

Chapter 2: IRS Update

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Corrections were made to this workbook through January of 2011. No subsequent modifications were made.

Most of the information contained in this chapter is derived from information found on the IRS website at www.irs.gov.

E-FILE UPDATE

As the IRS promotes more e-filing and requires most tax preparers to e-file beginning with 2010 returns, there is information the tax professional needs to know. Returns containing Form 5405, *First Time Homebuyer Credit and Repayment of the Credit*, cannot be electronically filed.

Note. Please see Chapter 12, New Legislation, for the rules about mandatory e-filing.

FORMS REQUIRING A SIGNATURE

A common question is: "How does a preparer e-file a tax return that has a form requiring the signature of the taxpayer?" The preparer may now be required to file a return requiring a signature electronically. The IRS reinvented Form 8453, *U.S. Individual Income Tax Transmittal for an IRS e-file Return*, to address this situation.

Prior to 2007, Form 8453 had to be signed and mailed to the IRS for any return that was electronically filed if the taxpayer did not use a self-selected personal identification number (PIN). Beginning with 2007 returns, the taxpayer was required to use a PIN or file the return by mail. The IRS redesigned Form 8453 in order to allow it to be used as a transmittal form for any tax return attachment or form requiring a signature.

Form 8453 can only be used to transmit certain forms (listed on the front page of the form). These include:

- Appendix A, *Statement by Taxpayer Using the Procedures in Rev. Proc. 2009-20 to Determine a Theft Loss Deduction Related to a Fraudulent Investment Arrangement*
- Form 1098-C, *Contributions of Motor Vehicles, Boats, and Airplanes* (or equivalent contemporaneous written acknowledgement)
- Form 2848, *Power of Attorney and Declaration of Representative* (or POA that states the agent is granted authority to sign the return)
- Form 3115, *Application for Change in Accounting Method*

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- Form 3468, *Investment Credit* (attach a copy of the first page of National Park Service Form 10-168a, *Historic Preservation Certification Application*, Part 2, with an indication that it was received by the Department of the Interior or the State Historic Preservation Officer, together with proof that the building is a certified historic structure or that such status was requested)
- Form 4136, *Credit for Federal Tax Paid on Fuels* (attach the certificate for biodiesel and, if applicable, statement of biodiesel reseller or a certificate from the provider identifying the product as renewable diesel and, if applicable, a statement from the reseller)
- Form 5713, *International Boycott Report*
- Form 8283, *Noncash Charitable Contributions*, Section A (if any statement or qualified appraisal is required) or Section B and any related attachments (including any qualified appraisal or partnership Form 8283)
- Form 8332, *Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent* (or certain pages from a divorce decree or separation agreement that went into effect after 1984 and before 2009)
- Form 8858, *Information Return of U.S. Persons With Respect to Foreign Disregarded Entities*
- Form 8885, *Health Coverage Tax Credit*, and all required attachments
- Form 1040, Schedule D-1, *Continuation Sheet for Schedule D* (or a statement with the same information), if electing not to include transactions on the electronic short-term capital gain (loss) or long-term capital gain (loss) records

The most frequent use of Form 8453 by a tax preparer is to transmit the information of a taxpayer whose divorce or separation agreement went into effect after 1984 and before 2009. These taxpayers were exempt from filing Form 8332, *Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent*, if they attached certain pages of the decree or agreement. However, the decree is required to give the years for which the claim is released and state all of the following:

1. The noncustodial parent can claim the child as a dependent without regard to any condition (such as payment of support).
2. The other parent will not claim the child as a dependent.
3. The years for which the claim is released.

The noncustodial parent must then attach all of the following pages from the decree or agreement:

1. Cover page (including the other parent's SSN on that page)
2. The pages that include all the information identified in (1) through (3) above
3. Signature page with the other parent's signature and date of agreement

Note. The noncustodial parent must attach the required information even if it was filed with a return in any prior year.

The Form 8453 is mailed to:

Internal Revenue Service
Attn: Shipping and Receiving, 0254
Receipt and Control Branch
Austin, TX 73344-0254

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No payments may be attached to Form 8453. If a payment is required, it is sent to the IRS with Form 1040-V, *Payment Voucher*.

Form 8453 must be mailed to the IRS within three business days of receiving acknowledgement that the IRS has accepted the electronically-filed tax return.

Example 1. Roberto Taxpayer's divorce was finalized in 1997. The divorce decree gave him the conditional exemption for his two children. Roberto meets all of the qualifications to claim the children as the noncustodial parent. Therefore, he files Form 8453 and attaches Form 8332.

Declaration Control Number (DCN)		00- - - - -0		IRS Use Only—Do not write or staple in this space.	
Form 8453 Department of the Treasury Internal Revenue Service		U.S. Individual Income Tax Transmittal for an IRS e-file Return For the year January 1–December 31, 2009 ▶ See instructions on back.		OMB No. 1545-0074 2009	
Use the IRS label. Otherwise, please print or type.	L A B E L H E R E	Your first name and initial ROBERTO		Last name TAXPAYER	
	If a joint return, spouse's first name and initial		Last name		Your social security number 111 : 11 : 1111
	Home address (number and street). If you have a P.O. box, see instructions. 27 EAST DOWNS STREET		Apt. no.		Important! You must enter your SSN(s) above.
	City, town or post office, state, and ZIP code ANYTOWN IA 55555				

**FILE THIS FORM ONLY IF YOU ARE ATTACHING ONE OR MORE
OF THE FOLLOWING FORMS OR SUPPORTING DOCUMENTS.**

Check the applicable box(es) to identify the attachments.

- ☐ Appendix A, Statement by Taxpayer Using the Procedures in Rev. Proc. 2009-20 to Determine a Theft Loss Deduction Related to a Fraudulent Investment Arrangement
- ☐ Form 1098-C, Contributions of Motor Vehicles, Boats, and Airplanes (or equivalent contemporaneous written acknowledgement)
- ☐ Form 2848, Power of Attorney and Declaration of Representative (or POA that states the agent is granted authority to sign the return)
- ☐ Form 3115, Application for Change in Accounting Method
- ☐ Form 3468 - attach a copy of the first page of NPS Form 10-168a, Historic Preservation Certification Application (Part 2—Description of Rehabilitation), with an indication that it was received by the Department of the Interior or the State Historic Preservation Officer, together with proof that the building is a certified historic structure (or that such status has been requested)
- ☐ Form 4136 - attach the Certificate for Biodiesel and, if applicable, Statement of Biodiesel Reseller or a certificate from the provider identifying the product as renewable diesel and, if applicable, a statement from the reseller
- ☐ Form 5713, International Boycott Report
- ☐ Form 8283, Noncash Charitable Contributions, Section A, (if any statement or qualified appraisal is required) or Section B, Donated Property, and any related attachments (including any qualified appraisal or partnership Form 8283)
- ☒ Form 8332, Release / Revocation of Release of Claim to Exemption for Child by Custodial Parent (or certain pages from a divorce decree or separation agreement, that went into effect after 1984 and before 2009) (see instructions)

Note. State income tax rules may be different regarding the submission of paper documents. The tax preparer must comply with the state rules.

MODERNIZED E-FILE UPDATE

The modernized e-File (MeF) system became available for certain Form 1040 returns on February 17, 2010.

The MeF system replaces the current IRS tax return filing technology with a modernized, Internet-based electronic filing platform. This transaction-based system allows tax return originators to transmit returns electronically to the IRS in real-time, which improves turnaround times.

The IRS plans to roll out 1040 MeF using a 3-phase strategy over three years:

1. The first phase of 1040 MeF occurred on February 17, 2010, and includes Form 1040, Form 4868, and 21 forms and schedules associated with Form 1040. The complete list is found on the IRS website.
2. The second phase of 1040 MeF will occur in January 2011. It will include the same forms as the first release. It will also involve additional hardware and code optimization.
3. The third phase of 1040 MeF will occur in January 2012. It will include the remaining forms filed under the current individual e-file program.

Currently, MeF is successfully processing electronically-filed tax returns for individuals, corporations, partnerships, excise tax filers, and exempt organizations. It provides real-time processing of tax returns and extensions. It improves error-detection, standardizes business rules and makes them easier to understand, and expedites acknowledgements. MeF also allows users to attach PDF files. MeF supports the following forms:

- 1040 (individuals)
- 1120, 1120S, 1120-F (corporations)
- 990, 990-EZ, 990-PF, 1120-POL, 990-N, 990 Redesign (exempt organizations)
- 1065, 1065-B (partnerships)
- 2290, 720, 8849 (excise tax)
- 4868, 7004, 8868 (extensions)

In 2008, the number of tax returns filed through MeF increased 49% over the previous year to more than 3 million accepted returns.

ADVANTAGES FOR PRACTITIONERS

MeF delivers significant value and benefits to practitioners beyond the capabilities of the legacy system.

Faster Acknowledgements. The IRS's goal is to provide a response time of approximately five minutes to the transmitter in nonpeak periods. MeF returns are processed as they are received instead of being delayed for batch processing as in the legacy program. This enhances customer service by allowing preparers to fix return issues in real-time. It is important for tax practitioners to discuss the response time they will experience with their transmitters.

Specific Explanation of Errors. Under the legacy program, one error code may apply to multiple types of e-file errors. MeF error codes use simple wording to clarify each error that triggers a rejection.

Improved Processing. Form 1040 and any attachments are submitted electronically to MeF in XML format. This allows for more effective use of data. MeF also allows attachments in PDF to accommodate late-legislation and form changes.

Prior-Year Returns. Practitioners should talk with their transmitter to determine which prior-year returns will be accepted by MeF.

IMPACT ON PRACTITIONERS

MeF will not change the way e-file returns are transmitted. Practitioners may not even know that the return was an MeF return, although a rapid acknowledgement verifies this. In most cases, the returns are sent to a transmitter, who then sends the returns to the IRS. Practitioners should discuss MeF with software development companies, especially about handling error codes. They should find out specifically what the provider is offering. Practitioners should learn whether their provider supports MeF, how the provider handles acknowledgements and error codes, and whether they support PDF files.

NEXT STEPS

MeF will offer clear advantages to practitioners once it becomes fully operational. The IRS established the 1040 MeF website at www.irs.gov/efile/content/0,,id=171945,00.html to keep practitioners updated on the status and changes with 1040 MeF, including deployment dates, tax practitioner working group minutes, and other information. Practitioners can also email 1040MeF@irs.gov for additional information and help with 1040 MeF.

ATTACHMENTS TO RETURN

Some forms require an attachment. While this was a problem under the legacy system because the practitioner had to file a Form 8453, MeF allows a PDF file to be attached to the return. **However, the IRS requests the filer give the PDF form a specific name.** The IRS has a website for recommended names and descriptions of PDF files at www.irs.gov/efile/article/0,,id=215188,00.html. A partial list of file names is shown in the following table.

Form/Schedule	Source or Comment	PDF File Name (limited to 64 characters)	Description of PDF Attachment
Schedule A (Form 1040)	Instructions for Schedules A (Form 1040), Page A-5, Other Than by Cash or Check.	MotorVehicleBoatAirplane ContribuionExcessOf500.pdf	Motor vehicle, boat or airplane contribution in excess of \$500.
Schedule D (Form 1040)	Instructions for Schedule D (Form 1040), page D-6, Specific Instructions Lines 1 and 8	ScheduleDContinuationStatement.pdf	Schedule D Continuation Statement
Schedule D (Form 1040)	Publication 550, "Sales of Stock to ESOPs or Certain Cooperatives", "How to report and postpone gain"	QualifiedReplacementProperty PurchaseStatement.pdf	Qualified Replacement Property Purchase Statement
Schedule D (Form 1040)	Publication 550, "Sales of Stock to ESOPs or Certain Cooperatives", "How to report and postpone gain"	ESOPOrCoopStockPurchaseConsent.pdf	ESOP or Coop Stock Purchase Consent

Note. Not all tax software companies have the ability to attach a PDF file to an e-filed return. Tax practitioners are cautioned to check with their software vendor to see what services they provide.

E-FILE SIGNATURE AUTHORIZATIONS

IRS e-file signature authorization forms must be completed and signed by the taxpayer before the return or the extension is transmitted to the IRS.

The taxpayer has the following responsibilities before signing either Form 8879, *IRS e-file Signature Authorization*, or Form 8878, *IRS e-file Signature Authorization for Form 4868 or Form 2350*:

1. Verify the accuracy of the prepared application for extension of time to file.
2. Check the appropriate box in Part II to authorize the electronic return originator (ERO) to enter or generate the taxpayer's PIN or to provide one themselves.
3. Indicate or verify their PIN when authorizing the ERO to enter or generate it (the PIN must be five numbers other than all zeros).
4. Sign and date Form 8879 or Form 8878.
5. Return the completed form to the ERO by hand delivery, U.S. mail, private delivery service, fax, email, or an Internet website.

Form 8878, *IRS e-file Signature Authorization for Form 4868 or Form 2350*

Form 8878 is not an application for an extension of time to file. Taxpayers must file the appropriate application for extension of time to file (Form 4868 or Form 2350). Form 8878 is used when a Form 4868 is being filed using the practitioner PIN method or when the taxpayer authorizes the ERO to enter or generate the taxpayer's PIN on Form 4868 or Form 2350.

Form **8878**
Department of the Treasury
Internal Revenue Service

**IRS e-file Signature Authorization for
Form 4868 or Form 2350**

▶ Do not send to the IRS. This is not an application for an extension of time to file.
▶ Keep this form for your records. See instructions.

OMB No. 1545-0074

2010**2**

Declaration Control Number (DCN) ▶

Taxpayer's name

Social security number

Spouse's name

Spouse's social security number

Part I Information from Extension Form—Tax Year Ending December 31, 2010 (Whole Dollars Only)

Check the box and complete the line(s) for the form you authorize your ERO to sign and file. Check only one box.

- 1** ☐ **Form 4868**, Application for Automatic Extension of Time To File U.S. Individual Income Tax Return
Amount you are paying from Form 4868, line 7 **1** _____
- 2** ☐ **Form 2350**, Application for Extension of Time To File U.S. Income Tax Return
- a** I request an extension of time until this date as shown on Form 2350, line 1 **2a** _____
- b** Amount you are paying from Form 2350, line 5 **2b** _____

Part II Taxpayer Declaration and Signature Authorization

Under penalties of perjury, I declare that I have examined a copy of my electronic application for extension of time to file for the tax year ending December 31, 2010, and to the best of my knowledge and belief, it is true, correct, and complete. I further declare that the information listed above is the information from my electronic application for extension of time to file. I consent to allow my intermediate service provider, transmitter, or electronic return originator (ERO) to send this form to the IRS and to receive from the IRS (a) an acknowledgement of receipt or reason for rejection of the transmission and (b) the reason for any delay in processing the form. If applicable, I authorize the U.S. Treasury and its designated Financial Agent to initiate an ACH electronic funds withdrawal (direct debit) entry to the financial institution account indicated in the tax preparation software for payment of my Federal taxes, and the financial institution to debit the entry to this account. This authorization is to remain in full force and effect until I notify the U.S. Treasury Financial Agent to terminate the authorization. To revoke a payment, I must contact the U.S. Treasury Financial Agent at 1-888-353-4537 no later than 2 business days prior to the payment (settlement) date. I also authorize the financial institutions involved in the processing of the electronic payment of taxes to receive confidential information necessary to answer inquiries and resolve issues related to the payment. I further acknowledge that the personal identification number (PIN) below is my signature for my electronic application for extension of time to file and, if applicable, my Electronic Funds Withdrawal Consent.

Taxpayer's PIN: check one box only

- ☐ I authorize _____ to enter or generate my PIN as
ERO firm name
Enter five numbers, but do not enter all zeros

my signature for my electronic application for extension of time to file for the tax year ending December 31, 2010.

- ☐ I will enter my PIN as my signature for my electronic application for extension of time to file for the tax year ending December 31, 2010. Check this box **only** if you are entering your own PIN **and** your extension form is filed using the Practitioner PIN method. The ERO must complete Part III below.

Your signature ▶ _____ Date ▶ _____

Spouse's PIN: check one box only

- ☐ I authorize _____ to enter or generate my PIN as
ERO firm name
Enter five numbers, but do not enter all zeros

my signature for my electronic application for extension of time to file for the tax year ending December 31, 2010.

- ☐ I will enter my PIN as my signature for my electronic application for extension of time to file for the tax year ending December 31, 2010. Check this box **only** if you are entering your own PIN **and** your extension form is filed using the Practitioner PIN method. The ERO must complete Part III below.

Spouse's signature ▶ _____ Date ▶ _____

Practitioner PIN Method for Form 4868 Only—continue below**Part III Certification and Authentication—Practitioner PIN Method for Form 4868 Only**

ERO's EFIN/PIN. Enter your six-digit EFIN followed by your five-digit self-selected PIN.

do not enter all zeros

I certify that the above numeric entry is my PIN, which is my signature to authorize submission of the electronic **Form 4868** and electronic funds withdrawal for the taxpayer(s) indicated above. I confirm that I am submitting **Form 4868** in accordance with the requirements of the Practitioner PIN method and **Publication 1345**, Handbook for Authorized IRS e-file Providers of Individual Income Tax Returns.

ERO's signature ▶ _____

Date ▶ _____

ERO Must Retain This Form — See Instructions**Do Not Submit This Form to the IRS Unless Requested To Do So**

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 32777M

Form **8878** (2010)

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The following table shows when and how to complete Form 8878:

IF e-filing . . .	THEN . . .
<ul style="list-style-type: none"> • Form 4868, and • Authorizing an electronic funds withdrawal, and • The taxpayer is entering his or her own PIN, and • The ERO is not using the Practitioner PIN method. 	Do not complete Form 8878.
<ul style="list-style-type: none"> • Form 4868, and • The taxpayer is not authorizing an electronic funds withdrawal. 	Do not complete Form 8878.
<ul style="list-style-type: none"> • Form 4868, and • Authorizing an electronic funds withdrawal, and • The ERO is using the Practitioner PIN method. 	Complete Form 8878, Parts I, II, and III.
<ul style="list-style-type: none"> • Form 4868, and • Authorizing an electronic funds withdrawal, and • Authorizing the ERO to enter or generate the taxpayer's PIN, and • The ERO is not using the Practitioner PIN method. 	Complete Form 8878, Parts I and II.
<ul style="list-style-type: none"> • Form 2350 	Complete Form 8878, Parts I and II only if the taxpayer authorizes the ERO to enter or generate the taxpayer's PIN.

Form 8879, *IRS e-file Signature Authorization*

Form 8879 is the declaration document and signature authorization for an e-filed return filed by an ERO. Form 8879 is completed when the practitioner PIN method is used or when the taxpayer authorizes the ERO to enter or generate the taxpayer's PIN on the e-filed individual income tax return.

The following table shows when and how to complete Form 8879.

IF the ERO is . . .	THEN . . .
Not using the Practitioner PIN method and the taxpayer enters his or her own PIN	Do not complete Form 8879.
Using the Practitioner PIN method and is authorized to enter or generate the taxpayer's PIN	Complete Form 8879, Parts I, II, and III.
Using the Practitioner PIN method and the taxpayer enters his or her own PIN	Complete Form 8879, Parts I, II, and III.
Not using the Practitioner PIN method and is authorized to enter or generate the taxpayer's PIN	Complete Form 8879, Parts I and II.

Forms 8878 and 8879 are **not** sent to the IRS. They should be retained by the preparer for three years from the due date of the return or the received date.

These forms should also be retained by the ERO in accordance with the form instructions.

E-PAY

Many taxpayers electronically file their returns in order to get a faster refund. However, when they owe income tax, they may be less likely to e-file. Even if they e-file a balance due return, they often send payment to the IRS by mail using Form 1040-V. In its attempt to further reduce paperwork, the IRS has four options taxpayers can use to electronically pay their federal income tax liability:

- Electronic funds withdrawal (EFW)
- Credit card
- Debit card
- Electronic federal tax payment system (EFTPS)

ELECTRONIC FUNDS WITHDRAWAL AND CREDIT OR DEBIT CARD PAYMENT OPTIONS FOR INDIVIDUALS

Taxpayers who file electronically using IRS e-file can pay electronically in a single step by authorizing an electronic funds withdrawal or by credit or debit card. This is referred to as integrated e-file and e-pay.

For paper-filed returns, taxpayers can pay by phone or Internet using a credit or debit card.

The table on the following page shows the types of individual taxes can be paid by electronic funds withdrawal or credit or debit card.

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Tax Type	Electronic Funds Withdrawal Payment Option	Credit or Debit Card Payment Option
Form 1040 series U.S. Individual Income Tax Return (current year)	E-file Form 1040 series tax return and simultaneously e-pay via tax preparation software or a tax professional.	E-file Form 1040 series tax return and simultaneously e-pay via tax preparation software or a tax professional. <hr/> E-file (or paper-file) tax return and e-pay by phone or Internet through a service provider.
Form 1040 series U.S. Individual Income Tax Return (Past Due) and related Notices (Tax Year 2000 and after)	Not applicable	E-pay by phone or Internet through a service provider (for taxpayers without an active installment agreement).
Form 1040 advance payment of a determined deficiency - audit adjustment or under reporter notice (Tax Year 2007 and after)	Not applicable	E-pay by phone or Internet through a service provider.
Form 1040-ES , Estimated Tax for Individuals	E-file Form 1040 series tax return and simultaneously e-pay up to four Form 1040-ES payments via tax preparation software or a tax professional. (See below for more detail.)	E-pay by phone or Internet through a service provider and, by doing so, simultaneously file Form 1040-ES.
Form 1040X, Amended U.S. Individual Income Tax Return (Tax Year 2006 and after)	Not applicable	E-pay by phone or Internet through a service provider.
Form 2350 , Application for Extension of Time to File U.S. Income Tax Return (current year)	E-file Form 2350 electronically and simultaneously e-pay via tax preparation software or a tax professional.	Not applicable
Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return (current year)	E-file Form 4868 electronically and simultaneously e-pay via tax preparation software or a tax professional.	E-pay by phone or Internet through a service provider and receive an extension of time to file.
Form 5329, Additional Taxes on Qualified Plans (including IRAs) and Other Tax-Favored Accounts (current year)	Not applicable	E-pay by phone or Internet through a service provider.
Installment Agreements, (Tax Year 2000 and after)	Not applicable	E-pay by phone or Internet through a service provider (for taxpayers with an active installment agreement). A recurring payment option is available to Internet users.
Trust Fund Recovery Penalty (Tax Year 2000 and after)	Not applicable	E-pay by phone or Internet through a service provider.

Credit or debit card payments should be in dollars and cents. The minimum payment is \$1.

Electronic funds withdrawal payments may be in whole dollars or dollars and cents, depending on the software package used. The amount of the tax payment may include penalty and/or interest. Some software packages will compute these amounts; and if not, they can be manually computed. A taxpayer can also choose to wait and be billed for any applicable penalty and/or interest owed.

Making an electronic payment eliminates the need to submit an associated payment voucher such as Form 1040-V.

Convenience fees are charged by many service providers. The fee is a deductible business or individual expense. For an individual expense, taxpayers may deduct the fee as a miscellaneous itemized deduction on Form 1040, Schedule A, subject to the 2% of AGI limit.

When Can Electronic Funds Withdrawal and Credit or Debit Card Payments Be Made?

Paying by phone or using Internet credit or debit card options are available year round. Most integrated e-file and e-pay options begin on January 15 and end on October 15.

However, please note the exceptions below:

1. For integrated e-file and e-pay using the MeF program, the option for the 2010 filing season began on February 16, 2010, and ends in late December 2010.
2. For Form 2350 and Form 4868, the option ends on the return due date (April 15, 2010) for domestic returns, and June 15, 2010, for foreign returns filed by taxpayers who are out of the country.
3. When Form 1040-ES is submitted via EFW, up to four estimated tax payments can be scheduled for the quarterly due dates noted below. A separate payment record is required for each payment. The bank account information can be the same or different for each payment record submitted.
 - April 15, 2010
 - June 15, 2010
 - September 15, 2010
 - January 18, 2011 (can be scheduled on or after January 18, 2010)

Note. When a Form 1040-ES payment is made via EFW, the IRS checks to see whether the taxpayer is enrolled in the Electronic Federal Tax Payment System (EFTPS). If not, a taxpayer is mailed an e-file 1040-ES PIN letter. EFTPS is another e-pay option for making payments.

Electronic Funds Withdrawal (EFW)

EFW is convenient for both individuals and businesses. It allows the taxpayer to e-file and e-pay in a single step. EFW is a free service from the IRS; however, the taxpayer's financial institution may charge a fee.

The taxpayer's bank account number is safeguarded along with other tax information. The IRS does not disclose the payment information for any purpose other than processing the transaction authorized by the taxpayer.

Most tax returns can be filed prior to the filing deadline. At the time of filing, a future date up to the filing deadline can be designated to have the payment transferred. However, for the following forms the payment is transferred on the date the form is e-filed or received:

- Form 720, *Quarterly Federal Excise Tax Return*
- Form 940, *Employer's Annual Federal Unemployment (FUTA) Tax Return*
- Form 941, *Employer's QUARTERLY Federal Tax Return*
- Form 944, *Employer's ANNUAL Federal Tax Return*
- Form 2290, *Heavy Highway Vehicle Use Tax Return*

Up to four Form 1040-ES payments for a tax year can be submitted with the previous tax year's e-filed return, regardless of whether the e-filed return has a balance due or not. A separate payment record is required for each estimated payment. The bank account can be the same or different for each payment entered.

Note. Electronic funds withdrawals cannot be initiated after the return or form is filed.

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Credit or Debit Card

Taxpayers may choose to pay their income tax using either debit or credit cards. This may be convenient because the taxpayer can e-file or paper-file early and make payment by credit or debit card in order to delay out-of-pocket expenses. Payments can be made by phone, Internet, or when e-filing. This method is safe and secure because standard, commercial card networks are used. The IRS does not store the card numbers.

These payment options are available through service providers that charge a fee for their services. Fees are based on the amount of the payment and may vary by service provider. When the taxpayer receives a statement from the service provider, the payment is identified as a “United States Treasury Tax Payment,” and the fee is identified as “Tax Payment Convenience Fee.”

A list of service providers and fees follows:

Service Provider	Telephone	Web Site	Convenience Fees (Credit Card Option)	Convenience Fees (ATM/Debit ¹ Card Option)	Customer Service Number
Official Payments Corporation	1-888-UPAY-TAX tm (1-888-872-9829) <i>Available in English and Spanish</i>	officialpayments.com/fed	2.35% ³	\$3.95 ²	1-877-754-4413
Link2Gov Corporation	1-888-PAY1040 tm (1-888-729-1040) <i>Available in English and Spanish</i>	PAY1040.com Businessstaxpayment.com	2.35% ³	\$3.89 ²	1-888-658-5465
RBS WorldPay, Inc.	1-888-9-PAY-TAX tm (1-888-972-9829) <i>Available in English and Spanish</i>	payUSAtax.com	1.95% ³	\$3.89 ²	1-888-877-0450 (live operator) 1-877-517-4881 (automated 24x7)

¹ The ATM/Debit card must be a Visa Debit Card, or a NYCE, Pulse or Star Debit Card.

² Flat fee per transaction.

³ Contact the service provider to receive up-to-date information regarding fees. The minimum convenience fee is \$1.

Caution. The service provider charges a convenience fee for providing this service. Because the payment is made by credit card, if the card bill is not paid timely, normal interest charges are added. For example, a \$20,000 income tax liability could have a \$470 convenience fee and then be assessed normal credit card interest after 30 days.

Note. If a taxpayer does not have the money to pay his income tax liability when due, he might want to consider setting up an installment agreement with the IRS.

ELECTRONIC FEDERAL TAX PAYMENT SYSTEM (EFTPS)

EFTPS is an electronic tax payment system provided at no charge by the U.S. Department of Treasury. It allows taxpayers to pay federal taxes electronically via the Internet or phone at any time.

Businesses and individuals can pay all their federal taxes using EFTPS. Individuals can pay their quarterly 1040-ES taxes electronically using EFTPS, and they can make payments weekly, monthly, or quarterly. Both business and individual payments can be scheduled in advance.

More than 9.5 million taxpayers are currently enrolled in the system. Since EFTPS started in 1996, there have been over 900 million electronic payments made, totaling over \$20 trillion.

To use EFTPS, the taxpayer must enroll. Enrollment and additional information can be found at www.eftps.gov/eftps.

E-SERVICES

In order to provide better, faster service to tax professionals, the IRS developed a number of e-services. These services are available to preparers anytime using an Internet connection. Users must be registered and e-file five or more returns to use certain services. If the user is a Circular 230 practitioner (attorney, CPA, or EA), the user may use e-services even if he does not e-file returns.

REGISTRATION

All tax professionals who wish to use e-services products must register online as individuals to create an electronic account. The registration process is a one-time automated process in which the user selects a username, password, and PIN. Once the registration information is validated, the registrant receives an onscreen acknowledgement. For security purposes, a confirmation code is sent via postal mail to the tax professional to complete the registration process.

PREPARER TAX IDENTIFICATION NUMBER (PTIN) APPLICATION

The IRS website no longer allows tax preparers to obtain a PTIN. Instead, preparers are required to register as a tax preparer. Once registered, they will receive a PTIN.

Note. All paid tax preparers must register and obtain PTINs starting in September 2010. For more information, see Chapter 6, Ethics.

ONLINE E-FILE APPLICATION

A new e-file application process combines the now obsolete Form 9041, *Application for Electronic/Magnetic Media Filing of Business and Employee Plan Returns*, and Form 8633, *Application to Participate in the IRS e-file Program*, into an integrated application available both online and via paper, using the new Form 8633. The online e-file application allows the application to be saved while it is in progress. An acknowledgement of completion is sent via email. Applications can be maintained and updated electronically. A new delegation-of-authority feature allows principals or responsible officials of the firm/organization to delegate e-services to their employees.

TAXPAYER IDENTIFICATION NUMBER (TIN) MATCHING

TIN matching is a pre-filing service offered to payers and/or authorized agents who submit any of six information returns subject to backup withholding (Forms 1099-B, 1099-INT, 1099-DIV, 1099-OID, 1099-PATR, and 1099-MISC). With **interactive TIN matching**, authorized payers can match up to 25 payees' TIN and name combinations against IRS records prior to submitting an information return. **Bulk TIN matching** allows payers and/or authorized agents filing any of the six information returns to match up to 100,000 TIN and name combinations. In order to participate in TIN matching, payers must be listed in the IRS payer account file database. If a firm has not filed information returns with the IRS in one of the past two tax years, the application will not be accepted.

Tax professionals who are active participants in the IRS e-file program and who e-file five or more accepted individual or business returns in a season are eligible to use the following incentive products:

1. **Disclosure Authorization.** Eligible tax professionals may complete authorization forms, view and modify existing forms, and receive acknowledgement of accepted submissions immediately — all online. Disclosure authorization allows tax professionals to electronically submit Form 2848, *Power of Attorney and Declaration of Representative*, and Form 8821, *Tax Information Authorization*. This e-service expedites processing and issues a real-time acknowledgment of accepted submissions.
2. **Electronic Account Resolution (EAR).** This allows tax professionals to expedite closure on clients' account problems by electronically sending/receiving account-related inquiries. Tax professionals may inquire about individual or business account problems, refunds, installment agreements, missing payments, or notices. Tax professionals must have a power of attorney on file before accessing a client's account. The IRS response is delivered to an electronic secure mailbox within three business days.
3. **Transcript Delivery System (TDS).** Eligible tax professionals may use TDS to request and receive account transcripts, wage and income documents, tax return transcripts, and verification of nonfiling letters. A new product, the Record of Account, combines both the return transcript and account transcript in one product. Tax professionals can request the products for both individual and business taxpayers. Tax preparers use the TDS application to resolve the clients' need for return and account information quickly, in a secure, online session. Tax professionals must have a power of attorney authorization on file with the IRS before accessing a client's account (or use disclosure authorization to file an authorization on a new client and obtain TDS information immediately).
4. **Reporting Agents.** Beginning May 2007, reporting agents who are accepted participants in the IRS e-file program were provided access to TDS and EAR products tailored to meet their reporting needs. Individual users must be employed by the reporting agent and be identified on the e-file application as a principal, principal consent, responsible official, or delegated user, in order to receive requested information under the reporting agent's taxpayer authorization.

E-SERVICES ASSISTANCE

Tax preparers using e-services can find assistance using the system at <https://la2.www4.irs.gov/PeopleBooks/CRMPROD/Training/3pdev/index.htm>. This site has an excellent tutorial on the use of e-services.

OFFER IN COMPROMISE

2

The offer-in-compromise (OIC) program has been in existence for many years. However, the IRS made many changes/enhancements to the program over the years. Some of the changes were made to reduce abuse of the program by taxpayers that only wanted to stall the collection process. Others were made to reduce the time it takes to process an OIC application and make a final determination on acceptance of the offer.

An OIC is an agreement between the taxpayer and the government that settles a tax liability for payment of less than the full amount owed. Absent special circumstances, an offer is not accepted if the IRS believes the liability can be paid in full as a lump sum or through a payment agreement.

In most cases, the IRS does not accept an OIC unless the amount offered by the taxpayer is equal to or greater than the reasonable collection potential (RCP). The RCP is used to measure the taxpayer's ability to pay and includes the value that can be realized from the taxpayer's assets, such as real property, automobiles, bank accounts, and other property. The RCP also includes anticipated future income, less certain amounts allowed for basic living expenses.

Note. Taxpayers should beware of promoter's claims that tax debts can be settled through the OIC program for "pennies on the dollar."

TYPES OF OIC

The IRS may accept an OIC for three reasons:

1. **Doubt as to Collectability.** Doubt exists that the taxpayer could ever pay the full amount of tax liability owed within the remainder of the statutory period for collections.

Example 2. Wanda owes \$20,000 for unpaid tax liabilities and agrees that the tax she owes is correct. The taxpayer's monthly income does not even meet her necessary living expenses. She does not own any real property and does not have the ability to fully pay the liability now or through monthly installment payments.

2. **Doubt as to Liability.** A legitimate doubt exists that the assessed tax liability is correct. Possible reasons to submit a doubt-as-to-liability offer include the following:

- The examiner made a mistake in interpreting the law.
- The examiner failed to consider the taxpayer's evidence.
- The taxpayer has new evidence.

Example 3. Grady was vice president of a corporation in 2004–2005. On December 31, 2005, Grady resigned from the corporation and was no longer a corporate officer. In 2006, the corporation accrued unpaid payroll taxes and Grady was assessed a trust fund recovery penalty as a responsible party of the corporation. Since Grady resigned prior to the payroll taxes accruing and was not contacted prior to the assessment, there is legitimate doubt that the assessed tax liability against him is correct.

3. **Effective Tax Administration.** There is no doubt that the tax is correct and there is potential to collect the full amount of the tax owed, but an exceptional circumstance exists that would allow the IRS to consider an OIC. To be eligible for compromise on this basis, a taxpayer must demonstrate that the collection of the tax would create an economic hardship or would be unfair and inequitable.

Example 4. Mr. and Mrs. Hexley have assets sufficient to satisfy the tax liability but they provide full-time care and assistance to a dependent child, who has a serious long-term illness. It is expected that Mr. and Mrs. Hexley will need to use the equity in assets to provide for adequate basic living expenses and medical care for the child. There is no doubt that the tax is correct.

OIC PAYMENT OPTIONS

In general, a taxpayer must submit a \$150 application fee and initial payment with Form 656, *Offer in Compromise*. Taxpayers may choose to pay their OIC using one of three payment options:

1. **Lump Sum Cash Offer.** Payable in nonrefundable installments; the offer amount must be paid in five or fewer installments upon written notice of acceptance. A nonrefundable payment of 20% of the offer amount in addition to the \$150 application fee is due upon filing Form 656.

If the offer will be paid in five or fewer installments in five months or less, the offer amount must include the realizable value of assets plus the amount that could be collected over 48 months of payments or the time remaining on the statute, whichever is less.

Note. The realizable value is what the assets could be sold for minus any costs of sale.

If the offer will be paid in five or fewer installments in more than five months and within 24 months, the offer amount must include the realizable value of assets plus the amount that could be collected over 60 months of payments or the time remaining on the statute, whichever is less.

If the offer will be paid in five or fewer installments in more than 24 months, the offer amount must include the realizable value of assets plus the amount that could be collected over the time remaining on the statute.

2. **Short-Term Periodic Payment Offer.** Payable in nonrefundable installments; the offer amount must be paid within 24 months of the date the IRS received the offer. The first payment and the \$150 application fee are due upon filing Form 656. Regular payments must be made during the offer investigation.

The offer amount must include the realizable value of assets plus the total amount the IRS could collect over 60 months of payments or the remainder of the statutory period for collection, whichever is less.

3. **Deferred Periodic Payment Offer.** Payable in nonrefundable installments; the offer amount must be paid over the remaining statutory period for collecting the tax. The first payment and the \$150 application fee are due upon filing Form 656. Regular payments must be made during the offer investigation.

The offer amount must include the realizable value of assets plus the total amount the IRS could collect through monthly payments during the remaining life of the statutory period for collection.

The IRS is not bound by either the offer amount or the terms proposed by the taxpayer. The OIC investigator may negotiate a different offer amount and terms when appropriate. The investigator may determine that the proposed offer amount is too low or the payment terms are too protracted to recommend acceptance. In this situation, the OIC investigator may advise the taxpayer as to what larger amount or different terms would likely be recommended for acceptance.

Note. A taxpayer does not qualify for an OIC if he is a debtor in an open bankruptcy proceeding.

LOW-INCOME EXEMPTION AND GUIDELINES

The application fee is waived if an individual (not a corporation, partnership, or other entity) taxpayer's income falls at or below IRS low-income guidelines. The Form 656-B, *Offer in Compromise Booklet*, contains a worksheet titled "Offer in Compromise Application Fee and Payment Worksheet" designed to assist taxpayers in determining whether they are eligible for the low-income exemption. Qualifying taxpayers are also exempt from making any OIC payments while the offer is being investigated.

OIC REJECTIONS

If a taxpayer's OIC is rejected, there is an appeal process. **Once the taxpayer receives the letter rejecting the offer, he has 30 days to request an appeal of the decision.** The taxpayer can request an appeals conference by filing Form 13711, *Request for Appeal of Offer in Compromise*, or sending a letter to the IRS. The letter must contain the following information:

- Name, address, SSN, and daytime telephone number;
- A statement that the taxpayer wants to appeal the IRS findings to the Appeals office;
- A copy of the rejected offer letter;
- Tax period or years involved;
- A list of the specific items the taxpayer disagrees with and the reasons for disagreement for each item;
- Any additional information the taxpayer wants Appeals to consider;
- The facts supporting the taxpayer's position on any issue that he disagrees with;
- The law or authority, if any, on which the taxpayer is relying; and
- A signed statement under the penalty of perjury, that the written protest is true .

A copy of Form 13711 is shown on the following page.

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Request for Appeal of Offer in Compromise

Please provide the information required in the spaces below. Be sure to sign and date this form.

Taxpayer name(s)			Taxpayer Identification Number(s)
Taxpayer name(s)			Taxpayer Identification Number(s)
Mailing address			Tax form number
City	State	ZIP Code	Tax period(s) ended
Taxpayer's current daytime phone number			Tax period(s) ended

Identify the specific item(s) you don't agree with as shown on the Income and Expense Table and Asset and Equity Table you received with your rejection letter. In the space next to the disagreed item, provide a brief statement indicating why you don't agree with our determination (for example: incorrect valuation of real estate, omitted mileage from vehicle deduction, etc.). Attach supporting documents and indicate on the document which issue they apply to. Additional pages may be attached. If you do not agree with the Service's analysis of economic hardship or Effective Tax Administration, please provide an explanation with documentation.

Disagreed item	Reason for disagreement	Supporting documentation attached	<input type="checkbox"/> Yes <input type="checkbox"/> No
Disagreed item	Reason for disagreement	Supporting documentation attached	<input type="checkbox"/> Yes <input type="checkbox"/> No
Disagreed item	Reason for disagreement	Supporting documentation attached	<input type="checkbox"/> Yes <input type="checkbox"/> No

Signature of Taxpayer(s)	Date signed
Signature of Taxpayer(s)	Date signed

If this application was prepared by someone other than the taxpayer, please fill in that person's name and address

Name			
Mailing address	City	State	ZIP Code

Name and signature of authorized representative (If a representative is signing this form, please attach a copy of your completed Form 2848, Power of Attorney and Declaration of Representative.)

Name of authorized representative	
Signature of authorized representative	Date signed
Telephone number of authorized representative	Best time to call

OIC UPDATE

In August 2009, Fred Schindler, IRS Director of Collection Policy announced that OIC receipts were up approximately 16% and that about 25% of the total receipts were accepted. He also said two studies of the OIC process were under way. One study examines the OIC processes and systems for the purpose of making them easier to navigate. The other examines taxpayer defaults due to the recession and determines whether an alternative plan is needed to help taxpayers pay their tax liabilities by offering some flexibility in changing payments/installment amounts.

PARTIAL PAYMENT INSTALLMENT AGREEMENTS (PPIA)

All taxpayers are expected to immediately pay delinquent tax liabilities in full. When this is not possible, taxpayers may be allowed to pay their liabilities over a prescribed period of time. The IRS implemented an additional payment option on January 17, 2005, known as the Partial Payment Installment Agreement (PPIA) for taxpayers with outstanding federal tax liabilities. This payment option was initiated with the passage of the American Jobs Creation Act of 2004. The legislation included language amending IRC §6159 to allow the IRS to enter into installment agreements that result in full or partial payment of the tax liability.

Prior to enactment of this legislation, taxpayers that could not fully pay their outstanding tax liabilities could only enter into an agreement with the IRS if it resulted in full payment of the liability. This left taxpayers with limited payment options if they were unable to meet this criterion.

Before a PPIA may be granted, equity in assets must be assessed and, if appropriate, used to make payment. In most cases, taxpayers are required to use equity in assets to pay liabilities. However, as discussed below, complete utilization of equity is not always required as a condition of a PPIA. The IRS considers levies or seizures if there is significant equity in assets. If enforcement action is appropriate, a PPIA is not granted.

PARTIAL PAYMENT INSTALLMENT AGREEMENT REQUIREMENTS

A full collection information statement is required for all PPIAs. Forms 433-A, *Collection Information Statement for Wage Earners and Self-Employed Individuals*, or Form 433-B, *Collection Information Statement for Businesses*, is used to determine the taxpayer's ability to pay. The forms are used to determine allowable expenses.

The IRS verifies submitted information by the following methods:

- Using bank statements to verify both income and expenses;
- Requesting documentation if assets, liabilities, expenses, or income appear questionable;
- Completing record checks to determine ownership and equity in real and personal property, including motor vehicles; and
- Requesting that taxpayers sell assets or borrow on equity in assets in order to make payment on the delinquent taxes, if appropriate.

The IRS review helps ensure that the taxpayer has the ability to pay current operating expenses as well as current taxes.

Note. Because the underlying liability is not fully paid, the trust fund recovery penalty usually is assessed on payroll tax amounts. The only exception to this requirement is in circumstances in which there is no collection potential from the responsible officers.

The taxpayer must agree to pay the maximum monthly amount based upon the taxpayer's ability to pay.

The IRS files or ensures that a Notice of Federal Tax Lien was previously filed on all aggregate liabilities exceeding certain limits.

Note. An online payment agreement application can be found at www.irs.gov/individuals/article/0,,id=149373,00.html.

ASSET EQUITY AND PARTIAL PAYMENT INSTALLMENT AGREEMENTS

No Asset/No Equity Cases

A PPIA may be granted if a taxpayer has no assets or equity in assets or has liquidated available assets to make a partial tax payment.

Asset Cases

A PPIA may be granted if a taxpayer does not sell or cannot borrow against assets with equity because:

1. The assets have minimal equity or the equity is insufficient to allow a creditor to loan funds.

Note. Some lenders require equity of greater than 20% of property value in order to grant a loan.

2. The taxpayer is unable to utilize equity.

Note. The property is held as a tenancy by the entirety when only one spouse owes the tax and the nonliable spouse declines to cooperate with the attempt to borrow. The property must not appear to have been transferred into the tenancy for the purpose of avoiding the tax collection.

3. The asset has some value but the taxpayer is unable to sell the asset because it is currently unmarketable.

Example 5. Nasty Chemicals, Inc., owns a vacant lot in a high-value area, but the lot cannot be sold until it meets certain environmental regulations.

4. The asset is necessary to generate income for the PPIA and the government will receive more from the future income generated by the asset than from the sale of the asset.
5. It would impose an economic hardship on the taxpayer to sell property, borrow on equity in property, or use a liquid asset to pay the taxes. Economic hardship is defined as not meeting reasonable basic living expenses.

Example 6. Granny Benson is on a fixed income, and has the ability to make small monthly payments. The only other asset is her principal residence and there is equity in the property. After the revenue officer does a risk analysis, he determines that seizing the property would cause an economic hardship because Granny cannot find suitable replacement housing and meet necessary living expenses if the property were seized.

6. The taxpayer's loan payment would exceed the taxpayer's disposable income and he would not qualify for a loan.

The taxpayer is normally required to make a good faith attempt to utilize equity before the IRS approves a PPIA. This includes using normal business standards when applying for loans using equity as collateral. Taxpayers are also required to submit copies of all documents used in the loan application process.

If the taxpayer does not comply with the requirement of making a good faith attempt to use equity in assets or is not willing to make monthly payments consistent with the ability to pay, the taxpayer is considered a "won't pay" and seizure/levy action may be appropriate. If enforcement action is appropriate, a PPIA is not granted.

If the taxpayer is unable to secure a loan or liquidate an asset following a good faith attempt to do so, the IRS makes a seizure/levy determination.

If it is determined that enforcement action is not appropriate, a PPIA can be granted.

In addition, taxpayers granted PPIAs will be subject to a subsequent financial review every two years. As a result of this review, the amount of the installment payments could increase or the agreement could be terminated if the taxpayer's financial condition improves.

The PPIA payment option provides an appropriate alternative for many taxpayers. Those who qualify for the PPIA option are strongly encouraged to make their payments via the direct debit method.

TAX-EXEMPT ORGANIZATIONS

2

In general, U.S. taxpayers are generous and want to help those individuals in need because of a disaster or other problem. However, they also appreciate receiving a charitable contribution deduction for their generosity. Consequently, their donations must be to an IRC §§501(c)(3) or 501(a) income tax-exempt organization qualifying under IRC §170.

If a qualifying organization does not exist for a desired purpose, a group may want to organize its own charity. The following provides information about forming and maintaining a tax-exempt organization that can receive tax deductible contributions. This section also discusses organizations, such as service clubs, that are tax-exempt, but to which donations are not deductible.

IRC §501(c)(3) EXEMPT ORGANIZATIONS

Organizations that meet the requirements of IRC §501(c)(3) are exempt from federal income tax as **charitable organizations**. In addition, contributions made to charitable organizations by individuals and corporations are deductible under IRC §170.

Every exempt charitable organization is classified as either a public charity or a private foundation. Generally, organizations that are classified as public charities are those that:

1. Are churches, hospitals, qualified medical research organizations affiliated with hospitals, schools, colleges, and universities;
2. Have an active program of fundraising and receive contributions from many sources, including the general public, governmental agencies, corporations, private foundations, or other public charities;
3. Receive income from the conduct of activities in furtherance of the organization's exempt purposes; or
4. Actively function in a supporting relationship to one or more existing public charities.

Private foundations, in contrast, typically have a single major source of funding (usually gifts from one family or corporation rather than funding from many sources) and most have as their primary activity the making of grants to other charitable organizations and to individuals, rather than the direct operation of charitable programs.

Creating the Organization

A charity's **organizing document** must limit the organization's purposes to those that are exempt as set forth in §501(c)(3). It must not expressly empower it to engage, other than as an insubstantial part, in activities that do not further those purposes. This requirement may be met if the purposes stated in the organizing document are limited by reference to §501(c)(3). In addition, an organization's assets must be permanently dedicated to an exempt purpose. This means that if an organization dissolves, its assets must be distributed for an exempt purpose described in §501(c)(3), or to the federal, state, or local governments for a public purpose. To establish that an organization's assets are permanently dedicated to an exempt purpose, the organizing document should contain a provision ensuring their distribution for an exempt purpose if the organization dissolves. Although reliance may be placed upon state law to establish permanent dedication of assets for exempt purposes, an organization's application can be processed by the IRS more rapidly if its organizing document includes a provision ensuring permanent dedication of assets for exempt purposes.

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1. **Bylaws.** Federal tax law does not require specific language in the internal operating rules of most organizations. However, state law may require nonprofit corporations to have bylaws. Nonprofit organizations generally find it advisable to have internal operating rules.
2. **Employer Identification Number.** Every organization must have an employer identification number (EIN), even if it does not have employees. The EIN is a unique number that identifies the organization to the IRS. To apply for an EIN, the organizers should obtain Form SS-4, *Application for Employer Identification Number*, and its instructions. They may also apply for an EIN online, by telephone, or by fax. The organizers should select “church or church-controlled organization” or “other nonprofit organization” as the **type of entity**.

Note. The employer identification number is **not the same as the tax-exempt number**. This term generally refers to a number assigned by a state agency that identifies organizations as exempt from state sales and use taxes.

3. **Charitable Solicitation.** Many states have laws regulating the solicitation of funds for charitable purposes. These statutes generally require organizations to register with a state agency before soliciting the state’s residents for contributions, and provide exemptions from registration for certain categories of organizations. In addition, organizations may be required to file periodic financial reports. State laws may impose additional requirements on fundraising activity involving paid solicitors and fundraising counsel. Charitable organizations may wish to contact the appropriate state agency before soliciting contributions to learn more about the requirements that apply in their state. In some states, municipal or other local governments may also require organizations soliciting charitable contributions to register and report.
4. **Financial Results Reporting.** In addition to registration and reporting requirements associated with the solicitation of charitable contributions, some states require organizations to register and file periodic financial results if they hold assets subject to a charitable trust.

Applying to the IRS for an Exemption

1. **Exemption Requirements.** To be tax-exempt under §501(c)(3), an organization must be organized and operated exclusively for exempt purposes set forth in §501(c)(3). None of its earnings may inure to any private shareholder or individual. In addition, it may not be an action organization (i.e., it may not attempt to influence legislation as a substantial part of its activities and it may not participate in any campaign activity for or against political candidates).

Organizations described in §501(c)(3) are commonly referred to as charitable organizations. Organizations described in §501(c)(3), other than “testing for public safety organizations,” are eligible to receive tax-deductible contributions in accordance with §170.

The organization must not be organized or operated for the benefit of private interests, and no part of a §501(c)(3) organization’s net earnings may inure to the benefit of any private shareholder or individual. If the organization engages in an excess benefit transaction with a person having substantial influence over the organization, an excise tax may be imposed on the person and any organization managers agreeing to the transaction.

IRC §501(c)(3) organizations are restricted in the types of political and legislative (lobbying) activities that they may conduct.

- 2. Exemption Application.** To be exempt under §501(c)(3), an organization must file an application for recognition of exemption with the IRS. The law provides limited exceptions to the filing requirement.

The form required to apply for exemption under §501(c)(3) is Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*. Form 1023 has instructions and checklists to help supply the information required to process the application. Organizers should also obtain Notice 1382, which supplements the Form 1023 package. The IRS will not process an incomplete application.

The following organizations are excepted from the exemption application requirement:

- a. Churches, their integrated auxiliaries, and conventions or associations of churches; and
- b. An organization that is not a private foundation whose gross receipts in each taxable year are normally not more than \$5,000. For purposes of the gross receipts test, an organization normally does not have more than \$5,000 annually in gross receipts if:
 - i. During its first tax year, the organization received gross receipts of \$7,500 or less;
 - ii. During its first two years, the organization had a total of \$12,000 or less in gross receipts; and
 - iii. In the case of an organization that has been in existence for at least three years, the total gross receipts received by the organization during the immediately preceding two years, plus the current year, are \$15,000 or less.¹

- 3. Exempt Organizations User Fees.** Common user fees are summarized below:²

Issue/Type of Request	Office of Jurisdiction	User Fee
Exemption application (Form 1023, 1024, or 1028)	EO Determinations	
Organizations with annual gross receipts < \$10,000 during preceding 4 years		\$ 400
Organizations with annual gross receipts ≥ \$10,000 during preceding 4 years		850
Group exemption requests		3,000
Accounting method changes	EO Technical	275
Accounting period changes		350
Qualified subsidiaries of section 501(c)(25) organizations		2,250
Letter rulings		10,000

¹. IRS Pub. 557, *Tax-Exempt Status for Your Organization*, p 22.

². [www.irs.gov/charities/article/0,,id=121515,00.html] Accessed on Sep. 10, 2010.

4. **IRS Processing.** The exemption application may provide enough information for the IRS to issue a ruling on the exempt status under §501(c)(3). Frequently, however, the IRS reviewer needs additional information to complete the application. The reviewer sends a letter requesting the additional information by a specified date.

- a. **Waiting for Acceptance.** If an annual exempt organization return is due while the organization's application for recognition of exempt status is pending with the IRS (including any appeal of a proposed adverse determination), the organization must file it, indicating that its exemption application is pending. Like other exempt organization returns, these are subject to public disclosure.

If an organization has unrelated business income of more than \$1,000, it must also file Form 990-T, *Exempt Organization Business Income Tax Return*.

The organization should comply with tax law requirements applicable to §501(c)(3) tax-exempt organizations. See IRS Pub. 4221-PC, *Compliance Guide for 501(c)(3) Public Charities*, for additional information.

- b. **Incomplete Application.** If an exemption application does not contain the required information, the IRS may return it with a letter of explanation and will not consider the application on its merits. If a completed application is submitted within the expected time period, it is considered received on the original submission date. In that case, if the original submission was timely, the application is considered timely filed.
- c. **Different Application Form Needed.** If a different application form is required for the organization, the IRS advises the organization and provides the appropriate application form to the organizer. Although supporting information previously furnished need not be duplicated, the organizer must provide any necessary additional information required for the application. If a reply is not received within the expected timeframe, the application is processed only for the paragraph under which it was originally applied.

When a specific application form is needed for the paragraph under which the organization qualifies, that form is required before a letter recognizing the exemption status can be issued. This includes cases in which an exemption letter is modified to recognize an organization's exempt status under a paragraph other than the paragraph under which it originally established exemption.

- d. **IRS Responses.** Organizations that submit a complete application receive an acknowledgment from the IRS. Others receive a letter requesting more information or have their incomplete application returned. Applicants also are notified if the application is forwarded to the headquarters of the IRS for consideration. These letters are sent as soon as possible after receipt of the organization's application.

5. Rulings and Determination Letters

- a. **Adverse Determination.** A proposed adverse ruling or determination letter is issued to an organization that does not provide sufficient information to establish its qualifications for exemption. An organization can appeal a proposed adverse ruling or determination letter.
- b. **Public Disclosure.** An exemption determination letter is subject to public disclosure.

Required Filings

2

1. **Annual Exempt Organization Return.** An exempt organization is required to make certain IRS filings. These may be made electronically.

Electronic filing provides fast acknowledgement that the IRS received the return. It reduces normal processing time, making compliance with reporting and disclosure requirements easier. Charities and nonprofits can file the following forms electronically through an approved IRS 990 e-file provider:

- Form 990, *Return of Organization Exempt from Income Tax*
- Form 990-EZ, *Short Form Return of Organization Exempt from Income Tax*
- Form 990-PF, *Return of Private Foundation*
- Form 990-N, *Electronic Notice (e-Postcard) for Tax-Exempt Organizations not Required To File Form 990 or 990-EZ*
- Form 8868, *Application for Extension of Time To File an Exempt Organization Return*
- Form 1120-POL, *U.S. Income Tax Return of Political Organizations*
- Form 7004, *Application for Automatic Extension of Time To File Certain Business Income Tax, Information, and Other Returns* (extension form for Form 1120-POL)

e-Postcard (Form 990-N). Small tax-exempt organizations (those normally with annual gross receipts up to \$50,000) may be required to file an annual electronic notice, Form 990-N, *Electronic Notice (e-Postcard) for Tax-Exempt Organizations not Required To File Form 990 or 990-EZ*. This filing requirement applies to tax periods beginning after December 31, 2006, and may apply to organizations that were not required to file returns previously.

2. **Unrelated Business Income Tax (UBIT).** The UBIT is imposed on the following:

- Organizations exempt from tax under §501(a) of the Internal Revenue Code
- Employees' trusts forming part of pension, profit-sharing, and stock bonus plans described in §401(a)
- Individual retirement arrangements
- State and municipal colleges and universities
- Qualified state tuition programs
- Medical savings accounts
- Coverdell savings accounts

The Code contains a number of modifications, exclusions, and exceptions to unrelated business income. For example, dividends, interest, certain other investment income, royalties, certain rental income, certain income from research activities, and gains or losses from the disposition of property are excluded when computing unrelated business income. In addition, the following activities are specifically excluded from the definition of unrelated trade or business:

- **Volunteer Labor.** Any trade or business is excluded in which substantially all the work is performed for the organization without compensation. Some fundraising activities, such as volunteer-operated bake sales, may meet this exception.
- **Convenience of Members.** Any trade or business is excluded that is carried on by an organization described in §501(c)(3) or by a governmental college or university primarily for the convenience of its members, students, patients, officers, or employees. A typical example of this is a school cafeteria.
- **Selling Donated Merchandise.** Any trade or business is excluded that consists of selling merchandise, substantially all of which the organization received as gifts or contributions. Many thrift shop operations of exempt organizations meet this exception.
- **Bingo.** Certain bingo games are not unrelated trade or business.

Ongoing Compliance

1. **Jeopardizing the Exemption.** A §501(c)(3) organization jeopardizes its exemption if it ceases to be operated exclusively for exempt purposes. An organization is operated exclusively for exempt purposes only if it engages primarily in activities that accomplish the exempt purposes specified in §501(c)(3). An organization is not so regarded if more than an insubstantial part of its activities does not further an exempt purpose. A §501(c)(3) organization must:
 - Absolutely refrain from participating in the political campaigns of candidates for local, state, or federal office;
 - Restrict its lobbying activities to an insubstantial part of its total activities;
 - Ensure that its earnings do not inure to the benefit of any private shareholder or individual;
 - Not operate for the benefit of private interests such as those of its founder, the founder's family, its shareholders or persons controlled by such interests;
 - Not operate for the primary purpose of conducting a trade or business that is not related to its exempt purpose, such as a school's operation of a factory;
 - Not provide commercial-type insurance as a substantial part of its activities;
 - Not have purposes or activities that are illegal or violate fundamental public policy; and
 - Satisfy annual filing requirements.
2. **Penalties.** In addition to losing the organization's §501(c)(3) exempt status, activities constituting inurement may result in the imposition of penalty excise taxes on individuals benefiting from excess benefit transactions.
 - a. **Inurement/Private Benefit.** A §501(c)(3) organization must not be organized or operated for the benefit of private interests, such as the creator or the creator's family, shareholders of the organization, other designated individuals, or persons controlled directly or indirectly by such private interests. No part of the net earnings of a §501(c)(3) organization may inure to the benefit of any private shareholder or individual. A private shareholder or individual is a person having a personal and private interest in the activities of the organization.
 - b. **Intermediate Sanctions.**
 - **Excise Tax on Excess Benefit Transactions.** IRC §4958 imposes an excise tax on excess benefit transactions between a disqualified person and an applicable tax-exempt organization. The disqualified person who benefits from an excess benefit transaction is liable for the excise tax. An organization manager may also be liable for an excise tax on the excess benefit transaction. These taxes are reported on Form 4720, *Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code*.
 - **Interaction Between IRC §4958 Taxes and Revocation of Exemption.** IRC §4958 does not affect the substantive standards for tax exemption under §§501(c)(3) or 501(c)(4). In appropriate cases, the IRS may also propose revocation of tax-exempt status, whether or not §4958 excise taxes are imposed.

- c. Political Campaign Activity.** Under the Code, all §501(c)(3) organizations are absolutely prohibited from directly or indirectly participating in, or intervening in, any political campaign on behalf of (or in opposition to) any candidate for elective public office. Contributions to political campaign funds or public statements of position (verbal or written) made on behalf of the organization in favor of or in opposition to any candidate for public office clearly violate the prohibition against political campaign activity. Violating this prohibition may result in denial or revocation of tax-exempt status and the imposition of certain excise taxes.

Certain activities or expenditures may not be prohibited depending on the facts and circumstances. For example, certain voter education activities (including presenting public forums and publishing voter education guides) conducted in a nonpartisan manner do not constitute prohibited political campaign activity. In addition, other activities intended to encourage people to participate in the electoral process, such as voter registration and “get out the vote” drives, would not be prohibited political campaign activity if conducted in a nonpartisan manner.

On the other hand, voter education or registration activities constitute prohibited participation or intervention if they have any of the following evidence of bias:

- Favoring one candidate over another
 - Opposing a candidate in some manner
 - Having the effect of favoring a candidate or group of candidates
- d. Employment Taxes.** While the exempt organization is not required to pay federal income tax in most cases, it is liable for employment taxes on the salaries and wages it pays its employees.

Care should be taken when classifying a worker as an independent contractor. In many cases, these individuals are employees and are subject to employment taxes. The penalty for failure to pay payroll taxes can be severe.

- e. Substantiation and Disclosure Requirements.** The IRS applies substantiation requirements for donors, and disclosure requirements for charitable organizations, in connection with charitable contributions.

A donor can deduct a charitable contribution of \$250 or more only if the donor has a written acknowledgment from the charitable organization. The donor must get the acknowledgement by the earlier of:

- The date the donor files the original return for the year the contribution is made, or
- The due date, including extensions, for filing the return.

The donor is responsible for requesting and obtaining the written acknowledgement from the donee.

A donor cannot claim a deduction for any contribution of cash, check, or other monetary gift made on or after January 1, 2007, unless the donor maintains a written record of the contribution.

Significant Events

1. **Reporting changes to the IRS.** An exempt organization that is required to file an annual return must report name, address, and structural and operational changes on its return. Regardless of whether an organization files an annual return, it may also report these changes to the EO (exempt organization) Determinations Office; however, such reporting does not relieve the organization from reporting the changes on its annual return.

Note. Any signed or state-certified articles of incorporation or association, constitution or trust instrument or other organization document, or the bylaws or other governing document showing changes are attached to the annual report. If signed or state-certified copies of a governing document are not available, an authorized officer may certify that the governing document provided is a complete and accurate copy of the original document.

An organization may request a determination letter regarding the effect of certain changes on its tax-exempt status or public charity status. For example, a determination letter is issued to classify or reclassify an organization as a public charity or a private foundation. An organization may also request a determination letter to determine whether an organization is exempt from filing annual information returns in certain situations. However, the IRS does not make any determination regarding any completed transaction.

If an organization is unsure about whether a proposed change in its purposes or activities is consistent with its status as an exempt organization or as a public charity, it may want to request a private letter ruling.

2. **Audits of Exempt Organizations.** Issues in an audit may include an organization's tax-exempt status and private foundation classification, whether it paid employment taxes and tax on unrelated business income when required, and whether it filed required returns and reports.
3. **Termination of an Exempt Organization.** Most tax-exempt organizations that terminate their operations, either through shutting down, transferring their assets, or merging with another tax-exempt organization, must inform the IRS about the details of the action.

For additional information, see www.irs.gov/charities/charitable/article/0,,id=136459,00.html.

WEB-BASED TRAINING FOR TAX-EXEMPT ORGANIZATIONS

The IRS provides online training for tax-exempt organizations at www.StayExempt.org. The site includes a web-based version of the popular exempt organization workshops and a number of mini-courses on topics of interest to tax-exempt organizations.

The StayExempt mini-course catalog includes the following courses:

- **Tour of Redesigned Form 990** (four parts)
- **Disaster Relief — Part I** (describes how charitable organizations may provide relief in disaster situations and the special tax rules that apply to such organizations)
- **Disaster Relief — Part II** (explains special rules that apply to employer-sponsored disaster relief organizations, the deductibility of contributions to disaster relief organizations, and the tax treatment of relief recipients)
- **403(b) Tax-Sheltered Annuity Plans — Employee** (explains advantages of participating in a tax-sheltered annuity plan)
- **403(b) Tax-Sheltered Annuity Plans — Employer** (explains recent regulatory changes and operational requirements for a tax-sheltered annuity plan)

- **Navigating IRS Resources** (explains using www.irs.gov to find workshops, outreach events, and publications)
- **Political Campaigns and Charities** (explains the ban on intervening in political campaign activities by tax-exempt and charitable organizations)
- **Can I Deduct My Charitable Contributions?** (describes what is deductible and what is not)
- **The Wonderful World of Foundation Classification** (describes two common types of classifications for §501(c)(3) organizations)
- **Applying for Tax-Exempt Status** (explains how to make the tax-exempt status application process easier and quicker for new organizations)

The five interactive **virtual workshop** sessions are:

- **Tax-Exempt Status** (explains how an organization can keep its §501(c)(3) exemption)
- **Unrelated Business Income** (answers the question, “Does the organization generate taxable income?”)
- **Employment Issues** (explains how an organization should treat workers for tax purposes)
- **Form 990** (lists records that the organization should keep in order to file an accurate Form 990)
- **Required Disclosures** (identifies items that are open to public inspection and what disclosures exempt organizations are required to make)

Users can complete the modules in any order and repeat them as many times as they like. The StayExempt site does not require registration, and visitors remain anonymous.

FORM 944, EMPLOYER'S ANNUAL FEDERAL TAX RETURN

In its attempt to reduce the burden on small employers, the IRS eliminated the quarterly Form 941 filing requirement and replaced it with an annual filing using Form 944. Unfortunately, this confused many businesses. Consequently, the IRS decided to allow small employers to use either Form 944 or Form 941.

Small businesses may be affected by changes to Form 944, *Employer's ANNUAL Federal Tax Return*. The changes include the option for small employers to choose whether they want to file Form 944 or Form 941, *Employer's QUARTERLY Federal Tax Return*. Additionally, the 2010 Form 944 includes lines for small employers to claim the COBRA credit and the payroll tax exemption allowed under the HIRE Act.

Employers who have an estimated employment tax liability of \$1,000 or less for the entire calendar year are eligible to file Form 944 annually rather than file Form 941 quarterly. In the past, filing this form was mandatory for employers who met the qualifications and were notified by the IRS to file Form 944.

Starting in 2010, employers who are Form 944 filers could opt out in writing no later than March 15, 2010, or by telephone no later than April 1, 2010. Form 941 employers who are eligible and want to file Form 944 could opt in during the same election period by the same methods as those opting out. Whether opting in or opting out of Form 944 filing, the IRS notifies the taxpayer in writing about which return to file.

Note. The same rules apply for later years. The new employer must call the IRS (800-829-4933) on or before the first day of the month their first quarterly return is due (April 1, July 1, October 1, or January 1).

Note. The Form 944 rules are affected by the HIRE Act passed on March 18, 2010. This information is found in Chapter 12, New Legislation.

PAYROLL TAX DEPOSITS

Employers who have been notified to file Form 944 can pay their fourth quarter tax liability with Form 944 if the fourth quarter tax liability is less than \$2,500. Employers must have deposited any tax due for the first, second, and third quarters according to the deposit rules to avoid failure-to-deposit penalties during those quarters.

AUTOMATED UNDERREPORTER (AUR)

As a part of the IRS's ongoing program of improving efficiency and reducing costs, it has developed the automated underreporter (AUR) system. Currently, 80% of all audits are correspondence audits. The system affects 4–5 million taxpayers each year. Nearly 3.5 million taxpayers received CP 2000 notices in 2007, and the IRS collected \$5 billion of revenue because of the notices.

Unfortunately, many taxpayers and tax practitioners do not understand how the system works and become frustrated when they receive a CP 2000 notice showing they owe additional income tax, penalties, and interest.

There are a number of reasons a taxpayer can receive a CP 2000 notice. Primarily, the IRS discovers problems when items reported on a return do not match items reported by banks, employers, businesses, and other payers. In addition, the CP 2000 reflects any corrections made by the IRS when the return was processed.

The AUR system produces over 4.5 million notices each year. Contrary to public perception, all but approximately 300,000 are reviewed by tax examiners. When a taxpayer receives a CP 2000 notice, he should realize that it is not a bill but is rather a proposed adjustment to the amount of tax owed. If the taxpayer does not agree with the proposed adjustment, he can send a response to the IRS stating why he disagrees and provide any evidence to support his case. The response can be either by telephone or a letter sent to the address shown on the notice.

All responses are reviewed by a trained staff member. The staff member enters all information received from the taxpayer into a database that is available to other staff members, should a second response be necessary. If the response was by telephone, the telephone assistants are instructed to leave detailed case notes to document any pertinent information they receive while on a telephone call. Most AUR cases are resolved with a single taxpayer contact.

If the taxpayer fails to respond to the notice by the date shown on the notice, the IRS assumes the proposed changes are correct and continues processing the proposal and ultimately assessing the additional tax. If a taxpayer cannot find the records needed to justify his position by the date shown, he should call the telephone number identified on the notice and request an extension of time. Generally, the IRS allows a 30-day extension beyond the response date listed on the notice. Additional time may be granted for unusual circumstances. However, additional interest and applicable penalties continue to accrue if the tax increase is ultimately determined to be correct.

If the taxpayer receives a CP 2000 notice regarding where the income was reported by the taxpayer on an electronically-filed return that has not been reconciled by the tax examiner, the taxpayer can call the toll-free number and explain to the tax examiner where the income was reported. If the examiner is satisfied, he can close the case while on the telephone.

If income was not reported and not taxable (such as an amended W-2) and the taxpayer has information that would allow the case to be closed, the tax examiner can provide the taxpayer with a personal e-fax number (provided the case is located at the site where the telephone assister is working). Once the faxed document is received, the tax examiner reviews the case and takes the necessary actions. If the taxpayer prefers to mail documents, the tax examiner reviews the case when the document is received and takes necessary actions.

While the process sounds simple, many taxpayers panic and immediately call their tax preparer. Consequently, it is left to the preparer to resolve the problem. In order for the tax preparer to handle the problem, the taxpayer must complete a signed Form 2848, *Power of Attorney and Declaration of Representation*, or a Form 8821, *Tax Information Authorization*.

One of the above forms is required even if the Third Party Designee box was checked on page 2 of Form 1040. This is because a check mark in this box only allows the tax preparer to discuss current return processing with the IRS. The checkbox authorization expires on the 1-year anniversary of the due date of the tax return (not including extensions). The IRS cannot extend the third-party designation beyond the 12-month period.

While the system works well in most cases, it is not perfect. The Treasury Inspector General for Tax Administration (TIGTA), at the request of the IRS Oversight Board, conducted a study of the AUR system. TIGTA randomly selected 138 notices for fiscal year 2007. They found 7 (5.1%) samples were sent incorrect notices. The errors resulted in \$18,968 of overassessed tax and \$1,146 of underassessed tax. Based on this information, TIGTA estimated 243,345 taxpayers would be overassessed and 97,430 would be underassessed over the next 5-year period based on the erroneous assessments. The IRS attributed the errors to employee mistakes.³

PRACTITIONER PRIORITY SERVICE®

Tax practitioners can use the Practitioner Priority Service® (PPS) as the first point of contact. This normally reduces the wait time to talk to an IRS representative.

The PPS is a professional support line (866-860-4259) staffed by IRS customer service representatives who are specially trained to handle questions about practitioners' accounts.

PPS is a toll-free, accounts-related service for all tax practitioners nationwide. It is the practitioners' first point of contact for assistance regarding taxpayers' account-related issues. The hours of service are weekdays, 8:00 a.m. until 8:00 p.m.

Questions regarding clients' individual tax accounts are handled by one of three campus sites: Brookhaven, New York; Memphis, Tennessee; and Philadelphia, Pennsylvania. Questions regarding clients' business accounts are handled by two campus sites: Cincinnati, Ohio and Ogden, Utah. Calls are routed based on an evaluation of the lowest expected wait time. Issues outside the scope of the employees' authority are transferred or referred to the appropriate IRS functions.

IDENTITY PROTECTION

Identity theft has become a major problem. The following information comes from the Federal Trade Commission (FTC) website.⁴

Identity theft occurs when someone uses an individual's personal identifying information without permission in order to commit fraud or other crimes. Examples of personal identifying information are name, social security number (SSN), or credit card number.

The FTC estimates that as many as 9 million Americans have their identities stolen each year. The crime takes many forms. Identity thieves may rent an apartment, obtain a credit card, or establish a telephone account in the individual's name. The victim may not find out about the theft until he reviews his credit report, notices charges he did not make on his credit card statement, or is contacted by a debt collector.

Identity theft is serious. While some identity-theft victims can resolve their problems quickly, others spend hundreds of dollars and considerable time repairing damage to their name and credit record. Some consumers victimized by identity theft may be denied job opportunities or loans for education, housing, or cars because of negative information on their credit reports. In rare cases, they may even be arrested for crimes they did not commit.

Note. Studies show victims spent up to 5,840 hours repairing the damages done from identity theft.

³. TIGTA Report 2008-40-180, *Most Automated Underreporter Program Notices Are Correct, However, Additional Oversight Is Needed*.

⁴. [www.ftc.gov/bcp/edu/microsites/idtheft/consumers/about-identity-theft.html] Accessed July 12, 2010.

HOW DO THIEVES STEAL AN IDENTITY?

Skilled identity thieves may use a variety of methods to obtain information, including the following:

1. **Dumpster Diving.** Thieves rummage through trash looking for bills or other paper with the person's personal information on it.
2. **Skimming.** Thieves steal credit/debit card numbers by using a special storage device when processing a person's card.
3. **Phishing.** Thieves pretend to be financial institutions or companies and send spam or pop-up messages to get a person to reveal her personal information.
4. **Changing a Person's Address.** Thieves divert a person's billing statements to another location by completing a change of address form.
5. **Old-Fashioned Stealing.** Thieves steal wallets; purses; and mail, including bank and credit card statements, pre-approved credit offers, new checks, or tax information. They steal personnel records or bribe employees who have access.
6. **Pretexting.** Thieves use false pretenses to obtain a person's personal information from financial institutions, telephone companies, and other sources.

WHAT DO THIEVES DO WITH A STOLEN IDENTITY?

Once identity thieves have personal information, they use it in a variety of ways.

Credit Card Fraud

- Thieves may open new credit card accounts. When they use the cards and don't pay the bills, the delinquent accounts appear on the victim's credit report.
- The identity thieves may change the billing address on the credit card so that the victim no longer receives bills, and then run up charges on the account. Because the bills are now sent to a different address, it may be some time before the victim realizes there is a problem.

Phone or Utilities Fraud

- Identity thieves may open a new phone or wireless account or run up charges on the victim's existing account.
- They may use the victim's name to get utility services like electricity, heating, or cable TV.

Bank/Finance Fraud

- Identity thieves may create counterfeit checks using the victim's name or account number.
- They may open a bank account and write bad checks.
- They may clone an ATM or debit card and make electronic withdrawals, draining the victim's accounts.
- They may take out a loan.

Government Documents Fraud

- Thieves may get a driver's license or official ID card issued in the victim's name but with the thief's picture.
- They may use the victim's name and SSN to get government benefits.
- They may file a fraudulent tax return using the victim's information.

Other Fraud

- Thieves may get a job using the victim's SSN.
- They may rent a house or get medical services.
- They may give the victim's personal information to police during an arrest. If they do not show up for their court date, a warrant for arrest is issued in the victim's name.

IRS ACTIVITY

The IRS has taken identity theft seriously. It has a division dedicated to detecting identity theft, finding the perpetrators, and convicting them.

Many of the phishing scams involve email or telephone calls from individuals pretending to be from the IRS. Tax practitioners should remind their clients that the IRS does not initiate communication with taxpayers through e-mail.

If the client receives a notice or letter from the IRS that leads the client to believe someone may have used their SSN fraudulently, the client should respond immediately to the name, address, and/or number printed on the IRS notice. If the notice states more than one tax return was filed or shows wages received from an unknown employer, this would indicate identity theft has occurred.

An identity thief might also use an SSN to file a tax return in order to receive a refund. If the thief files the tax return before the taxpayer does, the IRS will believe the taxpayer already filed and received a refund, if eligible.

When an SSN is stolen, it may be used by another individual to get a job. That person's employer would report income earned to the IRS using the victim's SSN, making it appear the victim did not report all of his income on his tax return.

If a victim has previously been in contact with the IRS and has not achieved a resolution, he should contact the IRS Identity Protection Specialized Unit toll-free at **800-908-4490**.

Possible Identity Theft

If tax records are not currently affected by identity theft but a person believes he may be at risk due to a lost/stolen purse or wallet, questionable credit card activity, credit report, or other activity, he needs to provide the IRS with proof of identity.

The victim should submit a copy (not the original documents) of a valid federal or state issued identification — such as a social security card, driver's license, or passport — along with a copy of a police report and/or a completed Form 14039, *IRS Identity Theft Affidavit*. An example of Form 14039 follows.

2010 Workbook

Form 14039 Rev. October 2009	Department of the Treasury - Internal Revenue Service Identity Theft Affidavit	OMB Number 1545-2139
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Please complete and submit this form if you are an actual or potential victim of identity theft and would like the IRS to mark your account to identify any questionable activity.

Please check one of the following boxes

☐ I am a **victim of identity theft** and I believe this incident **is affecting** my tax records *(Provide a short explanation of the tax impact)*

☐ I am a **victim of identity theft** and believe I may be at risk for **future impact** to my tax account

☐ I am a **potential victim** of identity theft and believe I may be at risk for future impact to my tax account.
(You should check "potential victim" if you have not experienced identity theft but are at risk due to a lost/stolen purse or wallet, questionable credit card or credit report activity, etc.)

Tax year(s) impacted and/or date the incident occurred <i>(if applicable or known)</i>	Last tax return filed (year) <i>(Enter NRF if not required to file)</i>
---	--

Taxpayer's last name	First name	Middle initial	Provide the last 4 digits of your Social Security Number (SSN) or your complete Individual Taxpayer Identification Number (ITIN)
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Taxpayer's current mailing address

City	State	ZIP code
------	-------	----------

Address on last tax return filed *(Check here ☐ if you are not required to file a tax return)*

City	State	ZIP code
------	-------	----------

Telephone number <input type="checkbox"/> Home <input type="checkbox"/> Work <input type="checkbox"/> Cell	Best time(s) to call
--	----------------------

Primary language ☐ English ☐ Spanish ☐ Other - specify

Under penalty of perjury, I declare that, to the best of my knowledge and belief, the information entered in this form is true, correct, complete, and made in good faith.

(Signature of taxpayer)	(Date signed mm/dd/yyyy)
-------------------------	--------------------------

Please submit this completed form and a photocopy of at least one of the following documents to verify your identity.
(Check the box next to the document you are submitting)

- ☐ a) Passport
- ☐ b) Driver's license
- ☐ c) Social Security Card
- ☐ d) Other valid U.S. Federal or State government issued identification**

** Please do not submit photocopies of federally issued identification where prohibited by 18 U.S.C. 701 (e.g., official badges designating federal employment).

Please submit the photocopies required above with this form using one of the options described on page 2 of this form.

For Privacy Act and Paperwork Reduction Act Notice, see page 2.

Form **14039** (Rev. 10-2009)

www.irs.gov

Catalog Number 52525A

These documents should be sent using one of the following options:

1. Postal mail:

Internal Revenue Service
PO Box 9039
Andover, MA 01810-0939

- 2. Fax:** 978-247-9965 (this is not a toll-free number). The hours of operation are Monday through Friday, 8:00 a.m. – 8:00 p.m. local time (Alaska and Hawaii follow Pacific Time).

Phony IRS E-Mail

Scammers sometimes do an excellent job of impersonating the IRS. They send email that directs the person to a website that appears to be an official IRS site. Clients should be reminded of the following:

- The IRS does not initiate taxpayer communications through email.
- The IRS does not request detailed personal information through email.
- The IRS does not send email requesting a taxpayer's PINs, passwords, or similar access information for credit cards, banks, or other financial accounts.

Report suspicious email and bogus IRS websites to **phishing@irs.gov**. If a person receives an email from someone claiming to be the IRS or directing them to an IRS site:

- Do not reply.
- Do not open any attachments. Attachments may contain malicious code that will infect the computer.
- Do not click on any links. If a person has clicked on links in a suspicious email or phishing website and entered confidential information, he should visit the IRS's Identity Theft page at **www.irs.gov/privacy/article/0,,id=186436,00.html**.

The individual should then use the following procedures to report the email or a bogus website to the IRS.

Reporting Phishing, Email Scams, and Bogus IRS Websites

Anyone receiving an email or finding a website that they think is pretending to be the IRS should forward the email or website URL to the IRS at **phishing@irs.gov**.

The message should be forwarded as received or with the Internet header of the email. The Internet header has additional information to help the IRS locate the sender.

After forwarding the email or header information to the IRS, delete the message.

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SAMPLE PHISHING EMAIL MESSAGES

From: Internal Revenue Service [mailto:admin@irs.gov]
Sent: Wednesday, March 01, 2006 12:45 PM
To: john.doe@jdoe.com
Subject: IRS Notification - Please Read This .



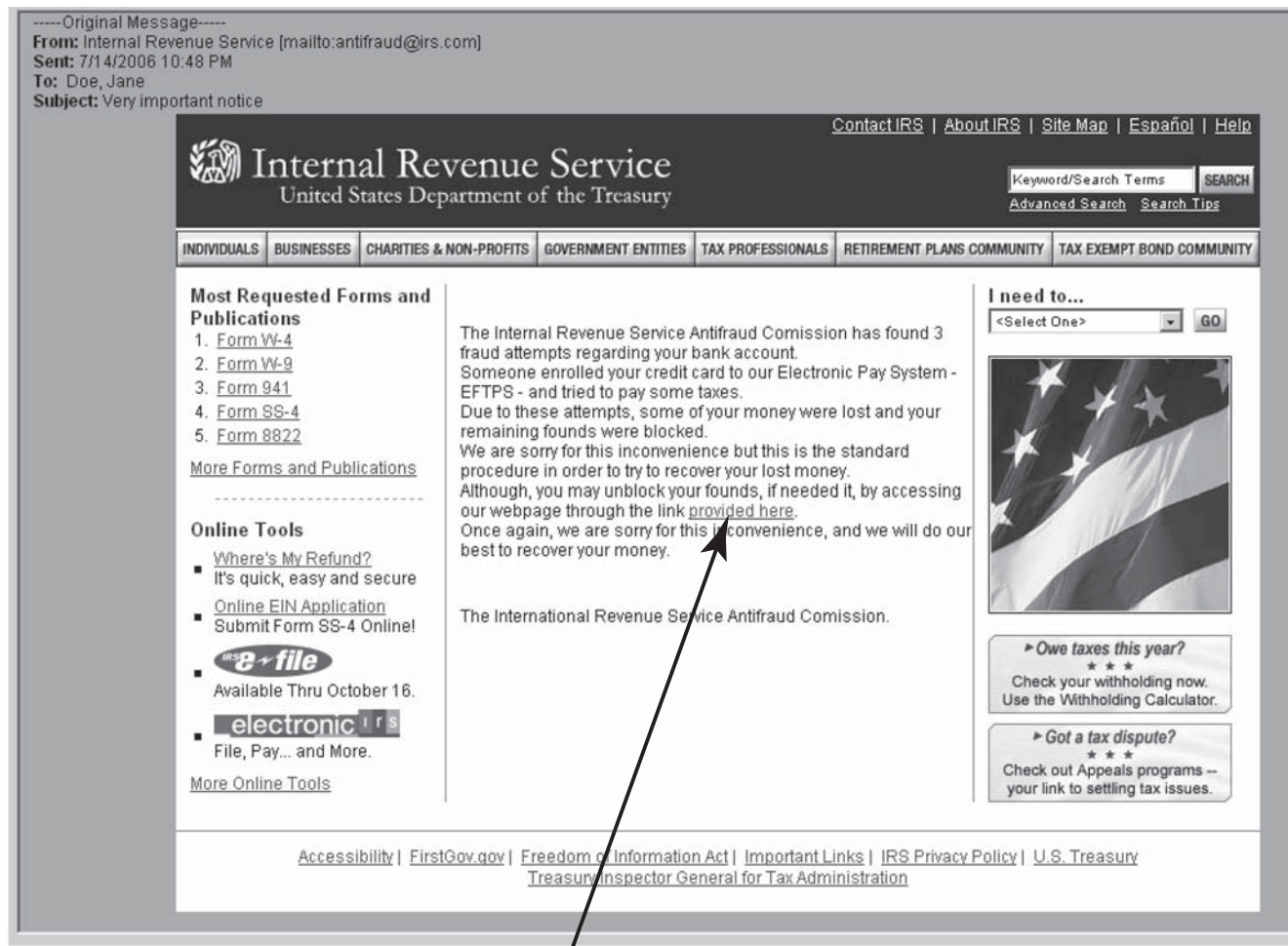
After the last annual calculations of your fiscal activity we have determined that you are eligible to receive a tax refund of **\$63.80**. Please submit the tax refund request and allow us 6-9 days in order to process it.

A refund can be delayed for a variety of reasons. For example submitting invalid records or applying after the deadline.

To access the form for your tax refund, please [click here](#)

Regards,
Internal Revenue Service

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THE IRS DOES NOT INITIATE CONTACT VIA EMAIL!

PROTECTING CLIENT DATA

Tax preparers have a responsibility to protect the data of their clients. The client information in files can be an easy target for identity thieves. The IRS has prepared Pub. 4557, *Safeguarding Taxpayer Data: A Guide for Your Business*, which can be downloaded from the IRS website. The publication includes several checklists that help businesses assess their security practices.

Note. For a thorough discussion about information security related to client records, see Chapter 2, Ethics, in the 2008 *University of Illinois Federal Tax Workbook*. This can be found on the accompanying CD.

ISSUE MANAGEMENT RESOLUTION SYSTEM

The IRS Communications, Liaison and Disclosure function established the Issue Management Resolution System (IMRS), a streamlined and structured process that facilitates stakeholder issue identification, resolution, and feedback.

The IMRS captures, develops, and responds to significant national and local stakeholder issues. When stakeholder organizations notify the IRS of concerns about IRS policies, practices, and procedures, analysts research and respond to the issues.

2010 Workbook

The IMRS also identifies nationwide trends in the reporting, filing, and paying requirements that may necessitate changes to IRS processes and procedures. Progress on stakeholder issues is closely monitored to ensure proper response and communication to the initiating stakeholder and all affected stakeholders.

The local stakeholder liaison office establishes relationships with organizations representing small business and self-employed taxpayers. They provide information about the policies, practices, and procedures that the IRS uses to ensure compliance with the tax laws. The following list can be used to establish a relationship with the IRS through a stakeholder liaison:

Stakeholder Liaison Areas	Phone
Mid-Atlantic (PA, NJ, DE, WV)	412-395-5243
New York	212-436-1056
Great Lakes (IN, MI, OH)	216-522-2563
Northeast (MA, ME, NH, VT, CT, RI)	203-781-3087
Midwest (MN, MT, WI, ND, SD, IA)	651-312-7836
Southwest (AZ, TX, NM)	214-413-5649
Central (IL, MO, KS, NE, OK)	913-722-7519
Mid-South (KY, TN, AL, MS, AR, LA)	405-297-4045
Southeast (FL, GA)	954-423-7686
South Atlantic (MD, VA, NC, SC)	336-378-2348
Northwest (AK, CO, WA, OR, UT, ID, WY)	206-220-5300
Western (CA, HI, NV)	510-637-4541

The IMRS provides three reports to let taxpayers know about issues identified across the country. *Hot Issues* contains IMRS issues and other current items of interest. The *IMRS Industry Issues Quarterly Report* provides a quarterly summary of IMRS issues of particular interest to small businesses. The *IMRS Monthly Overview* contains an update of issues opened and closed each month.

A few of the IMRS issues include:

1. IMRS 09-0001119. Estimated tax payments.

Issue: A wife called the toll-free helpline to get the amounts of the estimated taxes that were paid for the year and was told information would only be given to the primary taxpayer on the account even though they will be filing a joint return.

Response: Telephone assistors who help customers with account inquiries must ensure they are disclosing account information to persons authorized to receive this information. Based on the information received, there was no tax return filed. The assister did not have return information to determine whether a civil event that would change the filing status, such as a divorce, occurred. To avoid an unauthorized disclosure, the assister would need to verify this type of information. For this type of inquiry, the assister can send a Record of Account transcript to the name and address of record in lieu of providing the estimated tax payment information to the secondary name (spouse) on the account.

As a result of this IMRS issue, toll-free assisters will now check the remittance transaction research system (RTR). They will provide verification of estimated tax payments to the secondary taxpayer on an account without a filed return when the preceeding year shows a joint return with that same secondary taxpayer and the RTR shows a joint estimated tax voucher or a joint check, showing the intent to make joint estimated tax payments.

2. IMRS 10-0001218. Economic recovery payment (ERP).

Issue: Taxpayers requested a tool to check to see whether they received the ERP.

Response: The IRS developed the “Did I Receive an Economic Recovery Payment?” look-up tool, which gives taxpayers an easy way to determine whether they received the one-time \$250 ERP and which agency made the payment. Taxpayers can call 866-234-2942 to access the phone application. There is also an Internet application on **www.irs.gov**. Using the IRS look-up tool, taxpayers must enter three pieces of information to determine whether they received an ERP:

- SSN
- Date of birth
- Zip code from the last filed return

A separate telephone call or Internet inquiry must be made for each taxpayer, even if filing a joint tax return. Agency contact information and tips for avoiding refund delays relating to an ERP can be found in IRS Tax Tip 2010-21.

3. IMRS 10-0001261. Automated underreporter CP 2057 Soft Notices should honor a taxpayer’s request for an automatic adjustment instead of requiring a Form 1040X.

Issue: Practitioners would like the IRS to reconsider the need for submitting a 1040X when a taxpayer agrees with the CP 2057 and, instead, process the agreed response and make the adjustment. Since many taxpayers find Form 1040X complex, they must seek assistance from a practitioner to complete the form, which adds to their costs.

4. IMRS 10-0001258. Direct access to IRS assistor when calling AUR unit.

Issue: When calling the AUR unit’s toll-free number, tax professionals would like an option added to reach an IRS assistor after accessing the automated response system and going through all the telephone prompts.

Note. The IRS had not yet responded items 3 and 4 when this workbook was published.

5. IMRS 10-0001266. SSNs on taxpayer remittances.

Issue: Tax professionals and their clients expressed concerns about including full social security numbers on checks or money orders remitted to IRS in payment of balance due amounts.

Response: To ensure payments are posted to the correct account, the IRS encourages taxpayers to include their SSNs on checks and money orders submitted to the IRS. The IRS processes millions of returns and payments each year, including many from taxpayers with the same or similar names. Taxpayers concerned about providing their SSNs may consider using the electronic federal tax payment system. EFTPS is a secure alternative to mailing a check.

Between October 2009 and June 2010, 41 issues were entered into the IMRS process and most have been resolved.

2010 Workbook