,
  - b. Interested departments,
  - c. Agencies of the federal government, and
  - d. Appropriate state authorities.

**Censure**

13. Censure is a public reprimand to practitioners who violate the rules of practice. Censured practitioners may be subject to conditions imposed for a reasonable period in light of the gravity of the violation.

**Suspension**

14. A suspended practitioner is not allowed to practice before the IRS while the suspension is in effect.

**Reinstatement**

15. Five years after a practitioner's disbarment, the IRS may consider a petition for reinstatement.
- a. The IRS must be satisfied that the petitioner's conduct will comply with rules and regulations governing practice before the IRS.

**Records Disclosure**

16. The IRS will make available for public inspection the roster of
- a. Persons enrolled to practice;
  - b. Persons censured, suspended, or disbarred from practice before the IRS; and
  - c. Persons on the roster of all disqualified appraisers.
17. Other records of the Director of the Office of Professional Responsibility may be disclosed upon specific request, in accordance with the applicable disclosure rules of the IRS and the Treasury Department (Circular 230).



## 1.6 RENEWAL

To maintain active enrollment to practice before the IRS, enrolled agents must renew enrollment every third year after initial enrollment is granted. An enrolled agent's renewal schedule is determined by the last digit of the individual's Social Security or tax identification number as provided in Section 10.6(d) of Circular 230. The renewal schedules are staggered, with approximately one-third of enrolled agents renewing every year. To apply for renewal, individuals file Form 8554, *Application for Renewal of Enrollment to Practice Before the Internal Revenue Service*.

1. Application for renewal is based on the last digit of the enrolled agent's Social Security number or tax identification number.
  - a. Enrolled agents whose Social Security number or tax identification number ends in 0, 1, 2, or 3, except those who receive their initial enrollment after November 1, 2024, must apply for renewal between November 1, 2024, and January 31, 2025. The renewal is effective April 1, 2025.
  - b. Enrolled agents whose Social Security number or tax identification number ends in 4, 5, or 6, except those who receive their initial enrollment after November 1, 2022, must apply for renewal between November 1, 2022, and January 31, 2023. The renewal is effective April 1, 2023.
  - c. Enrolled agents whose Social Security number or tax identification number ends in 7, 8, or 9, except those who receive their initial enrollment after November 1, 2023, must apply for renewal between November 1, 2023, and January 31, 2024. The renewal is effective April 1, 2024.
  - d. Enrolled agents must renew between November 1 and January 31 of every third year. Enrolled agents who received their initial enrollment after November 1 and before April 2 of their renewal period do not have to renew until the next full renewal period after they received their initial enrollment.
2. Application for renewal is required to maintain active renewal status.
  - a. Failure to receive notice of the renewal requirement from the IRS does not justify circumventing the requirement.
  - b. A noncomplying enrolled agent will be given an opportunity to state the basis for the noncompliance with the possible consequence of being placed on the roster of inactive enrolled agents for a 3-year enrollment period.

**Continuing Education**

3. Renewal is conditioned on completing a minimum of 72 hours of continuing education (CE) credits during the 3-year enrollment cycle, including at least 16 hours in each of the 3 enrollment years (each enrollment year runs from January 1 to December 31).
  - a. All programs are measured in contact hours. A contact hour is 50 minutes of continuous participation.
  - b. Two hours per month of CE credit is required of an individual whose initial enrollment begins during a cycle.
  - c. An individual who receives initial enrollment during an enrollment cycle must complete 2 hours of ethics or professional conduct for each enrollment year during the enrollment cycle. Enrollment for any part of an enrollment year is considered enrollment for the entire year.
  - d. Qualified CE program. A course of learning may qualify for CE credit if it is a program designed to enhance professional knowledge in federal tax law, federal tax-related matters, qualified retirement plan matters, or federal tax-related ethics.
  - e. Teaching. For each contact hour of a qualifying program, the following CE credit is awarded:
    - 1) Two hours for actual subject preparation time, substantiated
    - 2) One hour as instructor, discussion leader, or speaker

NOTE: The maximum credit for instruction and preparation may not exceed 6 hours annually.

NOTE: The maximum credit for publication preparation may not exceed 25% of the CE requirement of an enrollment cycle.
  - f. Each individual applying for renewal must retain for a period of 4 years following the date of renewal of enrollment the documentation required with regard to qualifying CE credit hours.

## 1.7 IDENTITY THEFT

1. Identity theft occurs when someone uses another person's personal information such as name, Social Security number (SSN), or other identifying information, without permission, to commit fraud or other crimes.
2. Usually, an identity thief uses a legitimate taxpayer's identity to fraudulently file a tax return and claim a refund. Generally, the identity thief will use a stolen SSN to file a forged tax return and attempt to get a fraudulent refund early in the filing season.
3. A taxpayer may be unaware that this has happened until (s)he files his or her return later in the filing season and discovers that two returns have been filed using the same SSN. A taxpayer should be alert to possible identity theft if (s)he receives an IRS notice or letter that states:
  - a. More than one tax return for the taxpayer was filed,
  - b. The taxpayer has a balance due, has a refund offset, or has had collection actions taken against him or her for a year (s)he did not file a tax return, or
  - c. IRS records indicate that the taxpayer received wages from an employer unknown to the taxpayer.
4. Taxpayers subject to identity theft will need to fill out Form 14039, *Identity Theft Affidavit*. Taxpayers should be aware that the IRS does not initiate contact with taxpayers by email to request personal or financial information. This includes any type of electronic communication, such as text messages and social media channels.

# STUDY UNIT TWO

## TAX PREPARERS AND PENALTIES

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A tax return preparer does **not** have to be a practitioner (i.e., an enrolled agent, a CPA, an attorney, or any other person authorized to practice before the IRS) in order to prepare tax returns. Additionally, a tax return preparer is subject to Circular 230 **only if** (s)he is also a practitioner.

However, **all** tax return preparers are subject to preparer penalties. Preparer penalties include penalties for understatement of a taxpayer's liability due to unreasonable positions or willful or reckless conduct, for disclosing taxpayer information, and for promoting abusive tax shelters.

### 2.1 TAX PREPARERS

#### Defining Tax Return Preparer

1. A tax return preparer is any person who prepares for compensation, or employs one or more persons to prepare for compensation, all or a substantial portion of any return of tax or claim for refund under the IRC (Title 26).
  - a. Preparation of certain information returns is also within the scope of the tax return preparer rules.
  - b. Unless stated otherwise, tax return preparers include the following persons:
    - 1) A person who furnishes to a taxpayer or other preparer sufficient information and advice so that completion of the return is simply a mechanical matter is considered a tax return preparer.
    - 2) **Substantial portion.** A tax return preparer is a person who prepares for compensation, or employs another who prepares for compensation, a substantial portion of an applicable return.
      - a) Preparation outside the U.S. is included.
      - b) Length and complexity of the portion (or a schedule) are compared to the return as a whole.
    - 3) **Insubstantial Portion**
      - a) A portion or a schedule of a return is not considered substantial if it involves gross income, deductions, or amounts on the basis of which credits are determined of less than either
        - i) \$10,000 or
        - ii) \$400,000 and less than 20% of the AGI (or GI if not an individual) shown in the return.
      - b) A person who gives advice only on specific issues is generally not considered to be a tax return preparer.

- c) A tax return preparer of one return is not considered a preparer of another return because an entry or entries reported on the first may affect an entry reported on the second, unless the entries
  - i) Are directly reflected on the other return, e.g., a partnership and partner return, and
  - ii) Represent a substantial portion of the second return. A substantial portion of the return includes gross income over \$400,000 or greater than 20% of the gross income of the return.
- 4) **Primary responsibility.** If more than one tax return preparer is involved in preparing a return or claim for refund, the one with primary responsibility for the overall substantive accuracy is considered the (only) preparer for purposes of the signing requirement.
  - a) The tax preparer with primary responsibility cannot be relieved of that responsibility by sharing any of the following functional tasks:
    - i) Acquiring needed information
    - ii) Applying tax law
    - iii) Completing the return
    - iv) Reviewing the information, the application of tax law, and the return
    - v) Applying taxpayer policy
    - vi) Advising a position regarding the law
    - vii) Obtaining final determination or approval
- 5) **Compensation.** If no compensation is provided for a person (or for his or her employee) to prepare a return or claim for refund, the person is not a tax return preparer.
  - a) Absent an explicit or implicit agreement for compensation, a person is not a tax return preparer, even if (s)he receives a gift, return service, or favor.
- 6) **The following are not tax return preparers:**
  - a) An employee who prepares a return for the employer by whom (s)he is regularly and continuously employed
  - b) A fiduciary who prepares a return or refund claim for any person (the trust)
  - c) A person who prepares a refund claim in response to a notice of deficiency issued to another
  - d) A person who furnishes typing, reproducing, or other mechanical assistance
  - e) A person who merely gives an opinion about events that have not happened, i.e., planning
- 7) **A person can be a tax return preparer without regard to educational qualifications or professional status.**

**Mechanics of Preparing a Return**

2. Significant aspects of tax return preparation are making factual inquiries and taking a position relative to tax law.

**Inquiry of Client Financials**

- a. A tax return preparer may rely, if in good faith, upon information furnished by the taxpayer without having to obtain third-party verification.
  - 1) The preparer may not ignore the implications of the information furnished.
  - 2) The preparer must make reasonable inquiries if the information appears inaccurate or incomplete.
  - 3) **Deductions.** The preparer should make appropriate inquiries of the taxpayer to determine the existence of facts and circumstances required by an IRC section or regulations incidental to a deduction, including, e.g., substantiating documentary evidence, even if for a minimal amount.

**Preparer's Position on Law**

- b. A tax return preparer may not adopt a position without **substantial authority** for the position.
  - 1) There is substantial authority for the tax treatment of an item only if the weight of the authorities supporting the treatment is substantial in relation to the weight of authorities supporting contrary treatment.
    - a) What constitutes substantial authority is defined by statute and IRS statements.
      - i) A revenue ruling, for example, constitutes legal authority that, together with other authority, may be found substantial.
    - b) All authorities relevant to the tax treatment of an item, including the authorities contrary to the treatment, are taken into account in determining whether substantial authority exists.
    - c) The weight of authorities is determined in light of the pertinent facts and circumstances.
    - d) A tax return preparer may not rely on unreasonable assumptions.
    - e) There may be substantial authority for more than one position with respect to the same item.
    - f) A taxpayer's belief that there is a substantial authority for the tax treatment of an item is a subjective determination. It is important to note that the IRS definition of the substantial authority standard is an objective standard and this objective standard is the one the IRS holds tax return preparers to.
  - 2) A penalty will not apply if the position was disclosed and there is a reasonable basis for the position.

**Substantial and Reasonable Belief**

- 3) For tax shelters, tax preparers are required to have both substantial authority and a reasonable belief for their position and this belief must be “more likely than not” the proper treatment.
- 4) The penalty for unreasonable undisclosed positions is an amount equal to the greater of \$1,000 or 50% of the income derived from the position.

**Errors and Omissions**

- c. Circular 230 addresses the possibility of an omission from a taxpayer’s tax return in Sec. 10.21.
  - 1) It states that, when a practitioner discovers that a client has made an error or omission from any document filed with the IRS, (s)he must notify the client of the error or omission immediately.
  - 2) In addition, the practitioner must advise the client on the consequences of such an omission as provided by the IRC and regulations.

**3. Procedural Requirements****Signature**

- a. A tax return preparer is required to sign the return or claim for refund after it has been completed and before it is presented to the taxpayer.
  - 1) If the preparer is unavailable for signature, another preparer must review the entire preparation of the return (or claim) and then must sign it.
  - 2) If more than one preparer is involved, the preparer with primary responsibility for the overall accuracy of the return or claim is considered the preparer for purposes of the signing requirement.
  - 3) A valid signature is defined by state law and may be anything that clearly indicates the intent to sign.
  - 4) Requirements exist for the use of alternative methods when signing as a tax return preparer and not on behalf of the taxpayer.
    - a) Original returns, amended returns, or requests for filing extensions that include a separate signature line for a paid tax preparer may be signed via computer software programs, mechanical devices, or rubber stamps.
  - 5) Preparers physically unable to manually sign returns must indicate “unable to sign” as the signature.
  - 6) In a situation in which one or more persons are employed as tax return preparers, only the employer is considered to be a tax return preparer.

**Identifying Number**

- b. A return or refund claim prepared by a tax return preparer and filed with the IRS must include the preparer's identifying number.
  - 1) The identifying number of an individual is his or her preparer tax identification number (PTIN).
  - 2) The identifying number of the partnership or employer [employer identification number (EIN)], if applicable, also must be included.
  - 3) The address of the preparer's place of business where the return was prepared also must be included.
  - 4) The preparer is not required to sign or affix an identification number to the taxpayer's copy of a tax return.

**Copy to Taxpayer**

- c. A tax return preparer is required to furnish a completed copy of the return or refund claim to the taxpayer no later than the time it is presented for the taxpayer's signature.

**Employer of Preparers**

- d. A person who employs one or more tax return preparers is required to file a return setting forth the name, identifying number, and principal place of work of each employed tax return preparer.
  - 1) The IRS may approve an alternative reporting method.
  - 2) The requirements are satisfied if the tax return preparer
    - a) Retains a record of the information and
    - b) Makes it available for inspection upon request by the commissioner for the 3-year period following the relevant return period.
  - 3) A partnership is treated as the employer of the partners and shall retain and make available a record with respect to the employees (e.g., partners, others).
  - 4) A sole proprietor shall retain and make available a record with respect to himself or herself.

**Records**

- e. A tax return preparer is required to retain a completed copy of each return or claim prepared for 3 years after the close of the return period.
  - 1) Records relating to employment taxes and federal withholding taxes must be maintained for at least 4 years after the later of (a) the due date of the tax or (b) the date such tax was paid.
  - 2) Alternatively, a list may be kept that includes, for the returns and claims prepared, the following information:
    - a) The taxpayers' names
    - b) Taxpayer identification numbers
    - c) Their tax years
    - d) Types of returns or claims prepared
  - 3) The return period means the 12-month period beginning July 1 each year.



### **Accuracy**

4. While software is largely effective, users are advised to trust the software but verify all data inputs and outputs. For example, a complication stemming from the way brokerages keep stock transaction records means that software might import incomplete data, leading to possibly costly calculation errors. It is a taxpayer's responsibility to verify all tax information.
  - a. Some items to consider when checking for accuracy include inconsistencies with the source data, miscalculations, the recognition of duplicate entries, a need to read diagnostics, the matching of inputs and outputs across forms, etc.
  - b. The IRS provides two forms for correcting erroneous information provided in an information return.
    - 1) The IRS will send the taxpayer a Form 4852, *Substitute for Form W-2, Wage and Tax Statement, or Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*
      - a) Form 4852 may also be used to report income when a W-2, 1099, or other reporting document is not received.
      - b) Form 4852 is designed to be used by a taxpayer to report disputed amounts reported in a W-2 or 1099.
    - 2) Form 8082, *Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR)*, is used to report situations where an S corporation shareholder's return was going to be inconsistent with the corporate return, or a partner's return inconsistent with the partnership return.
      - a) When a difference between K-1 information and a Form 1040 has not been reported, the IRS can issue a correction notice without going through normal deficiency procedures, as though the taxpayer had made a math error on the return.
      - b) There is no administrative procedure to appeal the correction of an error in a return, so failure to properly report inconsistent treatment can lead to serious administrative difficulty that only the courts can fix.

### **Free File Software**

5. Everyone can use Free File, the free way to prepare and e-file federal taxes either through brand-name software or online fillable forms.
  - a. Individuals or families with 2022 adjusted gross incomes of \$73,000 or less can use Free File software. Free File Fillable Forms, the electronic version of IRS paper forms, has no income restrictions.
  - b. Free File software is a product of a public-private partnership between the IRS and the Free File Alliance, LLC. The Alliance is a consortium of approximately 20 tax software providers who make versions of their products available exclusively at [www.irs.gov/freefile](http://www.irs.gov/freefile).
    - 1) All Free File members must meet certain security requirements and use the latest in encryption technology to protect taxpayers' information.

**Data Security**

6. In an effort to thwart criminals from fraudulently preparing taxpayers' returns, the IRS is requiring all practitioners to be aware of data security and have a data security plan for all taxpayer information.
  - a. Cybercriminals are targeting client data, so it is important to
    - 1) Ensure the computer network has a firewall
    - 2) Set all electronic devices to update automatically
    - 3) Install anti-malware and antivirus security on all electronic devices
    - 4) Encrypt all files and emails
    - 5) Back up sensitive data to secure external sources not connected to the main network
    - 6) Limit access to taxpayer information to only the employees who need it to complete their work
  - b. Practitioners should not ignore evidence of a cybercrime, such as the following:
    - 1) Clients receive letters, refunds, or notices from the IRS when they are not expecting correspondence
    - 2) Clients responding to emails that the practitioner never sent
    - 3) Computers or networks locking out practitioners
    - 4) Computers or networks acting slower than usual
    - 5) The number of returns filed with the tax practitioner's Electronic Filing Identification Number (EFIN) exceeds the number of clients
  - c. Report any data theft or data loss to your local IRS Stakeholder Liaison.

## 2.2 DISCLOSURE OF TAXPAYER INFORMATION

1. A **penalty** is imposed on any tax return preparer who discloses or uses any tax return information without the consent of the taxpayer other than for the specific purpose of preparing, assisting in preparing, or providing services in connection with the preparation of any tax return of the taxpayer.
  - a. The penalty is \$250 per disclosure, with a maximum of \$10,000 per year.
  - b. If convicted of knowingly or recklessly disclosing the information, a preparer would be guilty of a misdemeanor and subject to up to \$1,000 in fines and up to a year in prison.
  - c. The criminal penalty is enhanced for disclosures connected to identity theft.
2. **Exceptions.** The penalty for disclosure is not imposed if the disclosure was made
  - a. Pursuant to other provisions of the Code
  - b. To a related taxpayer, provided the taxpayer had not expressly prohibited the disclosure
  - c. Pursuant to a court order
  - d. Pursuant to a subpoena issued by a federal or state grand jury or by the United States Congress
  - e. By one officer, employee, or partner to another officer, employee, shareholder, or partner
  - f. To provide information for educational purposes
  - g. To solicit tax return preparation services
  - h. For the purpose of a conflict, quality, or peer review
3. The **taxpayer's consent** must be a written, formal consent authorizing the disclosure for a specific purpose. The taxpayer must authorize a preparer to
  - a. Use the taxpayer's information to solicit additional current business in matters not related to the IRS from the taxpayer
  - b. Disclose the information to additional third parties
  - c. Disclose the information in connection with another person's return
4. The **confidentiality privilege** is extended to certain nonattorneys.
  - a. In noncriminal tax proceedings before the IRS, a taxpayer is entitled to the same common-law protections of confidentiality, with respect to the tax advice given by any "federally authorized tax practitioner," as a taxpayer would have if the advising individual were an attorney.
  - b. The privilege also applies in any noncriminal tax proceeding in federal court brought by or against the United States.
  - c. The privilege may not be asserted to prevent the disclosure of information to any regulatory body other than the IRS.

- d. A “federally authorized tax practitioner” includes any nonattorney who is authorized to practice before the IRS, such as an enrolled agent, an enrolled actuary, or a CPA.
- e. “Tax advice” is defined as advice given by an individual with respect to matters that are within the scope of the individual’s authority to practice before the IRS.
- f. The privilege does not apply to any written communication between a federally authorized tax practitioner and a director, shareholder, officer, employee, agent, or representative of a corporation in connection with the promotion of any tax shelter in which the corporation is a direct or indirect participant.

## 2.3 TAX SHELTERS

1. A tax shelter is a legal method of minimizing or decreasing an investor’s taxable income and, therefore, tax liability.
  - a. A tax benefit includes deductions, exclusions from gross income, nonrecognition of gain, tax credits, adjustments (or the absence of adjustment) to the basis of property, status as an entity exempt from federal income taxation, and any other tax consequences that may reduce a taxpayer’s federal tax liability by affecting the amount, timing, character, or source of any item of income, gain, expense, loss, or credit.
2. The IRS considers certain tax shelters potentially improper tax shelter activity. Taxpayers are required to disclose reportable transactions. Disclosures are reported to the IRS on Form 8886. A copy of Form 8886 must be attached to each year’s tax return that includes the transaction, and a copy must be filed with the Office of Tax Shelter Analysis in the first year of the transaction.
  - a. There are five major categories of reportable transactions:
    - 1) **Listed transactions.** These are tax avoidance transactions the IRS has identified by notice, regulation, or other forms of published guidance, or transactions that are expected to obtain the same or substantially similar types of tax consequences.
    - 2) **Confidential transactions.** These are transactions offered under conditions of confidentiality, such as where the disclosure of a transaction is limited in any manner by express or implied understanding or agreement whether or not such understanding or agreement is legally binding.
      - a) Regulations include a minimum fee requirement of \$250,000 for corporations (excluding S corporations) and \$50,000 for most other transactions.
    - 3) Transactions with **contractual protection.** These are transactions when the taxpayer has the right to a full or partial refund of fees paid to any person who makes or provides an oral or written statement about the potential tax consequences of a transaction if it is not sustained, or if fees are contingent on the taxpayer’s realization of tax benefits from the transaction.

- 4) **Loss transactions.** These are transactions when taxpayers claim losses under Sec. 165 exceeding certain thresholds for
  - a) Corporations (excluding S corporations) and partnerships having only corporations (excluding S corporations) as partners, exceeding \$10 million in a single year or \$20 million in any combination of taxable years.
  - b) All other partnerships, individuals, S corporations, or trusts, exceeding \$2 million in any single year or \$4 million in any combination of taxable years.
  - c) Individuals or trusts involved in certain foreign currency transactions, exceeding \$50,000 in any single taxable year.
    - i) Revenue Procedure 2003-24, known as the "Angel List," provides that certain losses are exceptions to the reporting requirements. Exceptions include, but are not limited to, loss from an asset sold or exchanged with a qualifying basis; fire, storm, or shipwreck; mark-to-market treatment; hedging transactions; basis treatment; abandonment of property; and the bulk sale of inventory.
- 5) **Transactions of interest.** These are transactions identified by the IRS via notice, regulation, or other published guidance as having the potential for tax avoidance or evasion, but which lack sufficient information to determine if they should be identified as tax avoidance transactions.
  - b. Generally, a penalty will be imposed if a person required to register a tax shelter fails to register the shelter timely.
    - 1) No penalty will be imposed on a person for failure to register a tax shelter if the failure is due to reasonable cause.
  - c. The fact that a transaction must be reported on Form 8886 does not mean the tax benefits from the transaction will be disallowed.
3. Tax return preparers are subject to a penalty for promoting abusive tax shelters equal to the lesser of
  - a. \$1,000 for each sale or organization of an abusive arrangement or plan, or
  - b. 100% of the income derived from the activity.

## 2.4 PENALTIES

Tax return preparers are subject to penalties for violations [Sec. 6696(a)]. The degree of severity varies among the penalties. Also subject to penalties are individuals with overall supervisory responsibility for advice given by a firm.

### 1. Compliance

- a. A penalty of up to \$28,000 per year may be imposed on a tax return preparer at \$55 for each failure to comply with each procedural requirement.
- b. Applicable procedural requirements with respect to returns, claims, and employees are
  - 1) Signing a return or claim
  - 2) Affixing an identifying number
  - 3) Furnishing a copy to the taxpayer
  - 4) Filing a correct information return
  - 5) Retaining records by copies or a list
- c. Reasonable cause precludes the imposition of penalties if willful neglect was not a cause.

### 2. Misconduct

- a. A court may issue an injunction upon finding that a tax return preparer has engaged in one of the following:
  - 1) Misrepresenting eligibility to practice before the IRS
  - 2) Guaranteeing a tax refund or allowance of a credit
  - 3) Substantially interfering with Internal Revenue laws through deceptive or fraudulent conduct
  - 4) Understating tax liability
- b. In the case of an **injunction**, the court might enjoin the person from
  - 1) Engaging in such conduct or
  - 2) Acting as a tax return preparer if the court finds a pattern of continual or repeated conduct.

### Accuracy-Related Penalty

3. Generally, the accuracy-related penalty is 20% of any portion of a tax underpayment attributable to (a) negligence or disregard of rules or regulations, (b) any substantial understatement of income tax, (c) any substantial valuation misstatement under Chapter 1 of the Internal Revenue Code, (d) any substantial overstatement of pension liabilities, (e) any substantial estate or gift tax valuation understatement, or (f) any claim of tax benefits from a transaction lacking economic substance [as defined by Sec. 7701(o)] or failing to meet the requirements of any similar rule of law.
  - a. The penalty is 40% of any portion of a tax underpayment attributable to one or more gross valuation misstatements in (c), (d), or (e) above if the applicable dollar limitation under Sec. 6662(h)(2) is met.
    - 1) The penalty also increases to 40% for failing to adequately disclose a transaction that lacks economic substance in (f) above.
    - 2) The penalty is 40% of any portion of an underpayment that is attributable to any undisclosed foreign financial asset understatement.

- b. **Reasonable basis.** Generally, the taxpayer can avoid the disregard of regulations and substantial understatement portions of the accuracy-related penalty if the position is adequately disclosed and has at least a reasonable basis. To avoid the disregard of regulations portion of the accuracy-related penalty, the position taken must also represent a good-faith challenge to the validity of the regulation.
  - 1) Reasonable basis is a relatively high standard of tax reporting that is significantly higher than not frivolous or not patently improper. The reasonable basis standard is not satisfied by a return position that is merely arguable.
  - 2) The penalty will not be imposed on any part of an underpayment if there was reasonable cause for the taxpayer's position and (s)he acted in good faith in taking that position.
- c. While some taxpayers choose to use tax software to prepare their tax returns, the Tax Court does not find reliance on tax preparation software justifiable to avoid an accuracy-related penalty.
  - 1) According to the Taxpayer Advocate Service, the Tax Court has observed that "the misuse of tax preparation software, even if unintentional or accidental, is no defense to accuracy-related penalties under section 6662." Examples of such rulings include *Bartlett v. Commissioner* and *Anyika v. Commissioner*.

### **Negligence**

- d. The term "negligence" includes any failure to make a reasonable attempt to comply with the provisions of the internal revenue laws or to exercise ordinary and reasonable care in the preparation of a return.

### **Substantial Understatement**

- e. An understatement is the excess of the amount of tax required to be shown on the return for the tax year, over the amount of tax shown on the return for the tax year, reduced by any rebates.
  - 1) There is a substantial understatement of income tax if the amount of the understatement for any year exceeds the greater of
    - a) 10% of the tax required to be shown on the return for the tax year or
    - b) \$5,000.
  - 2) An understatement of a corporation (other than an S corporation or a personal holding company) is substantial if it exceeds in any year the lesser of
    - a) 10% of the tax required to be shown on the return for the tax year (or, if greater, \$10,000) or
    - b) \$10,000,000.

**Substantial Valuation Misstatement**

- f. In general, a taxpayer is liable for a 20% penalty for a substantial valuation misstatement if all the following are true:
  - 1) The value or adjusted basis of any property claimed on the return is 150% or more of the correct amount (i.e., overvaluation).
  - 2) The taxpayer underpaid the tax by more than \$5,000 (\$10,000 for corporations other than S corporations) because of the misstatement.
  - 3) The taxpayer cannot establish reasonable cause for the underpayment and that (s)he acted in good faith.
- g. The taxpayer may be assessed a penalty of 40% for a gross valuation misstatement. If the value is misstated or the adjusted basis of property is 200% or more of the amount determined to be correct, the taxpayer will be assessed a penalty of 40%, instead of 20%, of the amount the taxpayer underpaid because of the gross valuation misstatement. The penalty rate is also 40% if the property's correct value or adjusted basis is zero.

**Transaction Lacking Economic Substance**

- h. The economic substance doctrine only applies to an individual that entered into a transaction in connection with a trade or business or an activity engaged in for the production of income.
- i. A transaction has economic substance for an individual taxpayer only if the transaction changes his or her economic position in a meaningful way (apart from federal income tax effects), or the taxpayer must have a substantial purpose (apart from federal income tax effects) for entering into the transaction.
  - 1) For purposes of determining whether economic substance exists, a transaction's profit potential will only be taken into account if the present value of the reasonably expected pre-tax profit from the transaction is substantial compared to the present value of the expected net tax benefits that would be allowed if the transaction were respected.
  - 2) If any part of an underpayment is due to any disallowance of claimed tax benefits by reason of a transaction lacking economic substance or failing to meet the requirements of any similar rule of law, that part of the underpayment will be subject to the 20% accuracy-related penalty even if the taxpayer had a reasonable cause and acted in good faith concerning that part.
  - 3) Additionally, the penalty increases to 40% if the taxpayer does not adequately disclose on the return or in a statement attached to the return the relevant facts affecting the tax treatment of a transaction that lacks economic substance. Relevant facts include any facts affecting the tax treatment of the transaction.



**Negotiating Refunds**

4. A penalty of \$560 is imposed on a tax return preparer for each taxpayer refund check (s)he negotiates, e.g., by endorsement.
  - a. Taxpayers may authorize the representative to receive a refund check.
    - 1) They must specifically authorize this on the Power of Attorney form.
    - 2) However, if the representative is a tax preparer, (s)he cannot be authorized to endorse or otherwise cash the check related to taxes.
    - 3) A tax return preparer will not be considered to have endorsed or otherwise negotiated a check solely as a result of having affixed the taxpayer's name to a refund check for the purpose of depositing the check into an account in the name of the taxpayer or in the joint names of the taxpayer and one or more other persons (excluding the tax return preparer) if authorized by the taxpayer or the taxpayer's recognized representative.

**Due Diligence Requirements**

5. Section 6695(g) imposes a \$560 penalty with respect to any return or claim for refund for each failure to comply with the four due diligence requirements imposed by regulations with respect to determining a taxpayer's eligibility for the Earned Income Credit, American Opportunity Tax Credit, Child Tax Credit, and Head of Household (HOH) filing status.
  - a. New expanded regulations clarify these requirements and set a performance standard for the "knowledge" requirement (i.e., what a reasonable and well informed tax return preparer, knowledgeable in the law, would do). The following are the four due diligence requirements:

**Completion and Submission of Form 8867**

- 1) Complete Form 8867, *Paid Preparer's Due Diligence Checklist*, truthfully and accurately and perform any actions described on Form 8867 for any applicable credit(s) claimed and HOH filing status.
  - a) Submit Form 8867 in the manner required.

**Computation of Credit(s)**

- 2) If credits are claimed on the return, complete the appropriate worksheet(s) associated with the applicable IRS form(s) or create equivalent worksheets.

**Knowledge**

- 3) Interview the taxpayer, ask questions, and document the taxpayer's responses and review the information to determine that the taxpayer is eligible to claim the credit(s) or file as HOH.
  - a) Do not ignore the implications of information furnished or known.
  - b) Make reasonable inquiries to conclude that the information furnished appears to be correct, consistent, and complete.
  - c) Document any additional inquiries made and the client's responses.

**Record Retention**

- 4) Satisfy the document retention requirement by retaining the following five records:
  - a) Form 8867;
  - b) The applicable worksheet(s) or the preparer's own worksheet(s) for any credits claimed;
  - c) Copies of any taxpayer documents relied on to determine eligibility for any credits or HOH filing status;
  - d) A record of how, when, and from whom the information used to prepare the form and worksheet(s) was obtained; and
  - e) A record of any additional information relied upon, including additional questions the preparer asked and the client's answers.
- b. These records must be kept for 3 years from the latest of the following due dates:
  - 1) The due date of the tax return (not including extensions)
  - 2) The date the return was filed (if a signing tax return preparer electronically filed the return)
  - 3) The date the return was presented to the taxpayer for signature (if the signing tax preparer is not electronically filing the return)
  - 4) The date a preparer submitted the part of the return for which they were responsible to the signing tax return preparer (if that preparer is a nonsigning tax return preparer)
- c. The retention of a copy of the Social Security cards of the taxpayer and each qualifying child is not required.

**Underpayment Penalty**

6. The IRC imposes penalties on tax return preparers for understating a taxpayer's liability due to unreasonable positions and willful or reckless conduct.
  - a. The tax return preparer who is subject to the penalties is the one who is primarily responsible for the position(s) on the return or claim for refund giving rise to an understatement. Generally, this is the signing tax return preparer.
7. Section 6694(a) imposes a penalty (the greater of \$1,000 or 50% of income derived by the preparer as to the return) on a tax return preparer for taking a position known (or which reasonably should be known) to have no reasonable belief of being sustained on the merits.
  - a. Four elements must be present for the penalty to apply:
    - 1) Understatement of tax liability. Under the IRC, understatement of liability means either
      - a) Understating net tax payable or
      - b) Overstating the net amount creditable or refundable.

**Reasonable Belief**

- 2) A position with no reasonable belief of success. The penalty is imposed for taking a position with no reasonable belief that the tax treatment of the position would more likely than not be sustained on its merits.
  - a) Regulations indicate the position must have a more likely than not possibility of being sustained by a court.
  - b) Disclosure of a position may shield a preparer from liability for a nonfrivolous position without a more likely than not chance of success.

**Frivolous Position**

- 3) Knowledge, or a frivolous position. For the penalty to apply, the tax return preparer must know that the position has no reasonable belief of a more likely than not chance of success, or the position must be frivolous.
  - a) The standard for determining knowledge is applied objectively. It is what a competent practitioner
    - i) Should have known or
    - ii) Actually knew.
- 4) Nondisclosure, or a frivolous position. The understatement penalty is not imposed if the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return, unless the position is frivolous.
- b. A tax return preparer may be excused from the penalty if (s)he
  - 1) Shows there was reasonable cause for the understatement and
  - 2) Acted in good faith.

**Willfulness**

- c. Section 6694(b) imposes a penalty of the greater of \$5,000 or 75% of income derived by the tax return preparer as to the return if an understatement of liability is willful or caused by intentional disregard of IRS rules and regulations.
  - 1) The burden is on the tax return preparer to prove that (s)he neither intentionally nor recklessly disregarded rules and regulations.
  - 2) Willfulness is implied from disregarding information furnished by the taxpayer or other persons or ignoring its implications by failing to make further inquiry.

**Abatement**

- d. Section 6694(d) allows abatement of the penalty if it is established in final administrative determination or judicial decision that there was no understatement, even if there was a willful attempt to understate.
- e. When the IRS examines a return for negligence or intentionally disregarded rules, the tax return preparer has the burden of proving his or her innocence.

**Avoidance vs. Evasion**

- 8. **Tax avoidance** is the minimization of tax liability through legal arrangements and transactions. The goal of a business is to maximize profits, and tax avoidance is a key element in obtaining this goal. Avoidance maneuvers take place prior to incurring a tax liability.
- 9. **Tax evasion** takes place once a tax liability has already been incurred (i.e., taxable actions have been completed). A key distinction between avoidance and evasion is taxpayer "intent." A taxpayer's intent is called into question when one of the "badges" of fraud is identified. These indicators include understatement of income, improper allocation of income, claiming of fictitious deductions, questionable conduct of the taxpayer, and accounting irregularities.
- 10. Concerning evasion, Sec. 7201 reads as follows: "Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than \$100,000 (\$500,000 in the case of a corporation), or imprisoned not more than five years, or both, together with the costs of prosecution."

**Liability and Assessment**

11. The IRC has an integrated penalty structure for tax return preparers. But generally applicable sanctions, such as the one mentioned below, may also apply to a tax return preparer.
- a. Section 6701 imposes a \$1,000 penalty for aiding or assisting in the preparation of any document if the person knows or has reason to believe
    - 1) That the document will be used in connection with any material (federal) tax matter and
    - 2) If it is so used, it will result in an understatement of tax liability.
      - a) The penalty is \$10,000 if the document relates to a corporate taxpayer's liability.
      - b) The burden of proof is on the government.
    - 3) A tax return preparer is not subject to penalty for failure to follow a rule or regulation if the preparer in good faith and with a reasonable basis takes the position that the rule or regulation does not accurately reflect the Code.
  - b. The Sec. 6701 penalty may not be imposed if a penalty is imposed under either of Secs. 6694(a) or (b) for the same violation.
    - 1) Furthermore, a penalty under Sec. 6694(a) would be offset against a Sec. 6694(b) penalty if it were also imposed for the same violation.
  - c. Repeated violations of Sec. 6694(a), or one violation of either of Secs. 6694(b) or 6701, may result in disciplinary action by the Director of the Office of Professional Responsibility (DP).
    - 1) Thus, a tax return preparer may jeopardize his or her ability to practice his or her profession in representing clients in matters before the IRS.

**Liability to Clients**

- d. A client may not be able to avoid liability for penalties by relying on a professional opinion. Furthermore, a tax return preparer may incur liability to a client who is dissatisfied with the tax liability that results from following the advice of the preparer; e.g., the preparer fails to inform the client that mortgage interest on the client's third (vacation) home is not deductible.
  - 1) Preparer negligence may be alleged in various forms, such as
    - a) Making computational errors
    - b) Filing of a tax return late
    - c) Providing inaccurate information
  - 2) Damages may include client losses, such as increased tax liability and penalties.

**Statute of Limitations**

- e. A 3-year limit applies to assessing the penalties for the procedural penalties and the understatement penalty.
  - 1) No period of limitation applies to assessing penalties for understatement due to willfulness or reckless conduct.

**Assessment**

- f. A tax return preparer who pays 15% or more of an assessed preparer penalty after receipt of notice and demand may file a claim for a refund within 30 days of the notice. The preparer also may request a conference with the IRS agent and present additional information and explanations showing that the penalty is not warranted.

12. Frivolous submission (returns and documents). In addition to other penalties that may be imposed, there is a penalty for filing a frivolous return.
- a. A frivolous return is one that
    - 1) Omits information necessary to determine the taxpayer's tax liability,
    - 2) Shows a substantially incorrect tax,
    - 3) Is based upon a frivolous position (e.g., that wages are not income), or
    - 4) Is based upon the taxpayer's desire to impede the collection of tax.
  - b. A return based on the taxpayer's altering or striking out the "penalty of perjury" language above the signature line also constitutes a frivolous return.
  - c. Section 6702 imposes a \$5,000 penalty on any person who submits a "specified frivolous submission." A specified frivolous submission is defined as a specified submission that is based on a position that the IRS has identified as frivolous or that reflects a desire to delay or impede the administration of Federal tax laws. A specified submission means a request for a collection due process hearing under Sec. 6320 or 6330 or an application for an installment agreement under Sec. 6159, an offer-in-compromise under Sec. 7122, or a taxpayer assistance order under Sec. 7811.

### **Fraud**

13. Fraudulent transactions. Such transactions ordinarily involve a willful or deliberate action with the intent to obtain an unauthorized benefit.
- a. Per Sec. 7206, a tax return preparer who willfully aids or assists in fraud or false statements shall be fined not more than \$250,000 (\$500,000 in the case of a corporation) or imprisoned not more than 3 years.

### **Income**

- b. Indicators of Fraud -- Income
  - 1) Omissions of specific items where similar items are included
  - 2) Omissions of entire sources of income
  - 3) Unexplained failure to report substantial amounts of income determined to have been received
  - 4) Substantial unexplained increases in net worth, especially over a period of years
  - 5) Substantial excess of personal expenditures over available resources
  - 6) Bank deposits from unexplained sources substantially exceeding reported income
  - 7) Concealment of bank accounts, brokerage accounts, and other property
  - 8) Inadequate explanation for dealing in large sums of currency or the unexplained expenditure of currency
  - 9) Consistent concealment of unexplained currency, especially in a business not calling for large amounts of cash
  - 10) Failure to deposit receipts to business account, contrary to normal practices
  - 11) Failure to file a return, especially for a period of several years although substantial amounts of taxable income were received
  - 12) Cashing checks representing income at check cashing services and banks other than the taxpayer's
  - 13) Covering up sources of receipts by false description of source of disclosed income and/or nontaxable receipts

**Expenses/Deductions**

- c. Indicators of Fraud -- Expenses or Deductions
  - 1) Substantial overstatement of deductions
  - 2) Substantial amounts of personal expenditures deducted as business expenses
  - 3) Claiming fictitious deductions
  - 4) Dependency exemption claimed for nonexistent, deceased, or self-supporting persons
  - 5) Loans of trust funds disguised as purchases or deductions

**Books/Records**

- d. Indicators of Fraud -- Books and Records
  - 1) Keeping two sets of books or no books
  - 2) False entries or alterations made on the books and records, backdated or postdated documents, false invoices, false applications, statements, other false documents, or applications
  - 3) Invoices that are irregularly numbered, unnumbered, or altered
  - 4) Checks made payable to third parties that are endorsed back to the taxpayer
  - 5) Checks made payable to vendors and other business payees that are cashed by the taxpayer
  - 6) Failure to keep adequate records, concealment of records, or refusal to make certain records available
  - 7) Variances between treatment of questionable items on the return as compared with books
  - 8) Intentional under- or overfooting of columns in journal or ledger
  - 9) Amounts on return not in agreement with amounts in books
  - 10) Amounts posted to ledger accounts not in agreement with source books or records
  - 11) Journalizing of questionable items out of correct account
  - 12) Recording income items in suspense or asset accounts
  - 13) False receipts to donors by exempt organizations

**Allocations of Income**

- e. Indicators of Fraud -- Allocations of Income
  - 1) Distribution of profits to fictitious partners
  - 2) Inclusion of income or deductions in the return of a related taxpayer when difference in tax rates is a factor

**Conduct of Taxpayer**

## f. Indicators of Fraud -- Conduct of Taxpayer

- 1) False statement about a material fact involved in the examination
- 2) Attempts to hinder the examination, for example, failure to answer pertinent questions; repeated cancellations of appointments; refusal to provide records; threatening potential witnesses, including the examiner; or assaulting the examiner
- 3) Failure to follow the advice of accountant or attorney
- 4) Failure to make full disclosure of relevant facts to the accountant
- 5) The taxpayer's knowledge of taxes and business practices where numerous questionable items appear on the returns
- 6) Testimony of employees concerning irregular business practices by the taxpayer
- 7) Destruction of books and records, especially if just after examination was started
- 8) Transfer of assets for purposes of concealment, or diversion of funds and/or assets by officials or trustees
- 9) Patterns of consistent failure over several years to report income fully
- 10) Proof that the return was incorrect to such an extent and in respect to items of such character and magnitude as to compel the conclusion that the falsity was known and deliberate
- 11) Payment of improper expenses by or for officials or trustees
- 12) Willful and intentional failure to execute pension plan amendments
- 13) Backdating of applications and related documents
- 14) Making false statements on TEGE (Tax Exempt/Government Entities) determination letter applications
- 15) Use of false Social Security numbers
- 16) Submission of false Form W-4
- 17) Submitting a false affidavit
- 18) Attempts to bribe the examiner

**Methods of Concealment**

## g. Indicators of Fraud -- Methods of Concealment

- 1) Inadequacy of consideration
- 2) Insolvency of transferor
- 3) Assets placed in other's names
- 4) Transfer of all or nearly all of debtors' property
- 5) Close relationship between parties to the transfer
- 6) Transfer made in anticipation of a tax assessment or while the investigation of a deficiency is pending
- 7) Reservation of any interest in the property transferred



- 8) Transaction not in the usual course of business
- 9) Retention of possession
- 10) Transactions surrounded by secrecy
- 11) False entries in books of transferor or transferee
- 12) Unusual disposition of the consideration received for the property
- 13) Use of secret bank accounts for income
- 14) Deposits into bank accounts under nominee names
- 15) Conduct of business transactions in false names

### **Badges**

14. Badges of fraud are facts that suggest fraud but that, standing alone, do not establish its existence. For example, failure to keep adequate records may be a badge of fraud.

### **Tax Return Disclosure Statements**

15. Form 8275 is used by taxpayers and tax return preparers to disclose items or positions that are not otherwise adequately disclosed on a tax return to avoid certain penalties. Form 8275-R is used to disclose a position taken contrary to a regulation.
- a. The form is filed to avoid the portions of the accuracy-related penalty due to a disregarding of rules or to a substantial understatement of income tax or non-tax shelter items if the return position has a reasonable basis.
    - 1) It can also be used for disclosures relating to preparer penalties for understatements due to unreasonable position or a disregarding of rules and the economic substance penalty.
  - b. The portion of the accuracy-related penalty attributable to the following types of misconduct cannot be avoided by disclosure on Form 8275:
    - 1) Negligence
    - 2) Disregard of regulations
    - 3) Any substantial understatement of income tax
    - 4) Any substantial valuation misstatement
    - 5) Any substantial overstatement of pension liabilities
    - 6) Any substantial estate or gift tax valuation understatements
    - 7) Any claim of tax benefits from a transaction lacking economic substance
    - 8) Any otherwise undisclosed foreign financial asset understatement
  - c. Form 8275 is filed by individuals, corporations, pass-through entities, and tax return preparers. For items attributable to a pass-through entity, disclosure should be made on the tax return of the entity. If the entity does not make disclosure, the partner, shareholder, etc., can make adequate disclosure of these items.



16. The penalties in the following table may be imposed on tax return preparers:

Act	Fine	Imprisonment
<b>Understatement:</b>		
Due to unreasonable positions	Greater of a) \$1,000 or b) 50% of income to be derived	N/A
Due to willful or reckless conduct	Greater of a) \$5,000 or b) 75% of income to be derived	N/A
<b>Preparing tax returns for other persons:</b>		
Failure to furnish copy to taxpayer	\$55 each, limited to \$28,000 per year	N/A
Failure to sign return	\$55 each, limited to \$28,000 per year	N/A
Failure to furnish identifying number	\$55 each, limited to \$28,000 per year	N/A
Failure to retain copy or list	\$55 each, limited to \$28,000 per year	N/A
Failure to file correct information returns	\$55 each, limited to \$28,000 per year	N/A
Endorses or negotiates checks made to taxpayer in respect of taxes imposed	\$560 each, unlimited	N/A
Failure to be diligent in determining credits and head of household status (for the best benefit of taxpayer)	\$560 each, unlimited	N/A
<b>Others:</b>		
Promoting abusive tax shelters	Lesser of a) \$1,000 for each organization or sale of promotion plan b) Income to be derived	N/A
Aiding and abetting understatement of tax liability	\$1,000 each year (noncorporate clients) \$10,000 each year (corporate clients)	N/A
Disclosure or use of information	\$250 per unauthorized disclosure, limited to \$10,000 per year	N/A
Convicted of knowingly or recklessly disclosing information (misdemeanor)	\$1,000	Up to 1 year
Fraud and false statements	\$250,000 (individual clients) \$500,000 (corporate clients)	Up to 3 years
Fraudulent returns, statements, or other documents	\$10,000 (individual clients) \$50,000 (corporate clients)	Up to 1 year
Tax evasion	\$100,000 (individual clients) \$500,000 (corporate clients)	Up to 5 years

# STUDY UNIT THREE

## REPRESENTATION

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3.2	<i>Centralized Authorization File (CAF)</i> .....	8

This study unit describes the rules concerning the representation of taxpayers before the IRS under the authority of a power of attorney. These rules apply to all offices of the IRS and apply to “practicing before the IRS.” In general, a power of attorney is a document signed by the taxpayer, as principal, by which an individual is appointed to perform certain specified acts on behalf of the principal.

### 3.1 REPRESENTATION

1. Representation is defined as acts performed on behalf of a taxpayer by a representative in practice before the Internal Revenue Service (IRS).
  - a. However, any person may appear as a witness for the taxpayer before the Internal Revenue Service, or furnish information at the request of the Internal Revenue Service or any of its officers or employees.

#### **Power of Attorney**

2. A power of attorney is a document signed by the taxpayer, as principal, by which an individual is appointed as attorney-in-fact to perform certain specified act(s) or kinds of act(s) on behalf of the principal. Specific types of powers of attorney include the following:
  - a. **General power of attorney.** The attorney-in-fact is authorized to perform any or all acts the taxpayer can perform.
  - b. **Durable power of attorney.** A power of attorney which specifies that the appointment of the attorney-in-fact will not end due to either the passage of time (i.e., the authority conveyed will continue until the death of the taxpayer) or the incompetency of the principal (e.g., the principal becomes unable or is adjudged incompetent to perform his or her business affairs).
  - c. **Limited (or special) power of attorney.** A power of attorney which is limited in any facet (i.e., a power of attorney authorizing the attorney-in-fact to perform only certain specified acts as contrasted to a general power of attorney authorizing the representative to perform any and all acts the taxpayer can perform).

**Recognized Representative**

3. A recognized representative is an individual who is appointed as an attorney-in-fact under a power of attorney, is a member of one of the following categories, and files a declaration of representative:
  - a. **Attorney**, which is any individual who is a member in good standing of the bar of the highest court of any state, possession, territory, commonwealth, or the District of Columbia
  - b. **Certified public accountant**, which is any individual who is duly qualified to practice as a certified public accountant in any state, possession, territory, commonwealth, or the District of Columbia
  - c. **Enrolled agent**, which is any individual who is enrolled to practice before the Internal Revenue Service and is in active status pursuant to the requirements of Circular 230
    - 1) Temporary recognition. Any individual who is granted temporary recognition as an enrolled agent by the Director of Practice.
  - d. **Enrolled actuary**, which is any individual who is enrolled as an actuary by and is in active status with the Joint Board for the Enrollment of Actuaries
  - e. Practice based on a relationship or special status with a taxpayer. Any individual authorized to represent a taxpayer with whom/which a special relationship exists. (For example, an individual may represent another individual who is his or her regular full-time employer or a member of his or her immediate family; an individual who is a bona fide officer or regular full-time employee of a corporation or certain other organizations may represent that entity.)
  - f. **Annual Filing Season Program (AFSP) participant**. Any AFSP participant who signs a return as having prepared it for a taxpayer, or who prepared a return with respect to which the instructions or regulations do not require that the return be signed by the preparer. The acts an AFSP participant may perform are limited to representation of a taxpayer before revenue agents and examining officers of the Examination Division in the offices of District Director with respect to the tax liability of the taxpayer for the taxable year or period covered by a return prepared by the AFSP participant.
    - 1) All unenrolled return preparers must provide a valid PTIN to represent a taxpayer before the IRS. Only unenrolled return preparers who participate in the AFSP program may represent a taxpayer, and only with respect to returns the AFSP participant prepared and signed.
  - g. Special appearance. Any individual who, upon written application, is authorized by the IRS to represent a taxpayer in a particular matter.

**Signing Tax Returns**

4. The filing of a power of attorney does not authorize the recognized representative to sign a tax return on behalf of the taxpayer unless such act is both
  - a. Permitted under the Internal Revenue Code and the regulations thereunder and
  - b. Specifically authorized in the power of attorney.

**Power of Attorney -- Other Items**

5. Situations in which a power of attorney is not required.
  - a. Disclosure of confidential tax return information. The submission of a tax information authorization to request the disclosure of confidential tax return information does not constitute practice before the Internal Revenue Service. Nevertheless, if a power of attorney is properly filed, the recognized representative also is authorized to receive and/or inspect confidential tax return information concerning the matter(s) specified in the power of attorney (provided the power of attorney places no limitations upon such disclosure).
6. Copy of power of attorney. The Internal Revenue Service will accept either the original or a copy of a power of attorney.
7. If a power of attorney fails to include all required information, the attorney-in-fact can correct the existing power of attorney without obtaining a new power of attorney.
8. Cases where taxpayer may be contacted directly. Where a recognized representative has unreasonably delayed or hindered an examination, collection, or investigation by failing to furnish, after repeated requests, nonprivileged information necessary to the examination, collection, or investigation, the Internal Revenue Service employee conducting the examination, collection, or investigation may request the permission of his or her immediate supervisor to contact the taxpayer directly for such information.
  - a. Effect of direct notification. Permission to bypass a recognized representative and contact a taxpayer directly does not automatically disqualify an individual to act as the recognized representative of a taxpayer in a matter. However, such information may be referred to the IRS for possible disciplinary proceedings under Circular 230.
9. A power of attorney does not give an individual the right to represent someone before a court. The practitioner must be admitted to practice before the court.

**POA, Form 2848**

10. A *Power of Attorney and Declaration of Representative* (POA, Form 2848) or a substitute Form 2848 (i.e., a non-IRS POA form) is generally required when a taxpayer wants to authorize another individual who is recognized to practice before the IRS to perform at least one of the following acts on his or her behalf:
  - a. Represent the taxpayer at a conference with the IRS
  - b. File a written response to the IRS
  - c. Sign a consent or an extension
11. The declaration of representative states the following:
  - a. I am not currently suspended or disbarred from practice, or ineligible for practice, before the Internal Revenue Service;
  - b. I am subject to regulations contained in Circular 230 (31 CFR, Subtitle A, Part 10), as amended, governing practice before the Internal Revenue Service;
  - c. I am authorized to represent the taxpayer identified in Part 1 (POA) for the tax matter(s) specified there; and
  - d. I am one of the individuals described in 26 CFR 601.502.

**Return Information**

12. Return information includes data received or prepared by the IRS regarding a return, deficiency, or penalty.
  - a. A change in a return is also considered return information.

**Disclosure**

13. Tax returns and return information are confidential and are generally not subject to disclosure. Disclosure of return information is permitted to
- a. A person designated by the taxpayer
  - b. Congressional committees
  - c. State tax officials
  - d. Certain other persons

**Tax Information Authorization (TIA)**

14. A representative must file a *Tax Information Authorization* (TIA, Form 8821) to receive or inspect confidential tax information on behalf of the taxpayer unless the representative has filed a POA to perform those specific acts.
- a. The IRS will accept a POA or TIA other than one on Form 2848 or 8821, respectively, provided that it includes all of the information required by the official form.
    - 1) However, for purposes of processing into the Centralized Authorization File, a Form 2848 must be attached to the nonstandard form.
      - a) The Form 2848 must be completed, but it does not need to be signed by the taxpayer.
  - b. With respect to disclosure, a TIA or POA is not required of a representative who
    - 1) Represents a taxpayer at a conference attended by the taxpayer.
    - 2) Represents an executor or administrator at a conference on an estate tax case if the representative presents evidence that (s)he
      - a) Prepared the estate tax return on behalf of the executor or administrator,
      - b) Is recognized to practice before the IRS, and
      - c) Is the attorney of record for the executor or administrator before the court where the will is probated or the estate is administered.
    - 3) Is appointed by a court as a trustee, a receiver, or an attorney for the taxpayer as a debtor.
    - 4) Practices in cases before the Tax Court if
      - a) The taxpayer's petition to the Tax Court was signed by the representative as counsel admitted to practice before the Tax Court.

**Multiple Representatives**

- c. The IRS will provide copies of written communications to no more than two designated representatives.
  - 1) The IRS practice is to give copies to the representative named first on the most recent POA unless it lists not more than two representatives to receive them.
  - 2) The limit to two individuals does not apply to TIA appointees.

**Scope of Authority**

15. A TIA or POA may relate to several matters, e.g., income taxes for several years.
- a. A power of attorney is a written authorization for an individual to act on behalf of an individual in tax matters. It is required by the IRS when the taxpayer wishes to authorize a recognized representative to act on his or her behalf.
    - 1) If the authorization is not limited, the individual can generally perform all acts that the taxpayer can perform.

- 2) In general, a representative can do all of the following:
    - a) Represent the taxpayer before any office of the IRS
    - b) Sign a waiver agreeing to a tax adjustment
    - c) Sign a consent to extend the statutory time period for assessment or collection of a tax
    - d) Sign a closing agreement
    - e) Receive, but not endorse or cash, a refund check
    - f) Record the interview
  - 3) An unenrolled return preparer is limited in scope to appearing before revenue agents and examining officers.
- b. Technical language is not necessary, but
- 1) The instrument must clearly specify which acts the representative is authorized to perform.
  - 2) "In all tax matters" does not sufficiently describe the representative's scope of authority.
- c. The scope of authority should be specific as to the
- 1) Tax matters, e.g., type of tax
  - 2) Years or periods
- d. A power of attorney may concern only a tax period listed on the form that ends no later than 3 years after the date a power of attorney is received by the IRS.
- e. The instrument need not list the divisions of the IRS involved in the matter.

### **POA Requirements**

16. A POA must contain the following information:
- a. Name and address of the taxpayer
  - b. Identification number of the taxpayer
  - c. Employee plan number (if applicable)
  - d. Name, address, and title (if employed full-time) of the recognized representative
  - e. The state in which the representative is admitted to practice, if the representative is an attorney or a CPA
  - f. Description of the matter(s) for which representation is authorized, which, if applicable, must include the
    - 1) Type of tax involved
    - 2) Federal tax form number
    - 3) Specific years involved
    - 4) Decedent's date of death (for estate matters)
  - g. A clear expression of the taxpayer's intention concerning the scope of authority granted to the recognized representative
  - h. Signature of the appointed representative

### **TIA Limitations**

17. A TIA does not authorize an appointee to
- a. Advocate the taxpayer's position with respect to federal tax laws;
  - b. Execute waivers, consents, or closing agreements; or
  - c. Otherwise represent the taxpayer before the IRS.

**Change of Authority**

18. The authority granted a representative by a POA may be changed by filing a new POA.
- a. A new POA is deemed to revoke a prior POA unless the new one contains a clause specifically stating that it does not revoke a prior POA.
  - b. A new POA revokes a prior POA if the taxpayer signs a statement listing the names and addresses of the individuals listed under the prior POA whose authority is revoked. "REVOKE" should be written across the power of attorney.

**Execution of a POA or TIA**

19. Form 2848 is used to appoint a representative to act on behalf of a taxpayer before the IRS.
- a. A representative recognized to practice before the IRS need only execute a declaration on the POA that (s)he is so recognized.
  - b. A TIA or POA for a specific type of taxpayer is properly executed when it is signed by the appropriate individual(s), as indicated below.
    - 1) Joint return, for representation by one party -- by both spouses unless one spouse is duly authorized in writing to sign for the other
    - 2) Partnership -- by all partners or a duly authorized partner
      - a) If a dissolved partnership is involved, each of the former living partners must execute a power of attorney.
    - 3) Corporation -- by an officer with authority to bind the corporation
    - 4) Person with a court-appointed guardian -- by the one appointed
    - 5) Decedent -- by the executor or administrator
  - c. Form 2848 should be mailed or faxed directly to the IRS.

**Substitution**

20. A properly executed POA and Declaration of Representative does permit the representative to make substitution of representatives by the taxpayer in the original POA.
- a. The POA must, however, state the intention to grant authority of substitution.
  - b. A substitution is made by filing the following items with the IRS:
    - 1) Notice of substitution
    - 2) A new declaration of representative
    - 3) A power of attorney that authorizes a substitution
  - c. Only the newly recognized representative will be considered the taxpayer's representative.
21. A POA is required for executing a waiver of notice to disallow a claim for credit or refund.



### **Partnership Audits**

22. In an administrative or judicial proceeding concerning partnership items, the determination of the tax treatment of partnership items is made at the partnership level in a single administrative partnership proceeding, rather than in individualized proceedings.
- a. Special rules govern proceedings that must be conducted at the partnership level for the assessment and collection of tax deficiencies or for tax refunds arising out of the partners' distributive shares of income, deductions, credits, etc.
  - b. Notice of the beginning of administrative proceedings and the resulting final partnership administrative adjustment must be given to all partners except those with less than a 1% interest in partnerships with more than 100 partners.
    - 1) However, a group of partners having an aggregate profits interest of 5% or more may request notice to be mailed to a designated partner.
  - c. Each partnership is supposed to name a partnership representative who is to receive notice on behalf of small partners not entitled to notice and to keep all partners informed of all administrative and judicial proceedings at the partnership level.
  - d. Settlement agreements may be entered into between the partnership representative and the IRS that bind the parties to the agreement and may extend to other partners who request to enter into consistent settlement agreements.

### **Representing a Decedent**

23. A **personal representative** of an estate is an executor, administrator, or anyone who is in charge of the decedent's property.
- a. Generally, an **executor** is named in a decedent's will to administer the estate and distribute properties as the decedent has directed.
  - b. An **administrator** is usually appointed by the court if no will exists, if no executor was named in the will, or if the named executor cannot or will not serve.
    - 1) Generally, an administrator performs the same duties and has the same responsibilities as an executor.
24. For estate tax purposes, if there is no executor or administrator appointed, qualified, and acting within the United States, the term "executor" includes anyone in actual or constructive possession of any property of the decedent.
25. The **primary duties** of a personal representative are to collect all the decedent's assets, pay his or her creditors, and distribute the remaining assets to the heirs or other beneficiaries. The personal representative must also perform the following duties:
- a. Apply for an employer identification number (EIN) for the estate.
  - b. File all tax returns, including income, estate, and gift tax returns, when due.
  - c. Pay the tax determined up to the date of discharge from duties.
26. It is the personal representative's duty to file the returns for the decedent and the estate when due.
- a. Reliance on an agent (attorney, accountant, etc.) is not reasonable cause for late filing.
27. All personal representatives must include fees paid to them from an estate in their gross income.



**Notice of Fiduciary Relationship**

28. The term **fiduciary** means any person acting for another person. It generally includes a guardian, trustee, executor, administrator, receiver, or conservator.
- a. A personal representative appointed to act in a fiduciary capacity for another must file a written notice with the IRS stating this. Form 56, *Notice Concerning Fiduciary Relationship*, is used for this purpose.
  - b. Form 56 should also be filed to notify the IRS if the fiduciary relationship is terminated or when a successor fiduciary is appointed if the estate has not been terminated.

**3.2 CENTRALIZED AUTHORIZATION FILE (CAF)**

1. A Centralized Authorization File (CAF) system is a computer file containing information regarding the authority of individuals appointed under powers of attorney or designated under the tax information authorization system. This system gives IRS personnel quicker access to authorization information.
2. A CAF number generally will be issued to
  - a. A recognized representative who files a POA and a written Declaration of Representative
  - b. An appointee authorized under a TIA
3. The issuance of a CAF number does not indicate that a person is either recognized or authorized to practice before the Internal Revenue Service. This determination is made under the provisions of Circular 230, 31 CFR Part 10.
4. A recognized representative or an appointee should include the same CAF number on every POA or TIA filed. However, because the CAF number is not a substantive requirement, a TIA or POA will not be rejected based on the absence of a CAF number.
5. Information from both POAs and TIAs is recorded on the CAF system.
  - a. This information enables IRS personnel who do not have access to the actual POAs or TIAs to send copies or computer-generated notices and communications to appointees or recognized representatives authorized by taxpayers.
6. Only documents that concern a tax period that ends no later than 3 years after the date a POA is received by the IRS will be recorded on the CAF system.
  - a. Documents that concern any tax period that ended prior to the date on which a POA is received by the IRS will be recorded on the CAF system provided that matters concerning such years are under consideration by the IRS.

# STUDY UNIT FOUR

## EXAMINATION OF RETURNS AND THE APPEALS PROCESS

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Although the U.S. tax system is founded on self-assessment and payment, the IRS examines and adjusts a percentage of returns filed to verify the tax reported is correct. This study unit addresses the examination and appeals process the IRS uses to monitor taxpayer behavior and resolve disputes as they arise.

### 4.1 EXAMINATION OF RETURNS

1. A tax return may be examined for a variety of reasons, and the examination may take place in any one of several ways.

#### Computer Scoring

- a. A tax return may be selected for examination on the basis of computer scoring. A computer program called the **Discriminant Function System (DIF)** assigns a numeric score to each individual and some corporate tax returns after they have been processed.
  - 1) The scoring formula determines which tax returns are most likely to be in error.
    - a) Returns selected from DIF have high scores.

#### Third-Party Information

- b. A return may be selected for examination on the basis of matching information on the return with information received from third parties such as Forms 1099 and W-2.
  - 1) For example, wages reported on the Form 1040 return should match wages per Form W-2 on the employer's return.
- c. Returns may be selected to address both the questionable treatment of an item and to study the behavior of similar taxpayers (a market segment) in handling a tax issue.
- d. Tax returns may be selected as a result of information received from other sources on potential noncompliance with the tax laws or inaccurate filing.

#### Other Contacts

2. The IRS must give the taxpayer **reasonable notice** before contacting other persons in examining or collecting a tax liability. The IRS also must provide the taxpayer with a record of persons contacted. The contact record is provided on both a periodic basis and upon taxpayer request.
  - a. The notice does not apply
    - 1) To any pending criminal investigation,
    - 2) When providing notice would jeopardize collection of any tax liability,
    - 3) When providing notice may result in reprisal against any person, or
    - 4) When the taxpayer authorized the contact.

**Rights/Process Explained**

3. Prior to the initial in-person interview, an officer or employee of the IRS must provide to the taxpayer an explanation of the audit or collection process and Publication 1, *Your Rights as a Taxpayer*.

**Representation**

4. A taxpayer may act on his or her own behalf or have someone represent or accompany him or her.
  - a. If a joint return was filed, either spouse or both can meet with the IRS.
  - b. The taxpayer can be represented by a federally authorized practitioner. The details of who is authorized are covered in Study Unit 3.

**Examination Location**

5. If the IRS notifies the taxpayer that the IRS will conduct an examination of the taxpayer's return through a personal interview, or the taxpayer requests such an interview, the taxpayer has the right to ask that the examination take place at a reasonable time and place that is convenient for both the taxpayer and the IRS.

**Jurisdiction**

6. The examination may be transferred to another IRS district office if
  - a. The taxpayer's books and records are kept in another district,
  - b. The taxpayer has changed domiciles, or
  - c. An executor or administrator has moved to another district.

**Proposed Changes**

7. If the IRS examiner proposes any changes to the taxpayer's return, the IRS examiner will explain the reasons for the changes. If the taxpayer does not agree with these changes, the taxpayer can meet with the examiner's supervisor.
  - a. The detailed document describing an IRS examiner's audit findings and stating the amount of deficiency or refund the agent found the taxpayer to owe or be owed is called the Revenue Agent's Report (RAR). This is the same as the 30-day letter discussed later in Subunit 4.2.

**Statute of Limitations**

8. The IRS has a general statute of limitations of 3 years from the due date of the tax return to assess any deficiency in tax payments.
  - a. If the taxpayer grossly misstates the income (for more than 25% of the gross income of the return) by not reporting income or understating the basis of an asset, the statute of limitations is 6 years.
  - b. If the taxpayer files a fraudulent return, there is no statute of limitations on that return.
  - c. If the taxpayer does not file a return, there is no statute of limitations on that return.

**Agreement**

9. If the taxpayer agrees with any proposed changes, (s)he can sign an agreement form and pay any additional tax due. The taxpayer must pay interest on any additional tax.
  - a. If payment is made when the agreement is signed, the interest is generally figured from the due date of the return to the date of payment.
  - b. If payment is not made when the agreement is signed, the taxpayer will receive a bill that includes interest.
    - 1) If payment is made within 10 business days of the billing date, no additional interest or penalties will be due.
    - 2) This period is extended to 21 calendar days if the amount due is less than \$100,000.

**Interest and Penalties**

10. Taxpayers must pay interest on penalties and on additional tax for
  - a. Failing to file returns,
  - b. Overstating valuations,
  - c. Understating valuations on estate and gift tax returns, and
  - d. Substantially understating tax liability.
11. Interest is generally figured from the date (including extensions) the tax return is due to the date the taxpayer pays the penalty and/or additional tax.

**Abatement**

12. The IRS may **abate** (reduce) the amount of interest owed if the interest is due to an unreasonable error or delay by an IRS officer or employee performing a ministerial or managerial act.
  - a. Only the amount of interest on income, estate, gift, generation-skipping, and certain excise taxes can be reduced.
13. If, for the same period of time that a taxpayer owes interest to the IRS on an underpayment, the IRS owes the taxpayer interest on an overpayment, on equivalent underpayments and overpayments, the net rate of interest on such amounts will be zero for such period.
  - a. Therefore, during an audit, the IRS nets underpayments and additional taxes owed plus interest against overpayments of tax plus interest paid.
14. If a practitioner or taxpayer believes overpayment of tax has occurred, Form 843, *Claim for Refund and Request for Abatement*, must be filed at the same service center in which the disputed return was filed.
  - a. If the taxpayer does not remember where (s)he filed this tax return, (s)he may file the form at the last service center (s)he filed a return.
  - b. When the taxpayer has already paid the tax, Form 843 must be filed within 3 years from the due date (plus the filing extension time) or 2 years from the time (s)he paid the interest, whichever is later.

**Notices Sent by the IRS**

15. IRS notices are often form letters referred to by the IRS as computer paragraphs. Accordingly, the following five notices are all designated CP (computer paragraph).
16. CP 12, Changes to Tax Return, Overpayment
  - a. When the IRS makes a correction to a tax return, it sends a math error notice to explain the changes to the taxpayer who filed the return.
    - 1) This notice explains the nature of the changes and includes an account statement showing how the changes affected the tax return.
    - 2) The notice also includes a short description of the changes.
      - a) If the taxpayer agrees with the correction made, (s)he does not need to reply to the notice.
    - 3) The IRS will issue a refund in 6 to 8 weeks unless the taxpayer owes other amounts the IRS is required to collect.
      - a) Examples include unpaid tax, penalty, or interest on another tax account.
17. CP 14, Balance Due, No Math Error
  - a. Notice CP 14 is not a math error notice.
    - 1) It shows the taxpayer the amount of underpaid tax according to IRS records.
      - a) The middle section of the notice shows the tax reported on the return, the credits applied, and the underpayment.
18. CP 49, Overpaid Tax Applied to Other Taxes You Owe
  - a. Reports an overpayment on one account and an underpayment on another.
    - 1) The first part of the notice deals with the overpaid account.
    - 2) The second part of the notice also deals with the overpaid account.
    - 3) The third part of the notice deals with the balance due account.
19. CP 90, Final Notice - Notice of Intent to Levy and Notice of Your Right to a Hearing
  - a. This notice tells the taxpayer that the IRS intends to issue a levy against any federal payments due the taxpayer, such as contractor/vendor payments, OPM retirement benefits, SSA benefits, salary, or employee travel advances or reimbursements because (s)he still has a balance due on his or her tax account.
    - 1) Property, or rights to property, such as real estate, automobiles, business assets, bank accounts, wages, commissions, and other income are also subject to levy.
    - 2) CP 90 also tells the taxpayer that the IRS may file a Federal Tax Lien if it has not already done so.
20. CP 2000, We Are Proposing Changes to Your Tax Return
  - a. This notice is to inform the taxpayer of changes the IRS proposes to the tax return because information reported by the taxpayer on it does not match what was reported to the IRS by the taxpayer's employers, banks, and other payers.
    - 1) The IRS sends a CP 2000 to provide detailed information about the differences, the changes proposed, and what to do if the taxpayer agrees or disagrees with the proposal.

**IRS Authority to Investigate**

21. Any investigator, agent, or other internal revenue officer by whatever term designated, whom the Secretary charges with duty of enforcing any of the criminal, seizure, or forfeiture provisions of any law of the United States pertaining to the commodities subject to tax may
- a. Carry firearms;
  - b. Execute and serve search warrants and arrest warrants, and serve subpoenas and summonses issued under authority of the United States;
  - c. In respect to the performance of such duty, make arrests without warrant for any offense against the United States committed in an officer's presence, or for any known felony under the laws of the United States if the officer has reasonable grounds to believe that the person to be arrested has committed, or is committing, such felony; and
  - d. In respect to the performance of such duty, make seizures of property subject to forfeiture to the United States.

**Audit Reconsideration**

22. This is a process used by the IRS to help the taxpayer when the taxpayer disagrees with the results of an IRS audit or a return created for the taxpayer by the IRS because the taxpayer did not file a tax return as authorized by Internal Revenue Code 6020(b).
- a. The taxpayer is permitted to request an audit reconsideration if the taxpayer
    - 1) Did not appear for the audit
    - 2) Moved and did not receive correspondence from the IRS
    - 3) Has additional information to present that the taxpayer did not provide during the original audit
    - 4) Disagrees with the audit assessment
  - b. Audit reconsideration requests will be **accepted** if
    - 1) Information is submitted that the IRS has not considered previously
    - 2) The taxpayer files a return after the IRS completed a return for the taxpayer
    - 3) The taxpayer believes the IRS made a computational or processing error in assessing the tax
    - 4) The liability is unpaid or credits are denied
  - c. Audit reconsideration requests are **not accepted** if the
    - 1) Taxpayer previously agreed to pay the amount of tax owed by signing an agreement such as a Form 906, *Closing Agreement On Final Determination Covering Specific Matters*; a compromise agreement; or an agreement on Form 870-AD with the Appeals office.
    - 2) Amount of tax owed is the result of final partnership item adjustments under the Bipartisan Budget Act of 2015 (BBA).
    - 3) United States Tax Court, or another court, has issued a final determination on the taxpayer's tax liability.

## 4.2 APPEALS WITHIN THE IRS

### Scope of Tax Law

1. Because people sometimes disagree on tax matters, the IRS has established an **appeals system**.
  - a. The IRS has concluded that most disagreements can be settled within this system without expensive and time-consuming court trials.
    - 1) The disagreements must arise within the scope of the tax laws.
      - a) For example, a case cannot be appealed based only on moral, religious, political, constitutional, conscientious, or similar grounds.
    - 2) Appeals officers have no prior involvement with the case.
  - b. If a taxpayer wishes to bypass the IRS appeals system, (s)he may take his or her case directly to court.
    - 1) The IRS also offers fast-track mediation services to help taxpayers resolve many disputes resulting from examinations, offers in compromise, trust fund recovery penalties, and certain other collection actions.
  - c. Taxpayers may be represented by attorneys, certified public accountants, or enrolled agents before appeals officers, revenue officers, counsel, or similar officers or employees of the Internal Revenue Service or the Treasury Department.

### Appeals Location

2. An appeal can be made to a local appeals office, which is separate from and independent of the IRS office taking the action the taxpayer disagrees with.
3. In order to request an appeals conference, the taxpayer must follow the instructions in the 30-day letter received from the IRS.
  - a. The IRS letter will contain a time limit during which the taxpayer may file a protest.
  - b. The letter notifies the taxpayer of his or her right to appeal the proposed changes within 30 days and includes
    - 1) A copy of the examination report explaining the examiner's proposed changes,
    - 2) An agreement or waiver form, and
    - 3) A copy of Publication 5, *Your Appeal Rights and How To Prepare a Protest If You Don't Agree*.
  - c. The taxpayer generally has 30 days from the date of the 30-day letter to tell the IRS whether (s)he will accept or appeal the proposed changes.
  - d. The letter will explain what steps the taxpayer should take, depending on which action is chosen.
  - e. If a taxpayer does not respond to a 30-day letter and does not reach an agreement with an Appeals Officer, the IRS will send the taxpayer a 90-day letter (covered on the next page).



### **90-Day Letter**

- f. A **Notice of Deficiency** is a 90-day letter (150-day letter if it is addressed to a taxpayer outside the U.S.) that requires a taxpayer who wants to dispute the adjustments to the tax owed to file a petition within 90 days (150 days for a taxpayer outside the U.S.) from the date the notice is mailed to the taxpayer.
  - 1) The 90-day notice notifies the taxpayer of the proposed additional liability.
  - 2) The taxpayer has 90 days to petition the Tax Court to hear the case.
    - a) If the taxpayer does not respond within 90 days of the notice, additional tax is assessed.
- g. If the petition to have the Tax Court hear the case is not filed on time, the tax will be due within 10 days, and the case cannot be taken to Tax Court.

### **Appeals Procedure**

- 4. The proposed increase or decrease in tax determines the appeals procedure.
  - a. If the total amount for any tax period is not more than \$25,000, a **small case** request may be filed.
  - b. If the total amount for any tax period is more than \$25,000, a formal written protest must be submitted. The protest should contain
    - 1) The name, address, identification number (i.e., EIN, SSN, etc.), and a daytime phone number of the taxpayer
    - 2) A statement that the taxpayer wants to appeal the IRS findings to the appeals office
    - 3) The date and office symbols from the letter showing the proposed changes and findings in disagreement (or a copy of the 30-day letter)
    - 4) The tax periods or years involved
    - 5) An itemized schedule of the changes with which there are disagreements
    - 6) A statement of facts supporting the taxpayer's position on any issue with which there is a disagreement
    - 7) A statement stating the law or other authority on which the argument is based
    - 8) A declaration that the statement of facts is true under penalties of perjury
      - a) To satisfy this submission requirement, the taxpayer must add the following signed declaration:

“Under penalties of perjury, I declare to the best of my knowledge and belief, the information contained in this protest and accompanying documents is true, correct, and complete.”
      - b) Alternatively, if a representative submits the protest for the taxpayer, (s)he can substitute a declaration stating
        - i) That (s)he prepared the protest and accompanying documents and
        - ii) Whether (s)he knows personally that the statement of facts in the protest and the accompanying documents is true and correct.
  - c. An interview with the IRS must be suspended immediately if the taxpayer indicates a desire to consult with a representative.
  - d. In all partnership and S corporation cases, a written protest must be filed without regard to the dollar amount at issue.



### **Repetitive Review**

5. If the same items were examined in either of the previous 2 years and the examination resulted in no change to the tax liability, the taxpayer should notify the person whose name and phone number appear in the appointment letter.
  - a. The IRS will suspend (not cancel) an audit while reviewing its files to determine whether to proceed.
  - b. This avoids repetitive examinations of the same items.

### **Statutory Period**

6. A claim for refund must be filed within 3 years from the due date (plus the filing extension time) or 2 years from the time the tax was paid, whichever is later.
  - a. In order to toll (suspend) the statute of limitations, the IRS must mail a Statutory Notice of Deficiency to the taxpayer before the end of the statutory period.
  - b. The Statutory Notice of Deficiency tolls the assessment statute of limitations but not the refund statute of limitations.
  - c. A refund claim for a prior year is made by filing an amended return such as Form 1040X for individuals or Form 1120X for corporations. Form 843 is used to claim a refund of any other tax.
7. If a tax is properly assessed, the statute of limitations for collecting the assessed amount is extended by 10 years from the assessment date.

### **Contesting Determination**

8. If, after a Collection Due Process hearing with the Office of Appeals to discuss an IRS levy or lien, the taxpayer does not agree with the appeals determination, the taxpayer has 30 days from the date of the determination to bring suit in court to contest the determination.

### 4.3 APPEALS TO THE COURTS

1. If a taxpayer and the IRS still disagree after an appeals conference or the election was made to bypass the IRS appeals system, the case may be taken to the U.S. Tax Court, the U.S. Court of Federal Claims, or a U.S. District Court.

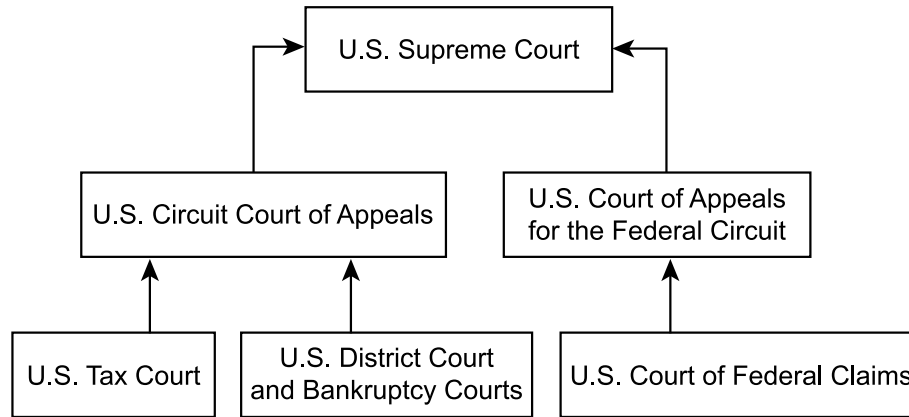


Figure 4-1

- a. The burden of proof is generally on the petitioner. However, in any court proceeding, the burden of proof shifts to the IRS for any factual issue if the taxpayer has introduced credible evidence for the issue, provided that the taxpayer has done all of the following:
  - 1) Complied with substantiation requirements in the Code
  - 2) Maintained all records required by the Code
  - 3) Cooperated with all reasonable requests for information from the IRS
  - 4) Had a net worth of \$7 million or less if the tax return is for a corporation, partnership, or trust
- b. After the filing of a petition in the Tax Court, the Appeals office will have exclusive settlement jurisdiction, for a period of 4 months, over cases docketed in the Tax Court. There is also vested in the Appeals offices authority to represent the regional commissioner in the commissioner's exclusive authority to settle
  - 1) All cases docketed in the Tax Court and designated for trial at any place within the territory comprising the region, and
  - 2) All docketed cases originating in the office of any district director situated within the region, or in which jurisdiction has been transferred to the region, which are designated for trial at Washington, D.C., unless the petitioner resides in, and the petitioner's books and records are located or can be made available in, the region that includes Washington, D.C.

## 2. Tax Court

- a. Generally, the Tax Court hears cases before any tax has been assessed or paid.
- b. In order to petition, the taxpayer must first receive a Notice of Deficiency.

### **Jurisdiction**

- c. The Tax Court has jurisdiction only over the following:
  - 1) Income tax
  - 2) Estate tax
  - 3) Gift tax
  - 4) Certain excise taxes of private foundations, public charities, qualified pension and other retirement plans, or real estate investment trusts
  - 5) Employment status determination

### **Small Tax Case Division**

- d. Any case decided in the Small Tax Case Division of the Tax Court will not be reviewed by any other court.
  - 1) The limit to be heard in the Small Tax Case Division is \$50,000.
  - 2) The Tax Court must approve the request that the case be handled under the small tax case procedure.

### **Practice before the Tax Court**

- e. With respect to docketed Tax Court cases, status solely as an enrolled agent or a CPA will not allow that person to practice before the Tax Court.
  - 1) An individual other than an attorney must demonstrate his or her qualifications satisfactorily to the Tax Court by means of a written examination given by the Tax Court.

### **(Non)Acquiescence**

- f. The IRS may announce an acquiescence or a nonacquiescence to any court decision except a decision of the Supreme Court.
  - 1) Acquiescence means that the IRS accepts the holding of the court in a case and that the IRS will follow it in disposing of cases with the same controlling facts. It does not indicate approval or disapproval of the reasons assigned by the court for its conclusions.
  - 2) Nonacquiescence signifies that, although the decision was not appealed or was not reviewed by the Supreme Court, the IRS does not agree with the holding of the court and will not follow it nationwide in disposing of other cases. With respect to opinions of an appellate court, the IRS will generally follow the holding of the circuit court in cases appealable to that circuit due to the binding nature of that opinion in lower courts, even when the office concludes that the opinion is erroneous.

### **Decision Types**

- g. The Tax Court issues two types of decisions: regular decisions and memorandum decisions.
  - 1) Regular decisions usually involve questions of law.
  - 2) Memorandum decisions usually involve questions of fact.

### 3. District Court and Court of Federal Claims

- a. Generally, District Courts and the Court of Federal Claims hear tax cases only after the tax has been paid and a claim for a refund has been filed.
- b. Claims for refund may be filed when a tax is deemed incorrect or excessive.
- c. The claim can be taken to court only if it is rejected or not acted on within 6 months from the date it is filed.
  - 1) A taxpayer may request, in writing, immediate rejection from the IRS to facilitate his or her court claim.
- d. The taxpayer must file suit no later than 2 years after the time of mailing of the rejected claim.
- e. A trial by jury is available in a District Court but not in the Tax Court.

#### **Appeal**

4. If either the taxpayer or the IRS Commissioner disagrees with the decision of the District Court, the decision may be appealed to the appropriate Circuit Court of Appeals.

### 4.4 PENALTIES

NOTE: The penalties in this subunit are assessed against the taxpayer.

#### **Negligence**

1. A 20% penalty will be imposed on the taxpayer for an understatement of tax due to negligence.
  - a. Negligence is defined as a failure to make a reasonable attempt to comply with the regulations issued by the IRS.
    - 1) Included in a failure to make a reasonable attempt are any attempts that show a "careless, reckless, or intentional disregard" for the rules.

#### **Fraud**

2. The IRS will impose a penalty of 75% of the tax owed when the taxpayer is party to tax fraud.
3. If the taxpayer files a frivolous income tax return, a \$5,000 frivolous return penalty, in addition to any other applicable penalty, is assessed against the taxpayer.

**Abatement**

- a. Taxpayers have the right to challenge the assessment of a penalty and may request the following:
  - 1) A review of the penalty prior to assessment (e.g., deficiency procedures)
  - 2) A penalty abatement after it is assessed and either before or after it is paid (post-assessment review)
  - 3) An abatement and refund after payment (claim for refund)
- b. A reduction or elimination of tax, penalties, or interest. Taxes may be abated when the IRS determines that there was an overassessment.
  - 1) General rule. The Secretary of the Treasury is authorized to abate the unpaid portion of the assessment of any tax or any liability in respect thereof, which is
    - a) Excessive in amount,
    - b) Assessed after the expiration of the period of limitation properly applicable thereto, or
    - c) Erroneously or illegally assessed.

**Reasonable Cause**

- c. The amount of interest owed may be abated by the IRS if the interest is due to unreasonable errors and delays by the IRS. In general,
  - 1) This applies in the case of any assessment of interest on any deficiency attributable in whole or in part to any unreasonable error or delay by an officer or employee of the IRS (acting in his or her official capacity) in performing a ministerial or managerial act; or
  - 2) If late payment of any tax was caused by office or employee error, the taxpayer can request the abatement of all or any part of such interest for any period.
    - a) This only applies if the taxpayer was not significantly responsible for the delay or error.
    - b) The taxpayer must contact the IRS in writing to request abatement.

**Interest Abatement**

- d. An abatement of interest is requested by writing "Request of abatement of interest under Sec. 6404(e)" at the top of Form 843.

**Passport Revocation**

- 4. The IRC authorizes the IRS to certify seriously delinquent tax debt to the State Department for action.
  - a. Seriously delinquent tax debt is an individual's unpaid, legally enforceable federal tax debt totaling more than \$55,000 (including interest and penalties) for which
    - 1) A Notice of Federal Tax Lien has been filed and all administrative remedies under the IRC have lapsed or been exhausted or
    - 2) A levy has been issued.
  - b. Upon receiving certification, the State Department shall deny the taxpayer's passport application and/or may revoke his or her current passport. If the taxpayer is overseas, the State Department may issue a limited validity passport good only for direct return to the United States.

# STUDY UNIT FIVE

## THE COLLECTION PROCESS

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The purpose of the IRS is to collect the proper amount of tax revenue while minimizing cost; serve the public by continually improving the quality of its products and services; and perform in a manner warranting the highest degree of public confidence in its integrity, efficiency, and fairness. This study unit explains the taxpayer's rights and responsibilities regarding payment and collection of federal tax.

### 5.1 COLLECTIONS

#### Notice

1. When a taxpayer does not pay the full amount of tax owed, (s)he will receive an **assessment**.
  - a. This assessment notifies the taxpayer of the balance due, demands payment, and begins the collection process.
    - 1) The notice requests payment within 10 days.
    - 2) Notices requesting payment are generated at the IRS service center.

#### Statutory Period

2. The IRS has 10 years from the date of assessment to collect the amount of tax assessed. This limit of time for collection of a debt is generally referred to as the **statute of limitations**. During this period, the tax may be collected by levy or by a proceeding in court.
  - a. However, the taxpayer and the IRS may agree upon an extension of the period of time in which to collect.
  - b. The 10-year collection period may be extended after it has expired if
    - 1) There has been a levy on any part of the taxpayer's property prior to the expiration and
    - 2) The extension is agreed to in writing before the levy is released.
  - c. The statute of limitations on collection can be suspended by various acts. The IRS must notify the taxpayer that (s)he may refuse to extend the statute of limitations.
    - 1) Filing a petition in bankruptcy under Title 11 of the U.S. Code automatically stays assessment and collection of tax.
      - a) The stay remains in effect until the bankruptcy court discharges liabilities or lifts the stay.
      - b) Although the bankruptcy court has the authority to state the amount or legality of the tax liability charged against the taxpayer filing for bankruptcy, it may not determine the amount or legality of a tax liability that has already been decided by the appropriate jurisdiction before the filing of the bankruptcy petition.
  - d. Form 872-A, *Special Consent to Extend the Time to Assess Tax*, indefinitely extends the period within which a tax may be assessed.

3. If a taxpayer is unable to pay the bill in full, (s)he is expected to pay as much as possible and contact the IRS for assistance.
  - a. The IRS will attempt to determine the best method of payment based on the taxpayer's current financial condition as reported on Forms 433 A, B, and F.
    - 1) In determining the taxpayer's general financial health, these forms require the reporting of, among many other items, the taxpayer's history of bankruptcy filings, financial obligations (e.g., settlement of lawsuits), and court ordered payments (e.g., garnishments). This information assists in determining whether the taxpayer is solvent or insolvent, i.e., the taxpayer's ability to pay an assessed tax liability.

### **Installment Agreements**

- b. The IRS is authorized to, and in certain cases must, enter into a written agreement for payments to be made in installments. The payment plan is based on an individual's current financial condition. The plan is subject to the following stipulations:
  - 1) Interest and penalties continue to accrue.
  - 2) The payments must be made on time, and the taxpayer must provide a financial update if requested by the IRS.
    - a) Otherwise, the agreement may be subject to termination.
    - b) The agreement also may be terminated if the IRS determines that the taxpayer's financial condition has significantly changed.
  - 3) The IRS must notify a taxpayer 30 days in advance before any changes in the agreement may be made.
    - a) The IRS must provide the opportunity for an independent administrative review of any termination of an installment agreement.
  - 4) In order to obtain an installment agreement, the taxpayer must file all of his or her tax returns and make the current estimated tax payment, if required. The IRS will assess a one-time fee to set up the agreement. Form 9465 is used to request a monthly installment agreement. Taxpayers who owe less than \$50,000 can instead request an installment agreement online and pay a lower set-up fee.
    - a) The IRS also may require that the taxpayer fill out Form 433-F, *Collection Information Statement*, explaining his or her situation.
      - i) For amounts between \$25,001 and \$50,000, installment agreements do not require the taxpayer to complete Form 433-F, *Collection Information Statement*. However, direct debit information (e.g., routing number and account number of the taxpayer's bank account) or a completed Form 2159, *Payroll Deduction Agreement*, must be provided.
    - b) The IRS may still file a Notice of Federal Tax Lien to secure the government's interest until the final payment is made.
    - c) The IRS cannot take any collection actions
      - i) While it considers a request for an installment agreement,
      - ii) While the agreement is in effect,
      - iii) For 30 days after an agreement is rejected, or
      - iv) For any period while an agreement rejection is being appealed.

**Guaranteed Installment Agreements**

- c. Under the following conditions, the IRS must enter into an installment agreement with any taxpayer requesting such an arrangement. These requirements also apply to the taxpayer's spouse if the liability proposed to be paid in installments relates to a joint return.
  - 1) The taxpayer must not owe more than \$10,000;
  - 2) During the past 5 years, the taxpayer must not have
    - a) Failed to file any income tax return,
    - b) Failed to pay any income tax, or
    - c) Entered into any installment agreement for payment of any income tax;
  - 3) The taxpayer is financially unable to pay the liability in full when due;
  - 4) The taxpayer must agree to pay in full within 6 years; and
  - 5) The taxpayer must agree to file and pay all tax returns while the agreement is in effect.

**Extension of Time to Pay**

- 4. Taxpayers can receive an extension of time for payment due to undue hardship. They must file a Form 1127, *Application for Extension of Time for Payment of Tax Due to Undue Hardship*. For estate tax and GSTT, the taxpayer uses Form 4768, *Application for Extension of Time to File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes*.
  - a. **Undue hardship** means more than an inconvenience. The taxpayer must show a substantial financial loss (e.g., selling property at a sacrifice price) if the tax is paid on the date it is due.
  - b. Generally, the full amount of the income tax owed, plus interest and any other penalties, must be paid on or before the 6-month extension due date (e.g., October 15). With a few exceptions, an extension of more than 6 months may be granted if the taxpayer is out of the country.
    - 1) If the request for an extension of time to pay is granted, it will only affect the failure-to-pay penalty. The taxpayer will still owe interest and any other penalties on the unpaid amount from the original due date (e.g., April 15) until the tax is paid in full.
    - 2) If full payment of the amount of the tax for which the taxpayer requested the extension, plus interest and other penalties, is not paid on or before the payment extension date, a failure-to-pay penalty will be imposed and calculated from the original due date.



**Collection Appeals Program**

5. In addition to contesting IRS assessments, a taxpayer may appeal collection activities.
- a. A taxpayer, or third party whose property is subject to a collection action, may appeal the following actions under the Collection Appeals Program (CAP):
    - 1) Levy or seizure action that has been or will be taken
    - 2) A Notice of Federal Tax Lien (NFTL) that has been or will be filed
    - 3) The filing of a notice of lien against an alter-ego or nominee's property
    - 4) Denials of requests to issue lien certificates, such as subordination, withdrawal, discharge, or non-attachment
    - 5) Rejected, proposed for modification or modified, or proposed for termination or terminated installment agreements
    - 6) Disallowance of taxpayer's request to return levied property
    - 7) Disallowance of property owner's claim for return of property
  - b. If a taxpayer disagrees with the decision of the IRS employee and wishes to appeal, the taxpayer must first request a conference with the employee's manager.
  - c. If the taxpayer does not resolve the disagreement with the collection manager, (s)he may submit Form 9423, *Collection Appeal Request*, to request consideration by Appeals. The taxpayer must let the collection office know within 2 business days after the conference with the collection manager that the taxpayer plans to submit Form 9423. The Form 9423 must be received or postmarked within 3 business days of the conference with the collection manager, or collection action may resume.
    - 1) If the taxpayer requests an appeal after the IRS makes a seizure, the taxpayer must appeal to the collection manager within 10 business days after the Notice of Seizure is provided to the taxpayer or left at the taxpayer's home or business.
  - d. If the taxpayer requests a conference and is not contacted by a manager or designee within 2 business days of the request, the taxpayer can contact the collection manager again or submit Form 9423. If submitting Form 9423, the taxpayer should note the date of the request for a conference in Block 15 and indicate that the taxpayer was not contacted by a manager. The Form 9423 should be received or postmarked within 4 business days of the taxpayer's request for a conference, as collection action may resume.
  - e. On the Form 9423, the taxpayer checks the collection action(s) disagreed with and explains why the disagreement exists. The taxpayer must also explain the solution to resolve the tax problem. Form 9423 is to be submitted to the collection office involved in the lien, levy, or seizure action.
  - f. In situations where the IRS action(s) create economic harm or the taxpayer wants help because the tax problem has not been resolved through normal channels, the taxpayer can contact the Taxpayer Advocate Service.
  - g. A taxpayer may appeal an installment agreement that has been rejected, proposed for modification or modified, or proposed for termination or terminated.
    - 1) If the taxpayer disagrees with the decision regarding the installment agreement, the taxpayer should appeal by completing a Form 9423.
    - 2) The taxpayer should provide it to the office or revenue officer who took the action regarding the installment agreement within 30 calendar days.

- h. What will happen when the taxpayer appeals the case? Normally, the IRS will stop the collection action(s) the taxpayer disagrees with until the appeal is settled, unless the IRS has reason to believe that collection or the amount owed is at risk.
- i. A taxpayer may represent himself or herself at an Appeals conference, or (s)he may be represented by an attorney, certified public accountant, or a person enrolled to practice before the IRS.
  - 1) If the taxpayer wants his or her representative to appear without him or her, the taxpayer must provide a properly completed Form 2848, *Power of Attorney and Declaration of Representative*.
- j. Once Appeals makes a decision regarding the taxpayer's case, that decision is binding on both the taxpayer and the IRS. The taxpayer cannot obtain a judicial review of Appeals' decision following a CAP. However, there may be other opportunities to obtain administrative or judicial review of the issue raised in the CAP hearing. For example, a third party may contest a wrongful levy by filing an action in district court.
  - 1) Providing false information, failing to provide all pertinent information, or fraud will void Appeals' decision.

### **Administrative Summons**

- 6. The administrative summons is among the IRS's most powerful tools for tax determination and collection. Unlike levies and federal tax liens, which directly seize or encumber assets, the summons is an administrative discovery device that is similar in intent and reach to a grand jury subpoena, and the IRS uses it to locate assets.
  - a. The IRS normally issues a summons during the investigative stage of an examination to compel production of records not voluntarily produced. If such summons is issued to a third party, the taxpayer identified in such summons is generally entitled to notice of the summons and is given an opportunity to begin a proceeding to quash the summons.
  - b. After the taxpayer's liability has been determined, the IRS may issue a summons to locate assets. The collection summons may request the same types of records as an investigative summons, that is, any books, records, papers, or other data that may be relevant to the collection of taxes. Typically, a collection summons requests bank records, financial statements and records, property records and records of property transfers, and transactions.
  - c. The IRS must provide advance notice to the taxpayer that third-party contacts will be made in connection with the collection of the taxpayer's liability. This notice requirement does not apply to John Doe summonses or to certain emergency summonses. In addition, the IRS is required to periodically provide the taxpayer with a list of specific contacts and also to provide the list upon the taxpayer's request. These rules do not apply, however, if the collection is in jeopardy or the taxpayer authorizes the contact.
  - d. Unlike an investigative summons issued during the examination of the taxpayer, if a collection summons is issued to any third party, the IRS is not required to notify the taxpayer of the summons and the taxpayer may not file a petition to quash the summons.

**Refund Offset**

7. Taxpayers owing past-due federal tax, state income tax, state unemployment compensation debts, child support, spousal support, or certain federal nontax debts, e.g., student loans, may have all or part of their refund used (offset) to pay the past-due amount. Offsets for federal taxes are made by the IRS. All other offsets are made by the Treasury Department's Bureau of Fiscal Services (BFS). For federal tax offsets, the taxpayer will receive a notice from the IRS. For all other offsets, the taxpayer will receive a notice from BFS.

**IRS Collection Financial Standards**

8. Collection Financial Standards are used to help determine a taxpayer's ability to pay a delinquent tax liability. Allowable living expenses include those expenses that meet the necessary expense test.
  - a. The necessary expense test is defined as expenses that are necessary to provide for a taxpayer's (and his or her family's) health and welfare and/or production of income.
9. **National Standards** apply nationwide and include
  - a. A standard monthly amount for food, clothing, and other items based on family size.
  - b. Minimum allowances for out-of-pocket healthcare expenses for which taxpayers and their dependents are allowed the standard amount monthly on a per-person basis.
10. Maximum allowances for monthly housing and utilities and transportation, known as the **Local Standards**, vary by location.
11. Generally, the total number of persons allowed for necessary living expenses should be the same as those allowed as dependents on the taxpayer's most recent year income tax return.
12. If the IRS determines that the facts and circumstances of a taxpayer's situation indicate that using the standards is inadequate to provide for basic living expenses, the IRS may allow for actual expenses.
  - a. The taxpayer must provide documentation that supports a determination that using national and local expense standards leaves them an inadequate means of providing for basic living expenses.

**5.2 OFFER IN COMPROMISE**

1. The IRS may accept an offer in compromise to settle unpaid tax accounts for less than the full amount of the balance due.
  - a. The amount offered must reflect the taxpayer's maximum ability to pay.
    - 1) Present and future earning capacity are considered.
  - b. The Commissioner of the IRS has the authority to compromise all taxes, interest, and penalties other than those relating to alcohol, tobacco, and firearms.

2. A compromise may be made on one, two, or all of three grounds:
  - a. Doubt as to the liability for the amount owed
    - 1) Doubt as to the liability for the amount owed must be supported by the evidence.
  - b. Doubt as to the taxpayer's ability to make full payment
    - 1) The total amount owed must be greater than the sum of the taxpayer's assets and future income.
  - c. Promotion of effective tax administration
    - 1) Existence of economic hardship or other special circumstance
3. There are two types of offer in compromise payment terms:
  - a. Lump sum cash payments must be paid within 5 or fewer installments within 5 or fewer months after the offer is accepted.
  - b. Periodic payments must be paid monthly until paid in accordance with the provisions of the offer. They must be payable in 6 or more monthly installments and within 24 months after the offer is accepted.
4. Before an offer in compromise is considered, the individual taxpayer must
  - a. File all legally required tax returns,
  - b. Make all required estimated tax payments for the current year,
  - c. Have received a bill for at least one tax debt included in the offer,
  - d. Not be in an open bankruptcy proceeding, and
  - e. If the taxpayer is a business owner with employees, make all required federal tax deposits for the current quarter and the two preceding quarters.
5. The submission for payment terms must include the \$205 application fee. In addition to the application fee, the following are required with the submission:
  - a. A nonrefundable 20% of the offered amount for lump sum cash offers. The remaining balance is paid by the five or fewer installments.
  - b. An initial proposed payment for periodic offers. The remaining proposed periodic payments must continue to be made while the offer is being evaluated.

NOTE: There is an exemption of these submission requirements for taxpayers at or below income levels based on poverty guidelines.

6. If the taxpayer is basing the **offer in compromise on doubt as to collectibility or promotion of effective tax administration**, the taxpayer must also submit Form 433-A, *Collection Information Statement for Wage Earners and Self-Employed Individuals*, or Form 433-B, *Collection Information Statement for Businesses*, with supporting documentation. Submission of both forms may be required.
  - a. If the taxpayer is basing the **offer in compromise on doubt as to liability**, the taxpayer must file a Form 656-L, *Offer in Compromise (Doubt as to Liability)*, instead of Form 656 and Form 433-A (OIC) and/or Form 433-B (OIC).

7. After acceptance of an offer, the taxpayer must remain current with filing and paying requirements for 5 years or until the amount of the offer is paid in full, whichever is longer.
  - a. The taxpayer may ask the IRS Office of Appeals to review a rejection of the offer in compromise.

### **Taxpayer Assistance Orders**

8. The National Taxpayer Advocate Office performs the following functions:
  - a. Assists taxpayers in resolving problems with the IRS
    - 1) The National Taxpayer Advocate is responsible for issuing Taxpayer Assistance Orders (TAOs) through the Problem Resolution Office.
      - a) TAOs are issued in assisting taxpayers suffering significant hardship as a result of how the revenue laws are being enforced.
      - b) The order may require the IRS to release levied property or stop any action, or refrain from taking further action, under any section of the IRS Code.
      - c) A TAO is requested by submitting Form 911.
  - b. Identifies areas in which taxpayers have problems in dealing with the IRS
  - c. Proposes changes to IRS administrative practices that would mitigate the problems that exist between the IRS and taxpayers
  - d. Identifies possible law changes that might mitigate the problems identified between the IRS and taxpayers

### **Interest**

9. Interest is generally figured from the due date of the return to either (a) the date payment is made, if paid when agreement of assessment is signed, or (b) the billing date, if paid within 21 days (10 days if the balance exceeds \$100,000).

### **Injured Spouse**

10. Form 8379, *Injured Spouse Allocation*, is filed by one spouse on a MFJ tax return when the joint overpayment was applied to a past-due obligation of the other spouse. The injured spouse may be able to get back his or her share of the joint refund.

### **Collection Statute Expiration Date**

11. The last date the IRS can collect unpaid tax from the taxpayer consists of the year, month, and day.
  - a. The IRS generally has 10 years from the date of assessment to collect tax.
    - 1) Certain actions by taxpayers either suspend or extend the collection statute of limitations.
    - 2) Examples include filing a Collection Due Process hearing request and submitting offers in compromise or installment agreements.

### 5.3 LIENS AND LEVIES

#### Lien

1. If a person neglects or refuses to pay a deficiency after demand, a lien attaches to all the person's property.
  - a. A lien is a claim against the assets of a taxpayer who has failed to pay a debt.
  - b. When the IRS files a Notice of Federal Tax Lien, all creditors of the taxpayer are notified of the lien. This results in an attachment of the lien to all of the taxpayer's property, including property that is acquired after the notice is filed.

#### Attachment Requirements

- c. Before the IRS files a Notice of Federal Tax Lien, three requirements must be met for the statutory lien to attach:
  - 1) The IRS must assess the liability.
  - 2) The IRS must send notice of tax due and demand for payment, unless waived by the taxpayer.
  - 3) The taxpayer must neglect or refuse to pay the tax within 10 days after notification.

#### Notice

- d. The IRS must notify the taxpayer in writing within 5 business days after filing a lien.
- e. Recording the notice provides constructive notice to potential purchasers and creditors that the government has a claim against the property.
  - 1) Recording restricts the ability to transfer or encumber the property.

#### Prepayment Removal

- f. There are several circumstances in which the lien is removed prior to the payment of the tax. The Secretary is the authority with the ability to withdraw a notice of a lien filed.

#### Release

- g. The IRS will issue a Release of the Notice of Federal Tax Lien within 30 days after the tax due is satisfied.
  - 1) The tax due also includes all fees charged by the state or other jurisdiction for both filing and releasing the lien.
    - a) The fees are added to the balance owed.
  - 2) Failure by the IRS to release a lien allows the taxpayer to bring a civil suit for damages.
- h. The IRS will discharge a lien on taxpayer property if the property has declined in value and a sale of the property will not generate any proceeds for the IRS.

**Appeal**

- i. A taxpayer may appeal the filing of a Notice of Federal Tax Lien if the taxpayer believes the IRS filed in error.
  - 1) Form 12153, *Request for a Collection Due Process or Equivalent Hearing*, is completed and sent to the address from which the lien (or levy, discussed below) came. The request must be received within 30 days.
  - 2) Upon the conclusion of the CDP hearing, the IRS will issue a determination stating whether the lien will be removed or will continue its existence.
    - a) If the taxpayer disagrees with the outcome of the hearing, (s)he has 30 days from the receipt of the letter to bring a suit to contest the determination.
  - 3) A lien is considered incorrect if it is filed while a taxpayer is in bankruptcy and subject to the automatic stay during bankruptcy.

**Levy**

- 2. The IRS is authorized to levy on a person's property to collect unpaid assessed taxes.
  - a. Levy is defined as the power of distraint and seizure by any means.

**Assessment**

- b. Before levy action can begin, the IRS must make a determination of tax liability and assess it.
  - 1) Interest is assessed from the date the taxes are required to be paid, usually the due date of the return.

**Notice and Demand**

- c. Within 60 days after making the assessment, the IRS is required to provide a notice and demand for payment to the person.
  - 1) It must be left at the person's home or usual place of business or sent by mail to the person's last known address.
  - 2) The notice is accompanied by a publication outlining the person's rights.
  - 3) The right to discuss the matter with the collection employee's manager is provided at any step of the collection process.
  - 4) The Taxpayer Advocate Service (TAS) is an independent organization within the IRS and is the taxpayer's "voice at the IRS."
    - a) TAS helps taxpayers whose problems are causing financial difficulty.
    - b) The taxpayer may be eligible for help if the taxpayer tried to resolve the tax problem through normal IRS channels or the taxpayer believes an IRS procedure is not working as designed.
  - 5) If the taxpayer agrees to the assessment of the deficiency and pays the amount within 21 calendar days (10 business days if  $\geq \$100,000$ ) after the date of the notice and demand, interest will not be imposed after the date of the notice and demand.
    - a) This suspension of interest does not apply to interest on penalties and additions to tax for failure to file, for failure to pay the stamp or asset transfer tax, and for the accuracy-related and fraud penalties.
  - 6) A deposit of cash by the taxpayer, if (s)he believes additional tax is owed, may stop the further accrual of interest on the amount sent, but interest will continue to accrue on accrued interest.



**Final Notice**

- d. If the taxpayer does not pay the tax within 10 days after notice and demand, a Notice of Intent to Levy must be provided at least 30 days in advance of levy.
  - 1) This notice may be given in person, left at the taxpayer's home or usual place of business, or sent by certified mail.

**Jeopardy Levy**

- e. If the IRS makes a finding that assessment or collection of a tax deficiency is in jeopardy, the IRS may waive the 10-day notice and demand period and/or the 30-day Final Notice of Intent to Levy period.
  - 1) A jeopardy levy is based on the collection of tax, interest, penalties, etc., being endangered by delay.
  - 2) In most cases, the following are insufficient bases for a jeopardy levy:
    - a) A bankruptcy petition filed by the person
    - b) Seized property that is perishable
    - c) Drug Enforcement Administration participation

**Exercise of Levy**

- f. The IRS is authorized to seize (take) and sell property of persons with unpaid assessed liability after proper notice.
  - 1) Certain property is exempt from levy. The exempt property includes the following:
    - a) Wearing apparel necessary for the taxpayer or for family members
    - b) School books and tools of a trade
    - c) Undelivered mail
    - d) Unemployment benefits
    - e) Workers' compensation
    - f) Certain annuity and pension benefits
    - g) Minimum exemption for wages, salary, and other income
    - h) Principal residence, unless the levy is approved in writing by a judge or magistrate of a U.S. District Court
    - i) Tangible personal or nonrental real property used in a trade or business, unless the levy is approved in writing by an area director or assistant area director of the IRS, or unless the collection is in jeopardy
  - 2) In most states that have state income taxes, the IRS can levy a state refund check and apply the state refund to a federal tax debt.



**Sale**

- g. After seizing property, the IRS gives notice of its pending sale to the person from whom it was seized and to the public.
  - 1) Sale must occur between 10 and 40 days after public notice is given.
    - a) The property may be sold by public auction or sealed bids.
  - 2) Perishable goods. If the taxpayer posts a bond or pays the appraised value, seized perishable goods must be returned.
    - a) Otherwise, they must be sold immediately.
  - 3) If real estate was sold, the taxpayer or anyone with an interest in the property may redeem it at any time within 180 days after the sale by paying the purchaser the amount paid for the property plus a certain percentage of interest.
  - 4) Before the date of sale, the IRS computes a “minimum bid price,” which is the lowest amount the IRS will accept for the sale of that property to protect the taxpayer’s interest in that property.
  - 5) The sale proceeds are applied first against the expenses of the proceedings, next against any federal excise tax imposed directly on the property, and then against the tax liability for which the levy was made.
  - 6) Any real property used as a residence by the taxpayer may not be seized to satisfy a levy of \$5,000 or less.

**Wages**

- h. A levy on wages begins from the date the levy is enacted until
  - 1) The tax liability assessed is satisfied,
  - 2) The levy is released, or
  - 3) The levy becomes unenforceable due to lapse of time.
- i. An exemption exists for an amount of weekly income equal to the standard deduction divided by 52.
  - 1) For example, a single taxpayer’s weekly levy exemption is \$249.03 ( $\$12,950 \div 52$ ).
- j. The IRS will release a levy if the IRS determines the levy is creating an economic hardship for the taxpayer.

**Discharging Taxes through Bankruptcy**

3. Income tax debts may be eligible for discharge under Chapter 7 or Chapter 13 of the Bankruptcy Code. Chapter 7 provides for full discharge of allowable debts. However, tax liens will not be removed with a Chapter 7 bankruptcy. Chapter 13 provides a payment plan to repay some debts, with the remainder of debts discharged. In order to remove the tax debts completely, the taxpayer must liquidate non-exempt assets (determined by each state) and meet certain qualifications or conditions.
  - a. The IRS will not discharge taxes through bankruptcy unless certain conditions are met. These conditions are applicable to tax returns and tax assessments independently. If any one of the following qualifications are not met, or are off by a day or two, the taxes will still be due at the end of the bankruptcy proceedings:
    - 1) Solely income taxes -- Only income taxes can be discharged in bankruptcy as opposed to payroll taxes and other types of taxes.
    - 2) Taxes must be at least 3 years old -- The tax debts and their respective returns must be filed at least 3 years before filing for bankruptcy. This is often called the 3-year rule. Understand that this includes filing extensions as well. So if the taxpayer received a 6-month extension, it would be 3 years from the extension date (typically October 15).
    - 3) Tax returns filed 2 years before bankruptcy filing -- Any IRS taxes to be discharged must have been filed 2 years before filing for bankruptcy. Therefore, a taxpayer cannot file unfiled tax returns today from 3 years ago and then file for Chapter 7. Substitute tax returns do not count.
    - 4) Taxes were assessed at least 240 days ago -- The IRS must have assessed applicable taxes at least 240 days before a petition is filed. Taxes can be assessed more than once in a year. An assessment is when the IRS reviews unpaid taxes and makes any changes (e.g., adding to the balance) to the tax return and taxes owed. Therefore, any taxes that do not meet this 240-day rule will not be discharged.
    - 5) No fraudulent tax activities or evasion -- A taxpayer convicted of tax evasion or fraudulent tax activities will not qualify to have his or her taxes discharged.
    - 6) A taxpayer must prove to the court that the last 4 years of tax returns have been filed and must have a copy of the most recent return.

## 5.4 TRUST FUND RECOVERY PENALTY

1. The trust fund recovery penalty was enacted to encourage the prompt payment of withheld income and employment taxes, including Social Security and collected excise taxes.
  - a. Excise taxes are paid when purchases are made on a specific good, such as gasoline.
  - b. Excise taxes are often included in the price of the product.
2. Trust fund taxes are composed of
  - a. Income taxes withheld, plus
  - b. The employee's portion of FICA taxes withheld.
3. The penalty is imposed against any person who is responsible for collecting or paying withheld income and employment taxes and who willfully fails to collect or pay them.
  - a. A person is responsible if (s)he has the duty to perform and the power to direct the collecting, accounting, and paying of trust fund taxes. This person may be a(n)
    - 1) Officer or employee of a corporation
    - 2) Member or employee of a partnership
    - 3) Corporate director or shareholder
    - 4) Member of a board of trustees

NOTE: Non-officer and/or non-equity employees have a low likelihood of receiving the penalty.
  - b. A person's failure to pay or collect taxes is willful if (s)he has free will or choice yet either intentionally disregards the law or is plainly indifferent to legal requirements.
  - c. An employee is not responsible if his or her function was solely to pay the bills as directed by a supervisor, rather than to determine which creditors would or would not be paid.
4. The penalty amount is 100% of the amount of trust fund taxes that were not paid.
5. The additional Medicare tax under Sec. 1411 is not designated as a trust fund tax.
6. Trust fund recovery penalties are excepted from discharge whether or not they were provided for in the plan or included on a timely filed proof of claim.
7. Trust fund recovery penalty assessments are based on liabilities recorded on the tax forms below.

Form Number	Form Title
Form CT-1	<i>Employer's Annual Railroad Retirement Tax Return</i>
Form 720	<i>Quarterly Federal Excise Tax Return</i>
Form 941	<i>Employer's Quarterly Federal Tax Return</i>
Form 943	<i>Employer's Annual Federal Tax Return for Agricultural Employees</i>
Form 944	<i>Employer's Annual Federal Tax Return</i>
Form 945	<i>Annual Return of Withheld Federal Income Tax</i>
Form 1042	<i>Annual Withholding Tax Return for U.S. Source Income of Foreign Persons</i>
Form 8288	<i>U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests</i>
Form 8804	<i>Annual Return for Partnership Withholding Tax (Section 1446)</i>

# STUDY UNIT SIX

## TAX AUTHORITY

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Tax law is comprised of three basic sources of authority: statutory law, administrative pronouncements, and judicial decisions. In combination, these sources provide the authority by which both taxpayers and governments must abide. Statutory law is contained in the Internal Revenue Code (IRC), which consists of sections that contain operational, definitional, or procedural rules relating to federal taxes. The Department of the Treasury has the responsibility of issuing administrative pronouncements, including Treasury regulations, that interpret and illustrate the rules contained in the IRC. Finally, if a disagreement arises regarding the interpretation of a tax law, a taxpayer may take his or her case to federal court to settle the dispute. Court decisions may serve as guidance for future tax decisions.

## 6.1 STATUTORY LAW (LEGISLATIVE LAW)

### IRC 1986

1. **The Internal Revenue Code (IRC)** of 1986 is the primary source of federal tax law. It imposes income, estate, gift, employment, and miscellaneous excise taxes as well as provisions controlling the administration of federal taxation. The IRC is found at Title 26 of the titles of the United States Code (U.S.C.).
  - a. The courts give great importance to the literal language of the IRC, but not every tax controversy can be resolved by the language in the Code.
    - 1) In cases where the literal language of the Code is ambiguous, the courts will consider the history of a particular Code section, including committee reports and other legislative history, Treasury regulations and other IRS published guidance interpreting the Code section, and the relationship of the particular Code section to other Code sections.
  - b. The Code is continually changing, requiring practitioners to carefully determine the law applicable to the year under examination.
    - 1) To do so, practitioners determine whether the applicable law has been modified and, if so, the date on which the changes became effective.
    - 2) Many publishers provide this information in small print immediately following the current Code section.

### Committee Reports

2. **Committee reports** are useful tools in determining Congressional intent behind certain tax laws and helping examiners apply the law properly.

### Treaties

3. In the U.S., a tax treaty is treated as equivalent to statutory law and overrides the IRC. The United States has income tax treaties with a number of foreign countries. Under these treaties, residents (not necessarily citizens) of foreign countries are taxed at a reduced rate or are exempt from U.S. income taxes on certain items of income they receive from sources within the United States. These reduced rates and exemptions vary among countries and specific items of income. Treaty provisions generally are reciprocal (i.e., apply to both treaty countries and their residents).

## 6.2 REGULATIONS, RULES, AND PROCEDURES (ADMINISTRATIVE LAW)

### Regulations

1. IRC Sec. 7805(a) grants general authority to the Secretary of the Treasury to “prescribe all needful rules and regulations for the enforcement” of the Code. All regulations are written by the Office of the Chief Counsel, IRS, and approved by the Secretary of the Treasury.
  - a. Regulations are issued as interpretations of specific Code sections and are organized in a sequential system consistent with the Code. The prefixed number designates the area of taxation referred to by the regulation.
  - b. Treasury Regulations (also referred to as Income Tax Regulations) are authorized by law. Nevertheless, courts are not bound to follow such administrative interpretations to the extent they conflict with the Code.
    - 1) The IRS is generally bound by regulations; the courts are not.
  - c. The Supreme Court has stated that “Treasury Regulations must be sustained unless unreasonable and plainly inconsistent with the revenue statutes.”
    - 1) However, if the regulation is promulgated under the “general authority to prescribe all needful rules and regulations, 26 U.S.C. Sec. 7805 . . . ‘we owe the interpretation less deference than a regulation issued under a specific grant of authority to define a statutory term or prescribe a method of executing a statutory provision.’”
    - 2) The effect of a regulation on the courts depends on whether the regulation is considered legislative, interpretative, or procedural.
2. A regulation can be characterized as one of three types: legislative, interpretative, or procedural.

### Legislative

- a. Legislative regulations are issued pursuant to specific authorization from, or direction by, Congress in particular Code sections.
  - 1) Legislative regulations are not issued pursuant to the authority of Sec. 7805 but under specific authority of a particular statute.
  - 2) Some Code sections that authorize legislative regulations are very brief.
    - a) For example, the consolidated tax return regulations are less than 2 pages, but related legislative regulations are more than 200 pages.
  - 3) When the Treasury promulgates a legislative regulation, the regulation has the force and effect of law.
    - a) A legislative regulation is as binding as a statute if it is
      - i) Within the grant of delegated power,
      - ii) Issued pursuant to proper procedure, and
      - iii) Reasonable.

NOTE: The delegating statute and the regulation also must be within constitutional bounds.
    - b) A reviewing court has no authority to substitute its judgment concerning the regulation’s content because Congress granted that discretion to the Treasury and not to the court.
    - c) A legislative regulation, however, may be overturned if it exceeds the scope of the power delegated to the Treasury, is contrary to the statute, or is unreasonable.

**Interpretative**

- b. An interpretative regulation explains the meaning of a statutory provision. Unlike a legislative regulation, there is no section-specific grant of authority for the promulgation of an interpretative regulation.
  - 1) Authority to issue an interpretative regulation is derived from the general grant of authority to prescribe all needful rules and regulations for enforcement of the tax laws.
  - 2) Interpretative regulations do not have the force and effect of law.
    - a) However, the courts customarily accord them substantial weight.
    - b) A regulation issued at the same time as the enactment of a Code provision is given more weight because it is more likely to represent the legislative intent.
    - c) Interpretative regulations that have been in existence for a long time are given greater weight than more recent ones.

**Procedural**

- c. Procedural regulations are promulgated under the procedural and administrative provisions of the Code by the Commissioner of the IRS, not the Secretary of the Treasury.
  - 1) Procedural regulations are binding on the IRS insofar as they affect a vital or personal interest of the taxpayer.
  - 2) Procedural regulations describing obligations to file forms and information appear to be given the force and effect of law.
- 3. Regulations can be further classified as proposed, temporary, or final.

**Proposed**

- a. Proposed regulations are issued to elicit comments from the public. Public hearings are held if written requests are made.
  - 1) Proposed regulations might be used as somewhat of an authority for taking a tax position.
    - a) The regulations themselves do not state this and must be considered as a weak authority at best.
  - 2) Notices of proposed rulemaking are required for proposed regulations and are published in the Federal Register so that interested parties have an opportunity to participate in the rule-making process.

**Temporary**

- b. Temporary regulations provide guidance to the IRS, tax practitioners, and the public until final regulations are issued.
  - 1) Temporary regulations have the same force and effect of law as final regulations until the final regulations are issued.
    - a) Public hearings are not held on temporary regulations unless written requests are made.
  - 2) Temporary regulations
    - a) Can be used as somewhat of an authority
    - b) May remain effective for a maximum of 3 years
    - c) Must be issued concurrently as proposed regulations

**Final**

- c. Final regulations are adopted after public comment on the proposed versions has been evaluated by the Treasury.
  - 1) When a proposed regulation becomes final or an existing regulation is amended, the document that describes the finalization or amendment is referred to as a Treasury Decision (TD).
  - 2) Some Code sections do not have final Treasury Regulations.

**Authority of the Regulations**

- 4. The IRS is bound by the regulations. The courts are not.
  - a. If both temporary and proposed regulations have been issued on the same Code section and the text of both are similar, taxpayers' positions should be based on the temporary regulations because they can be cited as an authority for proposing an adjustment.
  - b. When no temporary or final regulations have been issued, taxpayers may use a proposed regulation to support a position.
    - 1) The taxpayer should indicate that the proposed regulation is the best interpretation of the Code section available.

**Revenue Rulings**

- 5. A revenue ruling is an official interpretation of Internal Revenue law as applied to a given set of facts and is issued by the IRS.
  - a. Revenue rulings are published in Internal Revenue Bulletins (and later the Cumulative Bulletin) to inform and advise taxpayers, the IRS, and others on substantive tax issues.
  - b. Publication of revenue rulings is intended to promote uniform application of tax laws by IRS employees and to reduce the number of letter ruling requests.
  - c. Revenue rulings may be cited as precedent and relied upon when resolving disputes, but they do not have the force and effect of regulations.
    - 1) A revenue ruling is not binding on a court.

**Revenue Procedures**

- 6. A revenue procedure is an official IRS statement that prescribes procedures that affect the rights or duties of either a particular group of taxpayers or all taxpayers.
  - a. Revenue procedures primarily address administrative and procedural matters, e.g., in what format and to whom should a letter ruling request be submitted.
  - b. Revenue procedures do not have the force and effect of law, but they may be cited as precedent.
  - c. Revenue procedures are directive and not mandatory.



**IRB**

7. The Internal Revenue Bulletin (IRB) is the authoritative instrument of the Commissioner of Internal Revenue for announcing official IRS rulings and procedures and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published on a weekly basis by the Government Printing Office.
  - a. It is the policy of the IRS to publish in the IRB all substantive rulings necessary to promote a uniform application of the tax laws, including rulings that supersede, revoke, modify, or amend any of those previously published in the IRB.
    - 1) All published rulings apply retroactively unless otherwise indicated.
8. In addition to revenue rulings and revenue procedures, a number of miscellaneous documents that apply to tax law interpretation and administration are published in the IRB.

**Announcements**

- a. Announcements are public pronouncements on matters of general interest, such as effective dates of temporary regulations, clarification of rulings, and form instructions.
  - 1) They are issued when guidance of a substantive or procedural nature is needed quickly.
  - 2) Announcements can be relied on to the same extent as revenue rulings and revenue procedures.
  - 3) Announcements are identified by a number representing the year and a sequence number.

**Notices**

- b. Notices are public announcements issued by the IRS that
  - 1) Appear in the IRB and are included in the bound Cumulative Bulletin
  - 2) Are identified by a number representing the year and a sequence number
  - 3) Can be relied on to the same extent as revenue rulings and revenue procedures

**Delegation Orders**

- c. Commissioner Delegation Orders formally delegate authority to perform certain tasks or make certain decisions to specified IRS employees.
  - 1) Delegation orders are identified by a number and are located in the Internal Revenue Manual (IRM).

**Authority of Rulings and Procedures**

9. Rulings do not have the force and effect of Treasury Department Regulations, but they may be used as precedents.
  - a. In applying published rulings, the effects of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered.
  - b. Caution is urged against reaching the same conclusion in other cases, unless the facts and circumstances are substantially the same.

### **Publications**

10. IRS Publications explain the law in plain language for taxpayers and their advisors. They typically highlight changes in the law, provide examples illustrating IRS positions, and include worksheets.
  - a. Publications are nonbinding on the IRS and do not necessarily cover all positions for a given issue.
  - b. While a good source of general information, **publications should not be cited to sustain a position.**

### **Private Letter Ruling**

11. A **Private Letter Ruling** (PLR) represents the conclusion of the IRS for an individual taxpayer.
  - a. The application of a PLR is confined to the specific case for which it was issued, unless the issue involved was specifically covered by statute, regulations, ruling, opinion, or decision published in the IRB.

### **Technical Advice Memos**

12. **Technical Advice Memoranda** (TAMs) are requested by IRS area offices after a return has been filed, often in conjunction with an ongoing examination.
  - a. TAMs are binding on the IRS in relation to the taxpayer who is the subject of the ruling.
13. A PLR to a taxpayer or a TAM to an area director, which relates to a particular case, should not be applied or relied upon as a precedent in the disposition of other cases.
  - a. However, they provide insight with regard to the IRS's position on the law and serve as a guide.

### **Other Private Letter Rulings and Memos**

14. Existing PLRs and memoranda [including Confidential Unpublished Rulings (CURs), Advisory Memoranda (AMs), and General Counsel Memoranda (GCMs)] may not be used as precedents in the disposition of other cases but may be used as a guide with other research material in formulating an area office position on an issue.
15. Whenever an area office finds that a CUR, AM, or GCM represents the sole precedent or guide for determining the disposition of an issue and cannot to its own satisfaction find justification in the Code, regulations, or published rulings to support the indicated position, technical advice should be requested from the Headquarters Office.
  - a. Technical advice should be requested when taxpayers or their representatives take the position that the basis for the proposed action is not supported by statute, regulations, or published positions of the IRS.
    - 1) If it is believed that the position of the IRS should be published, the request for technical advice will contain a statement to that effect.
      - a) Instructions for requesting technical advice from the Headquarters Office are contained in the second revenue procedure issued each year.
      - i) Questions regarding the procedures should be addressed to the contacts listed in the revenue procedure.

**General Counsel Memos**

16. General Counsel Memoranda (GCMs) are legal memoranda from the Office of Chief Counsel prepared in connection with the review of certain proposed rulings (Rev. Ruls., PLRs, TAMs).
- They contain legal analyses of substantive issues and can be helpful in understanding the reasoning behind a particular ruling and the IRS's response to similar issues in the future.

**Technical Memos**

17. Technical Memoranda (TMs) function as transmittal documents for Treasury Decisions or Notices of Proposed Rule Making (NPRMs).
- They generally summarize or explain proposed or adopted regulations, provide background information, state the issues involved, and identify any controversial legal or policy questions.
  - TMs are helpful in tracing the history and rationale behind a regulation or regulation proposal.

**Internal Revenue Manual**

18. The Internal Revenue Manual (IRM) sets forth instructions, policies, and guidelines for the IRS's operations and organizations. The day-to-day conduct of IRS agents and other personnel and the procedures to be followed in various IRS activities are addressed in the Manual.
- Because an agency such as the IRS is bound by the procedural rules it adopts, IRS personnel must comply with Manual procedures. However, the policies and guidelines contained in the Manual are not legally binding because they are directory, not mandatory. Strict compliance is not required if the procedure does not affect a significant interest of the taxpayer or if the IRS's failure to comply with Manual procedures occurred in good faith and requiring strict compliance would affect the outcome of the government action at issue.

### 6.3 THE COURT SYSTEM (JUDICIAL LAW)

1. The court system is comprised of
  - a. U.S. Tax Court
  - b. U.S. District Courts and Bankruptcy Courts
  - c. U.S. Court of Federal Claims
  - d. Appellate courts
  - e. U.S. Supreme Court

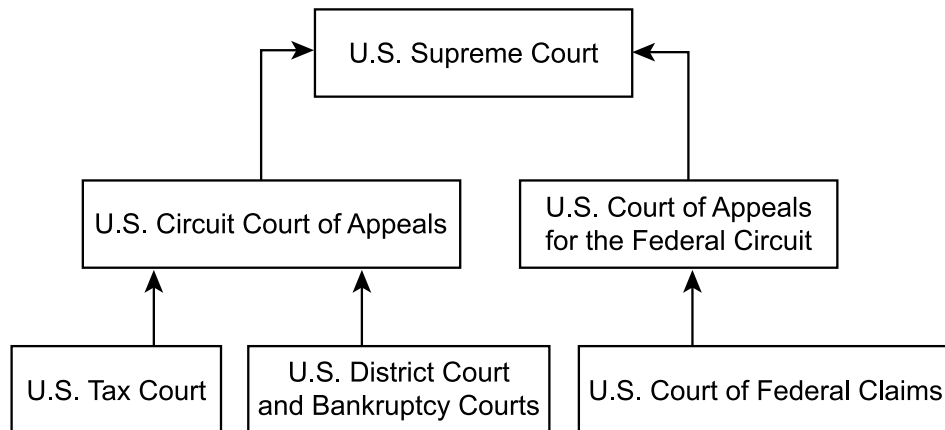


Figure 6-1

#### 2. Tax Court

- a. Decisions of the Tax Court are issued as either regular reports or memorandum decisions.
  - 1) Regular reports are published in bound volumes by the government.
  - 2) Memorandum decisions are usually published only commercially. A Tax Court memorandum decision is a report of a Tax Court decision thought to be of little value as a precedent because the issue has been decided one or more times before.
3. Cases from the U.S. Tax Court and the U.S. District Courts are appealed to the appropriate U.S. Circuit Court of Appeals. Cases from the U.S. Court of Federal Claims are appealed to the U.S. Court of Appeals for the Federal Circuit.
  - a. Bankruptcy courts are separate units of the district court.
    - 1) They resolve tax matters concerning taxpayers who are involved in an ongoing bankruptcy case.

#### 4. U.S. Supreme Court

- a. The U.S. Supreme Court generally reviews decisions of the courts of appeals and other federal courts.
- b. An appellant in an appropriate case may petition the Supreme Court to hear an appeal from the lower court's decision.
  - 1) A **writ of certiorari** is an order by the Supreme Court to send the case up for its consideration.
    - a) The court's certiorari jurisdiction is purely discretionary.
    - b) A denial of a petition for a writ of certiorari by the Supreme Court expresses no opinion on the merits of the case.
- c. If the Court determines that various lower courts are deciding a tax issue in an inconsistent manner, it may pronounce a decision and resolve the contradiction.

#### IRS Commissioner Decisions

- 5. The Commissioner of the IRS will make decisions on adverse regular decisions of the courts other than the Supreme Court. These decisions are published in the IRB.
  - a. Acquiescence by the commissioner generally means that the IRS will follow the court decision in cases involving similar facts.
  - b. Nonacquiescence by the commissioner means that the IRS does not accept an adverse decision and will not follow it in cases on the same issue.
  - c. An acquiescence or a nonacquiescence may be subsequently revised by the commissioner.
  - d. The acquiescence program is not intended as a substitute for a ruling or regulation program.
- 6. The **citator** contains case histories and recent case developments, such as appeals, writs of certiorari, and related cases. Citators are published commercially.
- 7. **Dictum** is a court statement of opinion on a legal point that is not necessary for the decision of the case.
  - a. It is not controlling but may be persuasive to another court deciding the issue dealt with by the dictum.
- 8. Decisions of the courts, other than the Supreme Court, are binding on the Commissioner only for the particular taxpayer and for the year litigated; thus, decisions of the lower courts do not require the IRS to alter its position for all taxpayers.
- 9. The IRC is federal law. All courts are bound by the Code sections.
- 10. In general, the IRS may exercise executive, judicial, and legislative power.

## 6.4 TAX RESEARCH

1. There are two classes of tax source materials: primary and secondary. Primary authorities consist of the law enacted by the legislature plus its official interpretation and indications of its meaning. Primary reference materials emanate from a branch of the government. Primary reference materials consist of the statutory law, administrative law, and judicial law. All other statements or explanations of what the law is or means are secondary authorities. The supporting authority for a rule of law should always be a primary authority.
2. Primary authorities include the following:
  - Constitution
  - Internal Revenue Code
  - House Ways and Means Committee Report
  - House debate
  - Senate Finance Committee Report
  - Senate debate
  - Conference Committee Report
  - Post-Conference House and Senate Debate
  - Treaties
  - Temporary and Final Regulations
  - Proposed Regulations
  - Revenue Rulings
  - Revenue Procedures
  - Private Letter Rulings
  - Technical Advice Memoranda
  - Determination Letters
  - IRS Press Releases
  - Notices
  - Any other similar documents published by the IRS in the Internal Revenue Bulletin
  - Court cases
3. Secondary authorities should be used as supporting authority only to supplement supporting primary authorities or when primary authorities in point are nonexistent. Secondary authorities serve chiefly as research tools that help locate primary authorities in point. Examples of secondary reference materials include tax services, citators, textbooks, journals, and newsletters.

# STUDY UNIT SEVEN

## RECORDKEEPING AND ELECTRONIC FILING

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This study unit covers the topics of recordkeeping and electronic filing. The IRS has strict guidelines involving the type of records to be retained and the length of time that individuals and employers should retain certain records. The records are used to show proof of transactions in case of an IRS examination. Electronic filing is a method of filing a tax return. It involves far less paperwork and increases the speed and efficiency of the processing of a return.

### 7.1 RECORDKEEPING

#### **Sufficient Records**

1. Taxpayers must keep permanent books of account or records that are sufficient to support items shown on a return.
  - a. The IRS recommends that taxpayers keep all sales slips, invoices, receipts, canceled checks, or other financial account statements relating to a particular transaction.
  - b. A taxpayer may replace hard copies of books and records with electronic documents, provided the system is in compliance with IRS requirements.
  - c. If a taxpayer cannot produce documents because of reasons beyond the taxpayer's control, the taxpayer may still reconstruct their records to prove a deduction.

**Availability of Records**

2. The records must be kept available at all times for inspection by IRS officers and designated employees and must be retained as long as they may be material. Since the IRS generally has 3 years from the date a return was due (or filed, if later) or 2 years from the date the tax was paid, whichever is later, to assess tax, a taxpayer must retain all records and forms until the later time.
  - a. If the taxpayer does not report income that should be reported and it is more than 25% of the gross income on the return, the statute of limitations is 6 years.
  - b. If the taxpayer overstates the basis of an asset by an amount that is more than 25% of the gross income on the return, the statute of limitations is 6 years.
  - c. For the 25% floor and specifically for goods or services from a trade or business, gross income includes gross receipts before deduction for cost of goods sold. Only items completely omitted are counted.

**EXAMPLE 7-1 Calculation of 25% of Gross Income Threshold for 6-Year S/L**

A sole proprietor had the following income transactions:

Gross receipts	\$300,000
Less: COGS	(200,000)
Net business income	\$100,000
Capital gains	40,000
Gross income	<u>\$140,000</u>

For determining the 25% GI threshold, the sole proprietor's GI is as follows:

Gross receipts	\$300,000
Capital gains	40,000
Gross income for 25% threshold	<u>\$340,000</u>

Note that for the nonbusiness item, i.e., capital gains, only the gain and not the sale amount is included.

- d. If the taxpayer files a fraudulent return, there is no statute of limitations on that return.
- e. If the taxpayer does not file a return, there is no statute of limitations on that return.
- f. If the taxpayer files for a credit or refund after a return is filed, the statute of limitations is the later of 3 years from the date the return was filed or 2 years after the tax was paid.
- g. If the taxpayer files a claim for a loss from worthless securities, the statute of limitations is 7 years.

**Basis of Property**

3. Records relating to the basis of property should be retained as long as they may be material.
  - a. The basis of property is material until the statute of limitations expires for the year the property is sold.



**Employment Taxes and Withholding**

4. A person required to keep records relating to employment taxes and federal withholding taxes must keep them in a convenient and safe location accessible to the IRS, if requested.
  - a. The records must be maintained for at least 4 years after the due date of the tax or the date such tax was paid, whichever is later.
  - b. An employer required to withhold income tax on wages must keep records of all employee compensation. Specific records required to be kept for income tax withholding include
    - 1) The name, address, and Social Security number of the employee;
    - 2) The total amount and date of each payment of remuneration and the period of services covered by such payment;
    - 3) The amount of such remuneration payment that constitutes wages subject to withholding;
    - 4) The amount of tax collected with respect to such remuneration payment and, if collected at a time other than the time such payment was made, the date collected;
    - 5) The fair market value and date of each payment of noncash compensation made to a retail commission salesperson if no income tax was withheld;
    - 6) For health and accident plans, information about the amount of each payment;
    - 7) The withholding exemption certificate (Form W-4) filed with the employer by the employee; and,
    - 8) In the case of tips, copies of any statement furnished by the employee unless the information disclosed by such statements is recorded on another document retained by the employer.
  - c. Employees are not required to keep additional records relating to employment taxes and withholding of income tax.

**Business Travel and Meals**

5. Taxpayers are required to substantiate business deductions for travel and deductible meals expenses.
  - a. Substantiation of amount, time, place, business relationship, attendees, and business purpose is generally required.
    - 1) Documentary evidence is not required for expenses (other than lodging) that are less than \$75.
  - b. Business related expense reimbursements are treated as paid under an **accountable plan**. To be an accountable plan, the reimbursement agreement must take place within a reasonable time period. The rules for a reasonable time period are as follows:
    - 1) The advance is received within 30 days of the time the expense was incurred.
    - 2) Expenses are adequately accounted for within 60 days after paid or incurred.
    - 3) Excess reimbursement is returned within 120 days after the expense was paid or incurred.

### **Charitable Contributions**

6. For cash contributions less than \$250, a canceled check, bank/credit union/credit card statement, or receipt letter/other written communication from the donee is sufficient and permissible documentation.
  - a. The documentation must show the name of the donee, date contributed, and amount contributed. In determining whether a contribution is \$250 or more, do not combine separate contributions.
  - b. Contributions of \$250 or more require acknowledgment from the donee (i.e., a canceled check is insufficient).

### **Employers**

7. Section 6060 states that a person who employs one or more income tax return preparers must make a return setting forth the name, identifying number, and place of work of each preparer and keep the records for up to 3 years.

### **Refusal to Submit Records/Information**

8. No practitioner shall neglect or refuse to promptly submit records or information in any matter before the IRS upon proper and lawful request by an authorized IRS employee.
  - a. A request can be refused if the tax preparer believes in good faith and on reasonable grounds that such record or information is privileged or that the request is of doubtful legality.
  - b. Section 7525 states that the taxpayer has a privilege of confidentiality with his or her federally authorized tax preparer with regards to tax advice.
    - 1) This privilege can only be asserted in noncriminal hearings.
    - 2) This privilege does not apply to the determination of an item on an original income tax return or to any tax shelters.

### **Transcripts**

9. A tax return preparer can obtain printouts of a taxpayer's account from the IRS.
10. Transcripts available from the IRS include the following:

### **Return Transcript**

- a. A return transcript includes most of the line items of a tax return as filed with the IRS but is not a copy of the return. Transcripts are only available for the following returns: Form 1040 series, Form 1065, Form 1120, Form 1120-A, Form 1120-H, Form 1120-L, and Form 1120-S.

**Account Transcript**

- b. An account transcript contains information on the financial status of the account, such as payments made on the account, penalty assessments, and adjustments made by the taxpayer or the IRS after the return was filed.
  - 1) Return information is limited to such items as tax liability and estimated tax payments.
  - 2) Account transcripts are available for most returns.

**Record of Account Transcript**

- c. A record of account transcript provides the most detailed information because it is a combination of the return transcript and the account transcript. It is available for the current year and 3 prior tax years.

**Wage and Income Transcript**

- d. The IRS can provide a transcript that includes data from information returns such as Form W-2, Form 1099 series, Form 1098 series, or Form 5498 series.
  - 1) State or local information is not included with the Form W-2 information.
  - 2) The IRS may be able to provide this transcript information for up to 10 years.

**Non-filing Transcript (Verification of Non-filing Letter)**

- e. A verification of non-filing letter indicates when the IRS has no record, as of the date of the transcript request, of a processed Form 1040-series tax return. This letter/transcript does not indicate any filing requirement.

**Requesting Transcripts**

- f. e-Services is a suite of web-based tools that allows eligible individuals to complete transactions online with the IRS.
  - 1) The tools include (a) Registration Services, (b) e-file Application, (c) Transcript Delivery System (TDS), and (d) Taxpayer Identification Number (TIN) Matching.
  - 2) e-Services users must gain access via a two-factor authentication process (Secure Access).
- g. The TDS is an e-service that assists tax practitioners working with the IRS on behalf of clients.
- h. Tax practitioners can request transcripts of their clients' tax records and receive them within minutes using a secure online tool delivered through the IRS Business Systems Modernization program.
  - 1) Paper requests for the same information can take days or weeks to complete.
- i. Tax practitioners use transcripts when representing their clients before the IRS.
  - 1) Transcripts are printouts of a taxpayer's account that show actions taken by the IRS or the taxpayer and any tax, penalties, or interest assessed.
  - 2) Tax returns can also be printed as transcripts to show most of the numbers reported on the return and those from accompanying schedules or forms.
  - 3) In many cases, transcripts are used instead of making copies of tax returns.

## 11. Documentation

- a. Supporting tax documentation, such as receipts, W-2s, 1099s, canceled checks, and credit card statements, can generally be discarded 3 years after the return's due date. The 3-year retention rule applies to all documentation discussed in this subsection.
  - 1) In some special circumstances, however, the taxpayer may need to hold on to tax documentation longer.
    - a) The IRS has 6 years, for example, to challenge a return if the taxpayer is suspected of underreporting income by 25% or more.
    - b) Copies of actual tax returns should be kept permanently.
- b. Legal documents (e.g., birth certificates, divorce decrees, lawsuit settlements).
  - 1) Proof of a live birth must be supported by an official document, such as a birth certificate.
  - 2) Documentation requirements for proof of foreign status and for identification include a passport; U.S. Citizenship and Immigration Services (USCIS) photo identification; visa issued by the U.S. Department of State; U.S. driver's license; U.S. military identification card; foreign driver's license; foreign military identification card; national identification card (must be current and contain name, photograph, address, date of birth, and expiration date); U.S. state identification card; foreign voter's registration card; civil birth certificate; medical records (only for dependents under 6 years of age); school records (only valid for dependents under 18 years of age).
  - 3) Reviews by the IRS of lawsuit settlements.
    - a) Information requested from the company paying the settlement:
      - i) Plaintiff's address, phone number, and Social Security number;
      - ii) Copies of the complaints, the settlement agreements, and/or waivers;
      - iii) The front and back of the checks; and
      - iv) Copies of any records documenting correspondence between the company and the plaintiffs with respect to negotiations affecting the outcome of the cases.
    - b) Information document request: Prior-year tax returns; original petition or claim filed; lawsuit settlement agreement; settlement checks or schedule of payments received; documentation of legal fees paid; disbursement schedule; and documentation from attorney indicating proceeds were not taxable.
  - 4) Divorce decrees are needed for verification of support, alimony payments, filing status, etc.

### **Prior and Subsequent Tax Returns**

- c. General information includes employer or taxpayer addresses, identification numbers, birth dates, and names. This information can be used for subsequent return preparation. Use of prior-year information can allow for faster and more accurate preparation.
  - 1) If an IRS agent is examining a tax return and determines that the taxpayer has deducted unallowable items as business expenses, (s)he will generally inspect prior years' returns to determine if the taxpayer has claimed the same types of expenses.
    - a) If the expenses are claimed and the amounts are material, the IRS agent has the authority to examine these returns for the purpose of making an adjustment.

### **Document Requirements for Tax Return Purposes**

- d. An income tax return preparer must furnish a completed copy of any tax return or refund claim that (s)he prepares for the taxpayer either before or at the same time as (s)he presents the return or claim to him or her for signing.
  - 1) The preparer or the employer of the preparer must retain a completed copy of the return for a 3-year period.

### **Business Entity Supporting Documents**

- e. **Articles of incorporation** (sometimes referred to as a "charter") are formation documents and are filed with a government authority to legally document the creation of a corporation. The articles contain information that includes but is not limited to
  - 1) Corporation name
  - 2) Principal office and mailing address
  - 3) Registered agent
  - 4) Directors and officers
  - 5) Authorized shares including class and par value
- f. **Corporate bylaws**, generally, are created subsequent to filing articles of incorporation; however, it is not uncommon to find them within the articles. Bylaws stipulate a corporation's rules, how it will operate, and the responsibilities of the people who own and manage it.
- g. A **partnership agreement** is a contract between two or more business partners that is used to stipulate the responsibilities and interest for each partner. Usually, the agreement includes rules for items such as
  - 1) Capital contributed by each partner
  - 2) Profit and loss distribution of each partner
  - 3) Salaries and draws
  - 4) Authority and decision-making powers
  - 5) Admission and withdrawal of partners

**NOTE: Items listed in e. through g. above represent examples of business entity supporting documents and are not an all-inclusive list.**

**Freedom of Information Act**

12. All IRS records are subject to Freedom of Information Act (FOIA) requests.
- a. However, FOIA does not require the IRS to release all documents that are subject to FOIA requests.
    - 1) The IRS may withhold information pursuant to nine exemptions and three exclusions contained in the FOIA statute.
    - 2) Documents must be made available electronically.
    - 3) The IRS maintains an electronic reading room only.
      - a) The online Electronic Reading Room is located at [www.irs.gov/privacy-disclosure/foia-library](http://www.irs.gov/privacy-disclosure/foia-library).

**Identity Protection Personal Identification Number (IP PIN)**

13. The IRS IP PIN is a 6-digit number assigned to eligible taxpayers to help prevent the misuse of their Social Security numbers on fraudulent federal income tax returns. The IP PIN helps the IRS verify a taxpayer's identity and accept his or her electronic or paper tax return.
- a. If a return is e-filed with the taxpayer's SSN and an incorrect or missing IP PIN, the IRS system will reject it until the return is submitted with the correct IP PIN or filed on paper. If the same conditions occur on a paper-filed return, the IRS will delay its processing and any refund that may be due for taxpayer protection while the IRS determines if the return is the taxpayer's.
  - b. The Internal Revenue Service is expanding the Identity Protection PIN Opt-In Program to all taxpayers who can verify their identities. The Identity Protection PIN (IP PIN) is a six-digit code known only to the taxpayer and to the IRS. It helps prevent identity thieves from filing fraudulent tax returns using a taxpayer's personally identifiable information. Electronic returns that do not contain the correct IP PIN will be rejected, and paper returns will go through additional scrutiny for fraud.
    - 1) Taxpayers who want an IP PIN for 2022 should go to [www.irs.gov/IPPIN](http://www.irs.gov/IPPIN) and use the Get an IP PIN tool. This online process will require taxpayers to verify their identities using the Secure Access authentication process if they do not already have an IRS account. An IP PIN is valid for one calendar year. A new IP PIN is generated each year for your account.

## 7.2 ELECTRONIC FILING

1. Tax return preparers who prepare income tax returns for individuals, trusts, and estates, such as Forms 1040 and 1041, and who reasonably expect to file 11 or more of these income tax returns in a calendar year are specified tax return preparers required to file these returns electronically.
  - a. Tax return preparers who are members of a firm are specified tax return preparers and must electronically file the income tax returns they prepare and file if the firm's preparers, in the aggregate, expect to file 11 or more of these income tax returns in a calendar year.
  - b. The e-file requirement does not apply to an individual income tax return when a tax return preparer's client chooses to have the return completed in paper format and the client, not the preparer, will file the paper return with the IRS.
    - 1) Preparers should document the client's choice to file in paper format and keep a signed copy on file. This documentation is completed by filing Form 8948 with the paper return.
2. Corporations with \$10 million or more in total assets and that file 250 or more returns a year are required to file electronically.
3. Partnerships with more than 100 partners (Schedule K-1) are required to file their returns electronically.

### **E-File Provider**

4. IRS e-file providers electronically file taxpayers' returns, including business, individual, and information returns.
  - a. An authorized provider is a business or organization authorized by the IRS to participate in IRS e-file.
  - b. A provider may be a sole proprietorship, partnership, corporation, or other entity.
5. Providers are described below and on the following pages. (Roles are not mutually exclusive.)

### **Electronic Return Originator (ERO)**

- a. An ERO originates the electronic submission of tax returns to the IRS. The ERO is usually the first point of contact for most taxpayers filing a return using IRS e-file.
  - 1) Although an ERO also may engage in return preparation, that activity is separate and different from the origination of the electronic submission of the return to the IRS.
    - a) After the taxpayer authorizes the filing of the return, an ERO originates the electronic submission of a return via IRS e-file.
    - b) An ERO must originate the electronic submission only of returns that the ERO either prepared or collected from a taxpayer.

- 2) In originating the electronic submission of a return, the ERO has a variety of responsibilities, including, but not limited to,
  - a) Timely originating the electronic submission of returns,
  - b) Submitting any required supporting paper documents to the IRS,
  - c) Providing copies to taxpayers,
  - d) Retaining records and making records available to the IRS,
  - e) Accepting returns only from taxpayers and authorized IRS e-file providers, and
  - f) Having only one Electronic Filing Identification Number (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.
    - i) For this purpose, the business entity is generally the entity that reports on its return the income derived from electronic filing.
    - ii) The IRS may issue more than one EFIN to accommodate a high volume of returns or as it determines appropriate.

### **Intermediate Service Provider**

- b. An intermediate service provider assists with processing return information between the ERO (or from a taxpayer who files electronically using a personal computer, modem, and commercial tax preparation software) and a transmitter. An intermediate service provider's responsibilities include, but are not limited to,
  - 1) Including its EFIN and the ERO's EFIN with all return information it forwards to a transmitter;
  - 2) Serving as a contact point between its client EROs and the IRS, if requested;
  - 3) Providing the IRS with a list of each client ERO, if requested; and
  - 4) Adhering to all applicable rules that apply to transmitters.

### **Reporting Agent**

- c. A reporting agent originates the electronic submission of certain returns for its clients and/or transmits the returns to the IRS.
  - 1) A reporting agent must be an accounting service, franchiser, bank, or other person who complies with Rev. Proc. 2012-32.
  - 2) Form 8655, *Reporting Agent Authorization*, must be submitted before applying for e-file.

### **Software Developer**

- d. An e-file software developer creates software for the purposes of formatting electronic return information according to the IRS e-file specifications and/or transmitting electronic return information directly to the IRS.
  - 1) Software developers must pass what is referred to as either acceptance or assurance testing.
  - 2) A software developer's responsibilities include, but are not limited to,
    - a) Promptly correcting any software error causing returns to reject and distributing the correction,
    - b) Ensuring its software creates accurate returns, and
    - c) Adhering to specifications published by the IRS.



**Transmitter**

- e. A transmitter transmits electronic tax return information directly to the IRS. A bump-up service provider that increases the transmission rate or line speed of formatted or reformatted information sent to the IRS via a public switched telephone network is also a transmitter.
  - 1) Prior to transmitting, testing to ensure the compatibility of the provider's system with that of the IRS must be completed. Transmitter responsibilities include, but are not limited to,
    - a) Ensuring EFINs of authorized e-file providers are included as required by IRS e-file specifications in the electronic return record of returns it transmits;
    - b) Timely transmitting returns to the IRS, retrieving acknowledgment files, and sending the acknowledgment file information to the ERO, intermediate service provider, or taxpayer (for Online Filing); and
    - c) Promptly correcting any transmission error that causes an electronic transmission to be rejected.

**Online Provider**

- 6. An online provider allows taxpayers to self-prepare returns by entering return data directly on commercially available software, software downloaded from an Internet site and prepared offline, or an online Internet site. An online provider also chooses another provider option (software developer, transmitter, or intermediate service provider) if being an online provider is a secondary activity.
  - a. Although an ERO also may use an Internet site to obtain information from taxpayers to subsequently originate the electronic submission of returns, the ERO is not an online provider.
  - b. The IRS has instructed online providers to use the following six security, privacy, and business standards:
    - 1) Extended validation secure socket layer (SSL) certificate
    - 2) External vulnerability scan
    - 3) Information privacy and safeguard policies
    - 4) Protection against bulk filing of fraudulent income tax returns
    - 5) Public domain name registration
    - 6) Reporting of security incidents
  - c. EROs, intermediate service providers, and online-provider transmitters must clearly display the firm's "doing business as" name at all locations and sites, including websites at which information from the taxpayers is obtained for electronic origination of returns by the ERO.

**ACA (Affordable Care Act) Provider**

- 7. An ACA provider is an organization engaged in manufacturing or importing branded prescription drugs sold to specified government programs ("covered entity"), a health insurance provider reporting net premiums written ("covered entity") that originates the electronic submission of its own information report(s), or a third party that will transmit report(s) on behalf of a covered entity.

**E-File Provider Requirements**

8. To become an IRS e-file provider, an applicant must (a) create an IRS e-Services account (i.e., Secure Access account), (b) submit an e-file application, and (c) pass a suitability check.
  - a. An e-Services account facilitates electronic interaction with the IRS. When creating an e-Services account, the applicant must
    - 1) Provide the applicant's legal name, Social Security number, birth date, phone number, e-mail address, and home mailing address;
    - 2) Provide the applicant's adjusted gross income from the current or prior tax year;
    - 3) Create a username, a password, a PIN, and an answer to a reminder question for the username;
    - 4) Ensure every principal and responsible official in the applicant's firm signs up for e-Services; and
    - 5) Return to e-Services to confirm registration within 30 days of receipt of the confirmation code in the mail.
  - b. Publication 1345, *Handbook for Authorized IRS e-file Providers of Individual Returns*, provides rules and requirements for participation in IRS e-file. Violation of a provision of this publication may subject an e-file provider to sanctions.
9. Each provider (principal or responsible official) must
  - a. Be a U.S. citizen or an alien lawfully admitted for permanent residence,
  - b. Be 18 years old as of the date of application,
  - c. Meet applicable state and local licensing and/or bonding requirements for the preparation and collection of tax returns, and
  - d. Submit fingerprints unless the individual provides evidence that (s)he is one of the following:
    - 1) Attorney
    - 2) Certified Public Accountant
    - 3) Enrolled Agent
    - 4) Officer of a publicly held corporation
    - 5) Banking official, bonded and fingerprinted within the last 2 years
10. The IRS will conduct a suitability check on the firm and each person listed on the application as a principal or responsible official.
  - a. Suitability checks may include the following:
    - 1) A criminal background check
    - 2) A tax compliance check to ensure that all required returns are filed and paid, and to identify assessed fraud penalties
    - 3) A check for prior noncompliance with IRS e-file requirements
  - b. The IRS does not complete suitability checks on applicants only applying to be software developers.
  - c. It can take the IRS 45 days to process the application and complete the suitability check.

11. The IRS assigns Electronic Filing Identification Numbers (EFINs) to all providers and assigns Electronic Transmission Identification Numbers (ETINs) to transmitters, software providers, and online providers.
12. Changes in situation that require revision of the IRS e-file application are as follows:
  - a. A provider functioning solely as a software developer or reporting agent intends to do business as an ERO, intermediate service provider, or transmitter.
  - b. An additional principal or responsible official (e.g., partner) of a firm needs to be added.
  - c. A principal or responsible official changes.
  - d. A principal or responsible official is being deleted.

Providers must update their application information within 30 days of the date of any changes to the information on their current application.
13. Situations that require submission of a new IRS e-file application include but are not limited to the following:
  - a. The provider wants to acquire a foreign EFIN.
  - b. The provider acquires an existing IRS e-file business by purchase, transfer, or gift. The provider may not use the EFIN, other identification numbers, or passwords of the previous provider.
14. Providers must have security systems in place to prevent unauthorized access to taxpayer accounts and personal information.
  - a. IRS Publication 4557 contains information to assist businesses and individuals with safeguarding taxpayer information.
  - b. Providers must implement security and privacy practices that are appropriate for the size, complexity, nature, and scope of their business activities.
  - c. Providers must register with the IRS all Internet websites from which information is collected from taxpayers (directly and indirectly) and used by the provider for federal returns that are filed electronically.

### **Form 8879**

- d. Form 8879, *IRS e-file Signature Authorization*, is the declaration document and signature authorization for a return e-filed by an ERO. This form is completed when the practitioner PIN method is used or when the taxpayer authorizes the ERO to enter or generate the taxpayer's PIN on the e-filed individual income tax return.
  - 1) The practitioner PIN method is an electronic signature option for taxpayers who use an ERO to e-file. The taxpayer creates a 5-digit PIN to use as the signature on the e-filed return.
    - a) Form 8879 is not sent to the IRS unless requested.
    - b) The completed form is retained for 3 years from the return due date or IRS received date, whichever is later.
    - c) The form may be retained electronically.
  - 2) Taxpayers must sign Form 8879 by handwritten signature or electronic signature if supported by computer software.

**Form 8453**

- e. Certain documentation is required to be mailed to the IRS. Form 8453, *U.S. Individual Income Tax Transmittal for an IRS e-file Return*, must accompany specific documentation mailed to the IRS.
    - 1) If the taxpayer is required to mail any documentation not listed on Form 8453, the taxpayer cannot file the tax return electronically.
    - 2) The ERO must mail Form 8453 to the IRS within 3 business days after receiving acknowledgment that the IRS has accepted the electronically filed tax return.
    - 3) The forms and supporting documentation requiring Form 8453 are
      - a) Form 1098-C, *Contributions of Motor Vehicles, Boats, and Airplanes* (or equivalent contemporaneous written acknowledgment)
      - b) Form 2848, *Power of Attorney and Declaration of Representative* (or POA that states the agent is granted authority to sign the return)
      - c) Form 3115, *Application for Change in Accounting Method*
      - d) Form 3468, *Investment Credit* (attach copies of documentation related to proof of certified historic structures)
      - e) Form 4136, *Credit for Federal Tax Paid on Fuels* (attach certificate for biodiesel and other applicable statements/certificates)
      - f) Form 5713, *International Boycott Report*
      - g) Form 8283, *Noncash Charitable Contributions*, Section A or B, and any related attachments
      - h) Form 8332, *Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent* (or certain pages from a divorce decree or separation agreement)
      - i) Form 8858, *Information Return of U.S. Persons With Respect to Foreign Disregarded Entities*
      - j) Form 8864, *Biodiesel and Renewable Diesel Fuels Credit* (attach the Certificate for Biodiesel and Statement of Biodiesel Reseller)
      - k) Form 8949, *Sales and Other Dispositions of Capital Assets*, or a statement with the same information, if electing not to report transactions electronically on Form 8949
  - f. IRS e-file returns have the same reporting requirements as paper returns.
    - 1) A provider must retain a copy of any Form 8453 until the end of the calendar year (Publication 1345).
  - g. A taxpayer filing electronically may pay by electronic funds withdrawal, credit or debit card, check, money order, or electronic payment made by phone or online. Finally, taxpayers may request an installment agreement to pay their tax.
15. Filing individual income tax returns using IRS e-file is limited to tax returns with prescribed due dates in the current and 2 previous tax years, e.g., 2022 (current year), 2021 (1st prior year), and 2020 (2nd prior year).
- a. The following returns are not processable by the IRS e-file program:
    - 1) Tax returns with fiscal-year tax periods
    - 2) Returns containing forms or schedules that cannot be processed by IRS e-file

**Fees**

16. If an ERO charges a fee for transmission of the electronic portion of a tax return, the fee may not be based on the time required to prepare the return, a percentage of the refund amount, or any other amount from the tax return (a contingent fee). An authorized ERO may not charge a separate fee for direct deposits.

**Refund Options**

17. EROs must advise taxpayers of the option to receive their refunds via either paper check or direct deposit.
- a. EROs must accept any direct deposit election to any eligible financial institution designated by the taxpayer and may not charge an additional fee for doing so.
  - b. Direct deposits may be deposited into any qualified account, including checking, savings, share draft, IRA, or consumer asset accounts.
    - 1) The provider should caution the taxpayer that not all financial institutions will allow joint refunds into individual accounts.

**Records**

18. An ERO who is the paid preparer of an electronic tax return must also retain for the prescribed amount of time the materials described in Reg. 1.6107-1(b) that are required to be kept by an income tax return preparer.

**Rejection of Return**

19. If the IRS rejects the electronic portion of a taxpayer's return and the reason for the rejection cannot be rectified by the actions described in Rev. Proc. 98-50, the ERO must take reasonable steps to inform the taxpayer that the taxpayer's return has not been filed within 24 hours of receiving the rejection.
- a. When the ERO advises the taxpayer that the taxpayer's return has not been filed, the ERO must provide the taxpayer with the business rules followed by an explanation.
  - b. Rejected electronic return data can be corrected and retransmitted without new signatures or authorizations if changes are not more than \$50 to "Total income" or "AGI" or more than \$14 to "Total tax," "Federal income tax withheld," "Refund," or "Amount you owe." Taxpayers must be given paper copies of the new electronic return data.
  - c. To be considered timely filed, the paper return must be postmarked by the later of the due date of the return, including extensions, or 10 calendar days after the date the IRS last gives notification the return was rejected.

**Refund Anticipation Loan**

20. A refund anticipation loan (RAL) is money borrowed by the taxpayer based on the taxpayer's anticipated income tax refund.
- a. A RAL is a contract between the taxpayer and the lender.
    - 1) The IRS has no involvement in RALs.
  - b. All parties to the RAL must ensure the taxpayer understands that a RAL is not a substitute for a faster return.
  - c. Any interest accrued as a result of a delay in the return of a refund is not the responsibility of the IRS since the IRS is not involved.
  - d. An ERO may assist a taxpayer in applying for a RAL and may charge a flat fee for doing so.
    - 1) The fee must be identical for all of the ERO's customers and must not be related to the amount of the refund or RAL.
  - e. An ERO that is also the return preparer and the financial institution that makes a RAL may not be related taxpayers.
  - f. An authorized IRS e-file provider, who is also the return preparer, and the financial institution that makes a RAL may not be related taxpayers within the meaning of Sec. 267 or Sec. 707.

**21. Advertising Standards**

- a. A provider must comply with the advertising and solicitation provisions of Circular 230.
  - 1) This circular prohibits the use or participation in the use of any form of public communication containing a false, fraudulent, misleading, deceptive, unduly influencing, coercive, or unfair statement or claim.
  - 2) Any claims concerning faster refunds by virtue of electronic filing must be consistent with the language in official IRS publications.
- b. A provider must adhere to all relevant federal, state, and local consumer protection laws that relate to advertising and soliciting.
- c. A provider must not use "Internal Revenue Service" or "IRS" within a firm's name.
  - 1) However, once accepted to participate in IRS e-file, a participant may represent itself as an "Authorized IRS e-file Provider."
- d. Advertising for a cooperative electronic return filing project must clearly state the names of all cooperating parties.
- e. If a provider uses radio, television, Internet, signage, or other methods of communication to advertise IRS e-file, the provider must keep a copy and provide it to the IRS upon request, the text or, if prerecorded, the recorded advertisement.
  - 1) According to Sec. 10.30 of Circular 230, the provider must keep a copy of the advertisement for a period of at least 36 months from the date of the last transmission or use.
  - 2) Publication 3112 states that providers must retain copies until the end of the calendar year following the last transmission or use.

- f. If a provider uses direct mail, e-mail, fax communications, or other distribution methods to advertise, the provider must retain a copy, as well as a list or other description of the firms, organizations, or individuals to whom the communication was sent.
  - 1) According to Sec. 10.30 of Circular 230, the provider must keep a copy of the advertisement for a period of at least 36 months from the date of the last transmission or use.
  - 2) Publication 3112 states that providers must retain the records until the end of the calendar year following the date sent and provide the records to the IRS upon request.
- g. The IRS does not have a copyright for the IRS e-file logo. Use of the logo only indicates that a provider offers this service to taxpayers or has performed it on behalf of a taxpayer.
  - 1) The logo must not be used to portray any other relationship between the IRS and any provider.

### **Business Taxpayers**

22. For purposes of electronic filing, the IRS defines a **Large Taxpayer** as a business or other entity (excluding partnerships) with total assets of \$10 million or more or a partnership with more than 100 partners (asset criteria does not apply to partnerships) that originates the electronic submission of its own return(s).
- a. A Large Taxpayer may choose to electronically file its own **corporate return** or use an authorized IRS e-file provider.
  - b. Business taxpayers that do not meet the Large Taxpayer criteria must use an authorized IRS e-file provider.
  - c. A business or individual that has more than 250 information returns (including but not limited to various 1099s and W-2s) to file must do so electronically. The 250-or-more requirement applies separately to each type of form.

### **Electronic Payments**

23. The Electronic Federal Tax Payment System (EFTPS) may be used to make electronic tax payments.
- a. Individual taxpayers may enroll in EFTPS by phone or online.
    - 1) Business taxpayers may use EFTPS directly or use a financial institution.
    - 2) Access to EFTPS is via a taxpayer's Social Security number or other Taxpayer Identification Number, personal identification number (PIN) assigned upon enrollment, and an Internet password.
  - b. After a taxpayer has enrolled in EFTPS, (s)he may transfer funds from his or her personal accounts directly to the IRS.
    - 1) When the taxpayer's information is accepted, the EFTPS system will provide the taxpayer with an Electronic Funds Transfer (EFT) Acknowledgment Number, which serves as a record of payment.
  - c. Transfers must be scheduled at least 1 day in advance of the tax due date.



- d. EFTPS allows individual taxpayers to schedule payments up to a year in advance. Certain business taxpayers may schedule payments up to 120 days in advance.
- e. EFTPS Direct vs. EFTPS via Financial Institution.
  - 1) EFTPS-Direct: Similar to individual EFTPS. Taxpayers may pay taxes using a telephone, online, or with the IRS's PC software up to 1 day before the date the tax is due.
  - 2) EFTPS-Through a Financial Institution: Taxpayers may pay taxes using the services of a financial institution. Taxpayers must initiate payment before the financial institution's processing deadline so that the financial institution can initiate the transfer up to 1 day before the tax is due.
  - 3) Same-Day Payment: A service offered by some financial institutions, allowing taxpayers to pay taxes on the same day the taxes are due.
- f. All taxpayers using EFTPS are responsible for ensuring that the tax payment is timely made, recording the EFTPS Acknowledgment Number, and making sure the account contains sufficient funds to cover the payment.

### **Sanctions**

24. The IRS may impose a sanction on an electronic return originator for various infractions. These sanctions range from a written reprimand to expulsion. Sanctions are ranked on levels one through three. The IRS reserves the right to select the sanction it wishes to impose.
- a. **Level one** infractions are violations that have **little or no adverse impact** on the quality of electronically filed returns or on IRS e-file.
    - 1) A level one infraction may result in a written reprimand.
  - b. **Level two** infractions that have an **adverse impact** upon the quality of electronically filed returns or on IRS e-file may result in a restriction in participation in the IRS e-file Program or a 1-year suspension beginning with the effective date of suspension.
    - 1) Level two infractions include continued level one infractions after the IRS has brought the level one infraction to the attention of the provider.
  - c. **Level three** infractions are violations that have a **significant adverse** impact on the quality of electronically filed returns or on IRS e-file.
    - 1) Level three infractions include continued level two infractions after the IRS has brought the level two infraction to the attention of the provider.
    - 2) A level three infraction may result in suspension from participation in IRS e-file for 2 years beginning with the effective date of the suspension year.
    - 3) Depending on the severity of the infraction, such as identity theft, fraud, or criminal conduct, the infraction may result in expulsion without the opportunity for future participation.
    - 4) The IRS reserves the right to suspend or expel a provider prior to administrative review for level three infractions.



**Administrative Review**

25. Most denied applicants and sanctioned providers are entitled to an administrative review. The administrative review is usually a two-step process.
- a. The denied applicant or sanctioned provider requests administrative review by the office that denied or sanctioned it.
  - b. If the reviewing office affirms the denial or the sanction, the applicant or provider may request an appeal to the IRS appeals office unless the sanction was a written reprimand (i.e., level one).
    - 1) Failure to respond within 30 calendar days of the date of any denial letter or sanction letter irrevocably terminates an applicant's or provider's right to an administrative review or appeal.

**EFIN Revocation**

26. The IRS may revoke participation of an authorized IRS e-file provider, a principal, or a responsible official in IRS e-file if either (a) a federal court order enjoins the participant from filing returns or (b) the participant is prohibited by a federal or state legal action that would prohibit participation in e-file.
- a. Revoked providers are not entitled to an administrative review process for revocation of participation in IRS e-file if the IRS denies or revokes a firm, principal, or responsible official because of a federal court order enjoining filing of returns or a federal or state legal action that prohibits participation in filing of returns. If the injunction or other legal action expires or is reversed, the revoked provider may reapply to participate in IRS e-file after the injunction or other legal action expires or is reversed.