

Chapter 3: IRS Update

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Please note. Corrections were made to this workbook through January of 2016. No subsequent modifications were made. For clarification about acronyms used throughout this chapter, see the Acronym Glossary at the end of the Index.

For your convenience, in-text website links are also provided as shortURLs. Anywhere you see **uofi.tax/xxx**, the link points to the address immediately following in brackets.

TAX ASPECTS OF THE MARIJUANA INDUSTRY

Note. Changes in federal enforcement efforts and ongoing revisions in state laws have created uncertainty about the civil or criminal liability that a practitioner may face if they provide advice to a taxpayer engaged in a marijuana-based business. It is possible that providing such advice may violate provisions of Circular 230. For further information, see **uofi.tax/15a3x19** [www.aicpa.org/Publications/TaxAdviser/2015/july/Pages/Houser_Jul15.aspx#fn_34].

HISTORY

The Marihuana [sic] Tax Act of 1937 was the first formal federal marijuana tax law. The law placed a tax on the sale of cannabis, hemp, and marijuana. This law's primary purpose was to permit the enforcement of the Uniform Drug Act, and it provided for an occupational tax and registration with the IRS. In 1969, the Supreme Court held this law to be unconstitutional and overturned it in *Leary v. U.S.*¹

In 1970, Congress replaced the unconstitutional 1937 act with the Comprehensive Drug Abuse Prevention Act of 1970,² also known as the Controlled Substance Act. The 1970 law has a 5-tiered schedule and regulates the manufacture, importation, possession, use, and distribution of certain drugs in the United States.

Under federal law, it is illegal to sell marijuana, due to its designation as a controlled substance. Although state laws are frequently in conflict, they have no impact on federal law because of the U.S. Constitution's Supremacy Clause. In addition, the Supreme Court has held that the federal government has a right to regulate or criminalize the sale and use of marijuana.

¹. *Leary v. U.S.*, 369 U.S. 6 (1969).

². PL 91-513.

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In 2009 and 2011, the Department of Justice (DOJ) issued new guidelines that allowed nonenforcement of federal law if certain criteria are met, thus providing a “safe harbor” of sorts to medical marijuana patients. In August 2013, James M. Cole, U.S. Deputy Attorney General, issued a memorandum concerning marijuana enforcement that identified several priorities for the DOJ.³ Due to this initiative, the federal government will rely on states that have passed marijuana laws to police the industry, unless one of the DOJ’s priorities is involved. In addition, marijuana cases will be evaluated on a case-by-case basis to determine whether federal enforcement is required.

Marijuana laws and the views of federal and state governments continue to change, particularly with respect to medical marijuana. Although marijuana is still a controlled substance, governments are increasingly interested only in the illegal distribution and sale of marijuana rather than its use.

There have been several recent cases concerning deductible expenses under federal tax law for marijuana growers. One such case, *Californians Helping to Alleviate Medical Problems*,⁴ concerned a business that was involved in both medical marijuana consulting and sales. The business was legal under California law but violated federal law. Generally, IRC §280E denies a deduction or credit for costs incurred in a business that is involved in the trafficking of a controlled substance. This Code section was the focal point of this case. The ordinary and necessary expenses were disallowed for the sales portion of the business but allowed for the consulting part of the business. Due to IRC §280E, a marijuana business may be required to track up to three different business functions to stay compliant with the law of its state as well as federal law.

In *Olive v. Comm’r*,⁵ all ordinary and necessary expenses were disallowed for a medical marijuana organization. The taxpayer attempted to use the same argument as in *Californians Helping to Alleviate Medical Problems v. Comm’r*, asserting that they provided other services not related to the medical marijuana sales, such as herbal remedies. The taxpayer also did not keep appropriate income and expense records. Upon audit of the 2004 and 2005 returns, the IRS verified some ordinary and necessary expenses, but the cost of goods sold (COGS) lacked substantiation. The Tax Court applied its own estimated COGS adjustment.

In both cases, the Tax Court upheld the application of IRC §280E for medical marijuana businesses by only allowing COGS adjustments. Ordinary and necessary business expenses were disallowed.

*Allgreens, LLC v. IRS*⁶ is a case that could have far-reaching effects for marijuana dispensaries. In this case, Allgreens was penalized for not depositing withholding taxes electronically. Beginning January 1, 2011, the IRS required all employers to electronically deposit their federal withholding taxes if a specific threshold was met.

Banks are hesitant to conduct business with commercial customers whose legality is questionable. Up until 2012, Allgreens had a bank account, but the bank closed the account due to the nature of the business. Allgreens was unable to secure a new account, and the only option available was to pay their taxes with cash.

When deposits were required, Allgreens would make an appointment with the local IRS office and pay the taxes due with cash on a timely basis. **This action resulted in a quarterly 10% penalty assessed to Allgreens by the IRS for failure to electronically deposit trust fund payments. By 2014, the penalty had reached \$25,000.**

The IRS informed Allgreens that the penalty could not be waived and suggested the company use a third party to submit the tax deposits. However, that third party would be exposed to money laundering statutes for handling money from the sale of a controlled substance.

³ *Memorandum for All United States Attorneys*. Cole, James M. Aug. 29, 2013. U.S. Department of Justice. [<http://medicalmarijuana.procon.org/sourcefiles/cole-DOJ-memo-aug-2013.pdf>] Accessed on Jun. 1, 2015.

⁴ *Californians Helping to Alleviate Medical Problems v. Comm’r*, 128 TC 173 (2007).

⁵ *Olive v. Comm’r*, 139 TC 2 (2012).

⁶ *Allgreens, LLC v. IRS*, U.S. Tax Court Docket No. 028012-14.

Allgreens' argument was based on "reasonable cause" due to their inability to obtain a bank account and make the required deposits. In 2014, guidelines were issued to provide banks with some assurances that they would not face federal charges by allowing a legitimate marijuana business to obtain a bank account. However, banks remain hesitant about the risks associated with accepting marijuana businesses as commercial customers.

Because of the substantial penalty Allgreens faced, it filed a petition in Tax Court in June 2014 asking the Tax Court for relief from the penalty. In part, Allgreen's complaint stated the following.⁷

The taxpayer is a timely and compliant taxpayer . . . However, due to federal banking regulations, the taxpayer and all licensed marijuana businesses in Colorado are unable to openly hold and access bank accounts. Thus, many marijuana business taxpayers are forced to make . . . tax deposits and income tax payments in cash or through money order directly to the IRS.

The IRS settled the case by waiving the penalties for Allgreens. The settlement prevented this case from establishing legal precedent that would have been helpful to other marijuana businesses in similar situations.

BUSINESS EXPENSES FOR TAX PURPOSES

IRC §162 defines what constitutes an expense for a trade or business and eliminates the deduction of ordinary and necessary business expenses for marijuana-based businesses because of the "illegality" of the venture. In addition, §280E places limits on what expenses an illegal marijuana-based business is allowed to deduct. These two Code sections work together to limit allowable expenses.

Marijuana-based businesses, like most other businesses, have both **direct** and **indirect** costs. Treas. Reg. §1.471-11(b)(2) defines direct costs as:

. . . those costs which are incident to and necessary for production or manufacturing operations or processes and are components of the costs of either direct material or direct labor. Direct material costs include the costs of those materials which become an integral part of the specific product and those materials which are consumed in the ordinary course of manufacturing and can be identified or associated with particular units or groups of units of that product.

Treas. Reg. §1.471-11(b)(3) defines indirect costs as any cost that is not considered a direct cost.

If the production of marijuana is considered a type of farming, then typical farming expenses related to the production are direct costs. Direct costs include expenses for soil, fertilizer and nutrients, lighting, plants and seeds, electricity, hydroponic supplies, and labor directly related to the growing and cultivating process. These types of direct costs are part of the COGS because they are directly related to the production of the product.⁸

Indirect costs for a marijuana business include the following. **These expenses are not allowed.**

- Building expenses or rental of space (A production facility, however, is allowed.)
- Packaging
- Utilities not related to direct costs
- Wages not related to direct costs
- Transportation
- State licenses and registration

⁷ *Bank Regs Led to Tax Woes for Weed Dispensary, Court Told.* Mahoney, Brian. Jun. 20, 2014. Law 360. [www.law360.com/articles/550375/bank-regs-led-to-tax-woes-for-weed-dispensary-court-told] Accessed on Apr. 20, 2015.

⁸ CCA 201504011 (Dec. 10, 2014).

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- Lab testing for medical marijuana (tests to detect pesticides, mold, and mildew; and potency tests)
- Business development
- Advertising and marketing
- Bank fees
- Phone and Internet
- Postage
- Employment taxes (unless direct labor)
- Security systems
- Scales

Because a marijuana-based business is a trade or business consisting of trafficking in a controlled substance and no IRC §162 deductions or credits are allowed, the only option to reduce income is through COGS. Therefore, it is important to evaluate all expenses and determine which are part of COGS and which are not allowed due to the limits of IRC §§162 and 280E. **Precise recordkeeping is necessary for marijuana-based businesses to be able to deduct COGS expenses.**

If the marijuana-based business has diversified and sells other products or services, this part of the business would be “legal” and have deductible expenses. Ordinary and necessary business expense deductions under IRC §162 are allowable if these other products or services are considered unrelated to the marijuana business. Consequently, there could be three separate businesses.

1. A business can deduct all ordinary and necessary business expenses that are **unrelated to the selling of a controlled substance**.
2. A business that is only involved in the **growing and selling of marijuana** can deduct direct costs and certain indirect costs that may be considered part of the COGS.
3. A business that **sells marijuana for resale** can deduct only direct costs related to the purchase of the marijuana finished product and transportation costs.

Cost of Goods Sold

In *Max Sobel Wholesale Liquors v. Comm'r*,⁹ the court determined that COGS was not a deduction within the meaning of IRC §162 but instead reduces gross receipts in calculating a taxpayer’s gross income. COGS is viewed as an adjustment to gross receipts.

In *Jeffrey Edmonson v. Comm'r*,¹⁰ Mr. Edmonson was a self-employed businessman who sold amphetamines, cocaine, and marijuana. Due to the illegal nature of his business, recordkeeping was minimal. Mr. Edmonson reconstructed records to file a return for 1974. Mr. Edmonson had various direct and indirect expenses associated with his business, and the IRS disallowed all expenses, including COGS.

⁹ *Max Sobel Wholesale Liquors v. Comm'r*, 69 TC 477 (1977), *aff’d* 630 F.2d 670 (9th Cir. 1980).

¹⁰ *Jeffrey Edmonson v. Comm'r*, TC Memo 1981-623 (Oct. 26, 1981).

The Tax Court established that Mr. Edmonson received the drugs on a consignment basis and then paid his supplier out of his sale proceeds. Mr. Edmonson testified about the cost of the drugs, and the court accepted his reconstruction of the COGS based on his “honest, forthright, and candid” testimony. The court ruled that his expenses (both direct and indirect) and his COGS were allowable as ordinary and necessary business expenses. In response to *Edmonson*, Congress enacted IRC §280E to restrict expenses that can be deducted for a business involved in the trafficking of certain controlled substances, including marijuana.

IRC §280E states the following.

No deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of schedule I and II of the Controlled Substances Act) which is prohibited by Federal law or the law of any State in which such trade or business is conducted.

Inventory in Determining COGS. IRC §280E disallows the ordinary and necessary expenses related to the trafficking of a controlled substance. However, COGS is governed by IRC §471, which sets forth the rules for inventories. As a general rule, whenever inventories are necessary to clearly determine the taxpayer’s income, inventory may be taken in a manner that conforms to the best accounting practice for the business to clearly reflect its income.¹¹

Treas. Reg. §1.471-11 states that a taxpayer must include in inventory all direct and indirect costs that are related to production. This is referred to as the **full absorption** method. A marijuana cultivation business must use the full absorption method.

COGS includes raw materials and supplies used in the business. It also includes the labor costs and other overhead related to the production or purchase of an item for resale. This can include freight, storage of raw materials, and even depreciation allocated to production. The following items should be taken into account when computing COGS.

- Beginning inventory
- Purchases less costs of items withdrawn for personal use
- Labor costs (generally applies to manufacturing)
- Materials and supplies used in the manufacturing process
- Other costs (e.g., freight in for raw materials)
- Inventory at yearend

For a marijuana business, IRC §280E determines which business expenditures are included in COGS. In addition, IRC §263A, which addresses the capitalization (or inclusion in inventory costs) of certain expenses, must be considered. The IRS Office of Chief Counsel issued CCM 201504011 in December 2014 to address the following issues.

1. The determination of COGS for a business trafficking in a controlled substance
2. IRS requirements for such a taxpayer to change an inventory method

The IRS stated that an applicable taxpayer uses IRC §471 inventory-costing methods as they were written when IRC §280E became law. Nothing in the enactment of §280E changed §471. Accordingly, in determining COGS, the marijuana farmer is allowed to deduct wages, rents, and repair expenses attributed to production activities. They cannot deduct expenses for general business or marketing activities. In addition, the IRS can require a change in inventory method if the taxpayer is not in compliance with the regulations and Code. Small taxpayers can refer to Rev. Proc. 2001-10 or Rev. Proc. 2002-28 and use a modified cash method as long as the method clearly reflects income and expenses.

¹¹ IRC §471(a).

Under IRC §471, both direct and indirect costs associated with the business must be allocated to the products produced during the year to clearly reflect income. Treas. Reg. §1.471-11 categorizes production costs as **direct** or **indirect** and provides guidance on what is included in each category.

Production costs include costs that are necessary to the production or manufacturing operation or processes. They include direct costs related to the production as well as fixed and variable indirect costs.¹²

Ordinary and Necessary Expenses

As mentioned earlier, an expense is generally deductible if it is an ordinary and necessary business expense.¹³ An expense is **necessary** if it is appropriate and helpful to the business.¹⁴ An expense is **ordinary** if it is a common and accepted expense for the type of business activity.¹⁵

UNIFORM CAPITALIZATION RULES

Generally, the IRC §263A uniform capitalization (UNICAP) rules must be followed, which require that certain indirect costs be allocated to inventory. However, under IRC §263A(b)(2)(B), there is a small business exception to the rules for taxpayers with average annual gross receipts that do not exceed \$10 million (determined using a 3-year average). The UNICAP rules require the capitalization of both direct and indirect costs allocable to real and tangible property produced by the taxpayer, property acquired for resale, inventories valued at market, property produced in a farming business, creative property, and property produced or acquired for resale by a foreign person.¹⁶

Observation. A medical marijuana business benefits from using the UNICAP rules even when it is not required because costs that are allocable to COGS are maximized. There is nothing in the Code or regulations that prevents a business from voluntarily using UNICAP. However, CCM 201504011 recommends that marijuana businesses use the full absorption rules of IRC §471, which provide greater limits on deductions than the UNICAP rules. Although a Chief Counsel Memorandum does not constitute legal precedent, IRS examiners, agents, and legal staff take recommendations from IRS legal counsel into account in an examination or litigation.

¹² Treas. Reg. §1.471-11(a).

¹³ IRC §162.

¹⁴ *Comm'r v. S.B. Heining*, 64 S.Ct. 249 (1943).

¹⁵ IRS Pub. 535, *Business Expenses*, p. 3 (2014).

¹⁶ Treas. Reg. §1.263A-1(a)(3).

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The following two tables provide a guideline for the various direct and indirect costs for a typical marijuana business.

Direct Cost	Description
Training	Directly related to growing or production
Transportation	Freight in of seed and plants to produce the marijuana
Contract labor	Legitimate contract labor directly connected to the production of the crop
Employee wages	Production workers only; direct labor costs of planting, cultivating, harvesting, and sorting identified or associated directly with the production/manufacturing
Marijuana	Purchase of marijuana final product by retailers
Seeds and plants	Purchase of plants and seeds by production facilities
Hydroponic supplies	Dirt, fertilizer, and other products
Compact fluorescent lamps (CFL)	Lighting directly related to the growing and production of the plants
Fans	Involved in the production of the product

Indirect Cost	Description
Rent/building purchase	Includes interest on a production facility mortgage and depreciation on the production facility
Utilities	Only allowed for the production facility; these could include electricity for growing lamps and heat for the facility
Repairs and maintenance	For the production facility only
Insurance	Insurance directly attributed to the production/manufacturing, workers' compensation for production workers, building insurance for the production facility, etc.
Costs of quality control and inspection	Lab testing for medical marijuana
License	Only if required for production, not sales

It should be noted that all these direct and indirect costs have some relationship to the direct production or farming of the product. The indirect costs listed would require some allocation for COGS.

Any costs **not** directly or indirectly related to a production/farming facility are not allowed, due to the IRC §280E limitation. The costs of marijuana sale and distribution are not allowable expenses. For a retail-only business, the costs of the marijuana itself and freight in are generally the only items that qualify as COGS.

Observation. Any costs directly related to production, cultivation, transportation, labor, or training are direct costs for the manufacture of the marijuana. The only indirect costs allowed are those directly related to the production facility.

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The following table provides an overview of typical nondeductible costs of a marijuana business, even though these expenses would be deductible by a “legal” business. This list is not all-inclusive but simply provides examples of some costs that may be incurred.

Nondeductible Cost	Description
Marketing/advertising	Directly related to sales
Sales staff	Wages and employment taxes
Interest/depreciation	The purchase expenses of a building that houses the sales facility (e.g., interest, depreciation of the building, and depreciation of business assets)
General administrative cost	Unless directly related to the production facility, these expenses are not deductible
Sales tax and other taxes collected	Many states charge state and local sales tax on the direct sale of marijuana
Pensions/health insurance	These benefits may be available to the employees but are not deductible unless they are direct expenses of the production facility
Licenses	Some states require licenses to sell marijuana as well as licenses for production and testing
Research and experimental costs	Generally not applicable to the retailer, but some of these expenses could apply to production

Some expenses in the preceding table may require allocation based on the facts and circumstances of the particular business. The retailer-only business not involved in the production or growing of marijuana generally has fewer expenses that qualify as COGS.

Example 1. In 2015, Joe established a marijuana business called The Marijuana Store for the sale of medical and recreational marijuana. Joe rented a building separate from his store to cultivate his marijuana crop and he trained the production staff who were directly involved in nurturing the plants. Joe purchased plants, seeds, lighting systems, fans, and hydroponic supplies. This business will be reported on Schedule F, *Profit or Loss From Farming*.

Joe also operates a store located apart from the production facility for security reasons. The store sells T-shirts, pipes, bumper stickers, and other promotional products. This business will be reported on Schedule C, *Profit or Loss From Business*.

Joe visits his tax preparer, Fred. Joe provides Fred with records showing the following income.

Gross income from marijuana sales	\$ 853,258
Gross income from store sales	<u>149,302</u>
Total gross income	\$1,002,560

Note. Records for marijuana sales are often **not** kept separate from the records for sales of other items or other business activities. Accordingly, the tax preparer may need to make additional inquiries in order to obtain separate amounts for these different activities. Separate records should be maintained for marijuana production or sales.

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The following expenses were incurred in the production of marijuana. These expenses are COGS; accordingly, they are reported on line 1b of Schedule F.

Note. Lighting and fans are depreciable assets. In this example, assume that an IRC §179 deduction was claimed in connection with these assets.

3

Expense	Cost	Direct	Indirect
Training of production workers	\$ 8,678	X	
Shipping cost for plants and seeds	1,208	X	
Seeds and plants	38,980	X	
Hydroponic supplies	9,678	X	
Lighting and fans	15,980	X	
Rent — production facility	36,000		X
Utilities — production facilities	4,561		X
Production worker wages	60,758	X	
Production worker employment taxes	6,647	X	
Production facility repairs	2,678		X
Production facility insurance	19,526		X
Quality control and lab testing	6,457		X
Total expenses	\$211,151		
Ending inventory	(16,234)		
Costs of goods sold	\$194,917		

Net profit is calculated as follows.

Gross income from marijuana sales	\$853,258
Less: COGS	(194,917)
Net profit from marijuana sales	\$658,341

All other expenses related to marijuana sales are not allowed. Joe's Schedule F follows.

Note. The \$149,302 of store sales are reported on a separate Schedule C because they are unrelated to the direct sale of marijuana. Ordinary and necessary expenses related to these store sales are fully deductible. **No other expenses for the sale of marijuana are allowed.** This is why separate records for marijuana sales are necessary. If the business only sold marijuana (regardless of whether it is for medical or recreational purposes), then any expenses related to the direct sales part of the business would not be deductible.

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For Example 1

SCHEDULE F (Form 1040)

Department of the Treasury
Internal Revenue Service (99)

Profit or Loss From Farming

► Attach to Form 1040, Form 1040NR, Form 1041, Form 1065, or Form 1065-B.
► Information about Schedule F and its separate instructions is at www.irs.gov/schedulef.

OMB No. 1545-0074

2015
Attachment
Sequence No. **14**

Name of proprietor Smoking Joe		Social security number (SSN) 98-765-4321	
A Principal crop or activity Farming	B Enter code from Part IV 1 1 1 9 0 0	C Accounting method: <input checked="" type="checkbox"/> Cash <input type="checkbox"/> Accrual	D Employer ID number (EIN), (see instr) 5 5 5 5 5 5 5 5 5 5
E Did you "materially participate" in the operation of this business during 2015? If "No," see instructions for limit on passive losses		<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	
F Did you make any payments in 2015 that would require you to file Form(s) 1099 (see instructions)?		<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	
G If "Yes," did you or will you file required Forms 1099?		<input type="checkbox"/> Yes <input type="checkbox"/> No	

Part I Farm Income—Cash Method. Complete Parts I and II (Accrual method. Complete Parts II and III, and Part I, line 9.)

1a Sales of livestock and other resale items (see instructions)	1a	853,258	
b Cost or other basis of livestock or other items reported on line 1a	1b	194,917	
c Subtract line 1b from line 1a	1c		658,341
2 Sales of livestock, produce, grains, and other products you raised	2		
3a Cooperative distributions (Form(s) 1099-PATR)	3a		3b Taxable amount
4a Agricultural program payments (see instructions)	4a		4b Taxable amount
5a Commodity Credit Corporation (CCC) loans reported under election	5a		5a
b CCC loans forfeited	5b		5c Taxable amount
6 Crop insurance proceeds and federal crop disaster payments (see instructions)			
a Amount received in 2015	6a		6b Taxable amount
c If election to defer to 2016 is attached, check here <input type="checkbox"/>	6d	Amount deferred from 2014	6d
7 Custom hire (machine work) income	7		
8 Other income, including federal and state gasoline or fuel tax credit or refund (see instructions)	8		
9 Gross income. Add amounts in the right column (lines 1c, 2, 3b, 4b, 5a, 5c, 6b, 6d, 7, and 8). If you use the accrual method, enter the amount from Part III, line 50 (see instructions)	9		658,341

Part II Farm Expenses—Cash and Accrual Method. Do not include personal or living expenses (see instructions).

10 Car and truck expenses (see instructions). Also attach Form 4562	10		23 Pension and profit-sharing plans	23	
11 Chemicals	11		24 Rent or lease (see instructions):	24	
12 Conservation expenses (see instructions)	12		a Vehicles, machinery, equipment	24a	
13 Custom hire (machine work)	13		b Other (land, animals, etc.)	24b	
14 Depreciation and section 179 expense (see instructions)	14		25 Repairs and maintenance	25	
15 Employee benefit programs other than on line 23	15		26 Seeds and plants	26	
16 Feed	16		27 Storage and warehousing	27	
17 Fertilizers and lime	17		28 Supplies	28	
18 Freight and trucking	18		29 Taxes	29	
19 Gasoline, fuel, and oil	19		30 Utilities	30	
20 Insurance (other than health)	20		31 Veterinary, breeding, and medicine	31	
21 Interest:			32 Other expenses (specify):		
a Mortgage (paid to banks, etc.)	21a		a	32a	
b Other	21b		b	32b	
22 Labor hired (less employment credits)	22		c	32c	
			d	32d	
			e	32e	
			f	32f	
33 Total expenses. Add lines 10 through 32f. If line 32f is negative, see instructions	33				
34 Net farm profit or (loss). Subtract line 33 from line 9	34				658,341
If a profit, stop here and see instructions for where to report. If a loss, complete lines 35 and 36.					
35 Did you receive an applicable subsidy in 2015? (see instructions) <input type="checkbox"/> Yes <input type="checkbox"/> No					
36 Check the box that describes your investment in this activity and see instructions for where to report your loss.					
a <input type="checkbox"/> All investment is at risk. b <input type="checkbox"/> Some investment is not at risk.					

For Paperwork Reduction Act Notice, see the separate instructions.

Cat. No. 11346H

Schedule F (Form 1040) 2015

In the preceding example, the business has a net profit of \$658,341. **If other ordinary and necessary business expenses were allowed under §162, the profit would have been much less. However, IRC §280E disallows all other expenses not directly related to COGS.**

The business in **Example 1** requires recordkeeping for the marijuana production facility, the sales income and expenses, and the sales and expenses of other related merchandise. When the IRS audits this type of business, it looks at how each expense was identified and categorized. Recordkeeping is very important, and allocations have to be clearly identified. **In many cases, a detailed description of the expense and why it was categorized as COGS could aid the taxpayer when faced with questions by the examiner.**

STATE-LEVEL LICENSES AND LAWS

There are several types of state marijuana licenses. The types of licenses vary depending on state law. These are summarized in the following table.

Grower or farmer	Grows the product from seeds or plants; may or may not process the product
Processor	Purchases the product from the grower and processes it for medical or recreational use
Retailer	Sells marijuana over the counter for medical or recreational use
Medical marijuana dispensaries	Dispenses medical marijuana to registered patients in various forms
Treatment licenses	Similar to the medical marijuana dispensaries; also provides treatment to patients and has more diversity in the business
Patients	Generally registered in their state; must present evidence of a medical purpose for the marijuana purchase

In most states, marijuana businesses must be licensed by the state, and patients must be registered to purchase medical marijuana. As of June 2015, 23 states have passed laws to legalize marijuana to some degree. Four states (Alaska, Colorado, Oregon, and Washington) have legalized recreational use of marijuana. State laws in this area are continually evolving.

Note. For updated information on the status of various state laws concerning marijuana use, see **uofi.tax/15a3x1** [www.governing.com/gov-data/state-marijuana-laws-map-medical-recreational.html] as well as **uofi.tax/15a3x2** [www.cnn.com/interactive/2014/01/politics/map-marijuana].

Marijuana is still illegal in many states. Its possession and/or use may constitute a felony or a misdemeanor, depending on prevailing state law. In addition, all states have laws concerning the transportation and cultivation of marijuana.¹⁷

¹⁷ For further details, see *Governing Data: State Marijuana Laws Map*. Apr. 17, 2015. [www.governing.com/gov-data/safety-justice/state-marijuana-laws-map-medical-recreational.html] Accessed on Jun. 1, 2015.

STREAMLINED APPLICATION FOR TAX-EXEMPT STATUS

Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, was created to make it easier to obtain tax-exempt status. The new Form 1023-EZ will improve and streamline the application process and allow an organization to begin its work earlier, which may be important if the need for the organization's services is urgent.

The IRS estimates that about 70% of new tax-exempt organizations will be able to utilize the form. IRS Commissioner John Koskinen stated:

*We believe that many small organizations will be able to complete this form without creating major compliance risks. Rather than using large amounts of IRS resources up front reviewing complex applications during a lengthy process, we believe the streamlined form will allow us to **devote more compliance activity on the back end to ensure groups are actually doing the charitable work they apply to do.***¹⁸

The IRS takes many months to process a Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*. This is because the IRS must carefully review each section of the application to ensure compliance. Additional communication with the applicant is frequently necessary to ensure the appropriate tax-exempt status is assigned. Prior to the introduction of Form 1023-EZ, all applications went through the same process, regardless of the organization's size or complexity. However, the IRS recognized the hardships to organizations and their missions by imposing such a lengthy process on all applications for tax-exempt status. Accordingly, Form 1023-EZ was created.

Note. The current rules associated with the granting of tax-exempt status are found in Rev. Proc. 2014-40.¹⁹

Note. Form 1023-EZ was introduced by the IRS on **July 1, 2014**,²⁰ and must be filed **electronically**.²¹

For organizations that meet the criteria to file Form 1023-EZ, using this easier method may be the best way to apply. Applicants using Form 1023-EZ are subject to a more lenient initial application process. However, the Form 1023-EZ instructions state that the "IRS will select a statistically valid random sample of applications for pre-determination reviews, which may result in requests for additional information." This means that despite a more streamlined initial process, a later, more intense examination could occur.

Currently, the IRS processes more than 70,000 tax-exempt applications annually. With the increasing number of tax-exempt organizations (EOs), the IRS created the Review of Operations Unit (ROO) as a review function for EOs.²² The purpose of the ROO is to streamline the EO application process with a post-application compliance review.

¹⁸ *New 1023-EZ Form Makes Applying for 501(c)(3) Tax-Exempt Status Easier; Most Charities Qualify*. Dec. 12, 2014. [www.irs.gov/uac/Newsroom/New-1023-EZ-Form-Makes-Applying-for-501c3Tax-Exempt-Status-Easier-Most-Charities-Qualify] Accessed on Apr. 20, 2015.

¹⁹ Rev. Proc. 2014-40, 2014-30 IRB 229.

²⁰ Ibid.

²¹ Instructions for Form 1023-EZ.

²² Treasury Inspector General for Tax Administration. *Performance Measures and Improved Case Tracking Would Help the Exempt Organizations Function, Better Allocate Resources*. Reference No. 2008-10-057 (Mar. 13, 2008).

In 2008, the Treasury Inspector General for Tax Administration (TIGTA) issued the report *Performance Measures and Improved Case Tracking Would Help the Exempt Organizations Function, Better Allocate Resources*.²³ This report scrutinized the ROO, the IRS unit that generally reviews EO applications and related items to determine the validity of the organization's application. The ROO generally selects EO returns for review approximately three to five years after the organization has received their exempt status to determine whether the organization is in compliance with the tax-exempt purpose outlined in the application.

Because the introduction of Form 1023-EZ (and the accompanying streamlined process) is recent, it is unknown what percentage of Forms 1023-EZ will be subject to scrutiny by the ROO. However, given the large number of organizations that may qualify to use Form 1023-EZ, it seems logical that a higher percentage of these simple streamlined returns may be reviewed.

ELIGIBILITY FOR FORM 1023-EZ

Only certain organizations are eligible to use Form 1023-EZ. The instructions to Form 1023-EZ provide a worksheet to assist in determining eligibility. In order to determine eligibility, the applicant must answer "yes" or "no" to each question. **Only those applicants that can answer "no" to all the questions are eligible to use Form 1023-EZ.** The questions in the eligibility worksheet follow.

Note. For more information on Form 1023-EZ eligibility, see **uofi.tax/15a3x3** [www.irs.gov/pub/irs-pdf/i1023ez.pdf].

1. Do you project that the annual gross receipts will exceed \$50,000 in any of the next three years?
2. Have the annual gross receipts exceeded \$50,000 in any of the past three years?
3. Does the organization have total assets in excess of \$250,000?
4. Was the organization formed under the laws of a foreign country? (United States territories and possessions are not considered foreign countries.)
5. Is the organization's mailing address in a foreign county? (United States territories and possessions are not considered foreign countries.)
6. Is the organization a successor to, or controlled by, an entity suspended under IRC §501(p) (suspension of tax-exempt status of terrorist organizations)?
7. Is the organization a limited liability company (LLC)? This applies if the organization has been formed under state laws as an LLC.
8. Is the organization a successor to a for-profit entity?
 - a. Has the organization substantially taken over all the assets and activities for a for-profit entity?
 - b. Has the organization been converted or merged with a for-profit entity?
 - c. Has the new organization installed the same officers, directors, or trustees as the for-profit entity that no longer exists?
9. Was the organization's status previously revoked, or is it a successor to a previously revoked organization? (This does not apply if the organization's tax-exempt status was automatically revoked because it failed to file the required Form 990-series return for the past three consecutive years.)

²³ Ibid.

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10. Is the organization a church or a convention or association of churches detailed in IRC §170(b)(1)(A)(i)? (These organizations have specific characteristics, which are provided in the Form 1023-EZ instructions.)
11. Is the organization a school, college, or university as defined in IRC §170(b)(1)(A)(ii)? (These organizations have specific characteristics, which are provided in the Form 1023-EZ instructions.)
12. Is the organization a hospital or medical research organization as defined in IRC §170(b)(1)(A)(iii) or a hospital organization as defined in IRC §501(r)(2)(A)(i)? (More information is provided on the Form 1023-EZ worksheet.)
13. Is the organization a cooperative hospital service organization as defined under IRC §501(e)?
14. Is the organization a cooperative service organization of operating educational organizations under IRC 501(f)?
15. Is the entity a qualified charitable risk pool as defined in IRC 501(n)?
16. Is the organization requesting a classification as a supporting organization under IRC §509(a)(3)?
17. Is a substantial purpose of the organization's activities to provide assistance to individuals through credit counseling activities?
18. Will the organization invest 5% or more of total assets in securities or funds not publicly traded?
19. Does the organization participate or intend to participate in partnerships in which the profits or losses are shared with partners that are not 501(e)(3) organizations?
20. Is the organization involved in the sale of carbon credits or carbon offsets?
21. Is the organization a health maintenance organization (HMO)?
22. Is the organization an accountable care organization (ACO) or is the organization engaged in or intend to engage in ACO activities?
23. Does the organization maintain or intend to maintain one or more donor advised funds?
24. Is the organization operated exclusively for testing public safety and requesting a foundation classification as defined in IRC §509(a)(4)?
25. Is the organization requesting a classification as a private operating foundation?
26. Is the organization applying for a retroactive reinstatement under section 5 or 6 of Rev. Proc. 2014-11, after being automatically revoked?

FILING FORM 1023-EZ²⁴

If Form 1023-EZ is filed within 27 months after the end of the month in which the organization is legally formed, the effective date of tax-exempt status is retroactive to the date the organization was legally formed. If the application is not filed within the 27-month period, the effective date of the tax-exempt status is the date the Form 1023-EZ was filed.

Note. Even if Form 1023-EZ is not filed within 27 months of formation, the organization may request a tax-exemption date that is retroactive to the organization's establishment date. Generally, a request must be in the form of a letter that explains why the organization believes it qualifies for a retroactive date. For further details on the required contents of the letter and the IRS address to which such a request should be sent, see the instructions to Form 1023-EZ.

²⁴ Instructions for Form 1023-EZ.

Organizations that are eligible to use Form 1023-EZ **must complete and submit the form electronically** by visiting **www.pay.gov**. There is a \$400 filing fee that can be paid directly from the applicant's bank account or by debit or credit card.

Note. For additional details on the filing procedure, see the instructions to Form 1023-EZ. Applicants that do not qualify to file Form 1023-EZ can file Form 1023. IRS customer account services may be reached at 877-829-5500, and they can provide assistance with completing this form.

Preliminary Information

Completing Form 1023-EZ requires the applicant organization to have some preliminary information to complete the form. This preliminary information includes the following items.

- Legal formation documents (see part II of Form 1023-EZ for a list of requirements)
- An employer identification number (EIN)
- IRC §501(c)(3) purpose and dissolution clauses
- The person who will be appointed as power of attorney (POA) to represent the organization before the IRS (if the applicant organization chooses to appoint a POA)

Note. If the applicant organization does not qualify to complete Form 1023-EZ and must instead use the longer Form 1023, this preliminary information is still required. The IRS provides an interactive online tool that the applicant organization may use to determine whether it has the necessary preliminary items of information. This tool can be found at **uofi.tax/15a3x5** [www.stayexempt.irs.gov/Starting-Out/Interactive-Form-1023-Prerequisite-Questions].

The organizational document must have language in it that limits the organization's purposes to those described in IRC §501(c)(3). These purposes may be charitable, religious, educational, scientific, literary, testing for public safety, fostering international amateur sports competition, or preventing cruelty to children or animals. An example of language that meets this requirement follows.²⁵

The organization is organized exclusively for charitable, religious, educational, and scientific purposes under section 501(c)(3) of the Internal Revenue Code, or corresponding section of any future federal tax code.

In addition, in order to qualify for tax-exempt status, the organization's assets must be committed to purposes listed in §501(c)(3), even upon dissolution. Accordingly, the organizational document must include language that ensures assets will be distributed for §501(c)(3) purposes if the organization dissolves. An example of language meeting this requirement follows.²⁶

Upon the dissolution of this organization, assets shall be distributed for one or more exempt purposes within the meaning of section 501(c)(3) of the Internal Revenue Code, or corresponding section of any future federal tax code, or shall be distributed to the federal government, or to a state or local government, for a public purpose.

Note. For further details regarding the required purpose and dissolution language, see the instructions for Form 1023-EZ.

²⁵ Instructions for Form 1023-EZ.

²⁶ Ibid.

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Obtaining and Canceling an EIN for a Tax-Exempt Organization. An organization that anticipates obtaining tax-exempt status generally files for an EIN before applying for EO status. The organization must be legally formed before this step is taken. The IRS issues the EIN and determines the initial filing requirements based on the information provided.

Note. An EIN application can be completed online at **uofi.tax/15a3x6** [<https://sa.www4.irs.gov/modiein/individual/index.jsp>].

If the organization is assigned an EIN but never applies for tax-exempt status, a letter should be sent to the IRS closing the account. This is an important step that is often overlooked, and tax professionals may be asked to assist in this process.

If the IRS is not informed that the nonprofit never came into existence, IRS records will show that a filing requirement remains. Notices will be issued asking for the required forms. The IRS will continue to send notices in connection with the EO's filing requirements unless it is notified that the EO was never established. A letter must be sent to the IRS requesting the closure of the tax-exempt EIN account if the organization:

- Never applied for formal exemption,
- Is not covered in a group ruling, **and**
- Never filed an information return.

To cancel the organization's EIN, the letter must state the reason for the request to close the EIN account. If the organization has a copy of the EIN assignment notice that was issued when the EIN was assigned, it should be included with the letter. If the EIN assignment notice is not attached to the letter, the complete legal name of the entity, the EIN, and the mailing address must be included.²⁷

The request letter must be sent to the IRS at the following address or faxed to the IRS at 801-620-7116.

Internal Revenue Service
Attn: EO Entity
Mail Stop 6273
Ogden, UT 84201

Completing Form 1023-EZ

Form 1023-EZ consists of the following six parts.

- Part I.** Identification of applicant
- Part II.** Organizational structure
- Part III.** Specific activities
- Part IV.** Foundation classification
- Part V.** Reinstatement after automatic revocation
- Part VI.** Signature

²⁷ *Canceling an EIN: Closing Your Account.* Dec. 18, 2014. [www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Canceling-an-EIN-Closing-Your-Account] Accessed on Jun. 3, 2015.

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Part I: Identification of Applicant. The applicant provides identifying information in part I of Form 1023-EZ. This section of the form follows.

Form 1023-EZ (Rev. June 2014) Department of the Treasury Internal Revenue Service	Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code Do not enter Social Security numbers on this form as it will be made public. Information about Form 1023-EZ and its separate instructions is at www.irs.gov/form1023	OMB No. 1545-0056 Note: If exempt status is approved, this application will be open for public inspection.
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☐ Check this box to attest that you have completed the Form 1023-EZ Eligibility Worksheet in the current instructions, are eligible to apply for exemption using Form 1023-EZ, and have read and understand the requirements to be exempt under section 501(c)(3).

Part I Identification of Applicant

1a Full Name of Organization				
b Address (number, street, and room/suite). If a P.O. box, see instructions.		c City	d State	e Zip code + 4
2 Employer Identification Number	3 Month Tax Year Ends (MM)	4 Person to Contact if More Information is Needed		
5 Contact Telephone Number		6 Fax Number (optional)	7 User Fee Submitted \$400.00	
8 List the names, titles, and mailing addresses of your officers, directors, and/or trustees. (If you have more than five, see instructions.)				
First Name:		Last Name:		Title:
Street Address:		City:	State:	Zip code + 4:
First Name:		Last Name:		Title:
Street Address:		City:	State:	Zip code + 4:
First Name:		Last Name:		Title:
Street Address:		City:	State:	Zip code + 4:
First Name:		Last Name:		Title:
Street Address:		City:	State:	Zip code + 4:
First Name:		Last Name:		Title:
Street Address:		City:	State:	Zip code + 4:
9a Organization's Website (if available):				
b Organization's Email (optional):				

Organizational Structure

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Part II: Organizational Structure. The organization must provide information about its structure in applying for tax-exempt status using Form 1023-EZ. Part II of Form 1023-EZ is used for this purpose. **Only corporations, unincorporated associations, or trusts may use Form 1023-EZ.**

Observation. Before applying for tax-exempt status, the organization should file all necessary documents with the relevant agencies of their state government. The questions in part II provide insight on what specific documents are required so that the organization will qualify for tax-exempt status. Ensuring that the state-level documents meet IRS requirements for tax-exempt status before filing Form 1023-EZ may save the organization substantial costs that may be incurred in resolving deficiencies in the relevant documentation after filing a request for tax-exempt status.

b Organization (if not a corporation):

Part II Organizational Structure

- 1 To file this form, you must be a corporation, an unincorporated association, or a trust. **Check the box** for the type of organization.
☐ Corporation ☐ Unincorporated association ☐ Trust
- 2 ☐ **Check this box** to attest that you have the organizing document necessary for the organizational structure indicated above.
(See the instructions for an explanation of **necessary organizing documents**.)
- 3 Date incorporated if a corporation, or formed if other than a corporation (MMDDYYYY): _____
- 4 State of Incorporation or other formation: _____
- 5 Section 501(c)(3) requires that your organizing document must limit your purposes to one or more exempt purposes within section 501(c)(3).
☐ **Check this box** to attest that your organizing document contains this limitation.
- 6 Section 501(c)(3) requires that your organizing document must not expressly empower you to engage, otherwise than as an insubstantial part of your activities, in activities that in themselves are not in furtherance of one or more exempt purposes.
☐ **Check this box** to attest that your organizing document does not expressly empower you to engage, otherwise than as an insubstantial part of your activities, in activities that in themselves are not in furtherance of one or more exempt purposes.
- 7 Section 501(c)(3) requires that your organizing document must provide that upon dissolution, your remaining assets be used exclusively for section 501(c)(3) exempt purposes. Depending on your entity type and the state in which you are formed, this requirement may be satisfied by operation of state law.
☐ **Check this box** to attest that your organizing document contains the dissolution provision required under section 501(c)(3) or that you do not need an express dissolution provision in your organizing document because you rely on the operation of state law in the state in which you are formed for your dissolution provision.

For Paperwork Reduction Act Notice, see the instructions

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Form **1023-EZ** (Rev. 6-2014)

Part III: Specific Activities. In order to qualify for tax-exempt status, the organization must generally have a purpose that conforms to those listed in IRC §501(c)(3). These IRC §501(c)(3) purposes are listed in part III, line two. Part III also requests information about other activities of the organization and lists certain activities that are prohibited.

Organizations that obtain tax-exempt status may have **unrelated business income (UBI)**.²⁸ UBI is income from a regularly conducted trade or business activity that is not substantially related to the organization's tax-exempt purpose or function. Generally, tax-exempt organizations must report and pay tax on UBI in excess of \$1,000.

Note. Failure to report UBI by tax-exempt organizations is an issue that has received increased IRS scrutiny in recent years. UBI is reported using Form 990-T, *Exempt Organization Business Tax Return*. For further details on UBI and the tax on UBI, see IRS Pub. 598, *Tax on Unrelated Business Income of Exempt Organizations*, and uofi.tax/15a3x7 [www.irs.gov/Charities-&-Non-Profits/Unrelated-Business-Income-Defined].

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Part III Your Specific Activities

- 1 Enter the appropriate 3-character NTEE Code that best describes your activities (See the instructions): _____
- 2 To qualify for exemption as a section 501(c)(3) organization, you must be organized and operated exclusively to further one or more of the following purposes. By checking the box or boxes below, you attest that you are organized and operated exclusively to further the purposes indicated. **Check all that apply.**

<input type="checkbox"/> Charitable	<input type="checkbox"/> Religious	<input type="checkbox"/> Educational
<input type="checkbox"/> Scientific	<input type="checkbox"/> Literary	<input type="checkbox"/> Testing for public safety
<input type="checkbox"/> To foster national or international amateur sports competition	<input type="checkbox"/> Prevention of cruelty to children or animals	
- 3 To qualify for exemption as a section 501(c)(3) organization, you must:
 - Refrain from supporting or opposing candidates in political campaigns in any way.
 - Ensure that your net earnings do not inure in whole or in part to the benefit of private shareholders or individuals (that is, board members, officers, key management employees, or other insiders).
 - Not further non-exempt purposes (such as purposes that benefit private interests) more than insubstantially.
 - Not be organized or operated for the primary purpose of conducting a trade or business that is not related to your exempt purpose(s).
 - Not devote more than an insubstantial part of your activities attempting to influence legislation or, if you made a section 501(h) election, not normally make expenditures in excess of expenditure limitations outlined in section 501(h).
 - Not provide commercial-type insurance as a substantial part of your activities.

☐ **Check this box** to attest that you have not conducted and will not conduct activities that violate these prohibitions and restrictions.
- 4 Do you or will you attempt to influence legislation? _____ ☐ Yes ☐ No
(If yes, consider filing Form 5768. See the instructions for more details.)
- 5 Do you or will you pay compensation to any of your officers, directors, or trustees? _____ ☐ Yes ☐ No
(Refer to the instructions for a definition of **compensation**.)
- 6 Do you or will you donate funds to or pay expenses for individual(s)? _____ ☐ Yes ☐ No
- 7 Do you or will you conduct activities or provide grants or other assistance to individual(s) or organization(s) outside the United States? _____ ☐ Yes ☐ No
- 8 Do you or will you engage in financial transactions (for example, loans, payments, rents, etc.) with any of your officers, directors, or trustees, or any entities they own or control? _____ ☐ Yes ☐ No
- 9 Do you or will you have unrelated business gross income of \$1,000 or more during a tax year? _____ ☐ Yes ☐ No
- 10 Do you or will you operate bingo or other gaming activities? _____ ☐ Yes ☐ No
- 11 Do you or will you provide disaster relief? _____ ☐ Yes ☐ No

²⁸ IRS Pub. 598, *Tax on Unrelated Business Income of Exempt Organizations*.

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Part IV: Foundation Classification. To qualify under IRC 501(c)(3), an organization must be either a public charity or a private foundation. The purpose of part IV of Form 1023-EZ is to classify the applicant organization into one of these two categories. A public charity typically has a broad number of donors and supporters, and a private foundation usually has a smaller number of donors. Classification is important because a public charity is subject to different tax rules than those that apply to a private foundation (including the rules regarding deductibility of contributions).

Note. For further details on the differences between a public charity and a private foundation, including the differences in the applicable tax rules, see IRC §501(c)(3) and related regulations and IRS Pub. 557, *Tax-Exempt Status for Your Organization*.

The following table summarizes some of the key differences between a public charity and a private foundation.

Public Charity	Private Foundation
Well known by general public	Less known by general public
Publicly funded (at least 33% of funds must come from general public and small donors)	Funded by an individual or small group
Donors may deduct contributions up to 50% of AGI	A donor limit of 30% of AGI may apply to certain private foundations
Simpler annual tax filing requirements; may qualify to file a simplified "electronic postcard" return if gross receipts for the year are \$50,000 or less	Complex annual tax filing requirements; Form 990-PF, <i>Return of Private Foundation</i> , must be filed annually

Note. Because private foundations are typically funded by a small control group instead of the general public, the tax rules applicable to private foundations are generally more stringent than the tax rules applicable to a public charity. For more information on the distinction between these two types of organizations, see uofi.tax/15a3x8 [www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations].

An organization applying for tax-exempt status must determine whether it qualifies as a public charity or a private foundation. The organization then indicates this on Form 1023-EZ, part IV, which follows.

Part IV Foundation Classification

Part IV is designed to classify you as an organization that is either a private foundation or a public charity. Public charity status is a more favorable tax status than private foundation status.

- 1 If you qualify for public charity status, check the appropriate box (1a - 1c below) and skip to Part V below.
 - a ☐ Check this box to attest that you normally receive at least one-third of your support from public sources or you normally receive at least 10 percent of your support from public sources and you have other characteristics of a publicly supported organization. **Sections 509(a)(1) and 170(b)(1)(A)(vi).**
 - b ☐ Check this box to attest that you normally receive more than one-third of your support from a combination of gifts, grants, contributions, membership fees, and gross receipts (from permitted sources) from activities related to your exempt functions and normally receive not more than one-third of your support from investment income and unrelated business taxable income. **Section 509(a)(2).**
 - c ☐ Check this box to attest that you are operated for the benefit of a college or university that is owned or operated by a governmental unit. **Sections 509(a)(1) and 170(b)(1)(A)(iv).**
- 2 If you are not described in items 1a - 1c above, you are a private foundation. As a private foundation, you are required by section 508(e) to have specific provisions in your organizing document, unless you rely on the operation of state law in the state in which you were formed to meet these requirements. These specific provisions require that you operate to avoid liability for private foundation excise taxes under sections 4941-4945.
☐ Check this box to attest that your organizing document contains the provisions required by section 508(e) or that your organizing document does not need to include the provisions required by section 508(e) because you rely on the operation of state law in your particular state to meet the requirements of section 508(e). (See the instructions for explanation of the section 508(e) requirements.)

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Part V: Reinstatement After Automatic Revocation. Generally, tax-exempt organizations that fail to comply with annual federal tax filing requirements for three consecutive years automatically lose their tax-exempt status.²⁹ Donors cannot make tax-deductible contributions to an organization with a revoked tax-exempt status. The organization may be required to file a Form 1120, *U.S. Corporation Income Tax Return*, and pay tax on income received. However, the organization may take appropriate steps to reinstate tax-exempt status.

Note. The IRS publishes a list of organizations with revoked tax-exempt status. This list can be found at [uofi.tax/15a3x9](http://www.irs.gov/Charities-&-Non-Profits/Automatic-Revocation-of-Exemption) [www.irs.gov/Charities-&-Non-Profits/Automatic-Revocation-of-Exemption].

Part V of Form 1023-EZ should only be completed if the tax-exempt status has been revoked.

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Part V Reinstatement After Automatic Revocation

Complete this section only if you are applying for reinstatement of exemption after being automatically revoked for failure to file required annual returns or notices for three consecutive years, and you are applying for reinstatement under section 4 or 7 of Revenue Procedure 2014-11. (Check only one box.)

- 1 ☐ **Check this box** if you are seeking retroactive reinstatement under section 4 of Revenue Procedure 2014-11. By checking this box, you attest that you meet the specified requirements of section 4, that your failure to file was not intentional, and that you have put in place procedures to file required returns or notices in the future. (See the instructions for requirements.)
- 2 ☐ **Check this box** if you are seeking reinstatement under section 7 of Revenue Procedure 2014-11, effective the date you are filling this application.

Part VI: Signature. An officer, director, or trustee listed on line 8 of part I and who is authorized to sign for the organization must sign the Form 1023-EZ. All signatures are electronic, and the signer must check the “penalties of perjury” box in part VI.

Part VI Signature

- ☐ **I declare under the penalties of perjury that I am authorized to sign this application on behalf of the above organization and that I have examined this application, and to the best of my knowledge it is true, correct, and complete.**

(Type name of signer)

(Type title or authority of signer)

(Date)

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²⁹ IRC §6033(j).

OFFERS IN COMPROMISE

An offer in compromise (OIC) is an application to settle an IRS tax liability for less than the full amount of tax and penalties that are due for a period or periods. The IRS objectives of the OIC program are as follows.³⁰

- Obtain what can reasonably be collected at the earliest possible time with the least cost to the government
- Resolve the taxpayer's delinquent tax liability in a manner that in the best interests of both the taxpayer and the IRS
- Provide the taxpayer with a fresh start toward future compliance with filing and payment requirements
- Collect tax that may not otherwise be collected

GROUNDINGS FOR AN OIC APPLICATION

After a taxpayer applies for an OIC, the IRS reviews the taxpayer's ability to pay, income, expenses, and asset equity. Acceptance of an OIC depends on meeting one or more of the following grounds.

- Doubt as to collectability
- Doubt as to liability
- The best interest of tax administration

The IRS may accept the OIC application on the basis of any of these three grounds. The taxpayer must submit appropriate documentation to establish that the grounds for application have been met.

Doubt as to Collectability

Doubt as to collectability exists in any case in which the taxpayer's assets and income are less than the full amount of the assessed liability. When doubt as to collectability has been established, an offer is generally considered acceptable if it closely approximates the amount that could reasonably be collected by other means, including through IRS administrative and judicial collection powers.

The following four components of collectability must be considered.³¹

1. Net equity in assets
2. Present and future income
3. Amounts collectable from third parties
4. Amounts available to the taxpayer but beyond IRS reach

Doubt as to Liability

Doubt as to liability exists when there is a genuine dispute as to the existence or amount of the correct tax liability under the law. Doubt as to liability does not exist when the liability has been established by a final court decision concerning the existence or amount of the liability.³²

³⁰ IRM 5.8.1.1.4 (2008).

³¹ IRM 33.3.2.3.2 (2010).

³² IRM 33.3.2.3.1 (2010).

Best Interests of Tax Administration

In general, when there are no grounds for compromise on collectability or liability grounds, a compromise may be entered into in order to promote effective tax administration. This applies when collection of the full liability would create economic hardship within the meaning of Treas. Reg. §301.6343-1 or when compelling public policy or equity considerations identified by the taxpayer provide a sufficient basis for compromising the liability.³³

Note. Further details on each of these three grounds can be found in Treas. Reg. §301.7122-1.

AVOIDING DELAYS

A common error that can delay the processing of an OIC is the use of outdated forms. For applications based on doubt as to collectability grounds or effective tax administration grounds, the most recent version of Form 656, *Offer in Compromise*, and Form 433-A (OIC), *Collection Information Statement for Wage Earners and Self-Employed Individuals*, and/or Form 433-B (OIC), *Collection Information Statement for Businesses*, must be used.

For OIC applications based on doubt as to liability grounds, Form 656-L, *Offer in Compromise (Doubt as to Liability)*, is used.

Note. Further information regarding the submission of an OIC may be found at **uofi.tax/15a3x10** [www.irs.gov/Individuals/Offer-in-Compromise-1].

OIC PREQUALIFIER TOOL

In order to determine whether the taxpayer is qualified to file an OIC application, the taxpayer may use the online OIC prequalifier tool. This tool asks the taxpayer various questions to determine their eligibility for an OIC.

Note. The OIC prequalifier tool can be found at **uofi.tax/15a3x10** [www.irs.gov/Individuals/Offer-in-Compromise-1] along with other helpful information associated with the OIC application and OIC approval process.

The prequalifier tool requires no personal information about the identity of the taxpayer. It is a generic application that provides a guideline of the information required. Once the taxpayer's information is entered, the prequalifier tool makes basic calculations to determine whether the taxpayer's circumstances fall under OIC guidelines in a manner that will lead to acceptance of the OIC application by the IRS.

Note. The prequalifier tool is much easier to complete than an actual OIC application. Because the OIC application requires the submission of documentation, it is prudent to obtain the necessary documentation from the taxpayer early in the process. The best point at which to obtain such documentation may be when using the prequalifier tool. Substantiation is important in addition to a complete interview of the taxpayer. The substantiation should be gathered at the beginning of the process.

³³ Treas. Reg. §301.7122-1(b)(3); and IRM 33.3.2.3.3 (2010).

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The OIC prequalifier has the following six basic sections.

1. Status
2. Basic information
3. Assets
4. Income
5. Expenses
6. Proposal

The status section asks questions about the preliminary factors the taxpayer **must meet** in order to be eligible for an OIC. If the taxpayer does not meet these preliminary requirements, then an OIC is not an option for the taxpayer (unless their circumstances change regarding the preliminary factors they initially did not meet). Being current with all tax filings and estimated tax payments is a prerequisite to filing an OIC application. In addition, the taxpayer does not qualify to file an OIC application if they have filed bankruptcy and the bankruptcy case is still open.³⁴

The OIC prequalifier status screen showing the preliminary factors which must be met follows.



Use this tool to see if you may be eligible for an offer in compromise. Enter your financial and tax filing status to calculate a preliminary offer amount. We make our final decision based on your completed OIC application and our associated investigation. This tool should only be used as a guide. Although it may show you can full pay your liability, you may still file an offer in compromise and discuss your individual financial situation with the IRS.

If you reside in a U.S. Territory, foreign country, or are military personnel using an APO or FPO address the OIC Pre-Qualifier is not applicable for your situation. Please proceed to the application in the [Offer in Compromise Booklet](#).

Are you in an open bankruptcy proceeding?

- ☐ Yes
- ☐ No

Have you filed all required federal tax returns?

- ☐ Yes
- ☐ No

Have you made all required estimated tax payments?

- ☐ Yes
- ☐ No
- ☐ N/A

If you are self-employed and have employees, have you submitted all required federal tax deposits?

- ☐ Yes
- ☐ No
- ☐ N/A

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³⁴ *Offer in Compromise*. Apr. 2, 2015. [www.irs.gov/Individuals/Offer-in-Compromise-1] Accessed on Apr. 22, 2015.

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The basic information section requests general information about the tax liability, household size, most recent tax filing, and state of residence. The general information screen follows.

Status	Basic Info	Assets	Income	Expenses	Proposal

Enter information about your location, household and tax debt.

ZIP or postal code

State

County

Total members of household

Total members of household 65 years or older

Total IRS tax debt (whole dollars)

What is the most recent tax year you are requesting to compromise?

(For example, if you owe 1040 taxes for 2007, 2008 and 2009, enter 2009)

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After the basic information section has been completed, the OIC prequalifier requests general information regarding the taxpayer's assets. The asset screen follows.



Enter information about your **assets** (in whole dollars). Your equity is the value of your asset minus what you still owe on the asset.

Total bank balances (checking, savings, money market, CDs, etc.)

\$

Home market value

\$

Home loan balance

\$

Vehicle 1 equity

\$

Vehicle 2 equity

\$

Retirement account equity (401k, IRA, etc.)

\$

Other real property (rental, business, land, timeshare, etc.)

\$

Other asset equity (airplane, motorcycle, recreational vehicle, etc.)

\$

Stocks, bonds and other investments

\$

Miscellaneous (art, coin and gun collections, etc.)

\$

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On the next screen, the taxpayer's sources and amounts of income must be identified. The questions regarding the taxpayer's income follow.



Enter information about your **monthly household income** (in whole dollars).

Gross wages

\$

Interest and dividends

\$

Distributions from partnerships, sub-S corporations, etc.

\$

Net rental income

\$

Net business income

\$

Child support received

\$

Alimony received

\$

Additional Income

\$

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Information concerning expenses is required on the next screen. If details on the actual expenses of the taxpayer are not available, an alternative is to use the IRS collection financial standards (CFS), which are discussed later in this chapter. However, it is best to obtain actual expense documentation from the taxpayer and complete this section with the amounts that likely would be shown in an actual OIC application. This ensures that the most accurate preliminary determination will be made in the prequalifier calculations.



Enter information about your **typical month's household expenses** (in whole dollars). Maximum allowances for expenses are determined based on your location and number of members of your household. We provide allowances for food, clothing, miscellaneous items and out-of-pocket medical expenses.

Rent or mortgage and utilities

\$

Vehicle 1 loan or lease payment

\$

Vehicle operating costs (gas, repairs, etc.)

\$

Total vehicles owned

Public transportation costs

\$

Health insurance premiums

\$

Federal, state and local taxes (Enter a 0 if no taxes)

\$

Court-ordered payments (child support, alimony, etc.)

\$

Child dependent care costs

\$

Life insurance premiums

\$

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If the taxpayer does not meet the criteria, the following message is displayed.



You do not qualify for an offer in compromise based on the information you provided. If you believe you have exceptional circumstances, such as serious illness, where paying your taxes in full might impair your ability to provide for yourself and your family, review the Offer in Compromise Booklet, complete the required forms (Form 656 / Form 433-A) and submit your offer.

You may check the information you entered by using the Previous button.

You may qualify for an installment agreement, which allows you to make monthly payments toward your debt.

For more information about your payment options, go to Make a Payment.



If the taxpayer does appear to meet the qualifications and has circumstances that may lead to an accepted OIC application, the final screen summarizes the key amounts for the taxpayer and indicates payment options to use as a guideline in the preparation of an actual OIC application.

FILING AN OIC APPLICATION

Form 656, *Offer in Compromise*, is used to apply for an OIC if the application is based on doubt as to collectability or on the premise that the offer is in the best interest of tax administration. Form 656 is published in a booklet format that contains the following information.

- Instructions (including information required, payment options, fee information, and how to apply)
- Form 433-A (OIC), *Collection Information Statement for Wage Earners and Self-Employed Individuals*
- Form 433-B (OIC), *Collection Information Statement for Businesses*
- Application checklist with mailing instructions

Note. The Form 656 booklet is found at **uofi.tax/15a3x11** [www.irs.gov/pub/irs-pdf/f656b.pdf]. It may be helpful to refer to IRS Pub. 1854, *How to Prepare a Collection Information Statement (Form 433-A)*, before completing Form 656. IRS Pub. 1854 can be found at **uofi.tax/15a3x12** [www.irs.gov/pub/irs-pdf/p1854.pdf].

For applications based on doubt as to liability, Form 656-L, *Offer in Compromise (Doubt as to Liability)*, is used. This is also published in a booklet format, with accompanying information similar to that found with Form 656.

Note. Form 656-L can be found at **uofi.tax/15a3x13** [www.irs.gov/pub/irs-pdf/f656l.pdf].

Filing Fee

In addition to the appropriate forms, an application fee of \$186 generally must be submitted. This fee must be paid separately from any other required payments. However, this fee does not need to be paid if the taxpayer is filing an OIC application based on doubt as to liability. **In addition, no fee payment is required if the individual qualifies for a low-income exemption.** The low-income exemption applies if the taxpayer's monthly income is below 250% of the federal poverty level (as defined by Health and Human Services (HHS) guidelines.) To qualify for this exemption, section 4 of the Form 656 must be completed.

Note. The HHS federal poverty guidelines for 2015 may be found at **uofi.tax/15a3x14** [http://aspe.hhs.gov/poverty/15poverty.cfm].

OIC PAYMENT OPTIONS

Payment can be made in either a lump sum or through periodic payments.

Lump Sum

Selection of the lump-sum option requires that a 20% down payment be included with the offer. Remaining payments are due after the OIC is accepted in **five or fewer monthly payments**.

Periodic Payments

For the periodic-payment option, an initial payment must accompany the offer. The remaining balance is due in six to 24 monthly installments, depending on the offer the taxpayer proposed.

Note. When using this option, monthly payments must be paid while the IRS is considering the offer. Failure to make the monthly payments will result in the offer being refused. **Interest and penalties will continue to accrue while the offer is being evaluated.**

Taxpayers are entitled to designate all payments while the offer is under consideration. The designation must be made in writing at the time the payment is made. In the memo section of the payment, identify “OIC,” the tax years, and the social security number or EIN. In the absence of a written designation, the payments will be applied in the best interest of the government. Once the taxpayer designates application of a payment, it cannot be changed.³⁵

For all offers accepted after December 31, 1999, interest on the OIC amount is also compromised within the offer. Interest does not accrue on the taxpayer’s accepted OIC amount from the date of acceptance until the OIC is paid.

Example 2. Fred and Frieda are married. Both spouses are wage earners, and they jointly operate a small delivery business on a part-time basis. The business is organized as a sole proprietorship in Frieda’s name. The business has a delinquent tax liability of \$102,862 that is attributable to tax years 2008 through 2013.

Both Fred and Frieda are near retirement. For 2014, the business lost money due to efforts by Fred and Frieda to downsize the business in anticipation of full retirement in about two years. The business has no employees and has filed all federal and state tax returns. No estimated tax payments were made in 2014.

Fred and Frieda wish to eliminate the delinquent tax debt before their retirement. Benny, their tax advisor, suggested that they apply for an OIC. Benny conducted a thorough interview and obtained all relevant information from Fred and Frieda about assets, liabilities, and sources and amounts of income for each spouse. Fred and Frieda provided Benny with all the required documentation. No information was provided concerning household expenses, so Benny used the CFS standards for their area of residence. In addition, Fred and Frieda signed Form 2848, *Power of Attorney and Declaration of Representative*, granting Benny the right to represent them in the OIC application process.

Note. The CFS standards are explained later in this chapter.

The Form 433-A that Benny prepared follows.

Observation. The following Form 433-A calculates the offer amount but makes no reference to the tax amount owed or the tax period(s).

³⁵ IRM 8.23.1.4.1.1 (2014).

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For Example 2

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Form **433-A (OIC)**
(Rev. January 2015)

Department of the Treasury — Internal Revenue Service Collection Information Statement for Wage Earners and Self-Employed Individuals

Use this form if you are

- ▶ An individual who owes income tax on a Form 1040, U.S. Individual Income Tax Return
- ▶ An individual who is self-employed or has self-employment income. You are considered to be self-employed if you are in business for yourself, or carry on a trade or business.
- ▶ An individual with a personal liability for Excise Tax
- ▶ An individual who is personally responsible for a partnership liability (only if the partnership is submitting an offer)
- ▶ An individual responsible for a Trust Fund Recovery Penalty

Wage earners Complete Sections 1, 2, 3, 7, 8, 9 and the signature line in Section 10.

Self-employed individuals Complete Sections 4, 5, 6, in addition to Sections 1, 2 (if applicable), 3, 7, 8, 9 and the signature line in Section 10.

Note: Include attachments if additional space is needed to respond completely to any question.

Section 1 Personal and Household Information

Last Name Bone		First Name Fred	Date of Birth (mm/dd/yyyy) 02/03/1949	Social Security Number 000 - 00 - 0001
Marital status <input type="checkbox"/> Unmarried <input checked="" type="checkbox"/> Married	Home Address (Street, City, State, ZIP Code) 123 Main Any Town, IL 61000		Do you: <input checked="" type="checkbox"/> Own your home <input type="checkbox"/> Rent <input type="checkbox"/> Other (specify e.g., share rent, live with relative, etc.)	
County of Residence Smith	Primary Phone (555) 555 - 5555		Mailing Address (if different from above or Post Office Box number)	
Secondary Phone (555) 555 - 5552	Fax Number () -			

Provide information about your spouse.

Spouse's Last Name Bone	Spouse's First Name Frieda	Date of Birth (mm/dd/yyyy) 03/02/1952	Social Security Number 000 - 00 - 0002
-----------------------------------	--------------------------------------	---	--

Provide information for all other persons in the household or claimed as a dependent.

Name	Age	Relationship	Claimed as a dependent on your Form 1040?	Contributes to household income?
			<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
			<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
			<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
			<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No

Section 2 Employment Information for Wage Earners

If you or your spouse have self-employment income (that is you file a Schedule C, E, F, etc.) instead of, or in addition to wage income, you must complete Business Information in Sections 4, 5, and 6.

Your Employer's Name Sam's Body Shop and Parts Center		Employer's Address (street, city, state, zip code) 456 Main Street Any Town, IL 61000	
Do you have an interest in this business? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	If yes, check the business interest that applies: <input type="checkbox"/> Partner <input type="checkbox"/> Officer <input type="checkbox"/> Sole proprietor		
Your Occupation Salesman	How long with this employer 27 (years) 3 (months)		
Spouse's Employer's Name AnyTown High School		Employer's Address (street, city, state, zip code) 789 Main Street Any Town, IL 61000	
Does your spouse have an interest in this business? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	If yes, check the business interest that applies: <input type="checkbox"/> Partner <input type="checkbox"/> Officer <input type="checkbox"/> Sole proprietor		
Spouse's Occupation Assistant	How long with this employer 24 (years) 6 (months)		

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Form **433-A (OIC)** (Rev. 1-2015)

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Section 3 Personal Asset Information

Use the **most current** statement for each type of account, such as checking, savings, money market and online accounts, stored value cards (such as, a payroll card from an employer), investment and retirement accounts (IRAs, Keogh, 401(k) plans, stocks, bonds, mutual funds, certificates of deposit), life insurance policies that have a cash value, and safe deposit boxes. Asset value is subject to adjustment by IRS based on individual circumstances. Enter the total amount available for each of the following (if additional space is needed include attachments).

Round to the nearest dollar. Do not enter a negative number. If any line item is a negative number, enter "0".

Cash and Investments (domestic and foreign)

<input type="checkbox"/> Cash <input checked="" type="checkbox"/> Checking <input type="checkbox"/> Savings <input type="checkbox"/> Money Market/CD <input type="checkbox"/> Online Account <input type="checkbox"/> Stored Value Card	
Bank Name	Account Number
Any Town Bank and Trust	ABCDE
(1a) \$	1,523
<input type="checkbox"/> Checking <input checked="" type="checkbox"/> Savings <input type="checkbox"/> Money Market/CD <input type="checkbox"/> Online Account <input type="checkbox"/> Stored Value Card	
Bank Name	Account Number
Any Town Bank and Trust	FGHIJ
(1b) \$	1,281
Total of bank accounts from attachment	
(1c) \$	
Add lines (1a) through (1c) less (\$1,000) =	
(1) \$	1,804
Investment Account: <input type="checkbox"/> Stocks <input type="checkbox"/> Bonds <input type="checkbox"/> Other	
Name of Financial Institution	Account Number
Current Market Value	Less Loan Balance
\$ _____ X .8 = \$ _____	- \$ _____ =
(2a) \$	
Investment Account: <input type="checkbox"/> Stocks <input type="checkbox"/> Bonds <input type="checkbox"/> Other	
Name of Financial Institution	Account Number
Current Market Value	Less Loan Balance
\$ _____ X .8 = \$ _____	- \$ _____ =
(2b) \$	
Total of investment accounts from attachment. [current market value X .8 less loan balance(s)]	
(2c) \$	
Add lines (2a) through (2c) =	
(2) \$	
Retirement Account: <input type="checkbox"/> 401K <input type="checkbox"/> IRA <input type="checkbox"/> Other	
Name of Financial Institution	Account Number
Current Market Value	Less Loan Balance
\$ _____ X .7 = \$ _____	- \$ _____ =
(3a) \$	0
Retirement Account: <input type="checkbox"/> 401K <input type="checkbox"/> IRA <input type="checkbox"/> Other	
Name of Financial Institution	Account Number
Current Market Value	Less Loan Balance
\$ _____ X .7 = \$ _____	- \$ _____ =
(3b) \$	
Total of investment accounts from attachment. [current market value X .7 less loan balance(s)]	
(3c) \$	
Add lines (3a) through (3c) =	
(3) \$	
Cash Value of Life Insurance Policies	
Name of Insurance Company	Policy Number
Life Insurance of America	1234567
Current Cash Value	Less Loan Balance
\$ 23,810	- \$ 0 =
(4a) \$	23,810
Total of life insurance policies from attachment	Less Loan Balance(s)
\$ _____	- \$ _____ =
(4b) \$	
Add lines (4a) through (4b) =	
(4) \$	23,810

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Section 3 (Continued)		Personal Asset Information	
Real Estate (Enter information about any house, condo, co-op, time share, etc. that you own or are buying)			
Property Address (Street Address, City, State, ZIP Code) 123 Main Any Town, IL 61000	Primary Residence <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	Date Purchased 01/02/1999	
County and Country Smith, United States	Date of Final Payment 05/29/2029		
How title is held (joint tenancy, etc.) Joint Tenancy	Description of Property 2 Bedroom Townhome		
Current Market Value		Less Loan Balance (Mortgages, etc.)	
\$ 113,000 X .8 = \$ 90,400		– \$ 126,000 (Total Value of Real Estate) =	
		(5a) \$ 0	
Property Address (Street Address, City, State, ZIP Code)			
Primary Residence <input type="checkbox"/> Yes <input type="checkbox"/> No			
Date Purchased			
County and Country			
Date of Final Payment			
How title is held (joint tenancy, etc.)			
Description of Property			
Current Market Value		Less Loan Balance (Mortgages, etc.)	
\$ _____ X .8 = \$ _____		– \$ _____ (Total Value of Real Estate) =	
		(5b) \$	
Total value of property(s) from attachment [current market value X .8 less any loan balance(s)]		(5c) \$	
		Add lines (5a) through (5c) =	
		(5) \$ 0	
Vehicles (Enter information about any cars, boats, motorcycles, etc. that you own or lease)			
Vehicle Make & Model Hyundai Tucson	Year 2013	Date Purchased 02/23/2014	Mileage 23,225
<input type="checkbox"/> Lease	Name of Creditor Any Town Bank and Trust		Date of Final Payment 02/23/2019
<input checked="" type="checkbox"/> Loan			Monthly Lease/Loan Amount \$ 614.23
Current Market Value		Less Loan Balance (Mortgages, etc.)	
\$ 29,216 X .8 = \$ 23,373		– \$ 28,521 Total value of vehicle (if the vehicle is leased, enter 0 as the total value) =	
		(6a) \$ 0	
		Subtract \$3,450 from line (6a). If line (6a) less line (6b) is a negative number, enter "0".	
		(6b) \$	
Vehicle Make & Model			
Year			
Date Purchased			
Mileage			
<input type="checkbox"/> Lease	Name of Creditor		Date of Final Payment
<input type="checkbox"/> Loan			Monthly Lease/Loan Amount \$
Current Market Value		Less Loan Balance (Mortgages, etc.)	
\$ _____ X .8 = \$ _____		– \$ _____ Total value of vehicle (if the vehicle is leased, enter 0 as the total value) =	
		(6c) \$ 0	
		If you are filing a joint offer, subtract \$3,450 from line (6c). If line (6c) less line (6d) is a negative number, enter "0".	
		(6d) \$ 0	
Total value of vehicles listed from attachment [current market value X .8 less any loan balance(s)]		(6e) \$	
		Total lines (6a) through (6e) =	
		(6) \$ 0	

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Section 3 (Continued) Personal Asset Information

Other valuable items (artwork, collections, jewelry, items of value in safe deposit boxes, interest in a company or business that is not publicly traded, etc.)

Description of asset:		
Current Market Value	Less Loan Balance	
\$ _____ X .8 = \$ _____	- \$ _____ =	(7a) \$ _____
Description of asset:		
Current Market Value	Less Loan Balance	
\$ _____ X .8 = \$ _____	- \$ _____ =	(7b) \$ _____
Total value of valuable items listed from attachment [current market value X .8 less any loan balance(s)]		(7c) \$ _____
Add lines (7a) through (7c) =		(7) \$ 0
Do not include amount on the lines with a letter beside the number. Round to the nearest whole dollar. Do not enter a negative number. If any line item is a negative, enter "0" on that line. Add lines (1) through (7) and enter the amount in Box A =		Box A Available Individual Equity in Assets \$ 25,614

NOTE: If you or your spouse are self-employed, Sections 4, 5, and 6 must be completed before continuing with Sections 7 and 8.

Section 4 Self-Employed Information

If you or your spouse are self-employed (e.g., files Schedule(s) C, E, F, etc.), complete this section.

Is your business a sole proprietorship? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No		Address of Business (If other than personal residence)	
Name of Business Delivery on Time			
Business Telephone Number (555) 555 - 5555	Employer Identification Number 11-111112	Business Website	Trade Name or DBA Delivery on Time
Description of Business Delivery Service	Total Number of Employees 0	Frequency of Tax Deposits	Average Gross Monthly Payroll \$
Do you or your spouse have any other business interests? Include any interest in an LLC, LLP, corporation, partnership, etc. <input type="checkbox"/> Yes (Percentage of ownership: _____) Title: _____ <input checked="" type="checkbox"/> No		Business Address (Street, City, State, ZIP code)	
Business Name		Business Telephone Number () -	Employer Identification Number
Type of business (Select one) <input type="checkbox"/> Partnership <input type="checkbox"/> LLC <input type="checkbox"/> Corporation <input type="checkbox"/> Other _____			

Section 5 Business Asset Information (for Self-Employed)

List business assets such as bank accounts, tools, books, machinery, equipment, business vehicles and real property that is owned/leased/rented. If additional space is needed, attach a list of items.

Round to the nearest whole dollar. Do not enter a negative number. If any line item is a negative number, enter "0".

<input type="checkbox"/> Cash <input checked="" type="checkbox"/> Checking <input type="checkbox"/> Savings <input type="checkbox"/> Money Market/CD <input type="checkbox"/> Online Account <input type="checkbox"/> Stored Value Card	
Bank Name Any Town Bank and Trust	Account Number 67891
	(8a) \$ 1,124
<input type="checkbox"/> Cash <input type="checkbox"/> Checking <input checked="" type="checkbox"/> Savings <input type="checkbox"/> Money Market/CD <input type="checkbox"/> Online Account <input type="checkbox"/> Stored Value Card	
Bank Name Any Town Bank and Trust	Account Number 11112
	(8b) \$ 50
Total value of bank accounts from attachment (8c) \$	
Add lines (8a) through (8c) =	(8) \$ 1,174

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Section 5 (Continued)		Business Asset Information (for Self-Employed)	
Description of asset:			
2010 Ford E350 Cargo Van			
Current Market Value	Less Loan Balance	(if leased or used in the production of income, enter 0 as the total value)	
\$ 18,816 X .8 = \$ 15,052	- \$ 0	=	(9a) \$ 15,052
Description of asset: 2013 Ford E350 Cargo Van			
Current Market Value	Less Loan Balance	(if leased or used in the production of income, enter 0 as the total value)	
\$ 19,801 X .8 = \$ 15,840	- \$ 22,201	=	(9b) \$ 0
Total value of assets listed from attachment [current market value X .8 less any loan balance(s)]			(9c) \$
Add lines (9a) through (9c) =			(9) \$ 15,052
IRS allowed deduction for professional books and tools of trade -			(10) \$ [4,540]
Enter the value of line (9) minus line (10). If less than zero enter zero. =			(11) \$ 10,512
Notes Receivable			
Do you have notes receivable? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No			
If yes, attach current listing which includes name and amount of note(s) receivable.			
Accounts Receivable			
Do you have accounts receivable, including e-payment, factoring companies, and any bartering or online auction accounts? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No			
If yes, you may be asked to provide a list of the account(s) receivable.			
Do not include amount on the lines with a letter beside the number. Round to the nearest whole dollar. Do not enter a negative number. If any line item is a negative, enter "0" on that line.			Box B
Add lines (8) and (11) and enter the amount in Box B =			Available Business Equity in Assets
			\$ 11,686

Section 6		Business Income and Expense Information (for Self-Employed)	
Note: If you provide a current profit and loss (P&L) statement for the information below, enter the total gross monthly income on line 17 and your monthly expenses on line 29 below. Do not complete lines (12) - (16) and (18) - (28). You may use the amounts claimed for income and expenses on your most recent Schedule C; however, if the amount has changed significantly within the past year, a current P&L should be submitted to substantiate the claim.			
Round to the nearest whole dollar. Do not enter a negative number. If any line item is a negative number, enter "0".			
Business Income (You may average 6-12 months income/receipts to determine your Gross monthly income/receipts.)			
Gross receipts	(12) \$	1,100	
Gross rental income	(13) \$		
Interest income	(14) \$		
Dividends	(15) \$		
Other income	(16) \$		
Add lines (12) through (16) =		(17) \$	1,100
Business Expenses (You may average 6-12 months expenses to determine your average expenses.)			
Materials purchased (e.g., items directly related to the production of a product or service)	(18) \$	125	
Inventory purchased (e.g., goods bought for resale)	(19) \$		
Gross wages and salaries	(20) \$		
Rent	(21) \$		
Supplies (items used to conduct business and used up within one year, e.g., books, office supplies, professional equipment, etc.)	(22) \$	8	
Utilities/telephones	(23) \$		
Vehicle costs (gas, oil, repairs, maintenance)	(24) \$	150	
Business Insurance	(25) \$	92	
Current Business Taxes (e.g., Real estate, excise, franchise, occupational, personal property, sales and employer's portion of employment taxes)	(26) \$	760	
Other secured debts (not credit cards)	(27) \$		
Other business expenses (include a list)	(28) \$		
Add lines (18) through (28) =		(29) \$	1,135
Do not enter a negative number. If any line item is a negative, enter "0" on that line.			Box C
Subtract line (29) from line (17) and enter the amount in Box C =			Net Business Income
			\$ 0

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Section 7 Monthly Household Income and Expense Information

Enter your household's gross monthly income. The information below is for yourself, your spouse, and anyone else who contributes to your household's income. The entire household includes spouse, significant other, children, and others who contribute to the household. This is necessary for the IRS to accurately evaluate your offer.

Monthly Household Income

Round to the nearest whole dollar.

Primary taxpayer					
Wages	Social Security	Pension(s)	Other Income (e.g. unemployment)	Total primary taxpayer income =	(30) \$
\$ 3,605	+ \$	+ \$	+ \$		3,605
Spouse					
Wages	Social Security	Pension(s)	Other Income (e.g. unemployment)	Total spouse income =	(31) \$
\$ 2,604	+ \$	+ \$	+ \$		2,604
Additional sources of income used to support the household, e.g., non-liable spouse, or anyone else who may contribute to the household income, etc.					(32) \$
Interest and dividends					(33) \$
Distributions (e.g., income from partnerships, sub-S Corporations, etc.)					(34) \$
Net rental income					(35) \$
Net business income from Box C					(36) \$ 0
Child support received					(37) \$
Alimony received					(38) \$
<p>Round to the nearest whole dollar. Do not enter a negative number. If any line item is a negative, enter "0" on that line. Add lines (30) through (38) and enter the amount in Box D =</p>					<p>Box D Total Household Income \$ 6,209</p>

Monthly Household Expenses

Enter your average monthly expenses.

Note: Expenses may be adjusted based on IRS Collection Financial Standards. The standards may be found at www.irs.gov.

Round to the nearest whole dollar.

Food, clothing, and miscellaneous (e.g., housekeeping supplies, personal care products, minimum payment on credit card). A reasonable estimate of these expenses may be used.	(39) \$	1,092
Housing and utilities (e.g., rent or mortgage payment and average monthly cost of property taxes, home insurance, maintenance, dues, fees and utilities including electricity, gas, other fuels, trash collection, water, cable television and internet, telephone, and cell phone).	(40) \$	1,542
Vehicle loan and/or lease payment(s)	(41) \$	642
Vehicle operating costs (e.g., average monthly cost of maintenance, repairs, insurance, fuel, registrations, licenses, inspections, parking, tolls, etc.). A reasonable estimate of these expenses may be used.	(42) \$	278
Public transportation costs (e.g., average monthly cost of fares for mass transit such as bus, train, ferry, taxi, etc.). A reasonable estimate of these expenses may be used.	(43) \$	0
Health insurance premiums	(44) \$	638
Out-of-pocket health care costs (e.g. average monthly cost of prescription drugs, medical services, and medical supplies like eyeglasses, hearing aids, etc.)	(45) \$	120
Court-ordered payments (e.g., monthly cost of any alimony, child support, etc.)	(46) \$	0
Child/dependent care payments (e.g., daycare, etc.)	(47) \$	0
Life insurance premiums	(48) \$	52
Current taxes (e.g., monthly cost of federal, state, and local tax, personal property tax, etc.)	(49) \$	700

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Section 7 Monthly Household Income and Expense Information (Continued)	
Other secured debts (e.g., any loan where you pledged an asset as collateral not previously listed, government guaranteed Student Loan)	(50) \$ 0
Delinquent State and Local Taxes	(51) \$ 151
Round to the nearest whole dollar. Do not enter a negative number. If any line item is a negative, enter "0" on that line. Add lines (39) through (51) and enter the amount in Box E =	Box E Total Household Expenses \$ 5,215
Round to the nearest whole dollar. Do not enter a negative number. If any line item is a negative, enter "0" on that line. Subtract Box E from Box D and enter the amount in Box F =	Box F Remaining Monthly Income \$ 994

Section 8 Calculate Your Minimum Offer Amount

The next steps calculate your minimum offer amount. The amount of time you take to pay your offer in full will affect your minimum offer amount. Paying over a shorter period of time will result in a smaller minimum offer amount.

Round to the nearest whole dollar.

If you will pay your offer in 5 months or less, multiply "Remaining Monthly Income" (Box F) by 12 to get "Future Remaining Income" (Box G). Do not enter a number less than \$0.

Enter the total from Box F \$	X 12 =	Box G Future Remaining Income \$
----------------------------------	--------	-------------------------------------

If you will pay your offer in more than 5 months, multiply "Remaining Monthly Income" (Box F) by 24 to get "Future Remaining Income" (Box H). Do not enter a number less than \$0.

Enter the total from Box F \$ 994	X 24 =	Box H Future Remaining Income \$ 23,856
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Determine your minimum offer amount by adding the total available assets from Box A and Box B (if applicable) to the amount in either Box G or Box H.

Enter the amount from Box A plus Box B (if applicable) \$ 37,300	+	Enter the amount from either Box G or Box H \$ 23,856	=	Offer Amount Your offer must be more than zero (\$0). Do not leave blank. Use whole dollars only. \$ 61,156
---	---	--	---	---

If you cannot pay the Offer Amount shown above due to special circumstances, explain on the Form 656, Offer in Compromise, Section 3. You must offer an amount more than \$0.

Section 9 Other Information	
Additional information IRS needs to consider settlement of your tax debt. If you or your business are currently in a bankruptcy proceeding, you are not eligible to apply for an offer.	Are you the beneficiary of a trust, estate, or life insurance policy? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
	Are you currently in bankruptcy? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
	Have you filed bankruptcy in the past 10 years? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
	Discharge/Dismissal Date (mm/dd/yyyy)
	Location Filed
	Are you or have you been party to a lawsuit? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No If yes, date the lawsuit was resolved: (mm/dd/yyyy)
	In the past 10 years, have you transferred any assets for less than their full value? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No If yes, date the asset was transferred: (mm/dd/yyyy)
	Have you lived outside the U.S. for 6 months or longer in the past 10 years? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Do you have any funds being held in trust by a third party? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No If yes, how much \$ Where:	

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Section 10

Signatures

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

 Signature of Taxpayer	Date (mm/dd/yyyy)
 Signature of Taxpayer	Date (mm/dd/yyyy)

Remember to include all applicable attachments listed below.

- ☒ Copies of the most recent pay stub, earnings statement, etc., from each employer
- ☐ Copies of the most recent statement for each investment and retirement account
- ☐ Copies of the most recent statement, etc., from all other sources of income such as pensions, Social Security, rental income, interest and dividends (including any received from a related partnership, corporation, LLC, LLP, etc.), court order for child support, alimony, and rent subsidies
- ☒ Copies of bank statements for the three most recent months
- ☒ Copies of the most recent statement from lender(s) on loans such as mortgages, second mortgages, vehicles, etc., showing monthly payments, loan payoffs, and balances
- ☐ List of Notes Receivable, if applicable
- ☒ Verification of State/Local Tax Liability, if applicable
- ☐ Documentation to support any special circumstances described in the "Explanation of Circumstances" on Form 656, if applicable
- ☒ Attach a Form 2848, *Power of Attorney*, if you would like your attorney, CPA, or enrolled agent to represent you and you do not have a current form on file with the IRS.

Based on the information in the OIC application, an offer amount of \$61,156 is calculated for Fred and Frieda. This is the minimum amount needed to apply for the OIC.

Benny informs Fred and Frieda about the \$186 application fee, which is sent with the application, and also advises them about their payment options. These options are summarized in the following table.³⁶

Lump Sum Cash Option	Periodic Payment Option
Fred and Frieda must submit an initial payment of 20% of the calculated offer ($\$61,156 \times 20\% = \$12,231$) with the OIC application.	The payments are made in six or more monthly installments, with the full amount of the offer paid within 24 months of acceptance of the offer.
If the IRS accepts the OIC, the remaining balance of \$48,925 ($\$61,156 - \$12,231$) may be paid in five or fewer payments (made over a period of five or fewer months)	Fred and Frieda submit the initial periodic payment of \$2,548 ($\$61,156 \div 24$ months) with the OIC application and continue to make monthly payments in the same amount while the IRS considers the offer.
If the offer is not accepted, the IRS retains the \$12,231 initial payment and will apply it against the tax liability.	

Note. If any refund is due on the current year tax return, the refund amount will be applied to the tax debt.

OIC CONDITIONS AND CONSEQUENCES

The IRS may deem an OIC agreement to be in default if the taxpayer is noncompliant during the period in which an OIC is effective.

Defaulted Offers in Compromise

An OIC can generally be deemed to be in default by the IRS if the taxpayer:³⁷

- Fails to make timely payments in accordance with the terms of the accepted OIC agreement,
- Does not comply with other terms of the OIC agreement, or
- Received an erroneous refund and fails to return it to the IRS.

If the taxpayer engages in such conduct, the IRS will seek to obtain compliance from the taxpayer before deeming the OIC agreement in default. If the taxpayer fails to comply with any requests for delinquent returns or payments, the OIC will be deemed to be in default.³⁸ An OIC agreement in default is considered to be no longer in effect.

After default, the entire tax liability (less any payments made by the taxpayer under the OIC agreement while it was in effect), is directed back to the regular IRS collection system. The IRS may use any of the usual collection methods available to obtain payment of the tax liability remaining at the time of default.

Note. For further information on the collection methods available to the IRS, see uofi.tax/15a3x15 [www.irs.gov/taxtopics/tc201.html].

³⁶ Topic 204: Offers in Compromise. May 12, 2015. [www.irs.gov/taxtopics/tc204.html] Accessed on Jun. 23, 2015.

³⁷ IRM 5.8.9 (2015).

³⁸ Ibid.

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When an OIC is declared to be in default, any refunds due within the calendar year in which the offer is accepted will be applied to the tax debt.³⁹

Rescinded OIC Agreements

Once an OIC application has been accepted, the IRS expects the taxpayer to comply with tax laws and not have any further delinquencies.⁴⁰ The IRS requires the taxpayer to abide by all the terms and conditions of the accepted OIC. These terms generally include a requirement to timely file all tax returns and pay all taxes for the 5-year period beginning with the OIC acceptance date. If the taxpayer does not adhere to these terms, the IRS may rescind the agreement.

IRS procedures for rescinding an OIC agreement include sending a letter to the taxpayer, identifying the particular OIC agreement, and indicating the grounds for its rescission.⁴¹ All rescission letters are reviewed and approved by IRS legal counsel before they are sent to the taxpayer.⁴²

Note. Failure to report or pay a shared responsibility payment under the Affordable Care Act does not constitute grounds for OIC rescission by the IRS.⁴³

Note. For further information on IRS rescission procedures, see IRM 5.8.9.

Statute of Limitations and Impact on OIC

IRC §6502(a)(1) provides that the IRS has 10 years after the taxes are assessed to collect the tax due. An OIC extends the 10-year statute of limitations for collection of the tax assessment.

When an OIC is made, the statute of limitations is suspended during the following periods.⁴⁴

- During the pending period (under IRS consideration to accept or reject)
- For 30 days following the rejection of the offer
- For the period the timely filed appeal is under consideration

IRC §7122 provides that the OIC amount includes the tax assessed, interest, and assessable penalty. From this total, the monthly payment amount or lump-sum payment can be calculated.

³⁹ *Topic 204: Offers in Compromise*. May 12, 2015. [www.irs.gov/taxtopics/tc204.html] Accessed on Jun. 1, 2015.

⁴⁰ *Ibid.*

⁴¹ IRM 5.8.9.2.2 (2015).

⁴² *Ibid.*

⁴³ Instructions for Form 656.

⁴⁴ Treas. Reg. §301.7122-1(g).

Example 3. Snow Bunny applied for an OIC in January 2010. The tax years covered by the OIC application are 2006 through 2008. Snow Bunny's tax liability for these years is \$51,000. However, her OIC application offered payment of \$20,000. Part of her offer required her to make monthly payments for 24 months to pay the \$20,000. The offer was approved, and Snow Bunny made the required payments, with the last payment made in December 2011.

In 2013, Snow Bunny started a small snow plowing business and failed to pay estimated tax payments, resulting in a balance due of \$10,000 for the 2013 tax year. The IRS issued a letter requesting the 2013 return in June 2015. Snow Bunny initially ignored the notice. She eventually filed the 2013 return in January 2016, with the \$10,000 balance due still remaining (along with applicable interest). Because the failure to file the 2013 tax return and pay the \$10,000 amount due is within five years of the date the OIC was accepted, the IRS sent Snow Bunny a letter rescinding the OIC agreement.

As a result, the offer accepted for the 2006–2008 tax years is void. If these returns were timely filed, the 10-year collection limitations period would normally expire on the 2006 return in 2016. However, due to the suspension of the statute while the offer was processed, that statute will expire in 2017. The 2007 return's collection statute will expire in 2018, and the 2008 return's collection statute will expire in 2019.

Even though the OIC agreement reduced Snow Bunny's tax liability from \$51,000 to \$20,000 for tax years 2006 through 2008, the IRS rescission means that the original balance due is reinstated. This \$51,000 balance is reduced by the \$20,000 that Snow Bunny paid under the OIC agreement while it was effective, leaving \$31,000 due. This \$31,000 (plus applicable interest and penalties) is the amount the IRS may now collect after the rescission of the OIC agreement.

Observation. Many taxpayers who apply for an OIC or who have an accepted OIC agreement do not understand the grounds for rescission or the conduct that will cause the agreement to be deemed in default. It is essential that practitioners advise clients of their obligations and the consequences for failure to adhere to those obligations during the OIC period and for the 5-year period after the OIC has been accepted.

CHANGES TO OIC GUIDELINES

In May 2012, some major changes were announced to the OIC guidelines in order to make it easier for taxpayers to get an OIC application approved.⁴⁵ The changes to the program include revising the calculation for the taxpayer's reasonable collection potential (RCP).

Generally, the taxpayer's RCP is the amount that the IRS can collect using all available collection methods.⁴⁶ The IRS uses the RCP to measure the taxpayer's ability to pay the tax debt. The RCP includes an evaluation of the taxpayer's assets, including property, bank accounts, and other assets. Generally, the taxpayer's RCP is represented by the following formula.

$$\begin{array}{l}
 100\% \text{ of the taxpayer's cash, investments, and accounts receivable} \\
 + \text{ The realizable value of vehicles, real estate, and personal assets} \\
 + \text{ Monthly disposable income for a future number of years} \\
 \hline
 \text{Taxpayer's RCP}
 \end{array}$$

⁴⁵ IRS News Rel. IR-2012-53 (May 12, 2012).

⁴⁶ IRM 5.8.4.3 (2013).

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The recent changes to the OIC evaluation process are summarized in the following table.

Rule Change	Previous Rule	New Rule
Number of years of income used for calculating taxpayer's RCP for OIC offers that would be fully paid in five or fewer months	The IRS considers four years of future income	The IRS considers only one year of future income
Number of years of income used for calculating taxpayer's RCP for OIC offers that would be fully paid in six to 24 months	The IRS considers five years of future income	The IRS considers two years of future income
Allowable expenses used to reduce income before determining ability to pay	Use national standards for specific types of expenses that are allowable (e.g. food, clothing, housing, utilities, transportation, etc.)	National standards still used, but allowable expenses now expanded to include delinquent state and local taxes and payments being made on federally guaranteed student loans; new allowance for credit card payments and bank fees
Equity in small business income-producing assets	Generally included in calculations to arrive at taxpayer's RCP	Generally not included in calculations to arrive at taxpayer's RCP if the asset is critical to the operation of a viable, ongoing business; income from the asset is still considered
Dissipated assets ^a	Included when calculating the taxpayer's RCP	Generally, no longer included when calculating the taxpayer's RCP (but still included if disposed of within six months before or after the tax assessment with a tax avoidance purpose or used for purposes other than for the production of income or for the health and welfare of the taxpayer or family)

^a A **dissipated asset** is any asset that has been sold, transferred, or spent on nonpriority items or debts and is no longer available to pay the tax liability. See *Dean v. Comm'r*, TC Memo 2009-269 (Nov. 25, 2009).

Note. For further information on these changes to the OIC program, which were made as part of the 2012 IRS Fresh Start initiative, see IRS News Rel. IR-2012-53. These changes have been incorporated into the OIC application forms and the Internal Revenue Manual (IRM).

Note. IRM 5.8.5 provides substantial information on OICs that practitioners may find extremely useful when assisting a taxpayer in completing an OIC application. In addition, IRM 5.8.5.6 and 5.8.5.7 provides guidance on the subject of allowable monthly living expenses.

Example 4. Scratch Tool and Die, a sole proprietorship owned by Ralph, relies on a stamping press to manufacture parts. Without the stamping press, the business would cease to operate. Ralph has a \$25,000 equity interest in the stamping press.

Ralph establishes to the IRS in his OIC application that the use of the press is necessary for the production of \$5,000 of monthly business net income. Because the press is an essential part of the business that generates income, the equity in the machine is not included in determining Ralph's RCP. However, the IRS takes into consideration the \$5,000 of monthly income generated by the machine when calculating Ralph's ability to pay his tax debt.

Example 5. Best Delivery is a business owned by Sharie. The business makes deliveries using 10 cargo vans. Sharie has no equity in eight of the vans, but she has \$30,000 equity in the other two vans. Sharie establishes to the IRS in her OIC application that the use of each van generates net income of \$10,000 per year for Best Delivery. Although all of the income generated by the vans is included in calculating Sharie's monthly income, the \$30,000 of equity in the vans is not included in calculations to determine Sharie's RCP.

IRS INTERNAL VERIFICATION

The taxpayer's OIC application should reflect information that is current on the application date.⁴⁷ The IRS may request updated information if the information becomes older than one year and it appears that the taxpayer's financial circumstances have significantly changed.⁴⁸ However, before contacting the taxpayer for updated information, the IRS will attempt to update information through available internal resources.

After the IRS receives the taxpayer's OIC submission, it attempts to verify as much of that information as possible using internal resources. These internal resources include previous tax returns filed by the taxpayer. Some steps that the IRS takes to verify OIC application amounts include the following.⁴⁹

- Determine that the taxpayer has disclosed all business activity in the OIC application by researching and cross-referencing the taxpayer's taxpayer identification number (TIN) with IRS business return information
- Ensure that the taxpayer has filed previous returns and has complied with federal tax laws
- Compare the income and expense amounts in the OIC application with those reported on tax returns
- Compare real estate tax and mortgage-related amounts in the OIC application with those reported on tax returns
- Identify any discrepancies between the OIC application and tax returns for investment accounts
- Verify sources of income, including income from employers, banks, and retirement accounts
- Determine if assets have been recently disposed of, including investment assets

Moreover, the IRS may take steps to determine whether there are any vehicles or real estate registered to the taxpayer that were not disclosed in the OIC application. This may involve the use of public records and a search of business records (to identify any indirect ownership through an entity).⁵⁰

⁴⁷ IRM 5.8.5.3 (2013).

⁴⁸ Ibid.

⁴⁹ IRM 5.8.5.3.1.1 (2013).

⁵⁰ Ibid.

Ownership in additional assets may be determined through searches of Uniform Commercial Code (UCC) filings, court records, and other names used by the taxpayer in the past.⁵¹

Note. UCC filings are used to register a security interest in property. The rules regarding the filing of the required form (frequently referred to as UCC Form 1 or UCC-1 Financing Statement) are governed by Article 9 of the UCC. The UCC has been adopted by most states, but state rules may differ regarding prioritization of security interests and other guidelines. Typically, the details on a security interest disclosed on a UCC Form 1 are registered at the Secretary of State's office, and this information is automatically made public.

IRS verification may also include researching taxpayer information with credit bureaus. This may provide information about the taxpayer's past residences, employers, and payment history. As with UCC filing research, this provides information about the taxpayer's debts, any liens on taxpayer property, and any property that the taxpayer has not listed in the OIC application.

Note. There are several internal IRS rules regarding the acquisition of a taxpayer credit report in the course of verifying an OIC application. These rules can be found in IRM 5.8.5.3.1.2 (2013).

COLLECTION FINANCIAL STANDARDS

IRS collection financial standards (CFS) are used in the calculations to determine the taxpayer's ability to pay delinquent taxes. Generally, sources of income are added together; this amount is then reduced by expenses. However, these expenses generally must be those allowable under CFS rules. In addition, national standards are generally used for allowable expense amounts (instead of the actual expenditures made by the taxpayer).

Accordingly, national standards are used for expenses associated with food, clothing, and other items. These national standard amounts vary with family size. National standards also exist for out-of-pocket healthcare costs.

Many expenses disclosed by the taxpayer in an OIC application are associated with housing costs, including utilities. Because of the disparity in such expenses across the country, localized standards are used for housing and utility expenses. This ensures a standard that is more appropriate and fair to the taxpayer. Local standards are also used for transportation costs, which include the ownership costs of an automobile.

Note. For further information on CFS and the amounts that are used for the various allowable expenses, see **uofi.tax/15a3x16** [www.irs.gov/Individuals/Collection-Financial-Standards].

IRS authority to use national and local guidelines within the OIC process is provided by IRC §7122(d)(2). This Code section requires the IRS to determine whether the use of the national and local guidelines for each taxpayer is appropriate based on a facts and circumstances analysis. The IRS may not apply these standards if it would result in the taxpayer not having adequate means to provide for basic living expenses.⁵²

Generally, the taxpayer can use these allowable national and local standard expense amounts in their OIC application (even if their actual expenses are lower). However, if the taxpayer's actual expenses are higher, the IRS may use the lower standard amounts. Generally, in order for the IRS to agree to the higher amount instead of imposing a lower standard amount for a particular expense, substantial and clear documentation of the actual expense amount and its necessity must be provided.

⁵¹ Ibid.

⁵² IRC §7122(d)(2)(B).

The IRS's use of CFS in calculating the taxpayer's ability to pay delinquent taxes has been upheld by the Tax Court. In *Drakes and Taylor v. Comm'r*,⁵³ the taxpayers owed \$75,157 for the 2006 and 2007 tax years. The taxpayer's OIC application offered the IRS payment of \$12,000, and the IRS rejected the taxpayer's application. After the rejection, the taxpayer claimed undue financial hardship, and the case was assigned to the Appeals Division for reconsideration.

Upon reconsideration, the Appeals Division settlement officer determined that the taxpayers could pay \$5,664 per month. However, the taxpayers were only willing to agree to a monthly installment of \$1,650 per month. In calculating the monthly amount the taxpayer could afford, the settlement officer used CFS and applied the national and local standards to arrive at the monthly installment requirement of \$5,664. Because the taxpayers had the ability to pay \$5,664 under CFS guidelines, the Tax Court held that there was no hardship to the taxpayers and that it was proper for the IRS to reject the taxpayer's OIC application.

REJECTED OIC APPLICATIONS

If an OIC is rejected, the taxpayer receives a letter that provides the reason the offer was rejected. If the taxpayer wishes to appeal the IRS rejection, they have **30 days from the date of the rejection letter to request an appeal**.

Note. IRS rejection of an OIC application should not be confused with returning the offer to the taxpayer for further information or clarification. The return of an offer does not constitute a rejection. When the offer is returned for additional information, the appeal process does not apply.

An appeal is requested by filing Form 13711, *Request for Appeal of Offer in Compromise*. Alternatively, a separate letter with the required information may also be used. It is essential to include the following information.

- The taxpayer's name, address, social security number, and daytime telephone number
- A statement that an appeal of the OIC rejection is desired
- A copy of the rejected OIC application
- An indication of the tax years to which the delinquent tax liability is attributable
- A list of any specific items with which the taxpayer disagrees (and a statement explaining the reasons for such disagreement)
- Additional information, if any, to be considered during the appeal
- Facts supporting the taxpayer's position
- The law or authority, if any, on which the taxpayer relies

The appeal request is signed under penalty of perjury. An appeal extends the statute of limitations.⁵⁴

Note. Further OIC appeal information, including an online self-help tool, can be found at **uofi.tax/15a3x17** [[www.irs.gov/Individuals/Appeal-a-rejected-OFFER-IN-COMPROMISE-\(OIC\)-Online-Self-Help-Tool-\(START\)](http://www.irs.gov/Individuals/Appeal-a-rejected-OFFER-IN-COMPROMISE-(OIC)-Online-Self-Help-Tool-(START))].

Observation. It is prudent to ensure that the taxpayer meets the preliminary qualifications to file an OIC application. In addition, ensuring that the taxpayer furnishes documentation and information that will result in an accurate OIC application is a helpful step in reducing the probability of rejection and will provide necessary information if a later appeal is requested.

⁵³ *Drakes and Taylor v. Comm'r*, TC Memo 2012-189 (Jul. 11, 2012).

⁵⁴ IRM 5.1.19.2.2 (2013).

CORRESPONDENCE AUDITS

Correspondence audits outnumber field audits. Correspondence audits generally involve simpler tax issues like charitable contributions, employee business expenses, alimony, mortgage interest, gambling, and home office deductions.⁵⁵ The following table compares the number of each type of audit over the past several tax years.⁵⁶

Fiscal Year	Correspondence Audits	Field Audits
2014	983,025	401,340
2013	1,091,964	466,093
2012	1,155,518	502,180
2011	1,199,339	525,389
2010	1,272,952	462,131
2009	1,128,369	450,075

GAO REPORT

On July 7, 2014, the U.S. Government Accounting Office (GAO) issued a report on IRS correspondence audits and how the IRS could improve tax compliance and reduce taxpayer burden. Because concerns had been expressed by “tax observers and IRS,” the GAO was asked to conduct an audit of the program. The GAO’s findings included the following.⁵⁷

- The audit response time of 30 to 45 days indicated by the IRS misled taxpayers, because the actual response time was often several months.
- The IRS failed to respond to more than 50% of the taxpayers under audit during one point in time covered by the GAO report.
- IRS personnel indicated that the IRS notices confused taxpayers, causing taxpayers to call with questions.
- The IRS often did not provide the taxpayer with a timeframe within which an audit would be concluded.
- The IRS had no method to determine whether audits have an impact on future compliance.

In addition, **five problems areas** were identified in the GAO report.

1. Communication with the taxpayer
2. The audit process
3. Audit resolution
4. Lack of resources to handle the process
5. Program metrics and tracking statistics

⁵⁵ IRM 4.19.11 (2007).

⁵⁶ *SOI Tax Stats: IRS Data Book*. Apr. 16, 2015. [www.irs.gov/uac/SOI-Tax-Stats-IRS-Data-Book] Accessed on Jun. 1, 2015.

⁵⁷ *IRS Correspondence Audits: Better Management Could Improve Tax Compliance and Reduce Taxpayer Burden*. Jul 7, 2014. GAO. [www.gao.gov/products/GAO-14-479] Accessed on Jun. 1, 2015.

After analyzing these problem areas, the GAO report recommended that the IRS take the following actions.

- Collect and periodically analyze data on audit response times to determine whether those responses are timely
- Establish objectives for certain programs
- Make decisions in accordance with program data, and document such decisions
- Track data not currently being analyzed to better evaluate performance
- Develop an implementation plan for the GAO recommendations

The IRS provided the intended corrective actions to the GAO in response to the recommendations. Nineteen improvements were suggested for the correspondence examination assessment program.⁵⁸

AUDIT PROCESS

The IRS uses a classification process to determine whether a particular tax return should be examined. The classification process is used to determine:⁵⁹

- Whether the return should be selected for examination,
- The specific issues on the return that should be examined, and
- How the examination should be conducted.

Goals of the classification process used to select returns for examination include the promotion of voluntary tax compliance and ensuring effective use of IRS examination resources.

Selection of a return for examination may be based on a high discriminate index function (DIF) score⁶⁰ or manual identification. The DIF scores and selects returns based on a predetermined formula. The higher the DIF score, the greater the probability for an audit.

Note. Although the DIF score is based on National Research Program (NRP) audit statistics, the details of how the DIF score is calculated are not released by the IRS. The NRP statistics are periodically updated as audits are completed in various areas, which changes the DIF scoring criteria. NRP data was updated in 2014 and will be updated in 2015.⁶¹

Correspondence audits are generally limited to a particular line item or category on a return. They are generally less complex and intrusive than a face-to-face audit. However, a correspondence audit frequently requires the taxpayer to handle the issues through a long correspondence process that may be problematic because of the current lack of IRS staff and resources necessary to respond on a timely basis.

Unlike face-to-face audits, the IRS generally does not perform the traditional compliance checks. Such compliance checks are used to identify patterns of noncompliance in previous years.

The automated nature of the correspondence audit process may make the process difficult for taxpayers. For example, standard delay periods are built in to the correspondence audit process in order to provide sufficient time for the taxpayer to respond. The automated correspondence exam (ACE) systems⁶² send out carefully timed follow-up correspondence, which may not reflect the fact that the taxpayer has already responded or provided the requested information. This may be confusing for the taxpayer and such automated letters continue until an IRS employee manually suppresses the mailing of the automatically timed follow-up correspondence.

⁵⁸ Ibid.

⁵⁹ IRM 4.19.11.1.2 (2007).

⁶⁰ IRM 4.19.11.1.3.3 (2007).

⁶¹ IRM 4.1.1.3 (2013).

⁶² IRM 4.19.20 (2013).

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For example, the 90-day statutory notice of deficiency (150 days if outside the United States) is generally issued 106 days after the initial letter if there is no response. This can result in assessments being made when the taxpayer does not legally owe the tax. A taxpayer delay in responding to the audit or a failure to respond to all issues may result in an assessment.⁶³

Frequently, new correspondence from the taxpayer is not matched to the original correspondence regarding the issues examined. This may result in an assessment if it appears that there has been no taxpayer response on the issue. Even if the taxpayer has timely responded, a 90-day notice of deficiency is issued if no indicator has been placed on the taxpayer's account indicating a response has been received.

BEST PRACTICES FOR CORRESPONDENCE AUDITS

The tax practitioner who represents a taxpayer in a correspondence audit can use certain practices to reduce the confusion and adverse impact that often occurs in the correspondence audit process. These practices include the following.

- The response to the correspondence audit letter should be **sent to the IRS as early as possible**.
- The practitioner should keep in mind that the initial time provided by the IRS for a response is generally 30 days. After 46 days, a second notice accompanied by a report of the additional tax owed is sent. Subsequent IRS correspondence is automated.
- The practitioner should contact the IRS using the address or phone number indicated in the IRS letter to request additional time to respond if the initial 30-day period provided is insufficient.
- For correspondence audits that involve multiple issues, **every issue should be addressed in the response**. Generally, the IRS will assess tax on those issues that are not addressed. Systematically identifying each issue and forwarding the relevant documentation (and citing the substantial authority, if applicable) helps eliminate confusion and miscommunication.

Note. For further details on what constitutes substantial authority, see Treas. Reg. §1.6662-4(d).

ADDRESSING PROPOSED CHANGES TO THE TAXPAYER'S RETURN

If the taxpayer agrees with the IRS's proposed changes, signing the final report generates the tax assessment or begins the refund process. If additional tax is due, the IRS issues a notice indicating the amount of tax (plus applicable interest and penalties) and provides a 10-day period for payment. If the 10-day period passes without full payment, additional penalties and interest continue to accrue on the unpaid amount.

If the taxpayer and the IRS fail to reach an agreement on the correspondence audit, the IRS issues a 30-day letter of notification of appeal rights. This letter includes the examination report and an agreement or waiver form. To preserve the appeal rights, a written protest is needed within 30 days of the date of the letter. The auditor documents the issues of the case and prepares the appeals request based on the information provided in the examination.

When requesting an appeal, specific information is required for a formal written protest. Instead of a formal written protest, a small case request can generally be prepared if the adjustments or changes to the taxpayer's return suggested by the IRS amount to \$25,000 or less. Form 12203, *Request for Appeals Review*, may be used for this purpose.

Note. Exempt organizations, employee plans, S corporations, and partnerships are not eligible to use the small case request.

⁶³ IRM 4.19.3.20.11.2 (2013).

ELECTRONIC FILING AND EFIN

3

In 1986, the IRS began its e-file program. In the first year of the e-file program, 25,000 returns were electronically filed. Since then, more than 1 billion tax returns have been e-filed, and the program has become the standard for filing federal and state tax returns.⁶⁴

Today, most tax preparers who e-file returns are referred to as electronic return originators (ERO). An ERO electronically submits returns to the IRS.

Note. Circular 230, §10.51, requires the tax preparer to file returns electronically if the preparer anticipates preparing and filing 11 or more returns. Failure to do so constitutes disreputable conduct under Circular 230. For further information regarding this requirement, see **uofi.tax/15a3x18** [www.irs.gov/Tax-Professionals/e-File-Providers-&Partners/Most-Tax-Return-Preparers-Must-Use-IRS-e-file].

APPLICATION FOR E-FILE PROGRAM

In order to become an ERO, a tax preparer must complete an application and obtain an electronic filing identification number (EFIN) from the IRS. All applicants and the principal officials of a tax firm must pass the following tests.

- An IRS suitability test
- A criminal background check
- A credit history evaluation
- A tax compliance check (both personal and business if applicable)

The tax compliance check involves a review of whether all personal and business returns have been filed, whether penalties had been assessed, and whether there was any prior noncompliance.⁶⁵

IRS Pub. 3112, *IRS E-File Application and Participation*, indicates that the IRS reviews several different areas for an applicant who wishes to obtain an EFIN to participate in the e-file program. The IRS can deny participation in the e-file program for a variety of reasons, including the following.⁶⁶

- The indictment or conviction of any criminal offense under United States or state law (or the existence of an active IRS criminal investigation)
- A failure to file accurate federal, state, or local tax returns
- A failure to pay any federal, state, or local tax liability
- The assessment of fraud penalties
- Any suspension or disbarment from practice before the IRS or before a state or local tax agency
- Engaging in disreputable conduct or other facts that may adversely affect the IRS e-file program
- Misrepresentation of information requested in the IRS e-file application
- Use of unethical practices in return preparation

⁶⁴ *IRS E-File History*. Aug. 18, 2012. [www.irs.gov/uac/IRS-E-File:-A-History] Accessed on Jun. 1, 2015.

⁶⁵ *Become an Authorized E-File Provider*. Jul. 22, 2014. [www.irs.gov/Tax-Professionals/e-File-Providers-&Partners/Become-an-Authorized-e-file-Provider] Accessed on Jun. 1, 2015.

⁶⁶ IRS Pub. 3112, *IRS E-File Application and Participation*.

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- Failure to comply with earned income credit due diligence requirements
- Stockpiling returns prior to official acceptance to participate in IRS e-file program
- Knowingly employing or accepting assistance from any firm or individual that has been denied participation in IRS e-file program or suspended or expelled from participating in the IRS e-file program
- Knowingly accepting employment with, or sharing fees with, any firm or individual that has been denied participation in the IRS e-file program or suspended or expelled from participating in the IRS e-file program

In addition, if the practitioner is under a federal or state court injunction that prohibits the filing of tax returns, e-file participation will be denied.

Note. For further details on the e-file system, see IRS Pub. 3112.

SANCTIONS

The IRS can impose the following four levels of sanctions on the provider, principal, or responsible official.

1. Reprimand
2. Restricted participation
3. Suspension
4. Expulsion with no future participation (used if fraud or criminal activity exists)

The applicant has a right to an administrative review within 30 calendar days of the date of the denial letter. If e-file participation is not granted after this review, the applicant can appeal to the Office of Appeals. The appeal must contain written documentation that provides support for the applicant's position.

APPLICABLE CASE LAW

In *Michael v. U.S.*,⁶⁷ Michael was denied e-file participation due to a failure to file accurate returns and failure to pay the tax assessed. In 1995, the IRS assessed tax preparer penalties against Michael under IRC §6694(b) for reckless and intentional disregard of the rules and regulations. In addition, penalties under IRC §6694(b) were assessed due to taking an unreasonable position. The penalty case was settled. Under the terms of the settlement, the IRS agreed to accept payment of \$1,000 in penalties for nine of the returns involved and \$250 in penalties for the remaining returns. Michael failed to pay the settlement. Each party had the option of reopening the case to enforce the agreement but neither made an application to do so.

In 1998, Michael applied to participate in the IRS e-file program. His application was denied due to the remaining settlement balance. Michael argued that the IRS never re-opened the case within the 60-day timeframe in order to enforce the agreement. Therefore, he argued that the amount was no longer owed and that the IRS had arbitrarily denied the application without cause. However, Rev. Proc. 98-50⁶⁸ clearly spells out the requirements to enter the IRS e-file program. The court determined that Michael did not meet the required e-file standards.

In another case,⁶⁹ Brenner Income Tax Centers obtained an EFIN on December 2, 1996. In 1998, the IRS conducted a random review to determine continued suitability for the e-file program. The IRS's random review of Brenner revealed that the company's 1997 return had not been filed and its 1996 return was filed after the extended due date. Accordingly, the IRS revoked Brenner's EFIN and suspended the firm's ability to participate in the e-file system.

⁶⁷ *Michael v. U.S.*, 36 Fed. Appx. 821 (6th Cir. 2002).

⁶⁸ Rev. Proc. 98-50, 1998-2 CB 368.

⁶⁹ *Brenner Income Tax Centers, Inc. v. Director of Practice of the IRS*, 87 F.Supp.2d 252 (S.D.N.Y. 2000).

Subsequently, the IRS conducted an additional suitability check and determined that the years 1994 through 1996 were not filed on a timely basis and the taxpayer “consistently filed extensions and then filed after the extension date.” The IRS found that both personal and business returns were not filed and tax liabilities remained unpaid.

The firm requested that the court reinstate its ability to participate in the e-file system. The court agreed with the IRS that Brenner was in violation of the e-file requirements and Brenner’s request for reinstatement as an e-file participant was denied.

In *Ekanem v. U.S.*,⁷⁰ Sunday Ekanem was suspended from the e-file program for accepting returns for filing from a paid preparer rather than directly from the taxpayer and for signing Form 8453, *U.S. Individual Income Tax Transmittal for an IRS e-file Return*, as a paid preparer.

Suspension from the e-file program for failure to pay an outstanding debt or file timely tax returns was at issue in *Forehand v. IRS*.⁷¹

*Sabat v. IRS*⁷² involved an individual with two felony convictions that reflected adversely on his character. In addition, the individual did not self-declare the felony convictions on the e-file application. This case resulted in denial of e-file participation and a finding of disreputable conduct.

APPLICATION FOR A NEW EFIN⁷³

There are several situations that require an e-file provider to apply for a new EFIN.

- They never participated in IRS e-file.
- They were previously denied participation in IRS e-file.
- They were previously suspended from IRS e-file.
- They have not submitted any e-file returns for more than two years.
- The structure of the business has changed, requiring the use of a new or different TIN.
- They have expanded the business and added a new location.

EFIN IDENTITY THEFT

A growing type of identity theft has adversely affected tax professionals. Tax professionals concerned with the identity theft of clients are often surprised about the theft of their own EFIN. More and more EFINS have been used to file fraudulent federal and state tax returns. Through the use of the IRS preparer tax identification number (PTIN) system, tax professionals can now regularly verify the number of returns filed and possibly identify fraudulent use of their EFIN.

On April 10, 2014, the IRS issued a news release concerning their work in stamping out identity theft. A new and key component for IRS criminal investigation (CI) efforts is to investigate the misuse of EFINS. From October 1, 2013 through March 31, 2014, the IRS revoked or suspended 395 EFINS based on recommendations from CI. In addition, CI initiated 60 investigations concerning EFINS used by individuals involved in refund fraud and identity theft schemes. By revoking and suspending the EFINS, the IRS can prevent the transmission of the fraudulent tax returns, thwarting the criminal attempts to steal refunds.⁷⁴

⁷⁰ *Ekanem v. U.S.*, 98-1 USTC ¶50,257 (D.Md. 1998).

⁷¹ *Forehand v. IRS*, 877 F.Supp. 592 (M.D. Ala. 1995).

⁷² *Sabat v. IRS*, 85 AFTR 2d 2000-1732, Civil Action No. 99-1751 (W.D. Pa. Mar. 16, 2000).

⁷³ IRS Pub. 3112, *IRS E-File Application and Participation*.

⁷⁴ IRS News Rel. IR-2014-50 (Apr. 10, 2014).

TAXPAYER ADVOCATE SERVICE

The Taxpayer Advocate Service (TAS) is an independent organization within the IRS, headed by the National Taxpayer Advocate (NTA). The roots of the TAS go back to 1979 when the Office of the Taxpayer Ombudsman was created. With the passage of the Taxpayer Bill of Rights 2⁷⁵ (TBOR2) in 1996, this function eventually evolved into the current TAS. TBOR2 established the functions of the TAS as follows.

- Assist taxpayers in resolving problems with the IRS
- Identify areas in which taxpayers have problems dealing with the IRS
- To the extent possible, propose changes in the administrative practices of the IRS to mitigate those identified problems
- Identify potential legislative changes that may be appropriate to mitigate such problems

The office of the NTA was codified by the IRS Restructuring and Reform Act of 1998 (RRA). The RRA amended IRC §7803(c), which is the statutory provision for the NTA, and IRC §7811, which outlines the structure of taxpayer assistance orders. IRC §7803(c) outlines the administration, function, and responsibilities of the NTA.

Congress mandated in the RRA that the NTA could not be an officer or an employee of the IRS for two years preceding or five years following their appointment. The NTA is not considered an IRS employee under this provision. The NTA reports semiannually to Congress. These reports are not reviewed by the IRS Commissioner, the Secretary of the Treasury, or the Office of Management and Budget prior to their submission to Congress.⁷⁶

The RRA provides for local taxpayer advocate (LTA) offices in each state. The LTA offices are required by law to maintain telephone systems, fax lines, and mailing addresses separate from those of the IRS. LTA offices report directly to the NTA.

The primary responsibility of the TAS is to assist taxpayers in resolving issues with the IRS. Most TAS cases fall into one of two general categories: **economic advocacy** and **systemic advocacy**.

A taxpayer qualifies for TAS assistance under **economic advocacy** if they have one of the following **economic hardship** situations.

- Suffers from or is about to suffer economic harm
- Faces an immediate threat of adverse IRS action
- Will likely incur significant costs if relief from IRS action is not granted
- Will likely suffer irreparable injury or long-term adverse impact if relief from IRS action is not granted

Practitioners should attempt to resolve a taxpayer's IRS problem through telephone contact or mail correspondence. If resolution is not achieved and the taxpayer's circumstances meet the qualifications previously listed, then the TAS should be contacted.

To request TAS assistance, the phone number for the TAS office nearest to the taxpayer should be called. A list of all the TAS offices is available on the IRS website at www.irs.gov/uac/Contact-a-Local-Taxpayer-Advocate. The toll-free phone number is 877-777-4778. The taxpayer should then complete Form 911, *Request for Taxpayer Advocate Service Assistance*. This completed form, and/or any other correspondence, should be faxed or mailed to the TAS office nearest to the city in which the taxpayer resides.

Note. To review the National Taxpayer Advocate's 2014 Annual Report to Congress, see uofi.tax/15a3x20 [www.taxpayeradvocate.irs.gov/reports].

⁷⁵ PL 104-168.

⁷⁶ IRC §7803(c).

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Form 911 (February 2015)	Department of the Treasury - Internal Revenue Service Request for Taxpayer Advocate Service Assistance (And Application for Taxpayer Assistance Order)	OMB Number 1545-1504
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Section I – Taxpayer Information (See Pages 3 and 4 for Form 911 Filing Requirements and Instructions for Completing this Form.)

1a. Your name as shown on tax return		1b. Taxpayer Identifying Number (SSN, ITIN, EIN)	
2a. Spouse's name as shown on tax return (if applicable)		2b. Spouse's Taxpayer Identifying Number (SSN, ITIN)	
3a. Your current street address (Number, Street, & Apt. Number)			
3b. City		3c. State (or Foreign Country)	3d. ZIP code
4. Fax number (if applicable)	5. Email address		
6. Tax form number (1040, 941, 720, etc.)		7. Tax year(s) or period(s)	
8. Person to contact if Section II is not being used		9a. Daytime phone number	9b. <input type="checkbox"/> Check here if you consent to have confidential information about your tax issue left on your answering machine or voice message at this number.
10. Best time to call		<input type="checkbox"/> Check if Cell Phone	
11. Preferred language (if applicable) <input type="checkbox"/> TTY/TDD Line <input type="checkbox"/> Interpreter needed - Specify language other than English (including sign language) _____ <input type="checkbox"/> Other (please specify) _____			
12a. Please describe the tax issue you are experiencing and any difficulties it may be creating (If more space is needed, attach additional sheets.) (See instructions for completing Lines 12a and 12b)			

12b. Please describe the relief/assistance you are requesting (If more space is needed, attach additional sheets.)

I understand that Taxpayer Advocate Service employees may contact third parties in order to respond to this request and I authorize such contacts to be made. Further, by authorizing the Taxpayer Advocate Service to contact third parties, I understand that I will not receive notice, pursuant to section 7602(c) of the Internal Revenue Code, of third parties contacted in connection with this request.

13a. Signature of Taxpayer or Corporate Officer, and title, if applicable	13b. Date signed
14a. Signature of spouse	14b. Date signed

Section II – Representative Information (Attach Form 2848 if not already on file with the IRS.)

1. Name of authorized representative	2. Centralized Authorization File (CAF) number	
3. Current mailing address	4. Daytime phone number	
	5. Fax number	
6. Signature of representative	7. Date signed	

Catalog Number 16965S

www.irs.gov

Form **911** (Rev. 2-2015)

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If the taxpayer qualifies for assistance, a TAS caseworker is assigned to the case. This caseworker becomes the single point of contact and works the case from inception to conclusion. The caseworker acts as mediator between the taxpayer and the appropriate IRS business unit.

TAS services are provided free of charge. The TAS has limited power to stop or overturn IRS actions.⁷⁷ Therefore, the TAS cannot lift wage garnishments or remove liens. However, it can advocate the taxpayer's issue to key IRS personnel.

TAXPAYER ASSISTANCE ORDERS

A taxpayer facing a significant hardship may file an application for a taxpayer assistance order (TAO) on Form 911. The NTA can subsequently issue a TAO to assist the taxpayer. Alternatively, the NTA can issue a TAO on its own when it sees a taxpayer facing a significant hardship.

Significant hardship refers to a serious privation caused or about to be caused to the taxpayer as a result of the manner in which the tax laws are being administered by the IRS. A significant hardship includes, but is not limited to, the following.⁷⁸

1. An immediate threat of adverse action

Example 6. The IRS serves a levy on Adam's bank account. Adam needs the bank funds to pay for medically necessary surgery that is scheduled to take place the following week. If the levy is not released, Adam will not have the funds to pay for the procedure. He is experiencing an immediate threat of adverse action.

2. A delay in resolving account problems of more than 30 days

Example 7. Camellia files a Form 4506, *Request for a Copy of Tax Return*. She does not receive the photocopy of the return after waiting more than 30 days beyond the normal time for processing. Camellia is experiencing a delay of more than 30 days.

3. Significant costs, including professional representation costs, if relief is not granted

Example 8. The IRS sends a notice requesting payment of outstanding employment taxes and penalties to Avalon Co. The notice states that Avalon has employment tax balances for 12 tax quarters that total \$20,000. Avalon provides documentation to the IRS that shows that there would be no balance due if the IRS applied all the payments to each quarter correctly. The IRS requests additional records and documentation. Because there are 12 quarters involved, Avalon asserts that it will need to hire an accountant to comply with the request. The accountant estimates her fees will be at least \$5,000 to organize all the records and provide a detailed analysis of how to apply the deposits and payments. Avalon Co. is facing significant costs.

4. Irreparable injury to, or a long-term adverse impact on, the taxpayer if relief is not granted

Example 9. Darren has arranged with a bank to refinance his mortgage to lower his monthly payments. He is unable to make the current monthly mortgage payment. Unless the monthly payment amount is lowered, the bank will foreclose on Darren's residence. The IRS refuses to subordinate the federal tax lien or discharge the property subject to the lien. As a result, the bank will not allow Darren to refinance. He is facing an irreparable injury if relief is not granted.

If an IRS employee is not following published administrative guidance, the NTA can take this into account in determining whether a TAO should be issued.

⁷⁷ Treas. Reg. §301.7811-1.

⁷⁸ Treas. Reg. §301.7811-1(a)(4)(ii).

A TAO can be issued to require the IRS to release levied property belonging to the taxpayer, cease collection activity, or other specific items.⁷⁹ Although a TAO can generally be issued to any IRS office, division, or function, it may not be directed to the IRS Criminal Investigation Division if it appears the TAO may impede a criminal investigation.

SYSTEMIC ADVOCACY

The Office of Systemic Advocacy studies, analyzes, and recommends action to produce a positive resolution to taxpayer problems. Systemic advocacy resolves problems by recommending administrative changes to IRS policy, procedures, and processes. Alternatively, depending on the issue, it can resolve problems by proposing legislative remedies.

The TAS does not accept systemic advocacy cases that involve processing original returns, unpostable or rejected returns, processing amended returns, and injured spouse claims. The TAS focuses its limited resources on economic burden cases and only those systemic burden cases in which it plays a more direct role in affecting the outcome. Examples of systemic cases that the TAS will accept include those referred by a congressional office and those that could be resolved if a taxpayer files an amended return, original return, or claim for refund.⁸⁰

The Office of Systemic Advocacy uses the Systemic Advocacy Management System (SAMS) database to receive, prioritize, and assign issues submitted by the public and IRS employees. Individuals, businesses, academic and research institutions, professional organizations, practitioners, and all other interested parties may submit issues.⁸¹

After the issue is submitted, an acknowledgement is sent to the taxpayer via e-mail. Based on the facts presented, a decision is made about whether the issue merits development as an advocacy project. If so, it is assigned. As the issue is reviewed and the status updated, additional e-mails may be sent.

An issue can also be submitted by completing Form 14411, *Systemic Advocacy Issue Submission Form*, which can be faxed to 202-317-4204 or e-mailed to Systemic.Advocacy@irs.gov.

⁷⁹ Treas. Reg. §301.7811-1.

⁸⁰ *Taxpayer Advocate Service Changes Case Acceptance Criteria*. [www.taxpayeradvocate.irs.gov/userfiles/file/TAS_change_case_criteria.pdf] Accessed on Sep. 9, 2015.

⁸¹ *Systemic Advocacy Management System (SAMS)*. Aug. 2, 2012. [[www.irs.gov/uac/Systemic-Advocacy-Management-System-\(SAMS\)](http://www.irs.gov/uac/Systemic-Advocacy-Management-System-(SAMS))] Accessed on Sep. 9, 2015.

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TAS STATISTICS

The following table provides additional detail reporting the types of cases addressed by the TAS in 2014.⁸²

Table 20. Taxpayer Advocate Service: Postfiling Taxpayer Assistance Program, by Type of Issue and Relief, Fiscal Year 2014

Type of issue and relief	Number	Percentage of total
Taxpayer Advocate Service cases received, by type of issue [1]:		
Total	216,697	100.0
Stolen identity	43,690	20.2
Pre-refund wage verification hold	35,220	16.3
Earned Income Tax Credit	13,450	6.2
Processing amended returns	10,245	4.7
Levies	8,086	3.7
Processing original returns	7,664	3.5
Injured spouse claims	7,284	3.4
Examination reconsideration	6,768	3.1
Open examination	5,302	2.4
IRS offset to IRS tax liability	4,789	2.2
Closed Automated Underreporter Program [2]	3,821	1.8
Unpostable and rejected returns	3,751	1.7
Other refund inquiries/issues [3]	3,740	1.7
Installment agreements	3,737	1.7
Application for tax-exempt status	3,589	1.7
All others	55,561	25.6
Taxpayer Advocate Service cases closed, by type of resolution [1]:		
Total	222,974	100.0
Relief provided to taxpayer, total	173,692	77.9
Taxpayer Assistance Order issued [4]	280	0.1
No Taxpayer Assistance Order issued [4]	173,412	77.8
Full relief	157,400	70.6
Individual taxpayer issue [5]	144,763	64.9
Systemic issue [6]	12,637	5.7
Partial relief	16,012	7.2
Individual taxpayer issue [5]	14,937	6.7
Systemic issue [6]	1,075	0.5
No relief provided to taxpayer, total	49,282	22.1
Taxpayer Assistance Order rescinded [4]	12	[7]
No Taxpayer Assistance Order issued [4]	49,270	22.1
No response from taxpayer	28,023	12.6
No relief provided by Taxpayer Advocate Service [8]	11,068	5.0
Taxpayer withdrew application for assistance	2,686	1.2
Tax law precluded relief	1,202	0.5
Hardship not related to revenue laws	565	0.3
Hardship not validated	473	0.2
All others	5,253	2.4
Congressional inquiries [9]	17,449	N/A

N/A—Not applicable.

[1] The Taxpayer Advocate Service generally receives cases from any of the following sources: IRS employee referrals based on IRS guidance; direct taxpayer requests for assistance (by phone, in person, outreach activities, or through correspondence); practitioners; and Congressional office referrals. Cases may be received in one fiscal year and closed in another.

[2] Under the Automated Underreporter Program, the IRS uses information returns from third parties to identify unreported income on returns filed by taxpayers.

[3] Includes cases related to erroneous, decedent, and document-fee refunds along with reimbursement of bank charges due to IRS error.

[4] The National Taxpayer Advocate has the authority to issue a Taxpayer Assistance Order (TAO) when a taxpayer is suffering or about to suffer a significant hardship as a result of the manner in which the Internal Revenue laws are being administered if relief is not granted. A TAO directs an IRS organizational unit to take a specific action or to review, expedite consideration of, or reconsider a taxpayer's case. However, in the majority of cases, the Taxpayer Advocate Service can resolve taxpayers' issues without issuing TAOs. Taxpayer Assistance Orders may be issued in one fiscal year and closed in another.

[5] An individual taxpayer issue is a single issue (applicable to an individual, corporation, or other entity) that requires a change or modification to an account.

[6] A systemic issue requires a change or modification to an established IRS procedure, process, or operation (e.g., computer program) that potentially impacts more than one taxpayer.

[7] Less than 0.05 percent.

[8] Another IRS division provided relief before Taxpayer Advocate Service intervention.

[9] In this table, Congressional inquiries (related to constituents' tax accounts) refers to those applications for taxpayer assistance received from Congressional offices during the fiscal year. This item is shown separately for information purposes, but counts are included in the data above.

NOTES:

Detail may not add to totals because of rounding.

The Taxpayer Advocate Service is an independent organization within the IRS that helps taxpayers resolve problems with the IRS and recommends changes that will prevent these problems.

SOURCE: Taxpayer Advocate Service, Business Assessment.

⁸² SOI Tax Stats. [www.irs.gov/uac/SOI-Tax-Stats-Taxpayer-Advocate-Service-Postfiling-Taxpayer-Assistance-Program-by-Type-of-Issue-and-Relief-IRS-Data-Book-Table-20] Accessed on Aug. 6, 2015.