

4 Current IRS Updates

I. Internal Revenue Service: Then and Now

Several years ago, the IRS initiated a major reorganization to consolidate and realign field responsibilities and streamline operations in order to deliver services more effectively and efficiently.

This comprehensive consolidation, combined with a redefined mission for some existing sites, is a key to the IRS's plans to provide an environment where accountabilities are focused and where IRS employees who provide customer service are given expanded authority to resolve taxpayer issues.

The IRS already has restructured from seven regional offices to four and from 63 district offices to 33. Currently, the IRS is restructuring from 12 computing sites to three; consolidating field administrative services and information systems support into fewer locations; and establishing specialized sites to improve customer services that deal with toll-free taxpayer service, automated telephone collection processes, correspondence examinations, tax account adjustments, underreporting of income, and toll-free forms distributions.

The IRS has developed a strategic plan through FY 2002. The purpose of the plan is to identify the IRS Mission, its Strategic Objectives for FY 2002, and its Business Vision and strategies for reaching the objectives.

Mission of the Internal Revenue Service

"The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost, serve the public by continually improving the quality of our products and services, and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency, and fairness."

Strategic Objectives

The IRS has identified its three Strategic Objectives for FY 2002:

1. **Increase compliance**—The objective is to encourage and assist taxpayers to voluntarily file timely and accurate returns and to pay on time, and, if taxpayers do not comply, to take appropriate compliance actions.

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2. **Improve customer service**—The objective is to improve telephone access, resolve as many inquiries as possible on the first contact, and make it easier for taxpayers, professionals, and others to comply with their tax obligations. New measures and goals for customer satisfaction and taxpayer burden are being developed to ensure that the IRS is sensitive to its customer's needs.
3. **Increased productivity**—The objective is to continually improve operations, and the quality of products and services provided to IRS customers, through strategic use of re-engineering and systems management tools and the development of a highly skilled workforce. This is done to improve compliance, provide improved customer service, and reduce the cost of tax administration.

IRS REORGANIZATION

As mentioned earlier, the IRS has four regions and has consolidated the management and management support structures of its former 63 districts into 33.

- The Midstates Regional Office is in Dallas.
- The Northeast Regional Office is in Manhattan.
- The Southeast Regional Office is in Atlanta.
- The Western Regional Office is in San Francisco.

In deciding on the new consolidated districts, IRS executives considered such factors as balancing workloads, leveling management spans of control, and keeping district areas contiguous.

Forty-Nine Districts Consolidate into 19

Headquarters	District Name	Area Covered
Baltimore	Delaware–Maryland	Delaware, District of Columbia, Maryland
Boston	New England	Maine, Massachusetts, New Hampshire, Vermont
Buffalo	Upstate New York	New York (north of Manhattan District)*
Chicago	Illinois	Illinois*
Cincinnati	Ohio	Ohio*
Denver	Rocky Mountain	Colorado, Idaho, Montana, Utah, Wyoming
Greensboro	North–South Carolina	North Carolina, South Carolina
Hartford	Connecticut–Rhode Island	Connecticut, Rhode Island
Milwaukee	Midwest	Iowa, Nebraska, Wisconsin
Nashville	Kentucky–Tennessee	Kentucky, Tennessee
New Orleans	Gulf Coast	Alabama, Louisiana, Mississippi
Oakland	Northern California	California (north of Central California)*
Oklahoma City	Arkansas–Oklahoma	Arkansas, Oklahoma
Philadelphia	Pennsylvania	Pennsylvania*
Phoenix	Southwest	Arizona, Nevada, New Mexico
Richmond	Virginia–West Virginia	Virginia, West Virginia
St. Louis	Kansas–Missouri	Kansas, Missouri

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St. Paul	North Central	Minnesota, North Dakota, South Dakota
Seattle	Pacific Northwest	Alaska, Hawaii, Oregon, Washington

*Each of these areas formerly consisted of two districts.

Fourteen Districts Kept the Same Boundaries, with Some Name Changes

Headquarters	District Name
Atlanta	Georgia
Austin	South Texas
Brooklyn	Brooklyn
Dallas	North Texas
Detroit	Michigan
Ft. Lauderdale	South Florida
Houston	Houston
Indianapolis	Indiana
Jacksonville	North Florida
Laguna Niguel	Southern California
Los Angeles	Los Angeles
Manhattan	Manhattan
Newark	New Jersey
San Jose	Central California

Information Related to Objectives

The following tables were taken from the National Commission on Restructuring the Internal Revenue Service (June 25, 1997). [Table 1](#) provides a schedule of various electronic filing objectives of the IRS. [Tables 2](#) and [3](#) provide information relating to the recovery rates of proposed audit deficiencies by the Appeals Division.

Table 1 Electronic Filing Plan for Individual Tax Returns

Feature	Implementation Year												
	98	99	00	01	02	03	04	05	06	07	08	09	10
<ul style="list-style-type: none"> Increased partnership between practitioners, tax software industry, transmitters, and IRS 	X	X	X	X	X	X	X	X	X	X	X	X	X
1. Creation of an electronic commerce advisory group	X												
2. Elimination of paper signature document Form 8453	X												
3. Elimination of paper W-2 filing (attached to 8453)	X												
4. Practitioner regulation in accordance		X											

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with Circular 230 to achieve more consistent compliance checks between paper and electronic preparers														
5. Authorization for preparer to discuss return information with IRS as checkoff box on return			X											
6. Field for inclusion of taxpayer/practitioner notes				X										
7. Acceptance by IRS of all 1040 forms, with retention of paper copies of attached forms/schedules by taxpayer/practitioner for forms that cannot be electronically received by IRS (i.e., treat forms as worksheets)	X													
• Expansion of TeleFile pool to include some 1040A filers		X	X											
• Increasing pool of 1040A and 1040EZ filers by changing limits		X	X											
• Additional electronic input of information returns				X										
• Due date realignment, including extensions for electronic filers				X										
• Capability to receive all forms				X										
• Paperless payment available for taxpayers		X												
• Incentives for transmitters for filing electronic returns	\$2	\$2	\$2	\$1	\$1	\$1								
• Paid preparers required to file all returns electronically									X					
• Systems to allow direct home PC filing (if not already supported by marketplace)				X	X	X								
• Secure access to account data for electronic filers										X				
• Improved marketing and advertising by IRS	X	X	X	X	X	X	X	X	X	X	X	X	X	X
• Simpler filing methods, such as return free filing														X
Projections of Individual Tax Returns by year (in millions) ²	119	120	122	123	124	126	128	130	132	134	136	138	140	
Estimated number of electronic returns (in millions), less TeleFile	25	30	40	45	50	55	80	85	95	98	100	102	104	
Estimated number of TeleFile returns by year (in millions) ²	6.5	7.0	7.5	8.0	8.5	9.0	9.2	9.4	9.6	9.8	10.0	10.2	10.4	
Remaining paper returns (in millions)	87.5	83	74.5	70	65.5	62	38.8	35.6	27.4	26.2	26	25.8	25.6	
Percent of paper returns	74	69	61	57	53	44	30	27	21	20	19	19	18	

Note 1: For previous tax year (e.g., Implementation Year 98 is Tax Year 1997)

1997 Workbook

Note 2: Extrapolated from IRS Calendar Year Projections of Individual Returns by Major Processing Categories, Table 13, and Tax Year 1996 TeleFile Profile, June 24, 1996

Recovery Rates in Appeals

	FY 1996	FY 1995	FY 1994	FY 1993	FY 1992	Five Year Total
Nondocketed						
Number of Work Units Closed	43,731	42,281	41,576	43,281	44,347	215,216
Additional Tax and Penalties:						
• Proposed (\$1,000)	11,623,092	9,893,945	8,629,987	8,507,266	8,891,067	47,545,357
• Revised (\$1,000)	3,880,121	2,877,568	2,384,268	2,519,875	2,588,071	14,249,903
Percent Recovered	33.38%	29.08%	27.63%	29.62%	29.11%	29.97%
Docketed						
Number of Work Units Closed	20,136	19,059	22,148	23,378	25,140	109,861
Additional Tax and Penalties:						
• Proposed (\$1,000)	2,043,079	2,341,895	2,939,049	2,492,774	3,194,118	13,010,915
• Revised (\$1,000)	435,602	615,915	768,859	447,616	832,348	3,100,340
Percent Recovered	21.32%	26.30%	26.16%	17.96%	26.06%	23.83%
Total						
Number of Work Units Closed	63,867	61,340	63,724	66,659	69,487	325,077
Additional Tax and Penalties:						
• Proposed (\$1,000)	13,666,171	12,235,840	11,569,036	11,000,040	12,085,185	60,556,272
• Revised (\$1,000)	4,315,723	3,493,483	3,153,127	2,967,491	3,420,419	17,350,243
Percent Recovered	31.58%	28.55%	27.25%	26.98%	28.30%	28.65%

Terminology: *Work units*—Historically, Appeals has tracked its inventory in "works units." A work unit generally involves one or more related taxpayers for one or more periods, for which the protests contain substantially the same primary issue. A work unit can, and often does, involve more than one tax return. *Additional tax and penalties*—All of the docketed amounts and the bulk of the nondocketed amounts represent District proposed deficiencies (as defined in I.R.C. §6211). However, the nondocketed figures also contain adjustments which are not subject to Tax Court jurisdiction. This includes cases referred to Appeals by Collection such as Trust Fund Recovery cases and Offer in Compromise cases.

Source: Office of the National Director of Appeals, IRS

Closures and Recovery Rates for "S" and Regular Docketed Tax Cases Closed FY~1992~FY~1996

Year	"S" ¹	0-\$10K	\$10K-\$100K	\$100K-\$1M	\$1M-\$10M	>\$10M	Total
FY 1992							

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• Closure	13,226	7,612	9,889	3,038	489	75	34,338
• Recovery Rate (%)	49.6	55.6	47.8	40.9	29.7	27.9	32.9
FY 1993							
• Closure	12,678	6,785	9,597	3,055	521	89	32,725
• Recovery Rate (%)	47.7	56.5	48.7	47.2	36.2	20.6	30.5
FY 1994							
• Closure	11,745	7,662	10,217	3,195	648	115	33,582
• Recovery Rate (%)	47.1	53.7	46.5	44.0	44.5	25.8	34.1
FY 1995							
• Closure	9,872	5,633	8,086	2,562	473	81	26,707
• Recovery Rate (%)	49.1	58.3	48.7	40.1	35.7	32.1	34.9
FY 1996							
• Closure	11,903	6,161	7,967	2,664	463	57	29,215
• Recovery Rate (%)	45.7	62.6	48.0	39.6	32.4	18.3	25.6

Note 1: "S" cases are under \$10,000, no appeal allowed and informal rules of evidence.

Terminology and Definitions—Office of Chief Counsel

Recovery rate: the percentages of taxes recovered in a settlement or litigated case to the amount of tax in dispute (Tax Owed on Decision / Tax in Dispute). Tax in Dispute is the amount of tax in the statutory notice and petition. Tax Owed on Decision is the amount of tax as found in the decision and stipulation and reflects the redetermined deficiency *after* application of carrybacks and other allowances from years not in dispute. Accordingly, the recovery rate reflects the result of litigation reduced by these carrybacks and other allowances.

Sustension rate: Sustension rate is the percentage of taxes sustained in a settled or litigated case to the amount of tax in dispute (Deficiency Sustained / Tax in Dispute). Tax in Dispute is the amount of tax in the statutory notice and petition. The Deficiency Sustained is the deficiency in dispute as redetermined in the decision and stipulation *before* application of carrybacks and other allowances from years not in dispute.

Sustension rate data is available only for docketed cases closed in fiscal years 1994 and 1995 involving corporate cases with over \$10 million dollars in dispute and CEP cases. This data historically had not been collected within Chief Counsel's information systems. However, Counsel has begun to collect sustension rate data on large corporate cases in order to evaluate litigation results more accurately (i.e., prior to the application of carrybacks from other nonlitigation tax years).

Source: Office of Chief Counsel, IRS

II. Taxpayer Advocate

The Taxpayer Advocate position was created by the Taxpayer Bill of Rights 2. The mission of the advocate has two primary facets:

1. Work with taxpayers to address their immediate problems or concerns and to provide appropriate relief.
2. Address continuing systemic problems through analysis of their underlying causes and to

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The Taxpayer Advocate has initiated the following five projects since the position was established:

1. **Revenue Protection Strategy**—A strategy, begun during FY 1995, to take a more aggressive stance to identify and prevent the fraud and abuse of the Earned Income Tax Credit.
2. **Last Known Address Study**—The IRS is attempting to improve the way it updates and maintains taxpayer address records.
3. **Customer Feedback System**—The IRS is implementing procedures for handling and reporting complaints related to employee misconduct.
4. **Joint Return Study**—The IRS is studying problems being experienced with the tax liabilities of divorced and separated taxpayers. Part of this includes a study on the issue of joint and several liability.
5. **Audit Reconsideration**—The IRS is implementing procedures to reduce the time frame for handling audit reconsiderations as well as the number of cases that need to be referred and subsequently handled in the Problem Resolution Office.

The Taxpayer Advocate is responsible for the identification and resolution of continuing problems that taxpayers are facing with the IRS. The Taxpayer Advocate has developed the following list of the 20 most serious problems:

1. Complexity of the tax law
2. Inability to readily reach the IRS by telephone
3. Lack of clarity and inappropriate tone of IRS communications with taxpayers
4. Erroneous IRS notices
5. Difficulty in understanding federal tax deposit requirements
6. Compliance burden on small businesses
7. Problems in the administration of penalties
8. IRS lack of understanding of taxpayers' concerns
9. Delays by IRS in compliance contacts
10. Problems in determining and maintaining taxpayers' current addresses
11. The cost to taxpayers of electronic filing
12. Problems in the administration of the Earned Income Tax Credit
13. Abatement of interest due because of IRS delays
14. Problems in mailing forms, estimated tax vouchers, etc.
15. Separate mailing of math error notices and affected refund checks
16. Delays by IRS in processing offers in compromise
17. Burden caused by IRS cash management practices
18. Lack of acknowledgement of taxpayers' submissions and payments
19. Lack of one-stop service
20. Inconvenient times and locations for doing business with IRS

1997 Workbook

III. Taxpayer Bill Of Rights

The First Taxpayer Bill of Rights was part of TAMRA 1988 (P.L. 100-647) and granted various rights to taxpayers in dealing with the IRS.

Key provisions of this bill (TBOR 1) include the following.

1. **Disclosure of taxpayer rights**—The IRS is required to disclose to the taxpayer rights and obligations during the audit, appeals, refund, and collection processes. (This resulted in Publication 1, Your Rights as a Taxpayer.)
2. **Interviewing standards**—The IRS must disclose standards for determining if the time and place for interviewing a taxpayer is reasonable (I.R.C. §7521).
3. **Erroneous written advice**—The IRS must abate any portion of any penalty or addition to tax attributable to erroneous written advice provided by the IRS in a response to a specific written request of the taxpayer (I.R.C. §6404).
4. **Taxpayer Assistance Orders (TAO)**—A policy instituted by the IRS to specifically relieve significant hardships caused by the IRS on taxpayers (I.R.C. §7811).
5. **Expiration of temporary regulations**—All temporary regulations issued after November 20, 1988, must also be issued as proposed regulations, meaning that public feedback is available. Also, any temporary regulation issued automatically expires three years after issuance (I.R.C. §7805).
6. **Installment payment agreements**—The IRS is to be more open to taxpayers with respect to installment agreements if doing so will facilitate collection (I.R.C. §6159).
7. **Office of Taxpayer Services**—This office is responsible for telephone services, walk-in services, educational services, and the design and production of tax and informational forms (I.R.C. §7802(c)).
8. **Intentional disregard of regulations**—A taxpayer may now sue the IRS for reckless or intentional disregard of the Internal Revenue Code or regulations in connection with the collection of tax (I.R.C. §7433).
9. **Disclosure by tax return preparer**—Unauthorized disclosure or use by a tax return preparer of information furnished for preparation can subject the preparer to a penalty of \$250 per disclosure, not to exceed \$10,000 in any calendar year (I.R.C. §6713).

The Taxpayer Bill of Rights 2 (TBOR 2), which is generally effective as of July 30, 1996, both added new provisions and amplified certain provisions of the First Taxpayer Bill of Rights. Some of the key provisions include the following.

1. **Taxpayer Advocate**—The Taxpayer Advocate replaces the "Ombudsman" and is given greater authority. The Advocate is also responsible for performing certain studies regarding tax

1997 Workbook

administration (I.R.C. §§7802 and 7811).

2. **Installment agreements**—The IRS must notify a taxpayer of its reasons for altering, modifying, or terminating an existing installment agreement at least 30 days before the action is taken (I.R.C. §6159).
3. **Interest and penalties**—The interest-free period for payment of tax after notice and demand (10 days) has been expanded to 21 days (I.R.C. §6601). The IRS now has broader authority to abate interest and penalties (I.R.C. §§6404 and 6656).
4. **Joint returns**—Taxpayers who file separate returns and subsequently decide to file joint returns may now do so *without* paying their full joint tax liability. In collection activities for a joint liability where the taxpayers are no longer married or sharing the same household, the IRS must disclose its collection activities upon the written request of one of the individuals (I.R.C. §6103).
5. **Collection activities**—The IRS now has authority to withdraw a public notice of tax lien prior to receiving full payment and to return property that has been seized (I.R.C. §§6323 and 6343). The amount of personal property and tools of a trade exempt from levy was raised slightly and indexed for inflation (I.R.C. §6334).

The amount of unpaid tax in an offer in compromise requiring approval by the IRS Chief Counsel was raised substantially (I.R.C. §7122(b)). Taxpayers can now sue for actual economic damages up to \$1 million when an IRS employee recklessly or intentionally disregards statutory or regulatory provisions in the collection of tax. (I.R.C. §7433).

6. **Information returns**—The burden of proof is now on the IRS concerning accuracy of forms 1099 or W-2 (I.R.C. §6201). Payee statements required to be furnished after December 31, 1996, must include the name, address, and telephone number for the person (entity) required to file the related information return.
7. **Litigation**—If a taxpayer prevails over the IRS in a tax dispute that is litigated, the burden of proof shifts to the IRS to establish that it was justified in its position against the taxpayer (I.R.C. §7430).
8. **Other**—The IRS's ability to issue retroactive regulations has been significantly reduced. (I.R.C. §7805). The IRS now treats "designated delivery services" equivalent to the U.S. Postal Service in terms of meeting the timely mailing—timely filing requirement (I.R.C. §7502). [See the What's New chapter.]

IV. Offers in Compromise

New Form 656

The IRS has issued a new Form 656, Offer in Compromise, dated in January, 1997. At this time, the IRS is not accepting any offer in compromise using an earlier version of the form.

The new form includes clearer instructions and schedules on how to compute the amount of the offer. This is important because the IRS will not accept for processing any offer that does not provide at least

1997 Workbook

the required "minimum amount."



Department of Treasury
Internal Revenue Service
Form 656 (Rev. 1-97)
Catalog Number 16728N

Form 656

Offer in Compromise

Item 1

Taxpayer's Name and Home or Business Address

Name _____

Street Address _____

City _____ State _____ Zip Code _____

Mailing Address (if different from above) _____

City _____ State _____ Zip Code _____

Item 2

Social Security Numbers

(a) Primary _____

(b) Secondary _____

Item 3

Employer Identification Number (Included in offer) _____

Item 4

Other Employer Identification Numbers (Not included in offer)

Item 5

To: Commissioner of Internal Revenue Service

I/we (includes all types of taxpayers) submit this offer to compromise the tax liabilities plus any interest, penalties, additions to tax, and additional amounts required by law (tax liability) for the tax type and period marked below: (Please mark an "X" for the correct description and fill-in the correct tax periods(s), adding additional periods if needed.)

1040/1120 Income tax—Year(s) _____

941 Employer's Quarterly Federal Tax Return—Quarterly Period(s) _____

940 Employer's Annual Federal Unemployment (FUTA) Tax Return—Year(s) _____

Trust Fund Recovery Penalty as a responsible person of (enter corporation name) _____

for failure to pay withholding and Federal Insurance Contributions Act Taxes (Social Security taxes)—Period(s) _____

Other Federal taxes (specify type and periods(s)) _____

Item 6

I/we submit this offer for the reason(s) checked below:

Doubt as to Liability— "I do not believe I owe this amount." You *must* include a detailed explanation of the reasons you believe you do not owe the tax.

Doubt as to Collectibility— "I have insufficient assets and income to pay the full amount." You *must* include a complete financial statement (Form 433-A and/ or Form 433-B).

Item 7

I/We offer to pay \$ _____

Paid in full with this offer.

Deposit of \$ _____ with this offer.

No deposit.

Check one of the following boxes.

Balance to be paid in 10, 30, 60, or 90 days from notice of acceptance of the offer. If more than one payment will be paid during the time frame checked, provide the amount of the payment and date to be paid on the line below

Other proposed payment terms. Enter the specific dates (mm/dd/yy format) and dollar amounts of the the payment terms you propose on the lines below

In addition to the above amount, IRS will add interest from the date IRS accepts the offer until the date you completely pay the amount offered, as required by section 6821 of the Internal Revenue Code. IRS compounds interest daily, as required by section 6822 of the Internal Revenue Code.

1997 Workbook

Item 8

By submitting this offer, I/we understand and agree to the following conditions:

- (a) I/we voluntarily submit all payments made on this offer.
- (b) IRS will apply payments made under the terms of this offer in the best interest of the government.
- (c) If IRS rejects the offer or I/we withdraw the offer, IRS will return any amount paid with the offer. If I/we agree in writing, IRS will apply the amount paid with the offer to the amount owed. If I/we agree to apply the payment, the date the offer is rejected or withdrawn will be considered the date of payment. I/we understand that IRS will not pay interest on any amount I/we submit with the offer.
- (d) I/we will comply with all provisions of the Internal Revenue Code relating to filing my/our returns and paying my/our required taxes for 5 years from the date IRS accepts the offer. This condition does not apply to offers based on Doubt as to Liability.**
- (e) I/we waive and agree to the suspension of any statutory periods of limitation (time limits provided for by law) for IRS assessment and collection of the tax liability for the tax periods identified in item (5).
- (f) IRS will keep all payments and credits made, received, or applied to the amount being compromised before this offer was submitted. IRS may keep any proceeds from a levy served prior to submission of the offer, but not received at the time the offer is submitted. If I/we have an installment agreement prior to submitting the offer, I/we must continue to make the payments as agreed while this offer is pending. Installment agreement payments will not be applied against the amount offered.
- (g) IRS will keep any refund, including interest, due to me/us because of overpayment of any tax or other liability, for tax periods extending through the calendar year that IRS accepts the offer. I/we may not designate a refund, to which the IRS is entitled, to be applied to estimated tax payments for the following year.** This condition doesn't apply if the offer is based only on Doubt as to Liability.
- (h) I/we will return to IRS any refund identified in (g) received after submission of this offer. This condition doesn't apply if the offer is based only on Doubt as to Liability.
- (i) The total amount IRS can collect under this offer can not be more than the full amount of the tax liability.
- (j) I/we understand that I/we remain responsible for the full amount of the tax liability, unless and until IRS accepts the offer in writing and I/we have met all the terms and conditions of the offer. IRS won't remove the original amount of the tax liability from its records until I/we have met all the terms of the offer.
- (k) I/we understand that the tax I/we offer to compromise is and will remain a tax liability until I/we meet all the terms and conditions of this offer. If I/we file bankruptcy before the terms and conditions of this offer are completed, any claim the IRS files in the bankruptcy proceeding will be a tax claim.
- (l) Once IRS accepts the offer in writing, I/we have no right to contest, in court or otherwise, the amount of the tax liability.

(m) The offer is pending starting with the date an authorized IRS official signs this form and accepts my/our waiver of the statutory periods of limitation. The offer remains pending until an authorized IRS official accepts, rejects or acknowledges withdrawal of the offer in writing. If I/we appeal the IRS decision on the offer, IRS will continue to treat the offer as pending until the Appeals Office accepts or rejects the offer in writing. If I/we don't file a protest within 30 days of the date IRS notifies me/us of the right to protest the decision, I/we waive the right to a hearing before the Appeals office about the offer in compromise.

(n) The waiver and suspension of any statutory periods of limitation for assessment and collection of the amount of the tax liability described in item (5), continues to apply: while the offer is pending (see (m) above), during the time I/we have not paid all of the amount offered, during the time I/we have not completed all terms and conditions of the offer, and for one additional year beyond each of the time periods identified in this paragraph.

(o) If I/we fail to meet any of the terms and conditions of the offer, the offer is in default, then IRS may: immediately file suit to collect the entire unpaid balance of the offer; immediately file suit to collect an amount equal to the original amount of the tax liability as liquidating damages, minus any payments already received under the terms of this offer; disregard the amount of the offer and apply all amounts already paid under the offer against the original amount of tax liability; or file suit or levy to collect the original amount of the tax liability, without further notice of any kind.

IRS will continue to add interest as required by section 6621 of the Internal Revenue Code, on the amount IRS determines is due after default. IRS will add interest from the date the offer is defaulted until I/we completely satisfy the amount owed.

Item 9

If I/we submit this offer on a substitute form, I/we affirm that this form is a verbatim duplicate of the official Form 656, and I/we agree to be bound by all the terms and conditions set forth in the official Form 656.

Under penalties of perjury, I declare that I have examined this offer, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct and complete.

(9a) Signature of Taxpayer-proponent

Date

(9b) Signature of Taxpayer-proponent

Date

For Official Use Only

I accept waiver of the statutory period of limitations for the Internal Revenue Service.

Signature of authorized Internal Revenue Service Official

Title

Date

1997 Workbook

Item 8

By submitting this offer, I/we understand and agree to the following conditions:

- (a) I/we voluntarily submit all payments made on this offer.
- (b) IRS will apply payments made under the terms of this offer in the best interest of the government.
- (c) If IRS rejects the offer or I/we withdraw the offer, IRS will return any amount paid with the offer. If I/we agree in writing, IRS will apply the amount paid with the offer to the amount owed. If I/we agree to apply the payment, the date the offer is rejected or withdrawn will be considered the date of payment. I/we understand that IRS will not pay interest on any amount I/we submit with the offer.
- (d) I/we will comply with all provisions of the Internal Revenue Code relating to filing my/our returns and paying my/our required taxes for 5 years from the date IRS accepts the offer. This condition does not apply to offers based on Doubt as to Liability.**
- (e) I/we waive and agree to the suspension of any statutory periods of limitation (time limits provided for by law) for IRS assessment and collection of the tax liability for the tax periods identified in item (5).
- (f) IRS will keep all payments and credits made, received, or applied to the amount being compromised before this offer was submitted. IRS may keep any proceeds from a levy served prior to submission of the offer, but not received at the time the offer is submitted. If I/we have an installment agreement prior to submitting the offer, I/we must continue to make the payments as agreed while this offer is pending. Installment agreement payments will not be applied against the amount offered.
- (g) IRS will keep any refund, including interest, due to me/us because of overpayment of any tax or other liability, for tax periods extending through the calendar year that IRS accepts the offer. I/we may not designate a refund, to which the IRS is entitled, to be applied to estimated tax payments for the following year.** This condition doesn't apply if the offer is based only on Doubt as to Liability.
- (h) I/we will return to IRS any refund identified in (g) received after submission of this offer. This condition doesn't apply if the offer is based only on Doubt as to Liability.
- (i) The total amount IRS can collect under this offer can not be more than the full amount of the tax liability.
- (j) I/we understand that I/we remain responsible for the full amount of the tax liability, unless and until IRS accepts the offer in writing and I/we have met all the terms and conditions of the offer. IRS won't remove the original amount of the tax liability from its records until I/we have met all the terms of the offer.
- (k) I/we understand that the tax I/we offer to compromise is and will remain a tax liability until I/we meet all the terms and conditions of this offer. If I/we file bankruptcy before the terms and conditions of this offer are completed, any claim the IRS files in the bankruptcy proceeding will be a tax claim.
- (l) Once IRS accepts the offer in writing, I/we have no right to contest, in court or otherwise, the amount of the tax liability.

(m) The offer is pending starting with the date an authorized IRS official signs this form and accepts my/our waiver of the statutory periods of limitation. The offer remains pending until an authorized IRS official accepts, rejects or acknowledges withdrawal of the offer in writing. If I/we appeal the IRS decision on the offer, IRS will continue to treat the offer as pending until the Appeals Office accepts or rejects the offer in writing. If I/we don't file a protest within 30 days of the date IRS notifies me/us of the right to protest the decision, I/we waive the right to a hearing before the Appeals office about the offer in compromise.

(n) The waiver and suspension of any statutory periods of limitation for assessment and collection of the amount of the tax liability described in item (5), continues to apply: while the offer is pending (see (m) above), during the time I/we have not paid all of the amount offered, during the time I/we have not completed all terms and conditions of the offer, and for one additional year beyond each of the time periods identified in this paragraph.

(o) If I/we fail to meet any of the terms and conditions of the offer, the offer is in default, then IRS may: immediately file suit to collect the entire unpaid balance of the offer; immediately file suit to collect an amount equal to the original amount of the tax liability as liquidating damages, minus any payments already received under the terms of this offer; disregard the amount of the offer and apply all amounts already paid under the offer against the original amount of tax liability; or file suit or levy to collect the original amount of the tax liability, without further notice of any kind.

IRS will continue to add interest as required by section 6621 of the Internal Revenue Code, on the amount IRS determines is due after default. IRS will add interest from the date the offer is defaulted until I/we completely satisfy the amount owed.

Item 9

If I/we submit this offer on a substitute form, I/we affirm that this form is a verbatim duplicate of the official Form 656, and I/we agree to be bound by all the terms and conditions set forth in the official Form 656.

Under penalties of perjury, I declare that I have examined this offer, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct and complete.

(9a) Signature of Taxpayer-proponent

Date

(9b) Signature of Taxpayer-proponent

Date

For Official Use Only

I accept waiver of the statutory period of limitations for the Internal Revenue Service.

Signature of authorized Internal Revenue Service Official

Title

Date

1997 Workbook



Department of Treasury
Internal Revenue Service

Form 656 (Rev. 1-97)
Catalog Number 16728N

Form 656

Offer in Compromise

- What you should know before submitting an offer in compromise
 - Worksheets to calculate an acceptable offer amount using Form 433-A and/or 433-B and Publication 1854*
 - How to correctly complete Form 656, Offer in Compromise
 - Two copies of Form 656
-

*Required forms can be obtained by calling 1-800-829-1040

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What You Should Know Before Preparing an Offer in Compromise

Legal Limitations on Compromise

IRS *may* legally compromise a tax liability owed based only on:

- **Collectibility**—doubt that IRS can collect the full amount owed and/or
- **Liability**—doubt as to whether you owe the amount

IRS *cannot* legally accept a compromise based solely on hardship.

Are You an Offer Candidate?

Do not submit an offer if:

- The entire amount you owe can be collected through liquidation of your assets or through a monthly installment plan.
- IRS can collect more from your assets and/or future income than you are offering.

IRS *will not* decide that "something is better than nothing" and accept the offer because you currently have no assets or income.

Additional Agreements

The IRS may require additional agreements which would require you to:

- Pay a percentage of future earnings
- Give up certain present or potential tax benefits

Suspending Collection

Submitting an offer does not automatically suspend collection activity.

- If there is an indication that you filed the offer to delay collection of the tax or if delay of collection would interfere with the Service's ability to collect the tax, then IRS will continue collection efforts.

- If you have an installment agreement prior to submitting the offer, you must continue making those payments while the offer is being considered.

Substitute Form 656

Offer in Compromise Form 656 is the official Offer in Compromise agreement. If you are using a substitute Form 656 that is a computer generated or photocopied substitute Form 656 be aware that:

- By signing the substitute Form 656 you affirm:
 1. That this form is a verbatim duplicate of the official Form 656;
 2. That you agree to be bound by all terms and conditions set forth in the official Form 656.

Can We Process Your Form 656?

IRS will return your offer to you and ask for clarification if you do not fill in every line item on the form. Refer to "How To Correctly Complete Form 656", page 6 that explains how to fill out the form. IRS cannot process your offer if it contains any of these problems:

- Substitute Form 656 is not a verbatim duplicate of the official Form 656
- Pre-printed terms of the offer form are altered
- Taxpayer is not identified
- Taxpayer Identification Number is not included

- An amount is not offered and/or payment terms are not stated
- Appropriate signatures are not present
- Forms 433-A and/or 433-B, if required, are missing or are incomplete
- IRS determines that the amount you offered is less than the equity and available income indicated on the attached Form 433-A and/or 433-B

1997 Workbook

Financial Information

Only applies when submitting an offer based on doubt as to collectibility.

You must file Form 433-A, Collection Information Statement for individuals, and/or Form 433-B for businesses with Form 656. You must use Publication 1854 "How to Prepare a Collection Information Statement (Form 433-A)".

■ If you do not submit your financial statements or you submit incomplete financial statements, IRS will return the entire offer package to you. The information you provide must be current and reflect activity within the 6 months prior to the date you submit the offer. IRS uses this information to evaluate the offer.

■ Do not include information relating to unsecured creditors (See Form 433-A—line 28 and Form 433-B—line 25). For example, do not include amounts you owe on credit cards or loans made without pledging assets as security.

■ If you owe personal income tax and you are also self employed you must submit both Forms 433-A and 433-B.

■ If only one spouse has a liability but both have income, prepare the form using only the liable spouse's income and expense information unless state community property laws allow collection from a non-liable spouse. Where community property laws do not apply, IRS will require disclosure of financial information on the non-liable spouse during the investigation.

■ Complete all the items on the form that apply to you.

■ Assets or income that is available to you but may not be available to IRS for direct collection action, should be included on the financial statement. Even if the IRS may not collect directly from the assets, those assets are available to raise funds and those funds should be included in the offer.

How Do I Compute the Offer Amount?

To aid you in calculating an acceptable offer amount use the "Work Sheet To Calculate An Acceptable Offer Amount" on page 4. Enter this amount on Line 7 of Form 656.

Investigation of the Offer

In determining the amount that would be acceptable to compromise your liability, an offer examiner will review your offer package to insure that:

■ You accurately included all assets and income available to you.

■ You only claimed the necessary expenses allowable for the health and welfare of you and your family and/or that provide for the production of income.

■ IRS receives any requested documentation. If IRS does not receive the requested documentation, we cannot recommend the offer for acceptance and the offer will be rejected.

If financial changes are made, the examiner will recompute the amount necessary for an acceptable offer.

If Your Offer Is Accepted

■ We will send confirmation of acceptance by mail.

■ You should promptly pay any unpaid offered amounts plus any required interest according to the terms of the offer.

■ You must comply with all contractual terms and conditions of the offer.

■ We will release all Notice of Federal Tax Lien(s) when the offer amount and any additional owed interest is paid in full.

■ Failure to adhere to the 5 year compliance requirement to file all returns and pay all amounts due may result in default of your offer. If this occurs the unpaid compromised tax liability will be reinstated, any released Notice of Federal Tax Lien will be reinstated and the collection process will resume.

Public Disclosure of Your Offer

The law requires that all accepted offers in compromise be made available for review by the general public. Therefore, it is possible that the details of the offer in compromise may become publicly known.

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Worksheet to Calculate an Acceptable Offer Amount Using Forms 433-A or 433-B

Read the terms and definitions below before preparing Forms 433-A or 433-B. You must use the National Standard expense amounts found in Publication 1854 to prepare Form 433-A.

Terms and Definitions

Current Market Value—The amount you could reasonably expect to be paid for the asset if you sold it. Do not guess at the value of an asset. Find out the value from realtors, used car dealers, publications, furniture dealers, or other experts on specific types of assets. If you get a written estimate, please include a copy with your financial statement.

Present and Future Income—Generally the amount collectible is your income minus necessary living expenses. We usually consider what we can collect over 5 years.

Necessary Expenses—(Not for business entities) Expenses needed to provide for you and your family's health and welfare and the production of income. All expenses must be reasonable in amount. IRS expense amounts are determined from the Bureau of Labor Statistics (BLS) Consumer Expenditure Survey. IRS also developed local standards for housing (includes utilities) from information received from the Bureau of Census.

Note: If the amount of your necessary expenses is unreasonable based on the BLS and local standards, IRS will not allow these expenses.

Expenses Not Generally Allowed—Tuition for private elementary and secondary schools, public or private college expenses, charitable contributions, voluntary retirement benefits, unsecured debts, cable television charges and any other expense that does not meet the "necessary expense" test.

Worksheet Instructions

Follow the steps in the appropriate worksheet below to compute the offer amount.

1. Use Form 433-A if you are an individual wage earner (go to worksheet 1)
2. Use Forms 433-A and 433-B if you are self-employed or if you are both self-employed and a wage earner (go to worksheet 2)
3. Use Form 433-B if the offer is for a business entity (go to worksheet 3)

Note: The offer investigator will review the form and compute an amount acceptable to compromise your liability. The amount you offered may have to be increased based on the investigator's review.

Worksheet 1: Individual Wage Earners

Step 1: Equity in Assets	Enter the dollar amount from line 30, Form 433-A	\$ _____
Step 2: Present and Future Income	(a) Enter the amount from line 41, Form 433-A	\$ _____
	(b) Necessary Expenses (Total lines 42-51)	\$ _____
	Line (a) minus line (b) =	\$ _____
	Multiply by 60 months =	\$ _____
Step 3: Offer Amount	Add total of steps 1 and 2 above = offer amount	\$ _____
	Note: If the offer amount is more than your total liability, you are not an offer candidate. Contact your local IRS office to resolve your liabilities.	
Step 4: Form 656	Enter the total amount from step 3 above in item 7 of Form 656.	

1997 Workbook

Worksheet 2: Self-Employed or Self-Employed and Wage Earners

Step 1: Equity in Assets	(a) Enter the dollar amount from line 30, Form 433-A \$ _____ (b) Enter the dollar amount from line 27, Form 433-B \$ _____ Enter total of lines (a) and (b) \$ _____
Step 2: Present and Future Income	Enter the amount from line 33, Form 433-B on line 34, Form 433-A. Include line 34 in total on line 41, Form 433A (a) Enter the amount from line 41, Form 433-A \$ _____ (b) Enter expenses (Total lines 42-51, Form 433-A) \$ _____ Line (a) minus line (b) = \$ _____ Multiply by 60 months = \$ _____
Step 3: Offer Amount	Add total of steps 1 and 2 above = offer amount \$ _____ Note: If the offer amount is more than your total liability, you are not an offer candidate. Contact your local IRS office to resolve your liabilities.
Step 4: Form 656	Enter the total amount from step 3 above in item 7 of Form 656.

Worksheet 3: Business Entities

Step 1: Equity in Assets	Enter the dollar amount from line 27, Form 433-B \$ _____
Step 2: Present and Future Income	(a) Enter the amount from line 33, Form 433-B \$ _____ (b) Enter expenses (Total lines 34-44) \$ _____ Line (a) minus line (b) = \$ _____ Multiply by 60 months = \$ _____
Step 3: Offer Amount	Add total of steps 1 and 2 above = offer amount \$ _____ Note: If the offer amount is more than your total liability, you are not an offer candidate. Contact your local IRS office to resolve your liabilities.
Step 4: Form 656	Enter the total amount from step 3 above in item 7 of Form 656.

1997 Workbook

How to Correctly Complete Form 656

Two Forms 656 are provided. Use one form to submit your offer in compromise. The other form may be used as a worksheet and retained for your personal records.

Failure to read and follow these instructions could result in IRS returning your offer. Questions may be directed to your local IRS office.

Item 1	<p>Enter the taxpayer's name and home or business address. You should also include a mailing address, if different.</p> <p>If the tax liability is owed jointly by a husband and wife and both wish to make an offer, show both names. If you owe one amount by yourself (such as employment taxes), and other amounts jointly (such as income taxes),</p>	<p>but only one person is submitting an offer, list all tax liabilities on one Form 656. If you owe one amount yourself and another amount jointly, and both parties submit an offer, you <i>must complete two Forms 656</i>, one for the amount you owe individually and one for the joint amount.</p>
Item 2	<p>Enter the social security number for the person submitting the offer. For example, if both husband and wife are submitting an offer on a joint income tax liability, the</p>	<p>social security number of both persons should be entered. However, if only the husband is submitting the offer, only his social security number should be entered.</p>
Item 3	<p>If the liability being compromised is owed by a business, enter the employer identification number.</p>	
Item 4	<p>Show the employer identification numbers for all other businesses (excluding corporate entities) which you own. Under the terms of the offer in compromise, you</p>	<p>are required to comply with the filing and paying requirements of the tax laws for a period of 5 years for all the businesses that you own.</p>
Item 5	<p>Check the blocks that identify your tax liability and enter the tax year or period of the liability. If you owe a type of tax not preprinted, list it in the "other" block, specifying the type of tax and tax year and/or period. Tax periods</p>	<p>related to Trust Fund Recovery assessments can be found on copies of notices and from the Notice of Federal Tax Lien.</p>
Item 6	<p>Check the applicable block describing the basis for your offer.</p> <p>■ If Doubt as to Liability you must submit a written statement describing in detail why you do not believe you owe the liability. <i>You must complete item 7.</i></p> <p>■ If Doubt as to Collectibility you must submit Collection Information Statement, Form 433-A for individual and/or Form 433-B for businesses. <i>You must complete item 7.</i></p>	<p>■ If you are submitting an offer on both Doubt as to Liability and Doubt as to Collectibility, please be advised that IRS will first determine whether your offer is acceptable based on Doubt as to Collectibility. If your offer is acceptable based on Doubt as to Collectibility, the liability issue will not be considered.</p>

1997 Workbook

Item 7

■ Enter the total amount of your offer from the worksheet. Do not include amounts you have already paid, IRS has already physically collected or is due to receive.

■ Enter the amount of your deposit. A deposit is not required, however IRS encourages deposits because it reflects your good faith effort to reach an acceptable compromise. However, the law requires that your deposit go into a special fund. IRS will not pay you interest whether the deposit is applied to an accepted offer, applied to your tax liability, or refunded to you. *When the IRS cashes your check it does not mean your offer is accepted.*

■ Enter how and when you will pay the remainder of your offer. We have provided some specific time periods: 10 days, 30 days, 60 days, or 90 days. You should pay the full amount of the offer as soon as possible. If we determine that you can pay in a shorter time frame, we will require earlier payment or we will reject your offer.

■ Enter other proposed payment terms if you cannot pay the offer amount within 90 days or if you intend to make more than one payment within the specific time frames above. Include the specific dates and payment amount that we will receive. For example, \$1000.00 to be paid on 12-31-97. When IRS reviews your financial statement, if we determine that you can pay in a shorter time frame, we will require earlier payment or we will reject your offer.

Item 8

It is important that you thoroughly read and understand the contractual requirements listed in this section.

Item 9

All persons submitting the offer should sign and date Form 656. Where applicable, include titles of authorized corporate officers, executors, trustees, Powers of Attorney, etc.

If you are using a substitute Form 656 be aware that:

■ By signing the substitute Form 656 you affirm:

- 1) That this form is a verbatim duplicate of the official Form 656.
- 2) That you agree to be bound by all the terms and conditions set forth in the official Form 656.

■ If the substitute form is two single sided pages, the taxpayer(s) must initial and date the first page in addition to signing and dating the second page.

Where to File

File your offer in compromise in the IRS district office in your area. If you have been working with a specific IRS employee, file the offer with that employee.

Review your offer form to ensure that all line items are entered correctly.

1997 Workbook

Form **433-A**
(Rev. September 1995)

Department of the Treasury — Internal Revenue Service

Collection Information Statement for Individuals

NOTE: Complete all blocks, except shaded areas, Write "N/A" (not applicable) in those blocks that do not apply. Instructions for certain line items are in Publication 1854.

1. Taxpayer(s) name(s) and address County _____	2. Home phone number ()	3. Marital status
	4.a. Taxpayer's social security number	b. Spouse's social security number

Section I. Employment Information

5. Taxpayer's employer or business <i>(name and address)</i>	a. How long employed	b. Business phone number ()	c. Occupation
	d. Number of exemptions claimed on Form W-4 _____	e. Pay period: <input type="checkbox"/> Weekly <input type="checkbox"/> Bi-weekly <input type="checkbox"/> Monthly <input type="checkbox"/> _____ Payday: _____ (Mon - Sun)	f. <i>(Check appropriate box)</i> <input type="checkbox"/> Wage earner <input type="checkbox"/> Sole proprietor <input type="checkbox"/> Partner
6. Spouse's employer or business <i>(name and address)</i>	a. How long employed	b. Business phone number ()	c. Occupation
	d. Number of exemptions claimed on Form W-4 _____	e. Pay period: <input type="checkbox"/> Weekly <input type="checkbox"/> Bi-weekly <input type="checkbox"/> Monthly <input type="checkbox"/> _____ Payday: _____ (Mon - Sun)	f. <i>(Check appropriate box)</i> <input type="checkbox"/> Wage earner <input type="checkbox"/> Sole proprietor <input type="checkbox"/> Partner

Section II. Personal Information

7. Name, address and telephone number of next of kin or other reference	8. Other names or aliases	9. Previous address(es)
10. Age and relationship of dependents living in your household <i>(exclude yourself and spouse)</i>		

11. Date of Birth	a. Taxpayer	b. Spouse	12. Latest filed income tax return <i>(tax year)</i>	a. Number of exemptions claimed	b. Adjusted Gross Income
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Section III. General Financial Information

13. Bank accounts *(include savings & loans, credit unions, IRA and retirement plans, certificates of deposit, etc.) Enter bank loans in item 28.*

Name of Institution	Address	Type of Account	Account No.	Balance
Total <i>(Enter in Item 21)</i>				

1997 Workbook

Section III - continued General Financial Information

14. Charge cards and lines of credit from banks, credit unions, and savings and loans. List all other charge accounts in item 28.

Type of Account or Card	Name and Address of Financial Institution	Monthly Payment	Credit Limit	Amount Owed	Credit Available
Totals (Enter in Item 27)					

15. Safe deposit boxes rented or accessed (List all locations, box numbers, and contents)

16. Real Property (Brief description and type of ownership)	Physical Address
a.	County _____
b.	County _____
c.	County _____

17. Life Insurance (Name of Company)	Policy Number	Type	Face Amount	Available Loan Value
		<input type="checkbox"/> Whole <input type="checkbox"/> Term		
		<input type="checkbox"/> Whole <input type="checkbox"/> Term		
		<input type="checkbox"/> Whole <input type="checkbox"/> Term		
Total (Enter in Item 23)				

18. Securities (stocks, bonds, mutual funds, money market funds, government securities, etc.):

Kind	Quantity or Denomination	Current Value	Where Located	Owner of Record

19. Other information relating to your financial condition. If you check the yes box, please give dates and explain on page 4. Additional Information or Comments:

a. Court proceedings	<input type="checkbox"/> Yes	<input type="checkbox"/> No	b. Bankruptcies	<input type="checkbox"/> Yes	<input type="checkbox"/> No
c. Repossessions	<input type="checkbox"/> Yes	<input type="checkbox"/> No	d. Recent sale or other transfer of assets for less than full value	<input type="checkbox"/> Yes	<input type="checkbox"/> No
e. Anticipated increase in income	<input type="checkbox"/> Yes	<input type="checkbox"/> No	f. Participant or beneficiary to trust, estate, profit sharing, etc.	<input type="checkbox"/> Yes	<input type="checkbox"/> No

1997 Workbook

Section III - continued General Financial Information

14. Charge cards and lines of credit from banks, credit unions, and savings and loans. List all other charge accounts in item 28.

Type of Account or Card	Name and Address of Financial Institution	Monthly Payment	Credit Limit	Amount Owed	Credit Available
Totals (Enter in Item 27)					

15. Safe deposit boxes rented or accessed (List all locations, box numbers, and contents)

16. Real Property (Brief description and type of ownership)	Physical Address
a.	County _____
b.	County _____
c.	County _____

17. Life Insurance (Name of Company)	Policy Number	Type	Face Amount	Available Loan Value
		<input type="checkbox"/> Whole <input type="checkbox"/> Term		
		<input type="checkbox"/> Whole <input type="checkbox"/> Term		
		<input type="checkbox"/> Whole <input type="checkbox"/> Term		
Total (Enter in Item 23)				

18. Securities (stocks, bonds, mutual funds, money market funds, government securities, etc.):

Kind	Quantity or Denomination	Current Value	Where Located	Owner of Record

19. Other information relating to your financial condition. If you check the yes box, please give dates and explain on page 4. Additional Information or Comments:

a. Court proceedings	<input type="checkbox"/> Yes	<input type="checkbox"/> No	b. Bankruptcies	<input type="checkbox"/> Yes	<input type="checkbox"/> No
c. Repossessions	<input type="checkbox"/> Yes	<input type="checkbox"/> No	d. Recent sale or other transfer of assets for less than full value	<input type="checkbox"/> Yes	<input type="checkbox"/> No
e. Anticipated increase in income	<input type="checkbox"/> Yes	<input type="checkbox"/> No	f. Participant or beneficiary to trust, estate, profit sharing, etc.	<input type="checkbox"/> Yes	<input type="checkbox"/> No

1997 Workbook

Section IV. Assets and Liabilities

Description	Current Market Value	Current Amount Owed	Equity in Asset	Amount of Monthly Payment	Name and Address of Lien/Note Holder/Lender	Date Pledged	Date of Final Payment
20. Cash							
21. Bank accounts (from Item 13)							
22. Securities (from Item 18)							
23. Cash or loan value of insurance							
24. Vehicles (model, year, license, tag#)							
a.							
b.							
c.							
25. Real property (from Section III, item 16)							
a.							
b.							
c.							
26. Other assets							
a.							
b.							
c.							
d.							
e.							
27. Bank revolving credit (from Item 14)							
28. Other Liabilities (including bank loans, judgments, notes, and charge accounts not entered in Item 13.1)							
a.							
b.							
c.							
d.							
e.							
f.							
g.							
29. Federal taxes owed (prior years)							
30. Totals			\$	\$			

Internal Revenue Service Use Only Below This Line

Financial Verification/Analysis

Item	Date Information or Encumbrance Verified	Date Property Inspected	Estimated Forced Sale Equity
Personal Residence			
Other Real Property			
Vehicles			
Other Personal Property			
State Employment (Husband and Wife)			
Income Tax Return			
Wage Statements (Husband and Wife)			
Sources of Income/Credit ID&B Report			
Expenses			
Other Assets/Liabilities			

1997 Workbook

Section V. Monthly Income and Expense Analysis

Total Income		Necessary Living Expenses		
Source	Gross		Claimed	(IRS use only) Allowed
31. Wages/Salaries (Taxpayer)	\$	42. National Standard Expenses	\$	\$
32. Wages/Salaries (Spouse)		43. Housing and utilities ¹		
33. Interest - Dividends		44. Transportation ²		
34. Net business income (from Form 433-B)		45. Health care		
35. Rental Income		46. Taxes (income and FICA)		
36. Pension (Taxpayer)		47. Court ordered payments		
37. Pension (Spouse)		48. Child/dependent care		
38. Child Support		49. Life insurance		
39. Alimony		50. Secured or legally-perfected debts (specify)		
40. Other		51. Other expenses (specify)		
41. Total Income	\$	52. Total Expenses	\$	\$
		53. (IRS use only) Net difference (income less necessary living expenses)	\$	

Certification Under penalties of perjury, I declare that to the best of my knowledge and belief this statement of assets, liabilities, and other information is true, correct, and complete.

54. Your signature	55. Spouse's signature (if joint return was filed)	56. Date
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Notes

1. Clothing and clothing services, food, housekeeping supplies, personal care products and services, and miscellaneous.
2. Rent or mortgage payment for the taxpayer's principal residence. Add the average monthly payment for the following expenses if they are not included in the rent or mortgage payment: property taxes, homeowner's or renter's insurance, parking, necessary maintenance and repair, homeowner dues, condominium fees and utilities. Utilities includes gas, electricity, water, fuel oil, coal, bottled gas, trash and garbage collection, wood and other fuels, septic cleaning and telephone.
3. Lease or purchase payments, insurance, registration fees, normal maintenance, fuel, public transportation, parking and tolls.

Additional information or comments:

Internal Revenue Service Use Only Below This Line

Explain any difference between Item 53 and the installment agreement payment amount:

Name of originator and IDRS assignment number:	Date
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1997 Workbook

How to prepare a Collection Information Statement (Form 433-A)

Complete all blocks, except shaded areas. Write "N/A" (Not Applicable) in those blocks that do not apply to you. *If you don't complete the form, we won't be able to help determine the best method for you to pay the amount due.* The areas explained below are the ones we have found to be the most confusing to people completing the form.

Section III

Item 13—Bank Accounts

Enter all accounts even if there is currently no balance. *Do Not* enter bank loans.

Item 14—Bank Charge Cards, Lines of Credit, etc.

Enter only credit issued by a bank, credit union, or savings and loan (MasterCard, Visa, overdraft protection, etc.). List other charge accounts such as oil companies and department stores in Item 28.

Item 16—Real Property Description and Ownership

List all real property that you own or are purchasing. Include the address, county, and type of buildings on the property. List the names of all owners and type of ownership (such as joint tenants, tenant in common, etc.)

Section IV

Items 24 thru 26—Vehicles, Real Property, and Other Assets

Current Market Value - Indicate the amount you could sell the asset for today.

Equity in Asset - Subtract liability (current amount owned) from current market value.

Date Pledged - Enter the date the loan was originally taken out or property given as security.

Date of Final Payment - Enter the date the loan will be fully paid. If you are behind in payments, enter "Behind."

List other assets you own such as campers, boats, jewelry, antiques, etc. in item 26.

Item 28—Other Liabilities

List all other liabilities, including charge accounts, bank loans and notes, personal loans, medical bills, etc.

Section V

If only one spouse has a tax liability, but both have income, list the total household income and expenses.

Items 31 and 32—Wages and Salaries

Enter your *gross* monthly wages and/or salaries. Do not deduct withholding, or allotments you elect to take out of your pay such as insurance payments, credit union deductions, car payments, etc. List these expenses in Section IV and Section V.

Item 34—Net Business Income

Enter your monthly *net* business income, that is, what you earn after you have paid your ordinary and necessary monthly business expenses.

Necessary Living Expenses

To be necessary, expenses must provide for the health and welfare of you and your family and/or provide for the production of income, and must be reasonable in amount. You may be asked to provide substantiation of certain expenses.

Item 42—National Standard Expenses

This category includes clothing and clothing services, food, housekeeping supplies, personal care products and services, and miscellaneous. Enter the amount you are allowed, based on your total monthly gross income and the size of your family, from the chart on the back of these instructions. If you claim a higher amount, you must substantiate why a higher amount is necessary for each item included in this category.

Item 43—Housing and Utilities

Enter the monthly rent or mortgage payment for your principal residence. Add the average monthly payment for the following expenses if they are *not* included in your rent or mortgage payment: property taxes, homeowner's or renter's insurance, parking, necessary maintenance and repair, homeowner dues, condominium fees, and utilities. Utilities includes gas, electricity, water, fuel oil, coal, bottled gas, trash and garbage collection, wood and other fuels, septic cleaning and telephone.

Item 44—Transportation

Enter your average monthly transportation expenses. Transportation expenses include: lease or purchase payments, insurance, registration fees, normal maintenance, fuel, public transportation, parking and tolls.

Item 50—Secured or Legally-perfected Debts

Do not enter mortgage payment entered in Item 43, or lease or purchase payments entered in Item 44.

Item 51—Other Expenses

Enter your average monthly payments for any other *necessary* expenses.

Item 53—Net Difference

Do not show an entry in this space. IRS use only.

Certification

For joint income tax liabilities, both husband and wife should sign the statement.



Department of the Treasury
Internal Revenue Service
Publication 1854 (Rev. 9-95)
Catalog No. 21563Q

1997 Workbook

V. Revised Collection Standards for Form 433-A

In early 1997, the IRS revised the National Standards (Form 433-A, Section V, line 42), the Housing and Utilities Standards (Form 433-A, Section V, line 43), and the Transportation Standards (Form 433-A, Section V, line 44). These revisions are generally based on updated statistics from the Bureau of Labor Statistics (BLS) and adjusted for inflation using the 1996 Consumer Price Index.

The National Standards are used by all states, whereas the Housing and Utilities Standard is a state-by-state chart, subdivided by county. The chart for Illinois has been provided as an example. The Transportation Standards are based on Census Region and Metropolitan Statistical Area (MSA).

Revised Collection Standards

Below are the latest revisions of the national standards used in collection financial analysis. The charts show the itemized monthly national standards and the total money national standards as revised in February 1997. The new standards are effective for financial analysis conducted on or after April 14, 1997.

This revision of the national standards is based on the 1994–95 Consumer Expenditure Survey (CES) conducted by the Bureau of Labor Statistics (BLS), adjusted for inflation using the 1996 Consumer Price Index. The 1994–95 CES is the latest survey broken out by income levels. Although most expense amounts have increased, there are several categories where there has been a decrease due to data secured by the BLS.

The Internal Revenue Manual, Pub. 1854, How to Prepare a Collection Information Statement (Form 433-A), and Form 433-F, Collection Information Statement (short form), will be revised to reflect the new information as soon as possible. The ACS financial screens are also in the process of being updated with the new standards.

Revisions to the local standards for housing and utilities and for transportation will be issued soon. We will share that information as soon as it becomes available.

Collection Financial Analysis Total Monthly National Standards (Rev. 2-97) Item 42—Form 433-A

Total Gross Monthly Income	Number of Persons				
	One	Two	Three	Four	Over Four
Less than \$830	336	453	563	704	+125
\$831 to \$1,249	382	510	627	740	+135
\$1,250 to \$1,669	421	610	714	776	+145
\$1,670 to \$2,499	510	662	757	805	+155

1997 Workbook

\$2,500 to \$3,329	537	744	835	896	+165
\$3,330 to \$4,169	600	802	917	1,029	+175
\$4,170 to \$5,829	746	927	985	1,133	+185
\$5,830 and over	958	1,194	1,352	1,424	+195

Expenses included housekeeping supplies, apparel and services, personal care products and services, food, and miscellaneous.

For each person in a family with more than four persons, add the amount in the "Over Four" column to the amount in the "Four" column.

Normally, expenses should be allowed only for persons who can be claimed as exemptions on the taxpayer's income tax return.

Dollar amounts are derived from the Bureau of Labor Statistics (BLS) Consumer Expenditure Survey, tables 1, 3, 4, and 5.

Collection Financial Analysis Total Monthly National Standards (Rev. 2-97) Item 43—Form 433-A

	Total Gross Monthly Income							
	Less than \$830	\$831 to \$1,249	\$1,250 to \$1,699	\$1,670 to \$2,499	\$2,500 to \$3,329	\$3,330 to \$4,169	\$4,170 to \$5,829	\$5,830 and Over
One person								
Housekeeping supplies	\$ 18	\$ 20	\$ 21	\$ 25	\$ 26	\$ 28	\$ 33	\$ 41
Apparel and services	41	50	72	115	122	124	161	322
Personal care products and services	14	21	22	23	29	35	40	56
Food	163	191	206	247	260	313	412	439
Miscellaneous	100	100	100	100	100	100	100	100
Total:	\$336	\$382	\$421	\$510	\$537	\$600	\$746	\$958
Two persons								
Housekeeping supplies	\$ 22	\$ 26	\$ 27	\$ 38	\$ 44	\$ 49	\$ 55	\$ 71
Apparel and services	68	69	94	116	123	160	195	323
Personal care products and services	19	23	27	32	44	47	56	64
Food	219	267	337	351	408	421	496	611
Miscellaneous	125	125	125	125	125	125	125	125
Total:	\$453	\$510	\$610	\$622	\$744	\$802	\$927	\$1,194
Three persons								
Housekeeping supplies	\$ 23	\$ 27	\$ 28	\$ 39	\$ 45	\$ 53	\$ 56	\$ 74
Apparel and services	106	109	129	138	168	197	198	354
Personal care products and services	22	27	32	39	45	48	57	65
Food	262	314	375	391	427	469	524	709
Miscellaneous	150	150	150	150	150	150	150	150
Total:	\$563	\$627	\$714	\$757	\$835	\$917	\$985	\$1,352
Four persons								

1997 Workbook

Housekeeping supplies	\$ 34	\$ 35	\$ 36	\$ 44	\$ 47	\$ 55	\$ 58	\$ 75
Apparel and services	109	140	141	142	172	198	235	355
Personal care products and services	26	28	33	44	47	49	60	71
Food	360	362	391	400	455	552	605	748
Miscellaneous	175	175	175	175	175	175	175	175
Total:	\$704	\$740	\$776	\$805	\$896	\$1,029	\$1,133	\$1,424
More than four persons								
For each additional person, add to four-person allowance:	\$125	\$135	\$145	\$155	\$165	\$175	\$185	\$195

Illinois Collection Standards: Housing and Utility Expenses Item 43—Form 433-A

County	Maximum Monthly Allowance		
	Family of 2 or Less	Family of 3	Family of 4 or More
Adams County	572	673	774
Alexander County	487	573	659
Bond County	589	693	797
Boone County	775	912	1,049
Brown County	524	616	709
Bureau County	618	727	836
Calhoun County	531	625	718
Carroll County	586	690	793
Cass County	554	651	749
Champaign County	766	901	1,036
Christian County	574	675	777
Clark County	521	613	705
Clay County	543	639	735
Clinton County	708	833	958
Coles County	637	750	862
Cook County	936	1,101	1,266
Crawford County	542	638	734
Cumberland County	566	666	765
De Witt County	586	690	793
DeKalb County	820	965	1,110
Douglas County	621	731	840
DuPage County	1,166	1,372	1,578
Edgar County	529	622	716
Edwards County	545	642	738
Effingham County	646	761	875
Fayette County	552	650	747
Ford County	574	675	777
Franklin County	573	674	775
Fulton County	562	661	760

1997 Workbook

Gallatin County	543	639	735
Greene County	486	572	658
Grundy County	763	898	1,032
Hamilton County	551	649	746
Hancock County	552	650	747
Hardin County	455	536	616
Henderson County	531	625	718
Henry County	618	727	836
Iroquois County	549	646	743
Jackson County	684	805	926
Jasper County	564	663	763
Jefferson County	654	769	884
Jersey County	623	733	843
Jo Daviess County	640	753	866
Johnson County	621	731	840
Kane County	972	1,144	1,316
Kankakee County	677	797	916
Kendall County	866	1,018	1,171
Knox County	568	668	768
La Salle County	644	758	872
Lake County	1,166	1,372	1,578
Lawrence County	543	639	735
Lee County	636	749	861
Livingston County	655	770	886
Logan County	628	739	850
Macon County	644	758	872
Macoupin County	605	711	818
Madison County	686	808	929
Marion County	620	729	839
Marshall County	609	716	824
Mason County	573	674	775
Massac County	563	662	761
McDonough County	574	675	777
McHenry County	1,032	1,214	1,397
McLean County	781	919	1,057
Menard County	663	780	897
Mercer County	597	703	808
Monroe County	752	885	1,017
Montgomery County	586	690	793
Morgan County	654	769	884
Moultrie County	598	704	810
Ogle County	694	816	938
Peoria County	681	801	922
Perry County	632	744	855

1997 Workbook

Perry County	632	744	855
Piatt County	661	777	894
Pike County	499	587	676
Pope County	598	704	810
Pulaski County	485	571	656
Putnam County	615	723	832
Randolph County	643	757	871
Richland County	534	628	723
Rock Island County	659	775	891
Saline County	589	693	797
Sangamon County	719	846	973
Schuyler County	552	650	747
Scott County	526	619	712
Shelby County	574	675	777
St. Clair County	717	844	970
Stark County	563	662	761
Stephenson County	668	786	904
Tazewell County	649	763	877
Union County	550	648	745
Vermilion County	587	691	794
Wabash County	640	753	866
Warren County	577	679	781
Washington County	685	806	927
Wayne County	544	640	736
White County	561	660	759
Whiteside County	605	711	818
Will County	927	1,090	1,254
Williamson County	598	704	810
Winnebago County	733	863	992
Woodford County	684	805	926

The Allowable Expenses for Transportation (Operating Costs and Public Transportation Costs) are provided by Census Region and Metropolitan Statistical Area (MSA). The following [two tables](#) provide a conversion from IRS Region to Census Region and MSA.

Allowable Transportation Expenses* Item 44—Form 433-A

	First Car	Second Car
National	\$335	\$269

<i>Operating Costs & Public Transportation Costs</i>			
Region/City	No Car	One Car	Two Cars
Northeast Region	\$198	\$250	\$303

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This information was correct when originally published. It has not been updated for any subsequent law changes.

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New York	258	311	364
Philadelphia	206	259	312
Boston	214	267	320
Pittsburgh	142	195	248
Buffalo	126	179	232
Midwest Region	170	222	275
Chicago	224	277	330
Detroit	270	323	376
Milwaukee	188	241	294
Minneapolis-St. Paul	237	290	343
Cleveland	173	226	279
Cincinnati	197	250	303
St. Louis	176	229	282
Kansas City	215	268	321
South Region	174	227	279
Washington, DC	251	304	357
Baltimore	196	249	302
Atlanta	252	305	358
Miami	244	297	350
Dallas-Ft. Worth	273	326	379
Houston	245	298	351
West Region	212	264	317
Los Angeles	235	288	341
San Francisco	267	320	373
San Diego	255	308	361
Portland	166	219	272
Seattle	221	274	327
Honolulu	269	322	375
Anchorage	271	324	377

*Does not include personal property taxes.

IRS Region—Census Region

- The **Northeast Region** covers the following states: Connecticut, Maine, Massachusetts, Michigan, New Hampshire, New Jersey, New York, Ohio, Pennsylvania, Rhode Island, and Vermont.
Michigan and Ohio are in the **Midwest Census Region**; the rest of the Northeast Region is in the **Northeast Census Region**.
- The **Southeast Region** covers the following states: Alabama, District of Columbia, Florida, Georgia, Indiana, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee, Delaware, Maryland, Virginia, and West Virginia.
Indiana is in the **Midwest Census Region**; the rest of the Southeast Region is in the **South Census Region**.
- The **Midstates Region** covers the following states: Arkansas, Illinois, Iowa, Kansas, Minnesota,

1997 Workbook

- The **Midstates Region** covers the following states: Arkansas, Illinois, Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, Oklahoma, South Dakota, Texas, and Wisconsin.
Arkansas, Oklahoma, and Texas are in the **South Census Region**; the rest of the Midstates Region is in the **Midwest Census Region**.
- The **Western Region** covers the following states: Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Washington, Utah, and Wyoming.
All of the Western Region is in the **West Census Region**.

Once the Census Region has been ascertained (from the previous list), it must be determined whether an MSA value should be used. If a taxpayer does not reside in an MSA, then the regional operating expense should be used.

The following [table](#) provides definitions for the MSAs that appear in the Allowable Transportation Expenses Table.

Metropolitan Statistical Area (MSA) Definitions by Census Region

Northeast Census Region: Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, Connecticut, Pennsylvania, New York, New Jersey		
MSA		Counties
New York	in NY	Bronx, Dutchess, Kings, Nassau, New York, Orange, Putnam, Queens, Richmond, Rockland, Suffolk, Westchester
New York	in NJ	Bergen, Essex, Hudson, Hunterdon, Mercer, Middlesex, Monmouth, Morris, Ocean, Passaic, Somerset, Sussex, Union, Warren
New York	in CT	Fairfield, Litchfield, Middlesex, New Haven
Philadelphia	in PA	Pike
Philadelphia	in PA	Bucks, Chester, Delaware, Montgomery, Philadelphia
Philadelphia	in NJ	Atlantic, Burlington, Camden, Cape May, Cumberland, Gloucester, Salem
Philadelphia	in DE	New Castle
Philadelphia	in MD	Cecil
Boston	in MA	Bristol, Essex, Hampden, Middlesex, Norfolk, Plymouth, Suffolk, Worcester
Boston	in NH	Hillsborough, Merrimack, Rockingham, Strafford
Boston	in CT	Windham
Boston	in ME	York
Pittsburgh		Allegheny, Beaver, Butler, Fayette, Washington, Westmoreland
Buffalo		Erie, Niagara

Midwest Census Region: North Dakota, South Dakota, Nebraska, Kansas, Missouri, Illinois, Indiana, Ohio, Michigan, Wisconsin, Minnesota, Iowa		
MSA		Counties (Unless Otherwise Specified)
Chicago	in IL	Cook, DeKalb, DuPage, Grundy, Kane, Kankakee, Kendall, Lake, McHenry, Will
Chicago	in IN	Lake, Porter
Chicago	in WI	Kenosha

1997 Workbook

Chicago	in WI	Kenosha
Detroit		Genesee, Lapeer, Lenawee, Livingston, Macomb, Monroe, Oakland, St. Clair, Washtenaw, Wayne
Milwaukee		Milwaukee, Ozaukee, Washington, Waukesha
Minneapolis-St. Paul	in MN	Anoka, Carver, Chisago, Dakota, Hennepin, Isanti, Ramsey, Scott, Sherburne, Washington, Wright
Minneapolis-St. Paul	in WI	Pierce, St. Croix
Cleveland		Ashtabula, Cuyahoga, Geauga, Lake, Lorain, Medina, Portage, Summit
Cincinnati	in OH	Brown, Butler, Clermont, Hamilton, Warren
Cincinnati	in KY	Boone, Campbell, Gallatin, Grant, Kenton, Pendleton
Cincinnati	in IN	Dearborn, Ohio
St. Louis	in MO	Franklin, Jefferson, Lincoln, St. Charles, St. Louis, Warren, St. Louis City
St. Louis	in IL	Clinton, Jersey, Madison, Monroe, St. Clair
Kansas City	in MO	Cass, Clay, Clinton, Jackson, Lafayette, Platte, Ray
Kansas City	in KS	Johnson, Leavenworth, Miami, Wyandotte

South Census Region: Texas, Oklahoma, Arkansas, Louisiana, Mississippi, Tennessee, Kentucky, West Virginia, Virginia, Maryland, District of Columbia, Delaware, North Carolina, South Carolina, Georgia, Florida, Alabama

MSA		Counties (Unless Otherwise Specified)
Washington, DC		District of Columbia
Washington, DC	in MD	Calvert, Charles, Frederick, Montgomery, Prince George's
Washington, DC	in VA	Arlington, Clarke, Culpepper, Fairfax, Fauquier, King George, Loudoun, Prince William, Spotsylvania, Stafford, Warren, Alexandria City, Fairfax City, Falls Church City, Fredericksburg City, Manassas City, Manassas Park City
Washington, DC	in WV	Berkeley, Jefferson
Baltimore		Anne Arundel, Baltimore, Carroll, Harford, Howard, Queen Anne's, Baltimore City
Atlanta		Barrow, Bartow, Carroll, Cherokee, Clayton, Cobb, Coweta, DeKalb, Douglas, Fayette, Forsyth, Fulton, Gwinnet, Henry, Newton, Paulding, Pickens, Rockdale, Spalding, Walton
Miami		Broward, Dade
Dallas-Ft. Worth		Collin, Dallas, Denton, Ellis, Henderson, Hood, Hunt, Johnson, Kaufman, Parker, Rockwall, Tarrant
Houston		Brazoria, Chambers, Fort Bend, Galveston, Harris, Liberty, Montgomery, Waller

West Census Region: New Mexico, Arizona, Colorado, Wyoming, Montana, Nevada, Utah, Washington, Oregon, Idaho, California, Alaska, Hawaii

MSA		Counties (Unless Otherwise Specified)
Los Angeles		Los Angeles
San Francisco		Alameda, Contra Costa, Marin, Nappa, San Francisco, San Mateo, Santa Clara, Santa Cruz, Solano, Sonoma

1997 Workbook

San Diego		San Diego
Portland	in OR	Clackamas, Columbia, Marion, Multnomah, Polk, Washington, Yamhill
Portland	in WA	Clark
Seattle		Island, King, Kitsap, Pierce, Snohomish, Thurston
Honolulu		Honolulu
Anchorage		Anchorage Borough

VI. Lifestyle (Financial Status) Audits

INTRODUCTION

Financial Status Audit is the new term for an old examination theory. The old term for these types of IRS exams was **indirect methods**. Whatever term is used, the National Office of the IRS is placing greater emphasis on this exam technique.

An IRS examiner can use two methods to examine a tax return. The first and most common is the **direct** method, which consists of verifying reported income and expenses and searching for potential unreported income. The second method is the **indirect** method, which considers **all** income of a taxpayer, taxable **and** nontaxable, and **all** expenses, deductible or nondeductible.

The **indirect** method places great importance on nontaxable income such as loans, gifts, and inheritances **and** nondeductible expenses such as personal living expenses.

PROCEDURAL OVERVIEW

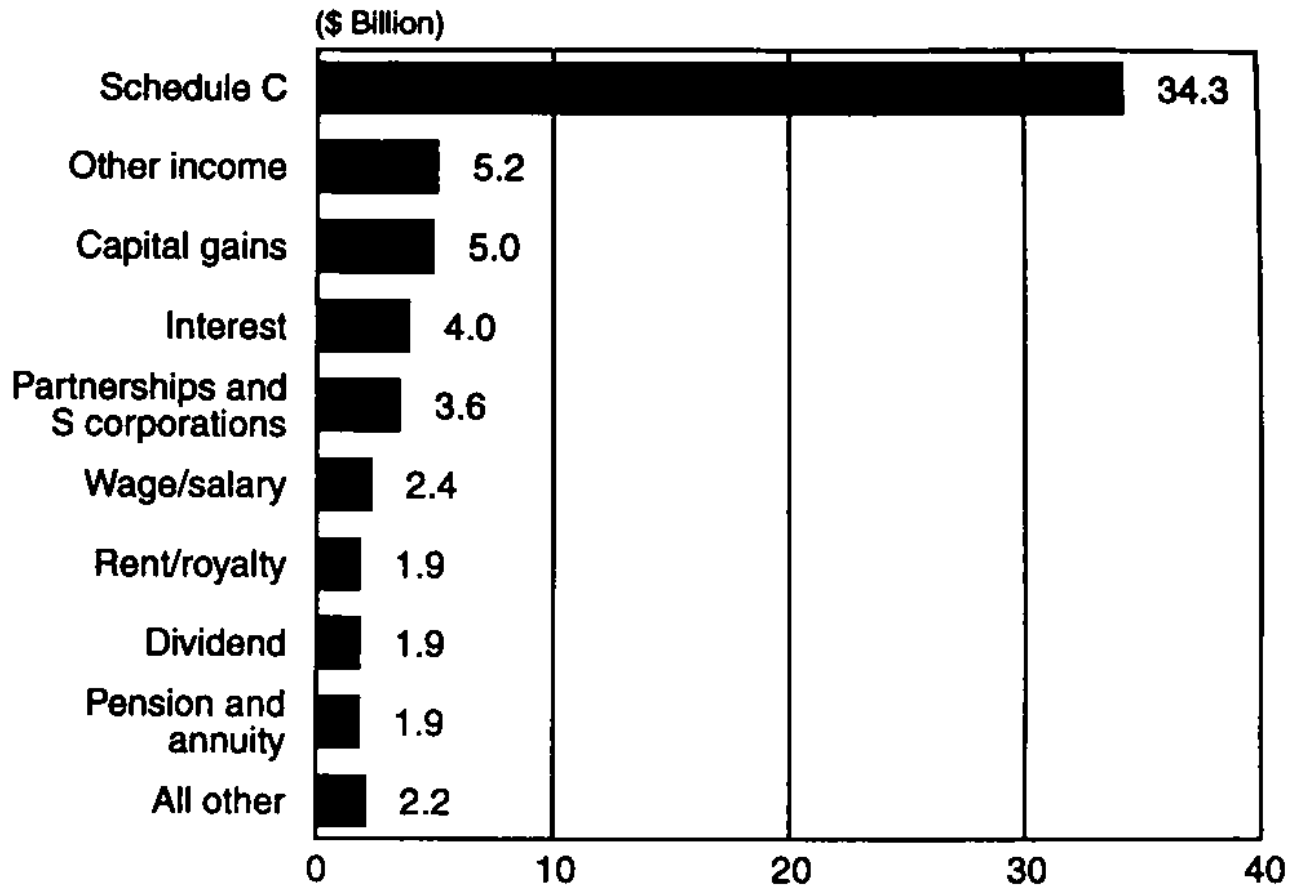
The Commissioner's determination in a deficiency (additional tax) case is generally entitled to a **presumption of correctness**. This presumption places upon the taxpayer both the burden of proof and the burden of going forward with evidence to establish the correct amounts of income [Tax Court Rule 142(g)].

The **presumption of correctness** arises only where it is supported by some **substantive evidence** that the taxpayer received unreported income. Once the government (IRS) has carried its initial burden of introducing some evidence linking the taxpayer with income-producing activities, the burden shifts to the taxpayer to **rebut** the presumption by establishing a **preponderance of the evidence** that the deficiency determination is arbitrary or erroneous.

What Is the Potential Tax Collection Benefit from These Types of Audits?

The Government Accounting Office estimates the following sources of underreported income (total estimated at \$62.1 billion):

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The following question areas will be of key interest to IRS examiners doing financial status audits.

1. **What is the standard of living of the taxpayer?**
 - a. What does the taxpayer and dependent family consume?
 - b. How much does it cost to maintain this consumption pattern?
 - c. Is reported net income sufficient to support the standard of living?
2. **What is the accumulated wealth of the taxpayer?**
 - a. How much has the taxpayer expended in the acquisition of capital assets?
 - b. When and how was this wealth accumulated?
 - c. Has reported income been sufficient to fund the accumulations?
3. **What is the economic history of the taxpayer?**
 - a.

1997 Workbook

- b. Is the taxpayer's business expanding or contracting?
- c. Does the reported business history match with the changes in the taxpayer's standard of living and wealth accumulation?

4. What is the business environment?

- a. What is typical profitability and return on investment for the taxpayer's market segment and locality?
- b. What are typical patterns of noncompliance in the taxpayer's market segments?
- c. What are the competitive pressures and economic health of the market segment within which the taxpayer operates?

5. Has the taxpayer made assertions to receipts or funds that were considered to be nontaxable?

- a. Do claims of nontaxable sources of support make economic sense?
- b. How credit-worthy is the taxpayer in view of the taxpayer's assertion that funding was secured from loans?
- c. In situations where the taxpayer has asserted that funds were received from other than conventional lending institutions, what was the lender's source of funds?

The term "**financial status**" finds meaning through a process of gathering information about a taxpayer. This information is reflective of the individual's financial status. The focal point is whether reported income is sufficient to support the individual's

- Financial lifestyle
- Standards of operating/living
- Expenditures and acquisitions

The following information details some of the analytical methods that will be used by examiners.

Analysis Process

- Cash T
- Personal Living Expense (PLE) statements
- Internal and external data

Components of Financial Status

Personal Living Expense Statement

1. Address

1997 Workbook

2. Neighborhood
3. Number of dependents
4. Age of dependents
5. Number of years in business
6. Investment income
7. Asset acquisition
8. Home
9. Recreational vehicles
10. Automobiles
11. College tuition
12. Licenses (professional/business)
13. Trips
14. Ratios
15. Interest expenses
16. Club memberships
17. Hobbies/toys
18. Change of address
19. Profit margins
20. Legal actions
21. Weddings—single to joint
22. Weddings—children of taxpayer
23. Use of credit
24. Level of sophistication
25. Insurance coverage/what is covered
26. Other personal living expenses
27. Average income for industry
28. Cultural background
29. Bank accounts (foreign and domestic)
30. Rental property
31. Loan information
32. Personal property
33. Nontaxable sources of income
34. Method of accounting
35. Sale of property
36. Location of business
37. Type of business (e.g., cash)
38. Number of employees
39. Work experience

1997 Workbook

40. Mortgage interest
41. Alimony—paid/received
42. Child support—paid/received
43. Gambling—gains/losses
44. Stocks and bonds
45. Trusts
46. Taxpayer Delinquent Account (TDA) investigations by IRS Collection Division personnel

External Sources of Data

Agencies

- Bureau of Labor Statistics
- Social Security Administration
- U.S. Post Office
- Department of Motor Vehicles
- Law Enforcement
- OSHA—Occupational Safety and Health Administration
- Department of Social Services
- Department of Agriculture
- Small Business Administration
- Department of Transportation
- Fictitious Name Register
- Better Business Bureau

Court Records

- Permits
- Licenses
- Sales tax
- Employment/unemployment data
- Mortgages (amount/holder)
- Liens/bankruptcy
- Probate
- Property records
- Divorce

State information

Corporations (charters, etc.)

1997 Workbook

City directory

Public utilities (electric, gas, water)

Credit applications/reports

Suppliers

Employer personnel records

Banks/savings and loans/credit unions

Insurance providers

Subscriber information services

- Dun & Bradstreet
- Robert Morris & Associates
- LEXIS

Former personal contacts (landlord, employer, employees, ex-spouse, neighbors)

Third-party contacts (e.g., taxpayer's landscaper or lumber yard can lead to addresses where lumber was delivered)

Newspaper articles

Informants

Cash Transaction (T) Account Example

Wages	\$2,904		
		Schedule C:	
Interest	\$504	Purchases	\$115,536
		Expenses (less depreciation)	\$48,837
Tax refunds	\$371		
		Schedule E:	
Pension income	\$16,676	Expenses (less depreciation)	\$5,624
Schedule C:		Personal living expenses ¹	
Gross receipts	\$165,675	Schedule A:	
		Taxes	\$996
Schedule E:		Interest	\$7,626
Rent receipts	\$4,277	Contributions	\$325
Total	\$190,443		
		Additional PLE	\$30,057
Understatement of Income²	\$20,499	Tax withholding	\$1,941
Balance	\$210,942	Balance	\$210,942

1

1997 Workbook

Personal living expenses were arrived at using the Bureau of Labor Statistics for a typical area of the United States. (The Bureau of Labor Statistics figure should be adjusted to reflect the geographical location of the taxpayer if available.) The additional personal living expenses were arrived at using the available BLS data for a family of three and were adjusted by subtracting the specifically listed BLS accounts for the type of expenditure already shown on the tax return. The actual known amounts as they appear on the tax return were then separately stated on the Cash T to arrive at total PLE.

²The \$20,499 represents the amount of understated Adjusted Gross Income. The most likely IRS exam conclusion is that Schedule C gross receipts were understated by \$20,499.

VII. MARKET SEGMENT SPECIALIZATION PROGRAM (MSSP) OVERVIEW— AUDIT GUIDELINES

Adapted from U.S. Department of the Treasury, Internal Revenue Service.

WHAT IS THE MARKET SEGMENT SPECIALIZATION PROGRAM?

- **The Market Segment Specialization Program (MSSP)** is a new approach to the examination of income tax returns that focuses on developing highly trained examiners for a **particular market segment** (e.g., industry, profession, or issue).
- The objective of MSSP is to conduct examinations with examiners who have the skills and use techniques to respond to the unique business practices of a **particular or specialized segment**.
- These examiners will spend a **majority** of their time auditing taxpayers in the market segment(s) for which they are specialists.
- **For example**, they will learn how the industry operates and become familiar with account/business practices and procedures common within the industry. They will identify sources of information and unique tax issues. They will keep current with industry changes through trade publications, trade seminars, and sharing information among specialists.
- As the specialists develop in-depth knowledge of a market segment, they will document and share their expertise by producing and/or updating audit technique guidelines.
- The MSSP concept is an integral part of a long-range plan to enhance the overall professional competence and expertise of examiners and increase the productivity of examinations.
- **MSSP and ISP (Issue Specialization Program) have both similarities and differences.**
- Although all examinations have audit techniques and specific tax issues as major components, the primary emphasis of MSSP is development of uniform and effective examination techniques.
- The major emphasis of ISP is the uniform identification, development, and resolution of tax issues in larger CEP-type examinations.
- The MSSP is directed at the general program and at the examination of all types and sizes of returns.

1997 Workbook

- Both programs emphasize knowledge of the industry and its business and accounting practices and treat communication with its customers and industry representatives as an integral part of the process.

HOW DOES MSSP WORK?

- **All other districts will use the Audit Techniques Guide (ATG) when examining returns in the market segment.**
- The user district will select examiners to become specialized in a market segment based on the information contained in the guide and through development of information during examination of market segment returns.
- The user district should furnish the R&D (Research & Development) district with all new pertinent information that may result from examinations. This would include general information relating to the market segment, changes in market segment policies and procedures, new audit techniques, and/or new issues, as well as differences in the business activities and practices of a market segment within difference geographic areas.
- Examiners who are specialized within a particular market segment, either within the R&D district or within the user district, will spend a significant portion of their time examining market segment returns in order to maintain their expertise within that selected segment.
- **The districts and service centers will play a key role in the implementation of MSSP.**

WHAT HAS BEEN ACCOMPLISHED IN MSSP TO DATE?

MSSP was first tested in 1986 in the Western Region, where the benefits of in-depth specialized audit procedures and techniques resulted in improved productivity in the examination process. The approach was extended to other industries throughout the Western Region in 1988.

Following are the **Audit Techniques Guides (ATG)** developed by the IRS for the **Market Segment Specialization Program (MSSP)**. Most can be ordered from the Superintendent of Documents (**phone number: (202) 512-1800**). The ATGs may be ordered by phone between 8 A.M. and 4:00 P.M. Eastern time.

ATG Name—Published Guides as of July 1997	Government Printing Office Stock #	Price
Air Charter	048-004-02347	\$2.50
Alaskan Commercial Fishing: Catcher Vessels	048-004-02357-1	8.50
Alaskan Commercial Fishing: Processors & Brokers	048-004-02358-0	6.50
Architects	048-004-02350-4	2.75
Artists and Art Galleries	N/A	N/A
Attorneys	N/A	N/A
Auto Body and Repair Industry	048-004-02363-6	11.00
Bars & Restaurants	048-004-02355-5	7.50
Bed & Breakfast	048-004-02345-8	3.75

1997 Workbook

Beauty/Barber Shops	048-004-02362-8	3.50
Cattle Auction Barns	048-004-02370-9	7.00
Commercial Printing	N/A	N/A
Entertainment:		
Music Industry	048-004-02364-4	6.00
Foreign Athletes & Entertainers		
Important 1040 Issues	048-004-02365-2	10.00
Garment Contractors	N/A	N/A
Garment Manufacturers	N/A	N/A
Gasoline Retailers	048-004-02353-9	6.00
Grain Farmers	048-004-02359-8	24.00
Independent Used Car Dealer	048-004-02371-7	15.00
Ministers	048-004-02343-1	3.00
Mobile Food Vendors	048-004-02356-3	12.00
Mortuary/Cemetery	048-004-02344-0	14.00
Oil & Gas	048-004-02372-5	16.00
Passive Activity Loss	048-004-02354-7	20.00
Pizza Restaurant	048-004-02346-6	4.50
Port Project	048-004-02380-1	12.00
Reforestation Industry	048-004-02361-0	12.00
Rehabilitation Tax Credit	048-004-02373-3	19.00
Resolution Trust Corp.—Cancellation of Indebtedness	048-004-02351-2	5.00
Taxicabs	048-004-02348-2	2.50
Tobacco Industry	048-004-02374-1	11.00
Tour Bus Industry	N/A	N/A
Trucking	048-004-02349-1	10.00
Wine Industry	048-004-02352-1	9.00

For information on newly released ATGs, refer to the IRS web site (<http://www.irs.ustreas.gov>).

Audit Technique Guides Observation After examination of the guides that are available to the public, several observations can be made:

1. They provide information that is helpful to the practitioner preparing tax returns for individuals in these businesses.
2. They will be valuable in the pre-audit preparation and research period.
3. The guides will reveal the approach of the IRS examiner and the types of tax issues he or she may raise.

Some Excerpts from the MSSP for Grain Farmers (Released to Public in 1996)

1997 Workbook

Background Information. This massive 16-chapter manual regarding IRS exams of grain farmers is intended to give IRS examiners an awareness of the exam issues. Much of the material is useful and informative to tax practitioners. It is our intention to provide an in-depth analysis of this MSSP manual in the 1998 Tax School Book.

Following are brief highlights of some of the technical exam issues addressed in the MSSP manual.

Treatment of Noncash Wages. The regulations provide no guidance or examples of when payments in commodities might be considered the **same as cash** and therefore **not qualified for the I.R.C. §3121(a)(8)(A) exclusion** from employment taxes. Consequently, an increasing number of farmers, **particularly farm corporations**, pay their officers and shareholders in grain.

Examiners must consider a number of facts in determining whether the **exclusion** applies. **This is especially true for farmers who operate in corporate form and pay a substantial portion of office salaries via commodities.**

Note: See pages 36–41 in the 1995 Tax School Book for a thorough discussion of this difficult technical issue.

Conservation Reserve Program (CRP) Payments. Per USDA regulations, land entered in CRP is **not** treated as rental property. The annual payments made under this program are **to compensate the landowners for the potential income from their land had they devoted such land to the production of an agricultural commodity**. CRP payments are **clearly reportable on Schedule F and are subject to self-employment tax** when received by landowners who are **operating farmers**.

Hedging Farm Commodities. The regulations **broadly construe** the term "**risk reduction**." Examiners should focus on whether a transaction **reduces a type of risk enumerated in the regulations**. It is appropriate for an examiner to consider whether a taxpayer is **overhedged**, and to the extent the taxpayer is overhedged, the transaction is not reducing risk and, therefore, **does not qualify as a hedging transaction**.

Hedging losses should be entered as **negative amounts on the "Other income" line on Schedule F**. However, they are seldom found there.

Hedging issues often result in unagreed cases. An unagreed case will require a detailed analysis of the farmer's trading accounts. Each transaction will have to be listed in the examiner's work papers.

Insurance Expense. By hiring a spouse as an employee, a farmer can take advantage of I.R.C. §105, which allows small businesses to **deduct 100% of costs of employee benefits**. A farmer transfers the family health insurance plan to the spouse's name, listing the farmer as a dependent. All family health insurance premiums **are then deductible as business expenses**.

The 100% deduction can be taken **only** after the farmer and spouse have formalized their employer-employee relationship. They need a **written employment agreement outlining the spouse's duties**. **The agreement also must specify reasonable wages and benefits**. The IRS does not permit employee discrimination—the same benefits must be made available to all employees.

1997 Workbook

Editorial Objection. The last sentence above is not correct. See p. 208 of the 1996 Tax School Book. If the employer provides a health insurance plan as an employee benefit, **there are no nondiscrimination requirements.** The employer may provide health insurance coverage to only one employee and may provide different coverage to different employees [**Treas. Reg. §1.105-5(a)**].

Interest Expense. Most farmers' business and personal assets are so intertwined, it is possible that **personal interest** could be deducted on Schedule F. For example, a loan on a personal use car could be obtained through an operating farm business loan. If the proceeds of a loan are used for both personal and business purposes, ensure that the interest is properly allocated.

Rent Expense. **Be alert for year-end rent payments.** There is a tendency to prepay rent the same as other expenses. **Prepaid rent is not deductible.** The first half of cash rent of farmland is usually due March 1. Many times farmers will pay rent to a **spouse** to reduce self-employment tax. If this occurs, verify that there is a true lessor-lessee relationship.

Storage Expense. The cost of elevator grain storage is generally deducted from sales proceeds when the stored grain is sold. A **double deduction** can occur if the farmer reports only the **net amount of the sales** as grain income and then deducts storage costs.

Labor Expense. Reasonable wages paid to the farmer's spouse or children for doing farm work are deductible, but there must be a true employer-employee relationship [**Rev. Rul. 72-23**]. Ordinarily, an employment relationship is present if

1. Substantial duties are performed, and
2. The amount of pay is reasonable in relation to the work performed, and
3. Payment is actually made.

VIII. IRS Classification Settlement Program

A. Background

A Classification Settlement Program, or CSP, establishes new procedures to resolve **worker classification** cases as early in the administrative process as possible, thereby reducing taxpayer burden. The procedures are designed to ensure that the taxpayer relief provisions under §530 of the Revenue Act of 1978 are properly applied. Under the CSP, the IRS examiners are able to offer businesses under examination a **worker classification settlement using a standard closing agreement.**

B. Description of the Classification Settlement Program (CSP)

Determination of eligibility: If the examining agent has reason to believe that a business may have

1997 Workbook

erroneously treated a worker as an independent contractor,

1. The examiner will develop the issue, including the business's eligibility for relief under §530.
2. The case will be presented to the examination group manager, who will confirm the business's eligibility for a **CSP settlement offer**.
3. If an offer is made and accepted by the business, the parties will sign a **CSP closing agreement** based on a standard closing agreement provided by the National Office.
4. **The business agrees to properly classify its workers prospectively.**

C. Types of Settlement Offers Available

1. **Full employment tax assessment for one taxable year under examination.**
 - a. The business meets the §530 reporting consistency requirement.
 - b. The business fails to meet the §530 substantive consistency requirement.

Example 1. Taxpayer is a masonry construction company with two bricklayers who perform identical duties. The company timely files a Form 1099 for one worker and a Form W-2 for the other. Because the company has treated the similarly situated workers **inconsistently**, the company is not entitled to relief under §530. **However, it is eligible for a one-year CSP.**

- c. The business cannot meet the §530 reasonable basis test requirement.

Example 2. Taxpayer is a painting company that engages the services of college students during the summer months to paint offices. Timely Forms 1099 are given to the workers. Taxpayer gives the students the option of being treated as employees of independent contractors. Because taxpayer has not established a **reasonable basis**, it is **not** entitled to relief under §530; **however, it is eligible for a one-year CSP.**

- d. The business is statutorily excluded by §530(d).

Example 3. Taxpayer is a computer services firm. Timely Forms 1099 are given to the workers. Because it is a technical services firm described in §530(d), it is **not** entitled to relief under §530; **however, it is eligible for a one-year CSP.**

- e. Tax computed using I.R.C. §3509 is applicable.
2. **Twenty-five percent (25%) of the employment tax liability for the audit year.**
 - a. Business must meet the §530 reporting consistency requirement.

1997 Workbook

- b. Business has a **colorable argument** that it meets the substantive consistency requirement and the reasonable basis test.

Example 4. Taxpayer, the owner of a lumber company that treats skidders as independent contractors, formerly worked for two other local companies as an **independent contractor** in the **prior year**. He states that his duties with the two other local lumber companies were identical to the workers he hired in the current year. Even though his response does not meet the safe haven, his argument is **colorable** and he is eligible for a 25% CSP.

Example 5. Taxpayer is the owner of a painting company that hires college students during the summer months to paint offices. He used to work for other painting contractors while a college student and **was given the option** of being treated as either an employee or an independent contractor. In discussions with other local business owners at the local building trades meetings, taxpayer learned that most other businesses handle treatment the same way. Because the taxpayer's argument may have merit, he is eligible for a 25% CSP.

Example 6. Taxpayer owns a masonry construction company that has two brick layers. The two workers perform similar duties. However, the company timely filed Form 1099 for one worker and a W-2 for the other worker. The worker for whom the Form 1099 was filed works without supervision and provides his own equipment. The worker for whom the W-2 was filed works with the business owner and uses equipment owned by the business. Because the taxpayer's argument has merit, the taxpayer is eligible for a 25% CSP.

- c. **The business agrees to properly classify its workers prospectively.**
 - d. Twenty-five percent (25%) will be determined by computing the deficiency for the **entire year**, using I.R.C. §3509, if applicable, and multiplying it by 25%.
3. **No employment tax assessment.**
- a. Meets the reporting and substantive consistency requirement.
 - b. Satisfies the reasonable basis test.
 - c. No assessment will be made and the business may choose to continue treating its workers as independent contractors.

D. Other Features

1. Agreement to prospectively treat workers as employees does **not** require the business to give up its claim to §530 relief for **prior years**.
2. The business may qualify for more than one CSP offer if several classes of workers are at issue.
3. Taxpayer participation in the CSP is **entirely voluntary**, and the taxpayer may accept CSP

1997 Workbook

- a. A taxpayer's **rejection** of the CSP offer **will not** affect the outcome of the examination.
 - b. A taxpayer declining to accept a settlement offer retains all rights to administrative appeal and judicial review.
4. Two-year test period.
The CSP was implemented on a two-year basis beginning on March 5, 1996.

E. Closing Agreements

If a taxpayer accepts the offer, a **standard closing agreement** will be prepared without any modification of the terms. The authorized group manager will execute the agreement on behalf of the Commissioner.

F. Practitioner Tips

1. Your success in obtaining a "**no change**" will depend on your initiative in demonstrating to the examiner that the business had a **reasonable basis for not relating the worker as an employee**. If cases or rulings are not available, look to
 - a. Results of a past audit.
 - b. A long-standing, recognized practice of a significant segment of the industry.
 - c. Any other reasonable basis—**BE CREATIVE!**
2. Some points to keep in mind to establish a **reasonable basis**.
 - a. Reliance on the advice of an accountant, **even if the accountant is not knowledgeable regarding worker classification**.
 - b. Reliance on practice in the community.
 - c. Distinguish the duties of the worker—for example, certain workers work without supervision and provide their own equipment (excluding some is better than no relief at all).
 - d. CSP may be available even if there is a **de minimis failure** to file all information returns. For example, if a business treated one class of 150 workers as independent contractors and **timely filed Form 1099 for all but three workers**, the taxpayer should **not** fail the reporting consistency requirement.

X. Electronic Tax Products from IRS

The Internal Revenue Service produces and provides publications, forms, and other tax materials and information to help taxpayers comply with the tax laws. These materials can be obtained via the Internet, CD-ROM, fax-on-demand, over the telephone, through the mail, and at local post offices and libraries.

1997 Workbook

Electronic Tax Products

If you have access to a personal computer, you may download and print any of 600 federal tax forms with instructions, approximately 90 tax publications, and other tax information materials. Additionally, for your convenience, the IRS Federal Tax Forms CD-ROM contains forms and publications, and you can request and receive forms over a fax machine.

Internet

World Wide Web—<http://www.irs.ustreas.gov>

FTP—<ftp.irs.ustreas.gov>

Telnet—<iris.irs.ustreas.gov>

Modem: 703-321-8020

CD-ROM. An alternative to downloading files from the Internet is getting the Federal Tax Forms CD-ROM. This CD contains over 600 current year IRS tax forms with instructions and tax publications as well as prior-year tax forms and instructions beginning with 1991. The cost for the CD is \$25.

To order the 1997 Federal Tax Forms CD-ROM (stock number 648-096-00004-6), contact the Government Printing Office's Superintendent of Documents, PO Box 371954, Pittsburgh, PA 15250-79754, or call 202-512-1800. Fax request to 202-512-2250. To obtain CD information electronically through GPO's World Wide Web site, enter http://www.gpo.gov/su_docs.

IRS Tax Fax. From a fax machine, dial 703-487-4160. Follow the voice prompts and key in your response—"1" to get a faxed index of nearly 100 more frequently requested IRS tax forms (with a two-digit item number for each form); or "2" to key in any two-digit item number. You can select up to three items to order during a single call. The forms are generally available for fax transmission at all times. Your order will be faxed back to you through your fax machine.

XI. Bankruptcy as an option: requirements for discharge of taxes

DISCHARGE OF UNPAID TAXES OF DEBTOR (IRS PUB. #908)

1. As a general rule, there is no discharge for an individual debtor at the termination of a bankruptcy case for prepetition taxes (as defined below) or for taxes for which no return, a late return (filed after a date two years before the filing of the bankruptcy petition), or a fraudulent return was filed. Claims against an individual for other taxes predating the bankruptcy petition by more than three years may be discharged.
2. **Prepetition taxes.** The following federal taxes are prepetition unsecured priority taxes of the government:

1997 Workbook

- a. Income taxes for tax years ending on or before the date of filing the bankruptcy petition, for which a return is last due (including extension) after a date three years before the filing of the petition.
- b. Income taxes assessed within 240 days before the date of filing the petition. This 240-day period is increased by any time, plus 30 days, during which an offer in compromise with respect to these taxes was pending, that was made within 240 days after the assessment.
- c. Income taxes, other than those for which no return, a later return (filed within two years of the filing of the bankruptcy petition), or a fraudulent return was filed, that were not assessed before but are assessable after the filing of the petition.
- d. Withholding taxes on which the debtor is liable in any capacity.
- e. Employment taxes on the first \$2,000 of wages, salaries, or commissions (including vacation, severance, and sick leave pay) earned by each individual employee from the debtor within the 90-day period before the earlier of the date of cessation of the debtor's business or the date of filing bankruptcy petition (whether or not actually paid before the date) and employment taxes for which a return is last due (including extensions) after a date three years before the filing of the petition.
- f. Excise taxes on transactions occurring before the date of filing the bankruptcy petition, for which a return, if required, is last due (including extensions) after a date three years before the filing of the petition. If a return is not required, these excise taxes include only those on transactions occurring during the three years immediately before the date of filing the petition.
- g. Taxes arising in the ordinary course of the debtor's business or financial affairs in an involuntary bankruptcy case, after the filing of the bankruptcy petition but before the earlier of the appointment of a trustee or the order for relief.