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Corrections were made to this workbook through January of 2004. No subsequent modifications were made.

EARNED INCOME TAX CREDIT

INTRODUCTION

The Earned Income Tax Credit (EITC), created in 1975, is intended to offset the cost of social security taxes and to provide an incentive to work. The credit is available to qualifying taxpayers who meet certain income requirements. The amount of credit varies depending on the filing status and the number of qualifying children (0,1 or 2). Married taxpayers filing separately cannot claim the EITC.

The maximum credit amounts for 2003 are:

- $382 if the taxpayer has no qualifying children.
- $2,547 if the taxpayer has one qualifying child.
- $4,204 if the taxpayer has two qualifying children.

Single taxpayers with no children can increase their EITC by $2,454 if they add a child to their return. Adding two children increases the credit to $4,088. For a married couple filing jointly, the increase is slightly less. Obviously, this type of credit can be attractive to unscrupulous taxpayers.

Upon audit, the IRS found a great amount of fraud for EITC. In fact, erroneous EITC refunds increase each year. The IRS released a report, *Compliance Estimates for EITC Claimed on 1999 Returns*, on February 28, 2002. The report indicated between $8.5 and $9.9 billion should not have been paid of the estimated $31.3 billion in EITC claims made by taxpayers who filed returns for tax year 1999. The level of fraud was between 27 and 32%. The level of fraud has been on an upward spiral since 1997 when the IRS estimated between $7.2 and $7.8 billion of the EITC should not have been paid.

IRS ENFORCEMENT

The IRS is devoting a significant amount of 2003 resources to combat EITC fraud. At the 2002 Nationwide Tax Forums, the IRS laid out its strategy to reduce fraudulent payments. It plans to:

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- Increase education, assistance, and outreach programs. This will be accomplished by using toll-free phone numbers, posting information on its website, www.irs.gov, and partnering with other organizations.
- Upgrade compliance enforcement using new math error adjustments and performing prerefund examinations.
- Increase criminal examinations.

So far, the IRS has developed and/or implemented:

- EITC education and enforcement programs for paid preparers.
- Obtained additional statutory authority to deny questionable claims during initial processing (math errors).
- Improved the examination case selection system.
- Enhanced the educational outreach program using a targeted advertising campaign, innovative partnerships, and practitioner assistance.
- Redesigned returns, publications, instructions, and schedules, resulting in a decrease in math errors.
- Increased enforcement activity by examining 2.7 million returns. The enforcement activity protected $5 billion in revenue.
- A system to monitor compliance with EITC regulations through the National Research Program (NRP).

The IRS also expects paid tax professionals to take responsibility when preparing an EITC return. Preparers are expected to complete Form 8867, *Paid Preparer's Earned Income Credit Checklist*, or a similar form. Following are expectations of preparers related to EITC:

- The EIC should be computed using the appropriate worksheet.
- The preparer must retain records relating to the tax return.
- If the preparer has knowledge of incorrect information on the tax return, and they sign the return, they will be subject to preparer penalties.
- Although preparers rely on taxpayer statements, they must make reasonable inquiries of the taxpayer.

DECEPTION EXAMPLES

Some taxpayers and tax preparers are very creative in the ways they use to defraud the government by filing erroneous returns claiming EITC.

Phantom Income

Example 1. Izzy and Urna Notalot are married, have four children, and file jointly. In 2002, the Notalots' total income was $2,000 which Izzy earned as a waiter. This income was reported on a W-2 Form. Izzy was surprised when he discovered he would receive a refund of $810 because of the EITC. He questioned his tax preparer and learned more about the EITC calculation. He asked the preparer to hold the return until he had a chance to talk to Urna.

Example 2. Izzy and Urna, from **Example 1,** suddenly remembered Urna received $8,500 selling flea market treasures at the local market. They returned to their tax preparer and told him about the omitted income. The preparer prepared a Schedule C for Urna and calculated the new tax. The Notalots now owe self-employment tax on Urna's Schedule C of $1,201, but the EITC has increased to $3,950. Consequently their net refund increased from $810 to $2,749. They will receive an additional $1,939.

Example 3. Izzy again asks the preparer to hold the return. He is not really sure whether he stayed in the same house with Urna during 2002. Upon discussing this with Urna, she agreed that he had not been there and he had two of the children with him. They decided each could file as head of household. Izzy also remembered he made $8,500 mowing lawns for the neighbors. Izzy's return now reported a net refund of $2,749. Since Urna did not have a W-2, her refund was only $1,949. In total, they had almost missed receiving $3,888 of additional refund.

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Note. This is a fictitious example. However, if something similar were to occur in real life, tax professionals should be very careful to document why they believed all of the Notalots' information was accurate.

Following is a Form 8867 completed by a tax preparer for the Notalot family.

Form **8867** (Rev. November 2002)
Department of the Treasury
Internal Revenue Service

Paid Preparer's Earned Income Credit Checklist

► Do not send to the IRS. Keep for your records.

OMB No. 1545-1629

For the definitions of the following terms, see **Pub. 596** for the year for which you are completing this form.
● **Investment Income** ● **Qualifying Child** ● **Earned Income**

Caution. Taxpayers who file **Form 2555** or **Form 2555-EZ cannot** take the earned income credit (EIC). Taxpayers who were nonresident aliens for any part of the year **cannot** take the EIC unless their filing status is married filing jointly.

Part I All Taxpayers

1 Taxpayer's name ► Izzy Notalot ..... Year after 2001 for which you are completing this form ► 2002

2 Is the taxpayer's filing status married filing jointly, head of household, qualifying widow(er), or single? ☑ Yes ☐ No

3 Does the taxpayer, and the taxpayer's spouse if filing jointly, have a social security number (SSN) that allows him or her to work or is valid for EIC purposes (see the instructions before answering)? . . ☑ Yes ☐ No

Next, if you checked "**No**" on line 2 **or** line 3, **stop;** the taxpayer **cannot** take the EIC. Otherwise, continue.

4 Is the taxpayer's **investment income** more than the limit that applies to the year on line 1? See Pub. 596 for the limit . . . . . ☐ Yes ☑ No

5 Could the taxpayer, or the taxpayer's spouse if filing jointly, be a **qualifying child** of another person in the year on line 1? . . . . . ☐ Yes ☑ No

Next, if you checked "**Yes**" on line 4 **or** line 5, **stop;** the taxpayer **cannot** take the EIC. Otherwise, go to Part II or Part III, whichever applies.

Part II Taxpayers With a Qualifying Child	**Child 1**	**Child 2**
Caution. If there are two children, complete lines 6–11 for one child before going to the next column.		
6 Is the child— ● The taxpayer's son, daughter, adopted child, or stepchild, or ● A descendant of the taxpayer's son, daughter, adopted child, or stepchild, or ● The taxpayer's brother, sister, stepbrother, or stepsister, or ● A descendant of the taxpayer's brother, sister, stepbrother, or stepsister, or ● The taxpayer's foster child?	☑ Yes ☐ No	☑ Yes ☐ No
7 If the child is married, is the taxpayer claiming the child as a dependent? (If the child is not married, check "Yes.")	☑ Yes ☐ No	☑ Yes ☐ No
8 Did the child live with the taxpayer in the United States for over half of the year?	☑ Yes ☐ No	☑ Yes ☐ No
9 Was the child (at the end of the year on line 1)— ● Under age 19, or ● Under age 24 and a full-time student, or ● Any age and permanently and totally disabled?	☑ Yes ☐ No	☑ Yes ☐ No
Next, if you checked "**Yes**" on lines 6 through 9, the child is the taxpayer's qualifying child; go to line 10a. If you checked "**No**" on line 6, 7, 8, **or** 9, the child is not the taxpayer's qualifying child. If the taxpayer does not have a qualifying child, go to Part III on the back to see if the taxpayer can take the EIC for taxpayers who do not have a qualifying child.		
10a Could any other person check "**Yes**" on lines 6 through 9 for the child? **Next,** if you checked **"No"** on line 10a, go to line 11. Otherwise, continue.	☐ Yes ☑ No	☐ Yes ☑ No
b Enter the child's relationship to the other person(s).		
c Is the other person(s) taking the EIC based on the child?	☐ Yes ☐ No	☐ Yes ☐ No
d If the tie-breaker rules applied, would the child be treated as the taxpayer's qualifying child (see the instructions before answering)?	☐ Yes ☐ No	☐ Yes ☐ No
11 Does the qualifying child have a valid SSN (see the instructions before answering)?	☑ Yes ☐ No	☑ Yes ☐ No

Did you check "Yes" on line 11?

☑ **Yes.** The taxpayer can take the EIC if the taxpayer's **earned income** and adjusted gross income are each less than the limit that applies to the taxpayer's filing status for the year on line 1. See Pub. 596 for the limit. Complete **Schedule EIC** and attach it to the taxpayer's return. If there are two qualifying children with SSNs, list them on Schedule EIC in the same order as they are listed here. If the taxpayer's EIC was reduced or disallowed for a year after 1996, see Pub. 596 to find out if **Form 8862** must also be filed.

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Note. More information can be found in Chapter 4, Ethics. Current cases of EITC fraud can be found in Chapter 15, Rulings and Cases.

CERTIFICATION PROGRAM[1]

Background. Approximately 19 million taxpayers claimed over $32 billion of earned income credits (EIC) on 2002 tax returns. Despite an increased compliance effort for the tax years 1998 to 2002, the IRS was unable to significantly reduce EIC noncompliance.

EIC Reform Initiative. The IRS announced a new 5-point initiative to:

- Reduce the backlog of pending EIC examinations,
- Review the existing audit process of claimed EIC,
- Increase outreach efforts,
- Enhance compliance efforts, and
- Establish a pilot certification program utilizing a **new Form 8836,** *Qualifying Children Residency Statement,* for high-risk taxpayers who attempt to use nonqualifying children to claim erroneous and/or fraudulent EIC.

Reducing the Backlog of EIC Examinations. Currently, approximately 7% of pending EIC examinations have been in progress for more than one year. The IRS will review existing examination strategies to determine how to reduce the backlog.

Reviewing the Existing Audit Process. Currently, the average EIC prerefund examination takes 225 days to resolve. During an EIC exam, the IRS issues a minimum of two and a maximum of six taxpayer notices. Many taxpayers fail to respond to the notices. The IRS will review the notices to ensure they clearly explain why the IRS is questioning the EIC claim and exactly what the taxpayers must do to prove their eligibility.

Increasing Compliance Efforts. Taxpayers who circumvent the EIC rules include:

- Taxpayers who fail to report all of their income,
- Married taxpayers who each file as single or head of household because their combined income is above the AGI phaseout limitation amount for EIC, and
- Married taxpayers with two or more children who each file as single or head of household and split the children claimed, thereby receiving up to $8,400 — or twice the maximum EIC limitation.

The IRS will identify returns with the highest risk of income misreporting by using its matching system for Forms W-2 and 1099. Beginning in 2004, the IRS will request information from 300,000 taxpayers who appear ineligible for the credit because they have failed to report all of their income.

In order to decrease the massive amount of filing status errors, the IRS will use third party data and will require EIC claimants to submit information about their marital status. In January 2004, the IRS will ask **5,000 taxpayers** to document their filing status where it appears that married taxpayers have circumvented the EIC rules by improperly filing as single or head of household.

Note. Filing status errors are responsible for approximately **$4 billion** in annual EIC erroneous refunds.

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Establishing a Pilot Child Residency Certification Program. A taxpayer can claim a qualified child for EIC purposes only if the child has the specified relationship to the taxpayer and the child has lived with the taxpayer more than half the year. The vast majority of erroneous qualifying child errors are caused by residency errors — either alone or in combination with relationship errors.

To combat this, the IRS established a pilot residency certification program prior to paying requested EIC refunds on certain 2003 tax returns. This new certification process involves only selected high-risk taxpayers. Certification will not be required for taxpayers who pose a lower risk of error, such as mothers and married joint-filing parents.

The IRS will select 25,000 high-risk taxpayers beginning in early 2004 to verify that the claimed EIC child (children) actually resided with them for more than half of 2003. A new form, the 2003 Form 8836 will be used in the pilot certification program. The EIC portion of their 2003 refund will be delayed until the required documentation is processed.

A special toll-free customer service number, 1-800-294-2723, has been established to provide assistance to taxpayers and preparers involved in this pilot certification program.

> **Note.** Qualifying child errors cause approximately **$3 billion** in annual EIC erroneous refunds.

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Form **8836**

Department of the Treasury
Internal Revenue Service

Qualifying Children Residency Statement

► See instructions starting on page 2.

OMB No. 1545-1829

2003

Attachment Sequence No. **136**

Part I **Taxpayer Information (to be completed by taxpayer)**

Your first name and initial	Last name	**Your social security number**
If you will be filing a joint return for 2003, spouse's first name and initial	Last name	**Spouse's social security number**
Home address (number and street). If you have a P.O. box, see instructions		Your daytime phone number ( )
City, town or post office, state, and ZIP code		Your evening phone number ( )

Part II **Qualifying Children Information (to be completed by taxpayer)**

Caution. If you have two qualifying children, see instructions before completing this part.

Child 1 ►	Child's first name	Last name	Child's social security number
Child 2 ►	Child's first name	Last name	Child's social security number

Part III **Proof of Residency (to be completed by taxpayer) (see instructions)**

Check **one or more** boxes below and attach any required documentation. The combined documentation must include your name, the child's name, street address, and dates the child lived with you to show that you and the child lived together for **more than half** of 2003. See **Residency Test** on page 2 for details and exceptions.

☐ I have attached copies of one or more of the following official records: Child-care records, community-based organization records, employment records, Indian tribal enrollment records, leases, medical records, religious records, school records, social service agency records, or utility bills.

☐ I have attached a letter on official letterhead from one or more of the following third parties: Child-care provider, clergy, community-based organization official, employer, health-care provider, Indian tribal official, landlord or property manager, school official, social service agency official, or utility company.

☐ A third party has completed Part IV below.

Note. The IRS may contact the third party who signs Part IV and any person or organization that provides the documentation you attach to this form.

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

Taxpayer Sign Here ►

Signature of spouse named in Part I ► **Date** ►

Part IV **Third Party Affidavit (to be completed by third party if the last box in Part III is checked)**

First, check the box below that best describes your relationship to the taxpayer or one or both children named above.

☐ Child-care provider ☐ Clergy ☐ Community-based organization official ☐ Employer ☐ Health-care provider
☐ Indian tribal official ☐ Landlord or property manager ☐ School official ☐ Social service agency official

Next, complete the following statement.

Based on my records or personal knowledge, I believe that one (or both) of the above-named taxpayer(s) **and** (check the box that applies)
☐ Child 1 ☐ Child 2 ☐ Child 1 and 2 lived together at the following address:

Address (number and street) ► _____

City, town or post office, state, and ZIP code ► _____

from month ► _____ day ► _____, **2003, through** month ► _____ day ► _____, **2003.**

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

Third Party Sign Here ► Date ►

Your name (print or type) ► Title (if any) ►

Name of organization (if any) ►

Address (including city, town or post office, state, and ZIP code) | Your daytime phone number ( )

For Privacy Act and Paperwork Reduction Act Notice, see page 4. Cat. No. 14955C Form **8836** (2003)

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Instructions

Purpose of Form

Use Form 8836 if the IRS sent this form to you and you have a qualifying child for the earned income credit (EIC). We need this form to show that you and your child met the **residency test** (defined on this page) for 2003.

Who Must File

File this form **only** if:

- You are claiming or expect to claim the EIC with a qualifying child for 2003 **and**
- The IRS sent this form to you with a letter directing you to file it.

If you do not file Form 8836, the IRS will not allow the EIC with a qualifying child for 2003.

For details on the EIC eligibility rules, including the definition of qualifying child, see **Pub. 596,** Earned Income Credit (EIC). You can order Pub. 596 by calling **1-800-TAX-FORM** (1-800-829-3676) or you can download it from the IRS website at **www.irs.gov.**

Pre-recorded information about the EIC is also available by phone 24 hours a day, 7 days a week. Call **1-800-829-4477** and select TeleTax Topic No. 601. Have paper and a pen or pencil handy to take notes.

When To File

There are two different time periods for filing Form 8836 for 2003. You may file Form 8836 either:

- **Before January 1, 2004.** If you file the form during this period, **you may be able to avoid a delay in receiving the EIC part of your tax refund for 2003.**
- **With your 2003 tax return.** Under this option, the EIC part of your refund **will be delayed** while we review the information you submitted.

Where To File

Send the form to:

Internal Revenue Service
Stop 4300, Annex R2
Kansas City, MO 64999-0065

Note. If you file this form after **December 31, 2003,** you may either file it at the above address or attach it to your tax return. If you file it with your return, be sure to send it to the Internal Revenue Service address shown in the instructions for your tax return.

You cannot file **this form** electronically. However, you may still file your tax return electronically. If you do so, send Form 8836 and all required attachments to:

Internal Revenue Service
Stop 4300, Annex R2
Kansas City, MO 64999-0065

Residency Test

Your child must have lived with you in the United States for more than half of 2003. Include the time that you or your child are temporarily apart due to a special circumstance, such as military service, school attendance, or juvenile detention. It does not matter where you lived with your child. For example, you may live with your child in a homeless shelter. For more details on the residency test, see Pub. 596.

Special Rule For a Child Who Was Born or Died in 2003. A child is considered to have lived with you for more than half of 2003 if the child was born or died in 2003 **and** your home was the child's home for the entire time he or she was alive in 2003.

What We Will Do After We Receive This Form

We will review the information you send us. We will let you know if you have met the residency test needed to get your EIC. If we need more information, we will contact you.

If you do not meet the residency test for a child, we will let you know. The IRS will not allow the EIC based on that child.

How To Get Help

Call **1-800-294-2723** if you need assistance completing this form or you are having difficulty obtaining the documentation you are required to provide with this form. Assistance is available Monday through Friday from 8:00 a.m. to 8:00 p.m. Eastern time.

You may also visit any IRS Taxpayer Assistance Center. To find out the location and hours of the nearest center, call **1-800-829-1040** or visit the IRS website at **www.irs.gov/localcontacts.** You also can contact the Taxpayer Advocate Service at **1-877-777-4778** or the local Taxpayer Advocate office in your area.

Part I

P.O. Box. Enter your box number **only** if your post office does not deliver mail to your home. Otherwise, enter your home street address.

Daytime and Evening Phone Numbers. Providing your daytime and evening phone numbers may help speed the processing of this form. We may have questions about the information you provided. By answering our questions over the phone, we may be able to continue processing the form without mailing you a letter. If you will be filing a joint return, you may enter either spouse's phone numbers.

Part II

Be sure that any child named is your qualifying child and you expect to claim that child for the EIC on your 2003 tax return.

Your qualifying child must have a valid social security number (SSN), unless the child was born and died in 2003. If the qualifying child was born and died in 2003

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and did not have an SSN, attach a copy of that child's birth certificate to Form 8836 and enter "Died" instead of the child's SSN.

For purposes of claiming the EIC, a valid SSN is a number issued by the Social Security Administration unless "Not Valid for Employment" is printed on the social security card and the number was issued solely to apply for or receive a Federally funded benefit.

If you have two qualifying children you may need to complete more than one Form 8836. For example, if in Part IV a doctor is signing for Child 1 and a clergyman is signing for Child 2, you will have to complete two forms. List Child 1 on the form you are giving to the doctor and Child 2 on the form you are giving to the clergyman.

Do not provide information for more than two qualifying children. You need only two qualifying children to claim the maximum EIC.

Part III

You must attach documentation showing that each qualifying child lived with you for more than half of 2003. You may need to send more than one item to show that your child lived with you for more than half of 2003.

If you and your spouse are filing a joint return, you only need to show that one of you lived with your child for more than half of 2003.

Who Can Provide Documents to You. You may submit documentation from any of the following third parties (other than you or your spouse).

- School official (such as a teacher, principal, or adminstrative assistant).
- Health-care provider (such as your doctor, your nurse practitioner, or a clinic official).
- Member of the clergy (such as your minister, priest, rabbi, or imam).
- Child-care provider who is age 18 or older (and not your neighbor or relative) **or** licensed or regulated by the state or local government for the area in which the child care was provided.
- Your employer.
- Landlord or property manager.
- Social service agency official (such as a case worker at a public assistance office).
- Community-based organization official (such as an official from the YMCA, YWCA, Boy Scouts, Girl Scouts, Boys and Girls Clubs, 4-H, Little League, Police Athletic League, immigrant advocacy groups, low-income taxpayer clinics, neighborhood associations, homeowners and condominium associations and other non-profit groups).
- Indian tribal official.
- Utility company (such as an electric power or natural gas company).

What Kind of Documents You Must Provide. You may provide either of the following from any third party listed above:

- A copy of an official record (such as child-care records, a lease, medical records, a pay stub, or school records), or
- A letter on official letterhead.

You also may ask any third party that is listed in Part IV of the form to complete the Part IV affidavit to show that you and your child lived together for part or all of 2003. See the instructions for Part IV on page 4.

What the Documents Must Show. If you send an official record or letter, it must clearly show:

- Your name, your child's name, or both names, and
- A street address and the dates that you or your child lived at that address during 2003, and
- The name, address, and phone number of the person or organization that provided the record or letter.

If someone fills out Part IV of this form for you, be sure that it is complete.

How Many Documents Do You Need? You may submit any combination of the documents listed above as long as they show, when taken together, that you lived with your child for more than half of 2003. In some cases, a single document will show that you and your child lived at the same address. In other cases, you may need to provide one document showing your name and address as well as a second document showing your child's name with the same address. Multiple documents may be necessary to show that your address and your child's address were the same for more than half of 2003.

Here are a few acceptable combinations of documents:

- One document that shows that both you and your child lived at the same address for more than half of 2003.
- One document that shows that you lived at an address for more than half of 2003 and a second document that shows that your child lived at the same address during the same period of time.
- One document that shows that you and your child lived at the same address for part of 2003 and a second document that shows that you and your child lived together for the remainder of 2003.
- If you have two children, separate documents for each child to show that each one lived with you for more than half of 2003.
- If you have two children, one document to show that both of your children lived with you for more than half of 2003.

Example 1. You attach a letter on official letterhead from Acme Medical Clinic showing that your child lived with you from January 1, 2003, through March 31, 2003. You also have Reverend Smith, your clergyman, complete Part IV showing that you and your child lived together from April 1, 2003, through July 31, 2003. You check the second and third boxes in Part III. Because the total time shown is more than half of the year, the residency test is met.

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Example 2. You attach a transcript of your child's grades from the Washington Elementary School showing that your child lived with you from January 1, 2003, through May 31, 2003. You also attach a letter on official letterhead from the principal of the Lincoln Middle School. The letter shows the dates of school attendance and that the child's address was the same as yours. The letter covers the period from September 1, 2003, through October 31, 2003. You check the first two boxes in Part III. Because the total time shown is more than half of the year, the residency test is met.

Note. If you cannot obtain official records, a letter, or a completed Part IV from one or more third parties to show that your child lived with you for more than half of 2003, call **1-800-294-2723** and we will help you.

Signing the Form. You must sign and date Part III under penalties of perjury before you send it to us with the documents. Criminal penalties may be imposed for making a false statement.

Part IV

You may skip Part IV if you are submitting official records or letters that show that your child lived with you for more than half the year in 2003.

TIP If you need to provide more than one affidavit (Part IV) to show that your child lived with you for more than half of 2003, complete as many additional Forms 8836 as you need. On the additional Forms 8836, you do not have to enter your spouse's name and SSN or your address.

Neither you nor your spouse may complete this part. A third party listed in Part IV who has records that show, or who personally knows, that you and your qualifying child lived together for part or all of 2003 must complete this part. The third party must complete all applicable information and sign Part IV under penalties of perjury. If the third party does not complete all applicable information in Part IV, the affidavit may not be accepted. Criminal penalties may be imposed for making a false statement.

Privacy Act and Paperwork Reduction Act Notice. The Privacy Act of 1974 and the Paperwork Reduction Act of 1980 require that when we ask you for information we must first tell you our legal right to ask for the information, why we are asking for it, and how it will be used. We must also tell you what could happen if we do not receive it and whether your response is voluntary, required to obtain a benefit, or mandatory under the law.

This notice applies to all papers you file with us. It also applies to any questions we need to ask you so we can complete, correct, or process your return; figure your tax; and collect tax, interest, or penalties.

Our legal right to ask for information is Internal Revenue Code sections 6001, 6011, and 6012(a), and their regulations. They say that you must file a return or statement with us for any tax for which you are liable. Your response is mandatory under these sections. Code section 6109 and its regulations say that you must provide your taxpayer identification number on what you file. This is so we know who you are, and can process your return and other papers.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as stated in Code section 6103.

We ask for tax return information to carry out the tax laws of the United States. We need it to figure and collect the right amount of tax.

We may give the information to the Department of Justice and to other Federal agencies, as provided by law. We may give it to cities, states, the District of Columbia, and U.S. commonwealths or possessions to carry out their tax laws. We may also disclose this information to other countries under a tax treaty, or to Federal and state agencies to enforce Federal nontax criminal laws and to combat terrorism.

If you do not file a return or give fraudulent information, you may be charged penalties and be subject to criminal prosecution.

Please keep this notice with your records. It may help you if we ask you for other information. If you have any questions about the rules for filing and giving information, please call or visit any Internal Revenue Service office.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is: **Recordkeeping,** 6 min.; **Learning about the law,** 11 min.; **Preparing the form,** 24 min.; **Copying, assembling, and sending the form to the IRS,** 20 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Tax Products Coordinating Committee, Western Area Distribution Center, Rancho Cordova, CA 95743-0001. **Do not** send the form to this address. Instead, see **Where To File** on page 2.

Draft as of 9/12/2003

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SCHEDULE K-1

The IRS provides the following reminders regarding Schedule K-1 from partnerships, S corporations, and trusts:

- Report income in the proper location on individual returns as instructed by Schedule K-1, column (c).
- Avoid netting or combining income and deductions on Schedule E, except for passive activity income and deductions from Form 8582. Generally, income and related deductions (such as unreimbursed partnership expenses and the IRC §179 expense deduction) must be reported separately. For more details, refer to the Schedule E instructions.
- Report losses carried forward from prior years due to at-risk and basis limitations on a separate line of Schedule E. Do not combine them with amounts reported for the current year.
- Refer to Form 8582, *Passive Activity Loss Limitations*, for instructions on properly reporting income and losses from passive activities. Beginning with tax year 2002, filers of Form 8582 must attach all three pages of Form 8582 (including the worksheets) to their tax returns.
- Report flow-through income even if a Schedule K-1 has not been received at the time the Form 1040 is filed. Except for partners in certain small partnerships, Form 8082, *Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR)*, must be attached to the tax return to indicate that the partner, shareholder, or beneficiary either did not receive a Schedule K-1 or disagrees with the amounts reported on the Schedule K-1.
- Identify amended information by checking the "Amended K-1" box on Schedule K-1. The flow-through entity is responsible for ensuring the box is clearly marked.

As with all IRS forms, it is important to ensure correct taxpayer identification numbers are entered on K-1s.

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THE IRS WEBSITE (WWW.IRS.GOV)

The IRS website has seen an exponential increase in traffic over the last few years. The IRS is actively seeking to move taxpayer inquiries, historically done over the telephone or in person, to the IRS website. Taxpayers and practitioners now have access to more information than ever before.

The information on the website is primarily organized according to the taxpayer type:

- **Individuals.** There are sections for abusive tax shelters, farmers, foreign nationals, household employers, innocent spouse, overseas taxpayers, retirees, students, self-employed, tax-exempt bonds, and trusts and estates.
- **Businesses.** There are sections for charities and nonprofits, closing a business, corporations, employer ID numbers, employment tax, industries, international businesses, operating a business, partnerships, small business/self-employed, and starting a business.
- **Charities and Nonprofits.**
- **Government Entities.**
- **Retirement Plans.**
- **Tax Professionals.** There are sections for breaking news, *e-file* providers, enrolled agents, enrolled actuaries, and others. In addition, the Internal Revenue Manual is available (Part 4 is the main part used by IRS Examination personnel), as well as the Internal Revenue Code, Internal Revenue Bulletins (IRBs), regulations, rulings, procedures, and others.

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On the home page, there is a link at the top titled The Newsroom. Taxpayers will find at this link the latest IRS news releases and fact sheets (current releases are listed first and featured), as well as various other topics. At this site, taxpayers will find another link in the left column entitled "Facts and Figures." This link contains various tables and statistics.

Under the heading IRS Data Books, there are many tables of reported information. A very small portion of the information available as of fiscal year 2002 (ending September 30, 2002) follows:

- Over 171 million total tax returns were filed in calendar year 2001 (over 129 million were 1040s).
- Approximately 827,000 total examinations occurred in fiscal year 2002 (coverage of 0.48%), of which over 743,000 were 1040s (audit coverage of 0.57%). Approximately two-thirds of the examinations were done by compliance centers.
- 20% of examinations conducted by revenue agents and compliance centers resulted in no changes.
- Nearly $21 billion of additional tax was recommended, two-thirds of which occurred during examinations of 3,749 out of the 10,908 (34.37%) corporate tax returns with assets of over $250,000,000.
- Table 11 shows examination coverage of returns examined (by type and size) with unagreed recommended additional tax.
- Nearly 40,000 examinations in fiscal year 2002 resulted in refunds of over $4 billion.
- Table 29 gives details of costs incurred by the IRS by budget activity for fiscal years 2001 and 2002.
- Table 31 is an IRS personnel summary for fiscal years 2001 and 2002.

There is easy access to IRS forms and publications from the website. Some forms are fill-in, and can be printed after they are completed. Other forms can be printed and/or downloaded. Older revisions of forms can also be found on the site. In July, the IRS made available to the public older revisions of nearly all forms back to 1992. For older forms, such as the 1913 Form 1040 found in Appendix E, the taxpayer or practitioner must call a distribution center or fax their request through normal channels.

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IRS MSSP AUDIT GUIDES

In the past decade, the IRS introduced and continued to develop their Market Segment Specialization Program (MSSP). One of the reasons the program was developed was to respond to practitioner concerns that taxpayers in different areas of the country, who had similar issues during audits, were not treated consistently. Market segments can be a particular industry, profession, or an issue that might be found in various different types of businesses.

The IRS publishes Audit Technique Guides (ATG) containing examination techniques, common issues, business practices, industry terminology, and other information to assist IRS examiners. If a revenue agent is assigned an audit of a taxpayer in an industry of which he is unfamiliar, the agent can consult a guide for help before and during the audit. These guides were originally only published internally; however, most of them now can be found on the IRS website under forms and publications. Most of the guides are written and updated by Issue Specialists, who are available on the telephone or at the job site for assisting examiners during an audit. The guides are between 25 and 250 pages long.

The following **Audit Technique Guides are available as of summer 2003** (guides updated in the last three years are shown):

Actors

Alaskan Commercial Fishing

Alternative Minimum Tax for Individuals

Architects

Artists and Art Galleries

Auto Body and Repair Industry

Auto Dealerships

Aviation Tax

Bail Bond Industry

Banking

Bars

Beauty and Barber Shops

Bed and Breakfasts

Business Consultants (updated March 2001)

Carpentry and Framing

Car Wash Industry

Child Care Providers (updated March 2000)

Clergy

Coal Excise Tax

Computers, Electronics, and High Technology

Construction Industry

Drywallers

Entertainment and Music Industry

Entertainers - Foreign Athletes and Entertainers 1040 Issues

Farming

Farm Hobby Losses, Cattle, and Horses (updated March 2001)

Furniture Manufacturing

Garden Supplies (updated February 2000)

Garment Contractors

Garment Industry

Grain Farmers

Hardwood Timber Industry

Laundromat Industry (updated June 2000)

Lawsuit Awards and Settlements (updated November 2000)

Livestock (updated April 2000)

Low Income Housing

Manufacturing Industry

Masonry and Concrete Industry

Ministers

Mobile Food Vendors

Mortuaries

Musicians

Oil and Gas Industry

Passive Activity Losses

Pizza Restaurants

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Placer Mining Industry

Port Project (Shipping)

Printers and Commercial Printing

Reforestation Industry

Rehabilitation Tax Credit (updated February 2002)

Research Credit

Restaurants

Retail Liquor Industry

Scrap Metal Industry

Shareholder Loans (updated June 2001)

Sports Franchises

Taxicabs

Tobacco Industry

Tour Bus Industry

Trucking Industry

Used Car Dealers

Veterinary Medicine

Wine Industry

The following **Audit Technique Guides are not available to the general public:**

Abusive Trusts

Air Charters

Cattle Auction Barns

Gasoline Retailers

Golf Courses

Net Operating Losses

Offshore Transactions

Partnerships (updated October 2002)

Real Estate Agents

There are also various Issue Papers that can be used by examiners to ensure consistent treatment by the IRS of various audit issues. Examiners also easily access CPE notes and training materials for various industries that have been published internally.

INTERNET EMPLOYER IDENTIFICATION NUMBERS (I-EINs)

The IRS now allows businesses to obtain employer identification numbers directly from its website. New business owners or their tax professionals apply for and obtain their EIN via the IRS website 24 hours a day, 7 days a week. No registration is required to use the system and the number is issued immediately. Although the Internet method is preferred, businesses may still obtain EINs by calling 1-800-829-4933 from 7:30 a.m. to 5:30 p.m. (local time), or by mail or fax (see Form SS-4 instructions).

The EIN on-line processing eliminates the need to send paperwork to the IRS. It also eliminates delays caused by incomplete application forms. The IRS issues an Employer Identification Number after a taxpayer, business owner, or their authorized representative submits a completed Form SS-4 on-line. Although the IRS calls this a “provisional” EIN, the I-EIN in nearly all cases is the permanent Federal Employer Identification Number for a business entity. The taxpayer may begin using the number for all business filings upon receipt. The IRS will contact the taxpayer if the number is voided. An I-EIN may be voided if:

- The name and SSN of the principal officer or member does not match according to SSA records or
- The business already has a number.

The following request types are **excluded** from the Internet application:

- Requests from addresses outside the continental United States, Alaska, and Hawaii
- LLCs that don’t provide information in Lines 7a, 7b, or 8a

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- Real Estate Mortgage Investment Conduits (REMIC)
- State and local governments
- Federal Government/Military
- Indian Tribal Government or Enterprise

I-EIN Frequently Asked Questions and Answers

Question A. What can the taxpayer do if his entire address won't fit on the address line on the Internet application?

Answer A. The Internet application only allows 35 characters on the address line. If an address does not fit in 35 characters, then the most essential information must be provided (i.e., apartment numbers, suite numbers). Commonly accepted abbreviations may be used to shorten the number of characters. It is critically important to ensure the business address is correct on the application.

Question B. Can a tax preparer or accountant apply for an EIN for their clients?

Answer B. Yes. However, tax professionals applying for an EIN for a client must complete two additional steps.

They must have a fully completed Form SS-4, *Application for Employer Identification Number,* on file before making the on-line application.

The taxpayer must sign a statement authorizing a third party to receive the EIN. A copy of the statement is included on the on-line application website.

Question C. Why does the Internet identify the Employer Identification Number as provisional?

Answer C. The information on Form SS-4 has not been verified by the IRS. In most cases, the number obtained via the Internet is permanent for the business. The IRS contacts the taxpayer if the number is voided; otherwise it can be considered permanent and used for business filings upon receipt.

Question D. What happens if the taxpayer forgets the number obtained over the Internet?

Answer D. IRS records are updated with EINs within five business days of the number being issued. After that time, the taxpayer may call 1-800-829-4933 and select EIN from the list of options. Once connected with an IRS employee, the taxpayer can tell the employee he received an EIN from the Internet but can't remember it. The IRS employee will ask the necessary disclosure and security questions prior to providing the number.

Question E. Do all EINs obtained on the Internet start with 20?

Answer E. Yes. The unique prefix simply identifies the EIN as a number issued via the Internet.

Question F. Is special special software or a certain computer required to obtain an EIN on the Internet?

Answer F. No. The IRS website can be accessed by any computer that has an Internet connection. A current Internet browser is needed which allows users to view and complete the application process on-line.

Question G. How soon can the EIN be used to make tax deposits?

Answer G. Immediately. Within two weeks, the taxpayer will receive paper deposit coupons and other filing requirements information.

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NEW EMPLOYMENT TAX *E-FILE* SYSTEM

INTRODUCTION

The Employment Tax *e-file* System offers an improved way to file for current 940 and 941 *e-file* and On-Line Filing Partners. Electronic Return Originators (EROs) will have the ability to offer electronic employment tax filing for their clients. The Employment Tax *e-file* System offers new features and greater flexibility for filing employment tax returns.

FEATURES OF THE NEW SYSTEM

More Filing Options

The Employment Tax *e-file* System accepts the following forms and schedules:

Form 941	Schedule B
Form 941PR	Form 940
Form 941SS	Form 940 PR
Form 941c	

More Flexible Filing

Forms 940 and 941 can now be filed in a single transmission file.

More Explicit Error Conditions

New error conditions pinpoint the location of the error in the transmission and provide complete information for each error identified.

Faster Acknowledgments

Transmissions are processed upon receipt and acknowledgments are returned in near real time. No more waiting for once or twice daily system processing cycles.

Integrated Payment Option

Eligible filers may submit a required payment along with their return, subject to limitations imposed by the Federal Tax Deposit Rules.

Completely Electronic Signature Process

Taxpayers and Reporting Agents can continue to sign their returns with their own IRS-issued Personal Identification Number (PIN)

WHO CAN PARTICIPATE

Authorized IRS *e-file* Provider/Electronic Return Originators (EROs)

If a tax preparer is already an ERO, there is no need to revise Form 8633, *Application to Participate in IRS e-file Program.*

Reporting Agents

An accounting service, franchiser, or bank (or other person that complies with Rev. Proc. 96-17, as modified by §21.02 of Rev. Proc. 99-39 and is authorized to prepare and electronically file Forms 940 and 941 for a taxpayer) can sign all of the electronic returns they file with a single PIN signature.

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Third Party Transmitters

A firm, organization, or individual that receives electronic return data from taxpayers, EROs, and Reporting Agents may reformat the data (if necessary), batch it with returns from other filers, and transmit the data to the IRS.

Software Developers

Companies that develop software for their own use or commercial sale for the purpose of electronically filing employment tax returns must have the software. The software must pass an Assurance Testing process prior to being approved for e-filing.

HOW TO PARTICIPATE

Transmitters, Reporting Agents, and Software Developers

Form 9041, *Application/Registration for Electronic Filing*, must be completed. Completed Forms 9041 are mailed to the Austin Submission Processing Center.

Internal Revenue Service
AUSPC, Electronic Filing Help Desk
Attention: *e-file* Unit, Stop 6380 AUSPC
P.O. Box 1231
Austin, TX 78767

Electronic Return Originators (EROs)

Approved EROs for the 1040 *e-file* program need to take no further action. They are approved to file employment tax returns electronically. New applicants must complete Form 8633, *Application to Participate in the IRS e-file Program.*

Business Taxpayers

Practitioners that currently use software to complete Forms 940/941 should consult their software provider regarding when they will offer the new employment tax *e-file* program. A list of approved software companies is available on-line or by checking the list of **Approved IRS *e-file* for Business Providers.**

HOW RETURNS ARE SIGNED

Authorized IRS *e-file* Providers

A Personal Identification Number (PIN) is used as the business filer's signature. The practitioner or taxpayer will register through an approved software provider for a PIN. The software will request information pertaining to the taxpayer. This must be completed before the return can be filed. The IRS sends the taxpayer the PIN. When the taxpayer receives the PIN, the practitioner can file Form 940 and 941 electronically.

Payroll Preparation Service

Reporting Agents may sign all of the electronic returns they file with a single PIN signature.

Business Filers

A PIN is used as the taxpayer's signature. When a PIN is registered through an approved software provider, the software will request information pertaining to the business. Once this information is submitted, the IRS sends the taxpayer a PIN which allows him to file Forms 940 and 941 electronically.

A PIN remains active provided it has been used during the previous year. If a PIN is lost, the taxpayer must notify the IRS Austin Help Desk at 512-460-8900.

Additional information regarding the Employment Tax *e-file* System can be found at www.irs.gov/efile. To access the XML Developer's Forum, click on the "IRS *e-file* for Business Software Developers and Transmitters" link. Then click on the "Form 94x" link. Questions may be directed to the Employment Tax *e-file* System Development Team at this e-mail address: e-fileemptax@irs.gov.

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FILING AND LOCK BOX ADDRESSES

At the end of this chapter in **Appendix A,** there are several "where to file" charts with current addresses for 2003. These addresses are used by businesses filing their own taxes or tax professionals filing taxes for clients.

ELECTRONIC FEDERAL TAX PAYMENT SYSTEM (EFTPS)

OVERVIEW

EFTPS is a tax payment system offered free from the U.S. Department of Treasury. More than four million taxpayers are currently using the system. More than $8.8 trillion dollars have been collected through EFTPS since 1996 ($1.5 trillion in 2002). Over 95% of all employment tax dollars are now collected through EFTPS. EFTPS offers the convenience and flexibility of making tax payments through the Internet, Personal Computer (PC) software, or phone. Taxpayers can select how they want to make their payments. There are two primary payment methods:

- EFTPS-Direct
- EFTPS-Through a Financial Institution

Taxpayers may also use the Same Day payment method offered by some financial institutions.

PAYMENT METHODS

EFTPS-Direct is an electronic payment method that allows taxpayers to access EFTPS directly to report tax information. On the date indicated, taxpayers instruct EFTPS to move the funds from a personal account to the Treasury's account. Funds will not move from an account until the date specified by the taxpayer. The two payment methods under EFTPS-Direct are:

- EFTPS-Online (Internet) and
- EFTPS-Phone.

With EFTPS-Direct both methods are interchangeable.

If a taxpayer elects to use **EFTPS-Through a Financial Institution,** he will instruct his financial institution to electronically move funds from his account to the Treasury's account. Taxpayers need to check with their financial institution to learn if they offer this service, how much it costs, and if they are eligible to use it. Not all financial institutions offer this service. Individuals can also pay their quarterly 1040ES estimated taxes electronically using EFTPS, and they can make payments weekly, monthly, or quarterly as well as schedule payments for the entire year in advance.

A taxpayer can initiate their tax payment 24 hours per day, 7 days per week. As an added convenience, EFTPS-Direct allows payment scheduling to **warehouse a tax payment.** Businesses can schedule payments up to 120 days in advance of their tax due date, and individuals can schedule payments up to 365 days in advance of their tax due date. EFTPS automatically makes the payments on the date indicated.

ENROLLMENT

EFTPS can be used to make all federal tax payments, including income, employment, estimated, and excise taxes.

To participate in EFTPS, the taxpayer must first enroll. To enroll or to obtain additional information on-line, a taxpayer can visit www.EFTPS.gov. To receive information by mail or fax, taxpayers may contact EFTPS Customer Service at:

- 1-800-555-4477 or 1-800-945-8400 (toll free),
- 1-800-945-8900 or 1-800-733-4829 (TDD Hearing-Impaired), and
- 1-800-945-8600 or 1-800-244-4829 (Español).

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CONFIRMATIONS

A taxpayer receives an EFT Acknowledgment Number to keep as a record of their tax payment. Taxpayers can use EFTPS-Online to make a payment, cancel a payment, review payment history, change bank account information, and print out a confirmation of their payment instruction. It is secured with both a PIN and Internet password combination.

UPGRADES RECENTLY MADE

On July 21, 2003, the IRS announced in news release IR-2003-90 that the EFTPS-Online website had undergone a major upgrade. Improvements include:

1. Individual taxpayers can schedule all four of their 1040ES estimated tax payments in one session without logging out.
2. Taxpayers can access payment history for a 16-month period of time.
3. Taxpayers can search, print, or download payment history by date, tax type, amount, and tax form.
4. Taxpayers can access links to states with electronic tax payment systems directly from the EFTPS website.

REQUIRED USE

Some business taxpayers are required to use EFTPS because they meet certain criteria. If total deposits of all federal taxes, including employment taxes, income taxes, Railroad Retirement taxes, social security taxes, and various other types of nonpayroll withholding taxes, during a calendar year exceed $200,000, the use of EFTPS is required in the second succeeding calendar year.

For example, if a business has more than $200,000 in federal tax deposits in calendar year 2001, then it is required to use EFTPS beginning in January 2003.

HELPFUL MATERIALS

- IRS Pub. 4066, *EFTPS Frequently Asked Questions*
- IRS Pub. 966, *A Full Range of Electronic Choices to Pay All Federal Taxes*
- IRS Pub. 3425, *5 Easy Ways to Use EFTPS for Tax Practitioners, Accountants, and Payroll Companies*
- IRS Pub. 3806, *The Easiest Way to Pay Your Federal Taxes for Individual Taxpayers*
- IRS Pub. 3889, *Something New for 1040ES Taxpayers*

EFTPS does not charge taxpayers for its services. If taxpayers use EFTPS through a financial institution or the same day payment mechanism (both available only to businesses), they may incur a fee.

IRS ELECTRONIC FILING *E-FILE* FOR TAX PROFESSIONALS

The IRS continues to encourage the use of the *e-file* program at all levels of the organization. The overall program allows the resources of the IRS to shift from tax processing to examination and collection. The IRS encourages tax professionals to market the benefits of e-filing to their clients. A quick summary follows that may assist tax professionals market e-filing to their clients.

With IRS *e-file:*

- Taxpayers can file electronically, sign electronically, and get a refund or pay electronically.
- IRS *e-file* offers accurate, safe, and fast alternatives to filing on paper.
- IRS computers quickly and automatically check for errors or missing information.
- The chance of an audit of an e-filed return is not greater than with a paper filed return.

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ELECTRONIC FILING QUESTIONS AND ANSWERS

Question A. Can an amended tax return be filed electronically?

Answer A. No. An amended return must be filed on a paper Form 1040X, *Amended U.S. Individual Income Tax Return,* and mailed to the appropriate Service Center for processing.

Question B. How can a mistake be corrected on a federal *e-file* return?

Answer B. A mistake cannot be corrected on an electronic return electronically. An amended or corrected return Form 1040X, *Amended U.S. Individual Income Tax Return,* must be filed as soon as possible. Include copies of any schedules that have been changed or any Form W-2 not included. The 1040X is a paper form.

Question C. Can a taxpayer file a return electronically even though she is filing a Form 8379, *Injured Spouse Claim and Allocation?*

Answer C. Yes. She can file electronically.

Question D. How can a tax preparer participate as an electronic filing originator?

Answer D. To participate in the *e-file* program, a tax preparer must submit **Form 8633** (PDF), *Application to Participate in the IRS e-file Program.* The application must be submitted to the appropriate Service Center as shown on Form 8633. **Pub. 1345** (PDF), *Handbook for Authorized IRS e-file Providers Individual Income Tax Returns*, provides information needed for applying to participate in the *e-file* program. Technical information can be found in **Pub. 1346** (PDF), *Electronic Return File Specifications and Record Layouts for Individual Income Tax Returns.* Updates to this publication appear on the Electronic Filing System Bulletin Board.

Question E. My client changed her name and notified the Social Security Administration. How long must she wait to file her tax return electronically?

Answer E. Two weeks after a taxpayer changes her name with the Social Security Administration, the IRS has the information and she should be able to file electronically. If she does not have two weeks to wait before the due date for filing her return timely, she will need to file a paper return.

Question F. A taxpayer's electronic tax return keeps getting rejected and indicates a dependent's social security number was used more than once or on another return. The taxpayer verified the social security numbers of all the dependents with the Social Security Administration and no one else is authorized to claim his children on their taxes. How can this error be corrected so his *e-file* return will be accepted?

Answer F. Unfortunately, the taxpayer will need to file a paper return this year. Documentation should be attached supporting the social security numbers in question for the dependents and a copy of the *e-file* rejection notice. Whether the cause of this rejection is the result of a typo on another return or an attempt by another party to claim the taxpayer's dependent, the IRS has security measures in place to ensure the accuracy of returns submitted. In such cases, the IRS will question the dependency exemptions claimed by any other party using the wrong social security number.

This same process is followed if the electronically filed return is rejected because the name and social security numbers of claimed dependents do not match.

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FORM 1041 *E-FILE* PROGRAM

PROGRAM HISTORY

Since **Tax Year 1986,** the IRS has offered voluntary programs for various forms of Electronic/Magnetic Media Filing of Form 1041 to the business community as a means of filing business returns. **For tax years 1986 through 1988,** the Andover Submission Processing Center was responsible for receiving and processing estate/trust returns submitted on magnetic tape. The program grew from 2,165 returns to 73,224 returns. **For tax years 1989 through 2002,** the IRS Philadelphia Submission Center had the responsibility of receiving and processing Forms 1041 on magnetic tape and diskette. **In processing year 1995,** the program was expanded to accept modem transmissions. **For processing year 2002,** Philadelphia Submission Processing Center processed 1.2 million returns and 1.3 million K-1s.

Beginning January 1, 2003, the Philadelphia Submission Processing Center will no longer accept returns filed electronically (modem). Electronically filed returns will now be transmitted through Electronic Management System (EMS) at the IRS Tennessee Computing Center in Memphis, Tennessee.

All electronically filed 1041 returns will be processed at the Ogden Submission Processing Center beginning January 27, 2003. The IRS will also be eliminating the filing of Forms 1041 on diskette.

Forms and Schedules accepted in the 1041 *e-file* program are listed in **Appendix B.**

FORM 1041 *E-FILE* QUESTIONS AND ANSWERS

Question A. How can I participate?

Answer A. All new 1041 *e-file* applicants who either develop software or transmit returns must complete Form 9041, *Application/Registration for Electronic Filing*, and check the application as new. Applicants who currently have an application on file for other *e-file* programs can check the application as revised and must indicate the type of return (Form 1041) they intend to file. Form 9041 applications must be sent to the Austin Submission Processing Center. To ensure the application is processed timely, the IRS should receive the form at least 60 calendar days before the entity transmits live returns electronically. The IRS will accept applications by mail or fax. The Austin Submission Processing Center fax number is 512-460-8962. The mailing address is:

Internal Revenue Service
Austin Submission Processing Center
Attn: EFU, Stop 6380
P.O. Box 1231
Austin, TX 78767

If fiduciaries use a third-party transmitter to file, the fiduciary is not required to file a Form 9041.

After review of the Form 9041, the IRS will assign an Electronic Transmitter Identification Number (ETIN) and a temporary password to each applicant. The ETIN and test password will be used to log on and transmit test data.

Question B. Where are related guidelines found?

Answer B. Pub. 1437, *Procedures for Electronic/Magnetic Media Filing of U.S. Income Tax Returns for Estates and Trust, Form 1041*, and **Pub. 1438,** *File Specifications, Validation Criteria and Record Layouts for Electronic or Magnetic Media Filing of U.S. Income Tax Return for Estates and Trusts, Form 1041*. The latest versions of these publications can be found on the Forms and Publication section on the IRS website.

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Question C. Who can be contacted for help?

Answer C. The IRS released a new centralized toll-free number for the e-help desk. The new number is 1-866-255-0654 and became operational on June 2, 2003. The e-help desk supports *e-file*, Electronic Federal Tax Payment System (EFTPS), TeleFile, and future e-services customers.

FORM 1065 *E-FILE* PROGRAM

PROGRAM HISTORY

Since **Tax Year 1986,** the IRS has offered voluntary programs for various forms of Electronic/Magnetic Media Filing of Form 1065, *U.S. Return of Partnership Income*, to the business community as a means of filing partnership returns. The IRS Andover Submission Processing Center (ASPC) was responsible for processing partnership returns submitted on magnetic tapes, diskettes, or transmitted electronically via the Bulletin Board System or MITRON. Participants could choose to file their entire partnership return electronically or use the "Paper-Parent Option" method. This method allowed the Form 1065 and related forms and schedules to be mailed to ASPC, and the Schedule K-1 and/or Forms 8308, *Report of a Sale or Exchange of Certain Partnership Interests*, to be transmitted electronically or submitted on magnetic tape. **From Tax Year 1986 through 1998,** the Paper-Parent Option was the preferred method of filing. During this time, an average of 1.4 million Schedule K-1s were filed on electronic/magnetic media annually.

Beginning with Tax Year 1999, the IRS implemented the Electronic Management System (EMS) as the method for transmitting partnership returns electronically. The IRS no longer processed partnership returns submitted on magnetic tape, diskette, or transmitted electronically via the Bulletin Board System or MITRON, and also discontinued the "Paper-Parent Option" method of filing. In addition, the Memphis Submission Processing Center (MSPC) inherited the responsibility for processing partnership returns filed electronically.

On June 5, 2000, the IRS began processing Tax Year 1999 partnership returns filed electronically on a voluntary basis at the Memphis Submission Processing Center (MSPC). All electronically filed partnership returns were transmitted through EMS at the IRS Tennessee Computing Center (TCC) in Memphis, Tennessee.

For Tax Year 2000, the IRS implemented the Legislative Mandate, Section 1224 of the Taxpayer Relief Act of 1997, which requires partnerships with more than 100 partners to file their return on magnetic media (electronically as prescribed by the IRS Commissioner) for taxable years ending or after December 31, 2000. **On February 22, 2001**, the IRS implemented the mandate and began processing Tax Year 2000 partnership returns that were mandated for electronic filing as well as nonmandated returns.

On January 12, 2002, the IRS began processing Tax Year 2001 partnership returns filed electronically.

1065 *E-FILE* VOLUME HISTORY

Tax Year	Accepted Forms 1065	Accepted Schedules K-1
1999	143	179,600
2000	8,897	3,501,847
2001	25,216	3,828,486

HOW TO PARTICIPATE

Form 9041, *Application/Registration for Electronic/Magnetic/Media Filing of Business Returns*, is submitted to the IRS Austin Submission Processing Center (AUSPC) in Austin, Texas. The AUSPC accepts application by mail or fax.

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Internal Revenue Service
Austin Submission Processing Center
ATTN: EFU, Stop 6380
Austin, TX 78767
AUSPC fax number is 512-460-8962 (not a toll-free number)

To ensure the application is processed timely, the IRS must receive the Form 9041 at least 60 days before the entity plans to file electronically.

First-time software developers/transmitters who intend to participate in the program need to submit Form 9041. Software developers/transmitters who participated in the program by transmitting Tax Year 2001 partnership returns do not need to file another Form 9041 unless there are changes to the information previously submitted. A new Form 9041 is only needed when information has changed from the previous year.

Software developers/transmitters who participated in the program for Tax Year 2001 do not need to call AUSPC to inform them that they will participate for Tax Year 2002. AUSPC will automatically mail a letter to each participant informing them of their Electronic Temporary Identification Number (ETIN) and temporary password that is needed for Business Acceptance Testing System (BATS). Testing is mandatory for all participants who develop software and/or transmit returns.

Forms, Schedules, and Statement Records Accepted Electronically for Form 1065 are listed at the end of this chapter in **Appendix C.**

SUBMISSION PROCESSING CENTERS

Electronically filed partnership returns will be processed at the IRS Ogden Submission Processing Center.

Internal Revenue Service
Ogden Submission Processing Center
1065 *e-file* Team, Stop 1057
Ogden, Utah 84201
801-620-7444

Internal Revenue Service
Austin Submission Processing Center
Attn: Electronic Filing Unit, Stop 6380
P.O. Box 1231
Austin, Texas 78767
512-460-8900

BURDEN REDUCTION

INDUSTRY ISSUE RESOLUTION PROGRAM — REV. PROC. 2003-36

Purpose

Revenue Procedure 2003-36 describes methods for business taxpayers, industry associations, and other interested parties to submit issues for consideration under the IRS's Industry Issue Resolution (IIR) Program. The objective of the IIR Program is to identify frequently disputed or burdensome tax issues that are common to a significant number of business taxpayers and to identify ways they may be resolved through published or other administrative guidance. Resolving issues through prefiling guidance rather than postfiling examination is a goal of the IRS and the Office of Chief Counsel. The Large and Mid-Size Business (LMSB) Division and the Small Business and Self-Employed (SB/SE) Division of the service share operational responsibility for the IIR Program.

Scope

Issues Appropriate for the Program. Issues most appropriate for consideration under the IIR Program generally will have two or more of the following characteristics:

- Proper tax treatment of a common factual situation is uncertain.
- The uncertainty leads to frequent, and often repetitive, examinations of the same issue.

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- The uncertainty results in taxpayer burden.
- The issue is significant and impacts a large number of taxpayers, either within an industry or across industry lines.
- Extensive factual development and an understanding of industry practices and views concerning the issue would assist the service in determining proper tax treatment.

Issues Not Appropriate for the Program. The following issues are not appropriate for consideration under the IIR Program:

- Issues that are primarily under the jurisdiction of Operating Divisions other than LMSB and SB/SE
- Issues that involve transactions lacking a bona fide business purpose, or transactions with a significant purpose of improperly reducing or avoiding federal taxes
- Issues that involve transfer pricing or international tax treaties

Recommendation and Selection Process

Recommendation Process. The LMSB and SB/SE Divisions review and evaluate the submitted issues and, if appropriate, may recommend an issue be included on the Treasury Department's and the Service's Guidance Priority List for the upcoming year or on periodic updates to the Guidance Priority List. The Guidance Priority List sets forth the published guidance that the Service expects to issue during the plan year. However, inclusion of an IIR item on the Guidance Priority List does not guarantee the published guidance will be issued.

Interested parties may submit issues at any time during the year. The LMSB and SB/SE Divisions review and evaluate the submitted issues generally after March 31 and August 31 of each year. Additionally, the LMSB and SB/SE Divisions review issues submitted by May 15, 2003, to determine whether to recommend those issues for inclusion on the 2003–2004 Guidance Priority List.

No Required Format

No specific format is required to submit an issue. However, information to include in the submission follows:

- An issue statement
- A description of why the issue is appropriate for the IIR Program
- An explanation of the need for guidance
- The estimated number of taxpayers affected by the issue
- The name and telephone number of a person to contact if additional information is needed

The submission may also include a recommendation regarding how the issue may be resolved.

Where to Submit

Interested parties should submit issues by e-mail to IIR@irs.gov, or by mail or fax to:

Internal Revenue Service
Office of Prefiling and Technical Services
Large and Mid-Size Business Division LM:PFT
Mint Building 3rd Floor M3-420
1111 Constitution Avenue NW
Washington, DC 20224
Fax: 202-283-8406

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Selection Process

When making their decision, the Office of Chief Counsel and the Treasury Department consider whether the requested guidance promotes sound tax administration.

An LMSB or SB/SE representative notifies the submitter when a decision has been made whether to include an issue on the Guidance Priority List or on a periodic update. A public announcement on the issues reviewed under the IIR Program and selected for the Guidance Priority List or a periodic update will be issued at least annually.

Guidance for Selected Issues

Guidance on selected issues may be in the form of published guidance, such as a regulation, revenue ruling, revenue procedure, or notice, prepared by the appropriate Office of the Associate Chief Counsel. In some situations, the guidance may require taxpayers to file a request for a change in method of accounting before changing the manner in which they treat the issue. Published guidance issued under the IIR Program is available on the Digital Daily at the IRS website. Selected issues also may be addressed in administrative guidance, such as an *Internal Revenue Manual* provision.

IIR Program Additional Information

IIR Team. If an issue submitted under the IIR Program is selected as a published guidance project, the IRS establishes a team (the IIR team) to provide assistance in analyzing the issue. IIR team members will include appropriate personnel from the LMSB and SB/SE Divisions, Appeals, the Office of Chief Counsel, and the Treasury Department.

Request for Information or Meeting. An IIR team may ask the submitter or other business taxpayers to meet voluntarily with the IRS to provide information or an opportunity to review books and records that could assist in the development of the issue. These activities are not for the purpose of examination or inspection within the meaning of IRC §7605(b).

Disclosure of Information. The IRS encourages interested parties to submit information that will assist the Service and the Treasury Department in reaching an appropriate resolution of the issue. Submissions and any additional information provided may be subject to disclosure under the Freedom of Information Act. All submissions made under the IIR Program are made available for public inspection and copying in their entirety. Therefore, submissions must not include confidential or taxpayer-specific information.

ABUSIVE TAX AVOIDANCE TRANSACTIONS

The IRS continues to focus many efforts on combating abusive tax avoidance transactions that continually arise throughout the nation.

STRATEGY

The Small Business and Self-Employed (SB/SE) Strategy and Program Plan for FY 2003 made noncompliance a major priority. Taxpayer Education and Communication's (TEC's) role in the strategy involves the implementation of an extensive counter-marketing plan against abusive tax schemes and the people who promote them.

There are two components to the TEC counter-marketing effort:

1. TEC partners with external stakeholders for delivery of the counter-marketing messages.
2. TEC counter-markets to address specific schemes and educate groups pursued by promoters.

In addition to mounting counter-marketing campaigns, TEC employees have been trained to recognize previously unidentified abusive tax schemes and promoters and refer them through proper channels to the Compliance function.

Because the promotions of abusive tax evasion schemes have increased, TEC will be cautioning taxpayers to beware of tax-savings pitches that sound too good to be true and urging them to seek expert advice before committing to any scheme that promises instant wealth or exemption from taxes.

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The IRS actively investigates promoters of these arrangements and examines returns of persons using the schemes. Both promoters and investors are subject to civil and/or criminal penalties.

For further information, visit the Criminal Investigation website at www.ustreas.gov/irs/ci.

If you have specific questions on a tax scheme or wish to report a possible scheme, call 866-775-7474 or send an e-mail to: irs.tax.shelter.hotline@irs.gov.

ABUSIVE SCHEMES COUNTER-MARKETING TOOLS

To reach the maximum audience, the IRS recognizes the importance of partnering with external stakeholders. As a result, toolkits have been developed to aid stakeholders in assisting the IRS with counter-marketing against abusive tax schemes.

For additional information, including PowerPoint presentations on these topics, contact the IRS Taxpayer Education & Communication (TEC) Abusive Schemes Center of Excellence staff at 636-940-6227.

EMPLOYER IDENTIFICATION NUMBERS (EINs)

The IRS assigns EINs in order to identify taxpayers who are required to file various business and employment tax returns. Taxpayers, other than individuals, need to secure an EIN in order to conduct business and comply with reporting requirements.

SOLE PROPRIETORS

Sole proprietors who have employees are required to have an EIN. If they do not have employees, they may use their social security number (SSN) for the identifying number on Schedule C or F. In addition, an individual who pays wages to a household (domestic) employee must request an EIN as a sole proprietor to comply with employment tax requirements.

Sole proprietors will need a new EIN if they file bankruptcy under Chapter 7 (liquidation) or Chapter 11 (reorganization), incorporate their business, become a partnership, or purchase the business from a former owner. They may not use the EIN of the former owner, even if that former owner is the taxpayer's spouse.

Sole proprietors do not need a new EIN if they merely change the name of the business, change the location, or add branch locations to the same business. If taxpayers who already have EINs for a schedule C or F business become a limited liability corporation, they do not need to apply for a new number.

CORPORATIONS

A corporation must have its own EIN, even if the shareholder is the only employee. The corporation cannot use the SSN of the shareholder. If a corporation becomes a subsidiary of a corporation, becomes a partnership or a sole proprietorship, creates a new corporation after a statutory merger, or moves and must apply for a new corporate charter, it must apply for a new EIN.

If a corporation is a division of a corporation, a surviving corporation after a statutory merger, declares bankruptcy, changes its business name, changes locations without a new corporate charter, adds locations or branches, converts to a Subchapter S corporation, or reorganizes and only changes identity or form, it does not need a new EIN.

PARTNERSHIP

A partnership must have its own EIN, even if it has no employees. It must be a different number than of any of the partners' SSNs. A new EIN is required if:

- A partnership incorporates.
- One partner takes over and the business becomes a sole proprietorship.

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- A partnership terminates and a new partnership is created.
- 50% of the ownership of the partnership capital changes hands within a 12-month period.

If a partnership declares bankruptcy, changes its name, or changes or adds locations, it does not need a new EIN.

ESTATES

If an estate creates a trust with estate funds or operates a sole proprietorship business after the owner's death, the estate needs to apply for a new EIN. However, if the executor changes names or addresses, a new EIN is not needed.

TRUSTS

A trust needs a new EIN if it changes to an estate, if a living or inter vivos trust changes to a testamentary trust, or if a living trust terminates by distributing its property to a residual trust. A trust does not need a new EIN if the trustee changes, or if a grantor or beneficiary changes names or addresses. If a person is a grantor for many trusts (e.g., a grandparent sets up trusts for all grandchildren), each of the trusts must have its own EIN.

APPLICATION PROCESS

Internet

Taxpayers can now obtain an immediate EIN by completing Form SS-4 on-line. They simply log onto the IRS website at https://sa2.www4.irs.gov/sa_vign/newFormSS4.do. Assuming they completely fill out the form that appears on their screen, they will be issued a provisional EIN. It is called a provisional EIN because the information on the SS-4 has yet to be verified. In most cases this will be the business's permanent EIN. The taxpayer will be contacted by the IRS if the number is voided because of incorrect information.

Telephone

Taxpayers can call a single nationwide **toll-free telephone** number (866) 816-2065 to get an EIN. The EIN can be used immediately to make a tax payment. The IRS suggests that the taxpayer complete Form SS-4 before calling, so that all necessary information is available when requested by the IRS representative. The IRS customer service representatives in three Service Centers will respond to taxpayer calls Monday through Friday from 7:30 a.m.–5:30 p.m. local time. Alaska and Hawaii taxpayers need to call between 7:30 a.m.–5:30 p.m. Pacific Time. Taxpayers located outside the United States will continue to call the Philadelphia Service Center at (215) 516-6999.

Fax

If an EIN is applied for by faxing the completed Form SS-4 to the applicable phone number, the EIN should be received within four business days. The fax number is available 24 hours per day, seven days per week. If an EIN request is mailed, the new EIN is mailed in four to six weeks after the request is received. The applicable fax numbers and addresses are found in IRS Pub. 1635 (Revision 1-2003), *Understanding Your EIN*:

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Employer ID Numbers (EIN) — Where to Apply for an EIN

If the taxpayer's principal business, office or agency, or legal residence in the case of an individual, is located in:	Call the Tele-TIN or Fax-TIN number shown or file with the "Internal Revenue Service Center" at:
Connecticut, Delaware, District of Columbia, Florida, Georgia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, South Carolina, Vermont, Virginia, West Virginia	Brookhaven IRS Center Attn: EIN Operations 1040 Waverly Ave. Holtsville, NY 00501 Tele-TIN: TOLL FREE (800) 829-4933 Fax-TIN: (631) 447-8960
Illinois, Indiana, Kentucky, Michigan	Cincinnati IRS Center Attn: EIN Operations Cincinnati, OH 45999 Tele-TIN: TOLL FREE (800) 829-4933 Fax-TIN: (859) 669-5760
Alabama, Alaska, Arizona, Arkansas, California, Colorado, Hawaii, Idaho, Iowa, Kansas, Louisiana, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Mexico, North Dakota, Oklahoma, Oregon, Puerto Rico, South Dakota, Tennessee, Texas, Utah, Washington, Wisconsin, Wyoming	Philadelphia IRS Center Attn: EIN Operations Philadelphia, PA 19255 Tele-TIN: TOLL FREE (800) 829-4933 Fax-TIN: (215) 516-3990
If the taxpayer has no legal residence, principal place of business, or principal office or agency in any state	Philadelphia IRS Center Attn: EIN Operations Philadelphia, PA 19255 Tele-TIN: NOT TOLL FREE (215) 516-6999 Fax-TIN: (215) 516-3990

By Practitioner

If practitioners wish to apply for an EIN for a client, they should call the toll-free number first. The practitioner should fax Form 2848, Form 8821, or Form SS-4 (revision 12-2001 or later) with a signed third-party designee to the dedicated fax number given. The EIN will then be given to the practitioner. The IRS accepts telephone applications for an EIN from a third party and will fax the EIN back to the third party's client if the third party provides the client's fax number at the time of application. The IRS will **accept an unlimited number of EIN requests** during the same telephone application.

Two-Digit Prefixes

The valid range of EIN prefixes has been expanded. The prefixes range from 01 to 99, excluding the prefixes 07, 08, 09, 17, 18, 19, 28, 29, 49, 78, and 79. In the past, EINs were issued with unique, state-specific, two-digit numbers. As of January 2, 2002, the two-digit prefixes are no longer state specific. For example, before 2002, EINs in Illinois began with either 37 or 36, depending upon the region in the state. A newly assigned EIN in Illinois will now include any valid two-digit prefix.

COMMON EIN PROBLEMS

IRS Pub. 1635 (Revision 1-2003), *Understanding Your EIN*, contains information on common problems encountered when processing requests for EINs. Avoiding these problems will help the EIN request process proceed without rejections:

1. Include the applicable SSN, EIN, or ITIN on line 7B of Form SS-4.

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2. Alien individuals with no effective income within the United States who do not have an ITIN or SSN must submit Form SS-4 with a copy of their Form W-7, *Application for IRS ITIN*.
3. Alien individuals applying as a sole proprietor must provide proof that an ITIN has been established.
4. The correct EIN must be entered on all returns filed after receiving the new EIN, especially if IRS preprinted labels and forms are not used.
5. The full legal name entered on Form SS-4, line 1, must be used on all tax returns for the entity. However, if a trade name is listed on Form SS-4, line 2, either name can be used, provided the name chosen is used on all business returns filed.
6. If a preprinted label is received containing errors, the information should be changed by crossing out the errors and legibly printing the correct information on the label.
7. If a preprinted label is not received, the taxpayer must legibly print or type the name, address, and EIN on the appropriate lines of the returns being filed.
8. If the EIN is not received by the time a return is filed, the taxpayer must write "applied for" in the space provided for the EIN.
9. If the taxpayer's address changes after the EIN is received, the IRS must be notified of the new address by filing Form 8822, *Change of Address.*
10. If the post office does not deliver mail to a street address but instead delivers it to a post office box, the P.O. Box number must be provided as the entity's mailing address instead of the street address.

IRS CLASSIFICATION OF RETURNS

The IRS separates all tax returns into activity codes. These codes are used in various types of internal and external reports. For example:

- IRS personnel split their examination time among various activity codes.
- Fiscal year reports break down examination activity into time spent examining returns in the various activity codes.
- IRS examination planning allocates examination resources for the upcoming fiscal year into planned staff years for the various activity codes.

The current National Research Program (NRP) examinations of individual Form 1040s will be used to update computer examination selection criteria for future years. A sampling of returns is intended to provide a valid statistical sample of returns in all activity codes. The current Unreported Income Project is also emphasizing examinations of taxpayers in certain activity codes.

For Forms 1040, the IRS recently switched to sorting based on total positive income (TPI). In the past, returns were sorted based on adjusted gross income (AGI), where taxpayers with large losses from Schedules C and E were grouped with lower-income wage earners who file returns showing W-2 income only. Now the IRS computes the TPI of every return at the time it is input. Therefore, a taxpayer with a Schedule C reporting gross receipts over $100,000 who shows a net loss or very small net income will not be grouped with a taxpayer with a Schedule C showing a small amount of gross receipts. Taxpayers who file more complicated returns and who have higher TPI will now be grouped together when their returns are classified. The IRS files a business plan each year and attempts to deliver a planned number of staff years of examination time in each of the activity codes.

Individual returns are divided into ten activity codes:

1. 1040A with TPI under $25,000

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2. Non-1040A with TPI under $25,000
3. Nonbusiness 1040 with TPI between $25,000 and $50,000
4. Nonbusiness 1040 with TPI between $50,000 and $100,000
5. Nonbusiness 1040 with TPI $100,000 and over
6. 1040 with Schedule C gross receipts under $25,000
7. 1040 with Schedule C gross receipts between $25,000 and $100,000
8. 1040 with Schedule C gross receipts $100,000 and over
9. 1040 with Schedule F gross receipts under $100,000
10. 1040 with Schedule F gross receipts $100,000 and over

If a tax return qualifies under two different categories (both a Schedule C and F, for example), then the schedule with the largest gross receipts is used. Therefore, a tax return with a Schedule C reporting $60,000 of gross receipts and a Schedule F reporting gross receipts of $110,000 would be classified as category 10. The IRS uses three-digit activity codes for these and other categories.

Partnership returns on Form 1065 are classified into five different activity codes:

1. A taxable Form 1065
2. Nontaxable returns processed before 1988
3. Ten or fewer partners with gross receipts under $100,000
4. Ten or fewer partners with gross receipts $100,000 and over
5. Eleven or more partners

A new code has been established for nontaxable **limited liability corporations.**

Subchapter S corporations on Form 1120S are divided into five different codes:

1. Taxable Forms 1120S
2. Nontaxable returns processed before January 1, 1991
3. Nontaxable returns with assets under $200,000
4. Nontaxable returns with assets between $200,000 and $10,000,000
5. Nontaxable returns with assets $10,000,000 and over

Corporate Forms 1120 are divided into nine different codes:

1. Returns with no balance sheet
2. Assets under $250,000
3. Assets between $250,000 and $1,000,000
4. Assets between $1,000,000 and $5,000,000
5. Assets between $5,000,000 and $10,000,000
6. Assets between $10,000,000 and $50,000,000
7. Assets between $50,000,000 and $100,000,000

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8. Assets between $100,000,000 and $250,000,000
9. Assets $250,000,000 and over

The above codes are used for Form 1120L, 1120M, 1120H, and 1120PH. Forms 1120F have four separate codes, and a separate code is used for 1120 DISC.

The last four categories are normally examined by the Large and Mid-Size Business (LMSB) division, while the other returns are examined by Small Business/Self-Employed (SBSE) personnel.

Also, there are five different codes for estate tax returns, three different codes for gift tax returns (based on total gifts), two codes for Forms 1041, ten different employment tax returns based on the form number, and over 50 different codes for excise taxes based on the type of product or commodity.

Although this section does not indicate which returns are targeted for audit in 2003, statistics from fiscal year 2002 can be used to predict the likelihood of an audit. **Tax returns filed with Schedule C attached are most likely to be audited.** Of the 171 million tax returns filed for fiscal year 2002, there is only a .48% chance of being audited. For returns with Schedule C attached, and total gross receipts (TGR) of less than $25,000, the audit likelihood increases to 2.67%. For TGR of between $25,000 and $100,000, the audit chances are 1.18%. Finally, for TGR of over $100,000, the audit chances are 1.45%.

ENDNOTES

1 Sources:

IRS News Release IR 2003-78 (June 13, 2003)

IRS Fact Sheet 2003-14

IRS Announcement 2003-40

New 2003 Form 8836, *Qualifying Children Residency Statement*

IRS News Release IR 2003-97 (August 5, 2003)

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APPENDIX A — SERVICE CENTERS AND LOCK BOX ADDRESSES

Locations of **Service Centers** and **Lock Boxes** for IRS Forms follows the listing of applicable states.

Connecticut	Massachusetts	Rhode Island
Delaware	Michigan	South Carolina
District of Columbia	New Hampshire	Vermont
Illinois	New Jersey	Virginia
Indiana	New York	West Virginia
Kentucky	North Carolina	Wisconsin
Maine	Ohio	
Maryland	Pennsylvania	

Form 940

Service Center
Cincinnati, OH 45999-0046

Lock Box
P.O. Box 105887
Atlanta, GA 30348-5887

Form 940EZ

Service Center
Cincinnati, OH 45999-0047

Lock Box
P.O. Box 105659
Atlanta, GA 30348-5659

Form 941

Service Center
Cincinnati, OH 45999-0005

Lock Box
P.O. Box 105703
Atlanta, GA 30348-5703

Form 943

Service Center
Cincinnati, OH 45999-0008

Lock Box
P.O. Box 105094
Atlanta, GA 30348-5094

Form 945

Service Center
Cincinnati, OH 45999-0042

Lock Box
P.O. Box 105092
Atlanta, GA 30348-5092

Form 1041

Service Center
Cincinnati, OH 45999-0048

Form 1041ES

Lock Box
P.O. Box 105401
Atlanta, GA 30348-5401

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Form 1065

Service Center
Cincinnati, OH 45999-0011

If the total assets at the end of tax year (Form 1065, page 1, item F) are less than $10 million
or

Service Center
Ogden, UT 84201-0011

If the total assets at the end of tax year (Form 1065, page 1, item F) are $10 million or more

Form 1120

Service Center
Cincinnati, OH 45999-0112

If the total assets at the end of the tax year are less than $10 million
or

Service Center
Ogden, UT 84201-0012

If the total assets at the end of the tax year are $10 million or more

Form 1120A

Service Center
Cincinnati, OH 45999-0112

If the total assets at the end of the tax year are less than $10 million
or

Service Center
Ogden, UT 84201-0012

If the total assets at the end of the tax year are $10 million or more

Form 1120S

Service Center
Cincinnati, OH 45999-0112

If the total assets at the end of the tax year are less than $10 million
or

Service Center
Ogden, UT 84201-0013

If the total assets at the end of the tax year are $10 million or more

Form 2290

Service Center
Cincinnati, OH 45999-0031

Lock Box
P.O. Box 105421
Atlanta, GA 30348-5421

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Alabama	Iowa	North Dakota
Alaska	Kansas	Oklahoma
Arizona	Louisiana	Oregon
Arkansas	Minnesota	South Dakota
California	Mississippi	Tennessee
Colorado	Missouri	Texas
Florida	Montana	Utah
Georgia	Nebraska	Washington
Hawaii	Nevada	Wyoming
Idaho	New Mexico	

Form 940

Service Center
Ogden, UT 84201-0046

Lock Box
P.O. Box 660095
Dallas, TX 75266-0095

Form 940EZ

Service Center
Ogden, UT 84201-0047

Lock Box
P.O. Box 660351
Dallas, TX 75266-0351

Form 941

Service Center
Ogden, UT 84201-0005

Lock Box
P.O. Box 660264
Dallas, TX 75266-0264

Form 943

Service Center
Ogden, UT 84201-0008

Lock Box
P.O. Box 660587
Dallas, TX 75266-0587

Form 945

Service Center
Ogden, UT 84201-0042

Lock Box
P.O. Box 660443
Dallas, TX 75266-0443

Form 2290

Service Center
Cincinnati, OH 45999-0031

Lock Box
P.O. Box 105421
Atlanta, GA 30348-5421

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Form 1041

Service Center
Ogden, UT 84201-0048

1041ES

Lock Box
P.O. Box 105401
Atlanta, GA

Form 1065

Service Center
Ogden, UT 84201-0011

Form 1120

Service Center
Ogden, UT 84201-0012

Form 1120A

Service Center
Ogden, UT 84201-0012

Form 1120S

Service Center
Ogden, UT 84201-0013

Puerto Rico	U.S. Virgin Islands

Form 940

Service Center
Philadelphia, PA 19255-0046

Lock Box
P.O. Box 80105
Cincinnati, OH 45280-0005

Form 940EZ

Service Center
Philadelphia, PA 19255-0047

Lock Box
P.O. Box 80105
Cincinnati, OH 45280-0005

No legal residence or principal place of business in any state

Form 941

Service Center
Philadelphia, PA 19255-0005

Lock Box
P.O. Box 80105
Cincinnati, OH 45280-0006

Form 943

Service Center
Philadelphia, PA 19255-8526

Lock Box
P.O. Box 80107
Cincinnati, OH 45280-0007

Form 945

Service Center
Philadelphia, PA 19255-0042

Lock Box
P.O. Box 80108
Cincinnati, OH 45280-0008

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A foreign country or a U.S. possession

Form 1041

Service Center
Philadelphia, PA 19255-0048

Canada and Mexico

1041ES

Lock Box
P.O. Box 105401
Atlanta, GA 30348-5401

Form 2290

Service Center
Cincinnati, OH 45999-0031

Lock Box
P.O. Box 105421
Atlanta, GA 30348-5421

If the corporation's principal business, office, or agency is located in a foreign country or U.S. possession (or the corporation is claiming the possessions corporation tax credit under sections 30A and 9936)

Form 1120

Service Center
Philadelphia, PA 19255-0012

Form 1120A

Service Center
Philadelphia, PA 19255-0012

Form 1120S

Service Center
Philadelphia, PA 19255-0013

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For all states and territories

Form 5500

Address for filing on paper

PWBA
P.O. Box 7043
Lawrence, KS 66044-7043

Address for filing on floppy disk, CD-ROM, or tape

PWBA
P.O. Box 7041
Lawrence, KS 66044-7041

Address for filing on paper, floppy disk, CD-ROM, or tape

PWBA/NCS
Attn: EFAST
3833 Greenway Drive
Lawrence, KS 66046-1290

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APPENDIX B — 1041 *E-FILE* FORMS AND SCHEDULES

FORMS AND SCHEDULES ACCEPTED IN THE 1041 *E-FILE* PROGRAM

Form 1041, *U.S. Income Tax Return for Estates and Trusts*

Form 1116, *Foreign Tax Credit*

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

Form 2210-F, *Underpayment of Estimated Tax by Farmers and Fishermen*

Form 2439, *Notice to Shareholder of Undistributed Long-Term Capital Gains*

Form 3468, *Investment Credit*

Form 4136, *Credit for Federal Tax Paid on Fuels*

Form 4255, *Recapture of Investment Credit*

Form 4562, *Depreciation and Amortization*

Form 4684, *Casualties and Thefts*

Form 4797, *Sale of Business Property*

Form 4835, *Farm Rental Income and Expenses*

Form 4952, *Investment Interest Expense Deduction*

Form 4970, *Tax on Accumulation Distribution of Trusts*

Form 4972, *Tax on Lump-Sum Distributions*

Form 6198, *At-Risk Limitations*

Form 6252, *Installment Sale Income*

Form 8271, *Investor Reporting of Tax Shelter Registration Number*

Form 8582, *Passive Activity Loss Limitations*

Form 8582-CR, *Passive Activity Credit Limitations*

Form 8801, *Credit for Prior Year Minimum Tax — Individuals and Fiduciaries*

Form 8824, *Like-Kind Exchanges*

Form 8829, *Expenses for Business Use of Your Home*

Schedule C (Form 1040), *Profit or Loss from Business*

Schedule C-EZ (Form 1040), *Net Profit from Business*

Schedule D (Form 1041), *Capital Gains and Losses*

Schedule E (Form 1040), *Supplemental Income and Loss*

Schedule F (Form 1040), *Profit or Loss from Farming*

Schedule H (Form 1040), *Household Employment Taxes*

Schedule J (Form 1041), *Information Return — Trust Allocation of an Accumulation Distribution*

Schedule K-1, *Beneficiary Share of Income, Deductions, Credits, etc.*

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Multiple Copies of Forms

The current 1041 *e-file* program accepts only one electronic transmission of the forms and schedules listed. If more than one of the listed schedules or forms needs to be filed with the 1041 estate or trust return, the entire return must be filed on paper.

Schedule D, *Capital Gains and Losses*

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

Form 2210F, *Underpayment of Estimated Tax by Farmers and Fishermen*

Form 3468, *Investment Credit*

Form 4136, *Credit for Federal Tax Paid on Fuels*

Form 4797, *Sales of Business Property*

Form 4952, *Investment Interest Expense Deduction*

Form 4970, *Tax on Accumulation Distribution of Trusts*

Form 8582, *Passive Activity Loss Limitations*

Form 8582-CR, *Passive Activity Credit Limitations*

Form 8801, *Credit for Prior Year Minimum Tax — Individuals, Estates, and Trusts*

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APPENDIX C — 1065 *E-FILE* FORMS AND SCHEDULES

Forms, Schedules and Statement Records Accepted Electronically for Form 1065

Form 1065, *U.S. Return of Partnership Income*

Schedule A (Form 5713), *International Boycott Factor (Section 999(1))*

Schedule A (Form 8609), *Annual Statement*

Schedule B (Form 5713), *Specifically Attributable Taxes and Income (Section 999)*

Schedule C (Form 5713), *Tax Effect of the International Boycott Provisions*

Schedule D (Form 1065), *Capital Gains and Losses*

Schedule F (Form 1040), *Profit or Loss from Farming*

Schedule J (Form 5471), *Accumulated Earnings and Profits (E&P) of Controlled Foreign Corporation*

Schedule K-1 (Form 1065), *Partner's Share of Income, Credits, Deductions, etc.*

Schedule K-1 (Form 8865), *Partner's Share of Income, Credits, Deductions, etc.*

Schedule M (Form 5471), *Transactions Between Controlled Foreign Corporation and Shareholders or Other Related Persons*

Schedule N (Form 5471), *Return of Officers, Directors, and 10% or More Shareholders of a Foreign Personal Holding Company*

Schedule O (Form 5471), *Organization or Reorganization of Foreign Corporation, and Acquisition and Disposition of its Stock*

Schedule O (Form 8865), *Transfer of Property to a Foreign Partnership*

Schedule P (Form 8865), *Acquisitions and Dispositions of, and Changes in Interest in a Foreign Partnership*

Form 982, *Reduction of Tax Attributes Due to Discharge of Indebtedness and Section 1082 Basis Adjustment*

Form 3468, *Investment Credit*

Form 4255, *Recapture of Investment Credit*

Form 4562, *Depreciation and Amortization*

Form 4684, *Casualties and Theft*

Form 4797, *Sale of Business Property*

Form 5471, *Information Return of U.S. Persons with Respect to Certain Corporations*

Form 5713, *International Boycott Report*

Form 5884, *Work Opportunity Credit*

Form 6252, *Installment Sale Income*

Form 6478, *Credit for Alcohol Used as Fuel*

Form 6765, *Credit for Increasing Research Activities*

Form 6781, *Gains and Losses from Section 1256 Contracts and Straddles*

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Form 8082, *Notice of Inconsistent Treatment of Amended Return*

Form 8271, *Investor Reporting of Tax Shelter*

Form 8275, *Disclosure Statement*

Form 8275-R, *Regulation Disclosure Statement*

Form 8283, *Non-Cash Charitable Contributions*

Form 8308, *Report of a Sale or Exchange of Certain Partnership*

Form 8586, *Low-Income Housing Credit*

Form 8609, *Low-Income Housing Credit Allocation Certification*

Form 8611, *Recapture of Low-Income Housing Credit*

Form 8621, *Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund*

Form 8697, *Interest Computation Under the Look-Back Method for Complete Long-Term Contracts*

Form 8820, *Orphan Drug Credit*

Form 8824, *Like-Kind Exchange*

Form 8825, *Real Estate Income and Expenses of a Partnership or an S Corporation*

Form 8826, *Disable Access Credit*

Form 8830, *Enhanced Oil Recovery Credit*

Form 8832, *Entity Classification Election*

Form 8834, *Qualified Electric Vehicle Credit*

Form 8835, *Renewable Electricity Production Credit*

Form 8844, *Empowerment Zone Employment Credit*

Form 8845, *Indian Employment Credit*

Form 8846, *Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips*

Form 8847, *Credit for Contributions to Selected Community Development Corporations*

Form 8861, *Welfare-to-Work Credit*

Form 8865, *Return of U.S. Persons with Respect to Certain Foreign Partnerships*

Form 8866, *Interest Computations Under the Look-Back Method for Property Depreciated Under the Income Forecast Method*

Statement ("STMbnn"). Statement Records for forms and/or schedules other than Schedule K-1 (Form 1065) or Schedule K-1 (Form 8865), in ascending numeric order.

Schedule K-1 (Form 1065) Statements (STMb99). If applicable, must be transmitted in ascending numeric sequence and immediately follow the Schedule K-1 Record to which they correspond.

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Schedule K-1 (Form 8865) Statements (STM100). If applicable, must be transmitted in ascending numeric sequence and immediately follow the Schedule K-1 Record to which they correspond.

Preparer Note Explanation Record. If applicable, must be transmitted following the Statement Record of the Form 1065 or Form 8865.

Election Explanation Record. If applicable, must be transmitted following the Preparer Note Explanation Record.

Regulatory Explanation Record. If applicable, must be transmitted following the Election Explanation Record or Preparer Note Explanation Record.

Summary Record or Schedule K-1 Summary Record. The final record for each Form 1065 tax return. This record will contain filer identification data, counts of the forms, schedules and statements included with one return.

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APPENDIX D — TOLL-FREE IRS NUMBERS

The IRS Toll-Free Numbers for Refund Inquiries and Business Related Inquiries

The IRS established new Customer Initiated toll-free numbers that were operational on December 2, 2002.

Practitioner Priority Service — 1-866-860-4259

Previously known as the Practitioner Hot-Line, this office accepts calls only from practitioners. It handles calls regarding accounts and procedures. The practitioner must have a valid power of attorney on file.

Refund Hotline — 1-800-829-1954

For Form 1040 individual and joint filers who want to check the status of their current year refund. Additionally, **two automated systems** are available and taxpayers are encouraged to use these systems **before calling** the refund hotline.

The two systems are available 24 hours per day, seven days per week:

- "Where's my Refund?" Internet application at www.irs.gov/
- The automated Tele-Tax System at 1-800-829-4477

Business & Specialty Tax Line — 1-800-829-4933

For small businesses, corporations, partnerships, and trust customers who need information and/or help related to business returns or business accounts. Taxpayers may apply for an Employer Identification Number, and request assistance with Forms 940, 941, 1041, 1065, 1120 S, Returns for Excise, Estate and Gift, and for issues related to Federal Tax Deposits.

Form 1040 Assistance — 1-800-829-1040

For individual and joint filers who need assistance with procedural or tax law information and/or help filing 1040 type individual returns (including Schedules C and E), and for assistance with general account information.

National Taxpayer Advocate — 1-877-777-4778

For taxpayers whose tax problems have not been resolved through normal channels. Taxpayer Advocate Service (TAS) provides an independent system to assure that tax problems are promptly and fairly handled. TAS operates independently of any other IRS office and reports directly to Congress through the National Taxpayer Advocate.

Taxpayer Advocacy Panel — 1-888-912-1227

For citizens who want to provide ideas and suggestions on how to improve IRS services or who want to make recommendations for improvement of IRS systems and procedures.

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Tele-Tax System — 1-800-829-4477

For individuals who need to check the status of their current year refund or who want to listen to recorded tax information. Available 24 hours per day, 7 days per week.

TDD Line — 1-800-829-4059

For hearing impaired taxpayers who need tax law and/or procedural information relating to filing their returns or who need information and/or assistance relating to their accounts.

Forms and Publications — 1-800-829-3676

For individuals, businesses, and tax practitioners who need IRS tax forms, instructions, and related materials and tax publications.

Tax Exempt/Government Entity — 1-877-829-5500

For taxpayers who need tax information or assistance relating to Tax Exempt or Government Entities, Tax Exempt Bonds, Employer/Employee Pension Plans, or Indian Tribal Agreements.

EFTPS — 1-800-945-8400 or 1-800-555-4477

For taxpayers who want to pay business or individual taxes through electronic funds transfer. The EFTPS toll-free numbers can provide callers with EFTPS enrollment forms, instructions, and customer assistance.

Extension to File Tele-File System — 1-888-796-1074

For individual filers who want to submit an Extension to file for a 1040-series return via telephone.

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APPENDIX E — FORM 1040, 1913

TO BE FILLED IN BY COLLECTOR.

List. No. .....

..... *District of* .....

Date received .....

Form 1040.

INCOME TAX.

THE PENALTY
FOR FAILURE TO HAVE THIS RETURN IN THE HANDS OF THE COLLECTOR OF INTERNAL REVENUE ON OR BEFORE MARCH 1 IS $20 TO $1,000.
(SEE INSTRUCTIONS ON PAGE 4.)

TO BE FILLED IN BY INTERNAL REVENUE BUREAU.

File No. .....

Assessment List .....

Page ..... *Line* .....

UNITED STATES INTERNAL REVENUE.

RETURN OF ANNUAL NET INCOME OF INDIVIDUALS.

(As provided by Act of Congress, approved October 3, 1913.)

RETURN OF NET INCOME RECEIVED OR ACCRUED DURING THE YEAR ENDED DECEMBER 31, 191 ....

(FOR THE YEAR 1913, FROM MARCH 1, TO DECEMBER 31.)

Filed by (or for) ..... (Full name of individual.) *of* ..... (Street and No.)

in the City, Town, or Post Office of ..... *State of* .....

(Fill in pages 2 and 3 before making entries below.)

1. GROSS INCOME (see page 2, line 12)		$
2. GENERAL DEDUCTIONS (see page 3, line 7)		$
3. NET INCOME		$
Deductions and exemptions allowed in computing income subject to the normal tax of 1 per cent.		
4. Dividends and net earnings received or accrued, of corporations, etc., subject to like tax. (See page 2, line 11) . . .	$	
5. Amount of income on which the normal tax has been deducted and withheld at the source. (See page 2, line 9, column A)		
6. Specific exemption of $3,000 or $4,000, as the case may be. (See Instructions 3 and 19)		
Total deductions and exemptions. (Items 4, 5, and 6)		$
7. TAXABLE INCOME on which the normal tax of 1 per cent is to be calculated. (See Instruction 3) .		$

8. When the net income shown above on line 3 exceeds $20,000, the additional tax thereon must be calculated as per schedule below:

	INCOME.	TAX.
1 per cent on amount over $20,000 and not exceeding $50,000 . .	$	$
2 " " 50,000 " " 75,000 . .		
3 " " 75,000 " " 100,000 . .		
4 " " 100,000 " " 250,000 . .		
5 " " 250,000 " " 500,000 . .		
6 " " 500,000		
Total additional or super tax		$
Total normal tax (1 per cent of amount entered on line 7) . .		$
Total tax liability		$

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GROSS INCOME.

This statement must show in the proper spaces the entire amount of gains, profits, and income received by or accrued to the individual from all sources during the year specified on page 1.

DESCRIPTION OF INCOME.	A. Amount of income on which tax has been deducted and withheld at the source.	B. Amount of income on which tax has NOT been deducted and withheld at the source.
1. Total amount derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid	$	$
2. Total amount derived from professions, vocations, businesses, trade, commerce, or sales or dealings in property, whether real or personal, growing out of the ownership or use of interest in real or personal property, including bonds, stocks, etc.		
3. Total amount derived from rents and from interest on notes, mortgages, and securities (other than reported on lines 5 and 6)		
4. Total amount of gains and profits derived from partnership business, whether the same be divided and distributed or not		
5. Total amount of fixed and determinable annual gains, profits, and income derived from interest upon bonds and mortgages or deeds of trust, or other similar obligations of corporations, joint-stock companies or associations, and insurance companies, whether payable annually or at shorter or longer periods		
6. Total amount of income derived from coupons, checks, or bills of exchange for or in payment of interest upon bonds issued in *foreign countries* and upon *foreign mortgages* or like obligations (not payable in the United States), and also from coupons, checks, or bills of exchange for or in payment of any dividends upon the stock or interest upon the obligations of foreign corporations, associations, and insurance companies engaged in business in foreign countries		
7. Total amount of income received from fiduciaries		
8. Total amount of income derived from any source whatever, not specified or entered elsewhere on this page		
9. TOTALS		
NOTES.—Enter total of Column A on line 5 of first page.		
10. AGGREGATE TOTALS OF COLUMNS A AND B		$
11. Total amount of income derived from dividends on the stock or from the net earnings of corporations, joint-stock companies, associations, or insurance companies subject to like tax (To be entered on line 4 of first page.)		$
12. TOTAL **"Gross Income"** (to be entered on line 1 of first page)		$

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GENERAL DEDUCTIONS.

1.	The amount of necessary expenses actually paid in carrying on business, but not including business expenses of partnerships, and not including personal, living, or family expenses .	$			
2.	All interest paid within the year on personal indebtedness of taxpayer				
3.	All national, State, county, school, and municipal taxes paid within the year (not including those assessed against local benefits)				
4.	Losses actually sustained during the year incurred in trade or arising from fires, storms, or shipwreck, and not compensated for by insurance or otherwise				
5.	Debts due which have been actually ascertained to be worthless and which have been charged off within the year				
6.	Amount representing a reasonable allowance for the exhaustion, wear, and tear of property arising out of its use or employment in the business, not to exceed, in the case of mines, 5 per cent of the gross value at the mine of the output for the year for which the computation is made, but no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof, for which an allowance is or has been made . . .				
7.	Total "GENERAL DEDUCTIONS" (to be entered on line 2 of first page)				

AFFIDAVIT TO BE EXECUTED BY INDIVIDUAL MAKING HIS OWN RETURN.

I solemnly swear (or affirm) that the foregoing return, to the best of my knowledge and belief, contains a true and complete statement of all gains, profits, and income received by or accrued to me during the year for which the return is made, and that I am entitled to all the deductions and exemptions entered or claimed therein, under the Federal Income-tax Law of October 3, 1913.

Sworn to and subscribed before me this .....

day of ..... , 191

..... (Signature of individual.)

SEAL OF OFFICER TAKING AFFIDAVIT.

.....

..... (Official capacity.)

AFFIDAVIT TO BE EXECUTED BY DULY AUTHORIZED AGENT MAKING RETURN FOR INDIVIDUAL.

I solemnly swear (or affirm) that I have sufficient knowledge of the affairs and property of ..... to enable me to make a full and complete return thereof, and that the foregoing return, to the best of my knowledge and belief, contains a true and complete statement of all gains, profits, and income received by or accrued to said individual during the year for which the return is made, and that the said individual is entitled, under the Federal Income-tax Law of October 3, 1913, to all the deductions and exemptions entered or claimed therein.

Sworn to and subscribed before me this .....

day of ..... , 191

..... (Signature of agent.)

ADDRESS IN FULL .....

.....

SEAL OF OFFICER TAKING AFFIDAVIT.

.....

..... (Official capacity.)

[SEE INSTRUCTIONS ON BACK OF THIS PAGE.]

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INSTRUCTIONS.

1. This return shall be made by every citizen of the United States, whether residing at home or abroad, and by every person residing in the United States, though not a citizen thereof, having a *net income* of $3,000 or over for the taxable year, and *also* by every *nonresident alien* deriving income from property owned and business, trade, or profession carried on *in the United States* by him.

2. When an individual by reason of minority, sickness or other disability, or absence from the United States, is unable to make his own return, it may be made for him by his *duly authorized* representative.

3. The *normaI tax* of 1 per cent shall be assessed on the total net income less the specific exemption of $3,000 or $4,000 as the case may be. (For the year 1913, the specific exemption allowable is $2,500 or $3,333.33, as the case may be.) If, however, the normal tax has been deducted and withheld on any part of the income at the source, or if any part of the income is received as dividends upon the stock or from the net earnings of any corporation, etc., which is taxable upon its net income, such income shall be deducted from the individual's total *net income* for the purpose of calculating the amount of income on which the individual is liable for the normal tax of 1 per cent by virtue of this return. (See page 1, line 7.)

4. The *additional or super tax* shall be calculated as stated on page 1.

5. This return shall be filed with the Collector of Internal Revenue for the district in which the individual resides if he has no other place of business, otherwise in the district in which he has his *principal place of business;* or in case the person resides in a foreign country, then with the collector for the district in which his principal business is carried on in the United States.

6. This return must be filed on or before the first day of March succeeding the close of the calendar year for which return is made.

7. The *penalty for failure to file the return within the time specified by law* is $20 to $1,000. In case of refusal or neglect to render the return within the required time (except in cases of sickness or absence), 50 per cent shall be added to amount of tax assessed. In case of *false or fraudulent return,* 100 per cent shall be added to such tax, and any person required by law to make, render, sign, or verify any return who makes any false or fraudulent return or statement with intent to defeat or evade the assessment required by this section to be made shall be guilty of a misdemeanor, and shall be fined not exceeding $2,000 or be imprisoned not exceeding one year, or both, at the discretion of the court, with the costs of prosecution.

8. When the return is not filed within the required time by reason of sickness or absence of the individual, an extension of time, not exceeding 30 days from March 1, within which to file such return, *may be* granted by the collector, *provided* an application therefor is made by the individual within the period for which such extension is desired.

9. This return properly filled out must be made under oath or affirmation. Affidavits may be made before any officer *authorized by law* to administer oaths. If before a justice of the peace or magistrate; not using a seal, a *certificate of the clerk of the court as to the authority* of such officer to administer oaths should be *attached to the return.*

10. Expense for medical attendance, store accounts, family supplies, wages of domestic servants, cost of board, room, or house rent for family or personal use, *are not expenses that can be deducted from gross income.* In case an individual owns his own residence he can not deduct the estimated value of his rent, neither shall he be required to include such estimated rental of his home as income.

11. The farmer, in computing the net income from his farm for his annual return, shall include all moneys received for produce and animals sold, and for the wool and hides of animals slaughtered, provided such wool and hides are sold, and he shall deduct therefrom the sums actually paid as purchase money for the animals sold or slaughtered during the year.

When animals were raised by the owner and are sold or slaughtered he shall not deduct their value as expenses or loss. He may deduct the amount of money actually paid as expense for producing any farm products, live stock, etc. In deducting expenses for repairs on farm property the amount deducted must not exceed the amount actually expended for such repairs during the year for which the return is made. (See page 3, item 6.) The cost of replacing tools or machinery is a deductible expense to the extent that the cost of the new articles does not exceed the value of the old.

12. In calculating losses, only such losses as shall have been actually sustained and the amount of which has been definitely ascertained during the year covered by the return can be deducted.

13. Persons receiving fees or emoluments for professional or other services, as in the case of physicians or lawyers, should include all actual receipts for services rendered in the year for which return is made, together with all unpaid accounts, charges for services, or contingent income due for that year, if good and collectible.

14. Debts which were contracted during the year for which return is made, but found in said year to be worthless, may be deducted from gross income for said year, but such debts can not be regarded as worthless until after legal proceedings to recover the same have proved fruitless, or it clearly appears that the debtor is insolvent. If debts contracted prior to the year for which return is made were included as income in return for year in which said debts were contracted, and such debts shall subsequently prove to be worthless, they may be deducted under the head of losses in the return for the year in which such debts were charged off as worthless.

15. Amounts due or accrued to the individual members of a partnership from the net earnings of the partnership, whether apportioned and distributed or not, shall be included in the annual return of the individual.

16. United States pensions shall be included as income.

17. Estimated advance in value of real estate is not required to be reported as income, unless the increased value is taken up on the books of the individual as an increase of assets.

18. Costs of suits and other legal proceedings arising from ordinary business may be treated as an expense of such business, and may be deducted from gross income for the year in which such costs were paid.

19. An unmarried individual or a married individual not living with wife or husband shall be allowed an exemption of $3,000. When husband and wife live together they shall be allowed jointly a total exemption of only $4,000 on their aggregate income. They may make a joint return, both subscribing thereto, or if they have separate incomes, they may make separate returns; but in no case shall they jointly claim more than $4,000 exemption on their aggregate income.

20. In computing net income there shall be excluded the compensation of all officers and employees of a State or any political subdivision thereof, except when such compensation is paid by the United States Government.

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