

Chapter 3: Representation Before the IRS

Responsibility to Determine the Correct Tax Liability	A133	IRS Appeals.....	A170
Authorities	A134	Fast Track Settlement	A170
Penalties and Other Sanctions	A136	Audit Reconsideration.....	A172
Illustrative Examples	A138	Risk Analysis of an Appeal	A174
Client Engagement Letters	A138	IRS Hazards of Litigation.....	A174
Scope of the Engagement	A140	Appeals Conference.....	A175
Responsibilities and Requirements	A140	Settlement Agreements	A177
Fees and Payment Terms	A142	Closing Agreements.....	A178
Disengagement	A142	Post Appeals Mediation.....	A178
Sample Representation		Litigation	A179
Engagement Letter	A143	IRS Collections	A180
Communicating with the IRS.....	A145	Taxpayer Billing and Payment.....	A180
Circular 230 Responsibilities	A145	Collection Actions.....	A185
Tax Information Authorization.....	A146	Collection Relief Available.....	A186
IRS Notices	A154	Collection Statute Expiration Date	A187
Penalty Relief.....	A157	Collection Appeals	A187
Taxpayer And Practitioner Resources.....	A160	Criminal Investigations	A189
IRS Examinations.....	A165	Attorney versus Practitioner Role.....	A190
Selection for Audit	A165	Statute of Limitations.....	A190
Statute of Limitations	A165	Nonfilers.....	A190
Amended Returns	A166	Types of Nonfiler	A190
Notification	A167	Definition of a Return.....	A191
Types of Audit.....	A167	IRS SFR Programs	A191
Request for Taxpayer Records	A167	Statute of Limitations.....	A192
Audit Outcome	A168	Voluntary Disclosure Practice.....	A192

Please note. Corrections were made to this workbook through January of 2022. No subsequent modifications were made.

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

2021 Workbook

About the Author

Marshall J. Heap, PhD, EA, served as a Tax Content Development and Instruction Specialist at the University of Illinois Tax School from 2017 to 2020. An EA since 1984, Marshall is an ex-Senior Manager of PriceWaterhouseCoopers and has seven years of recent experience as an approved IRS continuing education provider. Marshall’s academic background is in Computing and associated fields with degrees from the following UK Universities: The Open University (BSc), London, Birkbeck College (MSc), and Reading (PhD).

Other chapter contributors and reviewers are listed at the front of this volume.

The Taxpayer Bill of Rights identifies 10 fundamental rights for all taxpayers, one of which is the **right to retain representation**. That right states, “[t]axpayers have the right to retain an authorized representative of their choice to represent them in their dealings with the IRS. Taxpayers have the right to seek assistance from a Low Income Taxpayer Clinic if they cannot afford representation.”¹

Besides discussing representation of clients during IRS audits and collection proceedings, this chapter also considers other aspects of practice before the IRS including the following.

- Responsibilities a practitioner has in determining a client’s tax liabilities
- Issues a practitioner should consider when drafting an IRS representation engagement letter
- How a practitioner should respond if they know or suspect their client committed a tax crime
- What assistance a practitioner can provide to a nonfiler

Example 1. Paul Nofyler has been a self-employed landscaper for many years. Wanting to expand his business, he visits a local bank to borrow funds. When the bank requests his last three years of tax returns, Paul explains he needs to get those records out of storage. What is not known to the banker is that Paul has not filed any returns for at least the last 10 years.

Treasury Department Circular No. 230, which was last revised in June 2014 (referred to as Circular 230 in the text) provides the rules for persons representing taxpayers before the IRS.² Only tax practitioners recognized by Circular 230 can represent taxpayers before the IRS.³ Tax practitioners include attorneys, certified public accountants, and enrolled agents.⁴ **The term “practitioner” in this text refers to an individual recognized to practice before the IRS under Circular 230.**

Note. In the November 17, 2020 Priority Guidance Plan for 2020–2021, the IRS scheduled an update to the regulations under 31 U.S.C. §330 governing practice before the IRS (i.e., Circular 230). However, no update to Circular 230 was available when this chapter was written.

¹ *Taxpayer Bill of Rights 9: The Right to Retain Representation*. Jan. 22, 2021. IRS. [www.irs.gov/newsroom/taxpayer-bill-of-rights-9] Accessed on Mar. 12, 2021.

² Circular 230, §10.0.

³ Circular 230, §10.2(a)(5).

⁴ *Ibid.*

Representation before the IRS (representation) is not specifically defined in Circular 230. Instead, Circular 230 indicates that **IRS representation** is part of **practice before the IRS** which includes “preparing documents; filing documents; corresponding and communicating with the IRS; rendering written advice with respect to any entity, transaction, plan or arrangement, or other plan or arrangement having a potential for tax avoidance or evasion; and **representing a client at conferences, hearings, and meetings.**”⁵

Similarly, Treasury regulations state that representation constitutes acts performed on behalf of a taxpayer by a representative in practice before the IRS including the preparation and filing of necessary documents, correspondence with and communications to the IRS, and the representation of a taxpayer at conferences, hearings, and meetings with the IRS.⁶ Furthermore, anyone who represents a taxpayer through correspondence with the IRS **must** submit a power of attorney (POA), including the declaration of representative and any other required statement(s), **even though no personal appearance before the IRS is contemplated.**⁷

Example 2. Use the same facts as **Example 1.** Paul finds a return he prepared for 2010. Paul thinks about an old friend, Marco Counter, who prepares tax returns as a sideline to his regular employment. Paul immediately contacts Marco. Marco tells Paul he cannot represent him because he is not a CPA, attorney, or enrolled agent. Marco admits to Paul that even though he prepares about 200 returns per year, he does not sign them. Instead, he indicates on his software that any returns he worked with were “self-prepared.”

For most tax preparers, the most frequently prepared documents are tax returns. Practitioners have well defined responsibilities in determining the tax liabilities reflected on their clients’ tax returns.

Example 3. Use the same facts as **Example 2.** Paul’s dilemma keeps getting worse. While trying to reconstruct many years of income and expenses to generate tax returns for the lender, Paul receives a letter from the IRS requesting tax returns from his years of noncompliance.

RESPONSIBILITY TO DETERMINE THE CORRECT TAX LIABILITY

If a taxpayer’s return is audited, the IRS examiner’s responsibility is to determine the correct tax liability as prescribed by the Internal Revenue Code (IRC or Code).⁸ In fact, the Internal Revenue Manual (IRM) specifically states:⁹

It is imperative that examiners can identify the applicable law, correctly interpret its meaning in light of congressional intent, and, in a fair and impartial manner, correctly apply the law based on the facts and circumstances of the case.

Tax preparers are subject to similar requirements as specified in Circular 230. For example, practitioners must exercise due diligence as to accuracy when preparing tax returns and other IRS documents.¹⁰ Similarly, practitioners must exercise due diligence when communicating both with the IRS and their clients.¹¹ When a practitioner relies on the work product of another person, it is presumed that the practitioner exercised due diligence provided that “the practitioner used reasonable care in engaging, supervising, training, and evaluating the person, taking proper account of the nature of the relationship between the practitioner and the person.”¹²

⁵ Circular 230, §10.2(a)(4).

⁶ Treas. Regs. §§601.501(b)(13) and (10).

⁷ Treas. Reg. §601.504(d).

⁸ IRM 4.10.7.1 (2018).

⁹ Ibid.

¹⁰ Circular 230, §10.22.

¹¹ Ibid.

¹² Ibid.

2021 Workbook

Additionally, a practitioner may not willfully, recklessly, or through gross incompetence sign a tax return or claim for refund containing a position that the preparer should know or reasonably know:¹³

1. Lacks a reasonable basis,
2. Is a willful attempt to understate the tax liability, or
3. Recklessly or intentionally disregards rules or regulations.

Similarly, a practitioner may not advise a client to take a position on a tax return or claim for refund or prepare a portion of a tax return or claim for refund that meets any of the three preceding conditions.¹⁴

Circular 230 describes best practices, which include the following.¹⁵

- Clearly communicating the terms of the engagement to the client (covered in detail in the next section)
- Establishing the facts and determining which facts are relevant
- Evaluating the reasonableness of any assumptions or representations
- Relating the applicable law (including potentially applicable judicial doctrines) to the relevant facts
- Arriving at a conclusion supported by the law and the facts

Example 4. Use the same facts as **Example 3**. Exasperated, Paul schedules an appointment with Sue Ketchum, a CPA. At the meeting, Paul explains his situation and asks if Sue can file returns for the missing years based on what Paul remembers. He tells Sue that he has no documentation to support his memory. He also explains to Sue that the IRS has scheduled a meeting with him. Sue responds by telling Paul she must discuss the situation with her boss because she does not own the practice. She makes no promises to Paul regarding the potential for representing him.

AUTHORITIES

When preparing a tax return or claim for refund, the practitioner must ensure that any positions taken on the return either have a **reasonable basis** or have **substantial authority**.¹⁶ Because reasonable basis is a **lesser** standard than substantial authority, positions taken that meet the reasonable basis standard must be adequately disclosed (discussed later).¹⁷ Any position that fails to meet either of these standards results in an understatement of the taxpayer's liability for which the preparer can be sanctioned (discussed later).¹⁸

The following table summarizes the various authoritative standards and their associated probability of success of being upheld.

Level of Confidence	Probability
More-likely-than-not ¹⁹	> 5
Substantial authority ²⁰	> 4
Reasonable basis ²¹	> 2

¹³ Circular 230, §10.34.

¹⁴ Ibid.

¹⁵ Circular 230, §10.33.

¹⁶ IRC §6694.

¹⁷ IRC §6694(a)(2)(B).

¹⁸ IRC §6694.

¹⁹ Treas. Reg. §1.6694-2.

²⁰ Treas. Reg. §1.6662-4(d)(2).

²¹ Treas. Reg. §1.6662-3(d)(3); *Statement on Standards for Tax Services (SSTS) No. 1, Tax Return Positions (Preface)*. AICPA. [www.aicpa.org/InterestAreas/Tax/Resources/StandardsEthics/StatementsonStandardsforTaxServices/DownloadableDocuments/Preface.pdf] Accessed on Jun. 3, 2021.

Reasonable Basis²²

Reasonable basis is a standard of tax reporting. The standard is significantly higher than a position taken that is **not** frivolous or **not** patently improper. It is also not satisfied by an arguable return position. A return position has a reasonable basis if it is based on **one or more authorities** (considering the relevance and persuasiveness of the authorities, and subsequent developments.)

Note. See the 2021 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 4: Rulings and Cases, for a list of authorities and their order of precedence.

When meeting the reasonable basis standard, a practitioner may rely in good faith without verification upon information furnished by their client, as well as information and advice provided by another advisor, another tax return preparer, or other party (including advisors or tax return preparers at the practitioner's firm).

Disclosure.²³ Generally, disclosure of a tax return position is made on Form 8275, *Disclosure Statement*. However, if the position is contrary to a regulation, disclosure must be made on Form 8275-R, *Regulation Disclosure Statement*.



Practitioner Planning Tip

Disclosing information on Form 8275 provides an explanation for a position taken on the tax return. Taking this step may help avoid certain penalties.²⁴

Substantial Authority²⁵

There is substantial authority for a tax return position if the weight of the authorities supporting the treatment is substantial compared to the weight of contrary authorities. All relevant authorities, whether in favor of or against the position taken, should be considered. The applicability of an authority to the relevant facts should be weighed. Higher weight is given to more recently issued authorities. It is also possible for substantial authority to exist for multiple positions concerning the same item.

The substantial authority standard is **less** stringent than the **more-likely-than-not** standard (i.e., where there is a greater than 50% chance of a position being upheld) but **more** stringent than the reasonable basis standard.

Tax Shelters²⁶

A tax shelter is an entity, plan, or arrangement whose purpose is to **avoid or evade** federal income tax. The term **tax shelter** only applies to entities that are structured as one of the following.

- A partnership or other entity (such as a corporation or trust)
- An investment plan or arrangement
- Any other plan or arrangement

²² Treas. Regs. §§1.6694-2(d)(2), 1.6662-3(b)(3), and 1.6662-4(d)(3)(iii).

²³ Treas. Reg. §1.6662-4(f).

²⁴ See instructions to Form 8275.

²⁵ Treas. Reg. §1.6662-4(d).

²⁶ Treas. Reg. §1.6662-4(g).

2021 Workbook

A **tax shelter item** is any item of income, gain, loss, deduction, or credit if the item is directly or indirectly attributable to the principal purpose of a tax shelter.

Note. In determining whether a tax shelter item gives rise to a tax understatement, it does not matter if a disclosure of the tax return position was made.

Noncorporate Taxpayers. The tax attributable to a tax shelter item of a noncorporate taxpayer is **not** considered understated if **both** of the following exist.

1. There is **substantial authority** for the tax treatment of that item.
2. The taxpayer reasonably believed at the time the return was filed that the tax treatment of that item was **more likely than not** the proper treatment.

Note. As previously stated, the more-likely-than-not standard is **more** stringent than the substantial authority standard.

Corporate Taxpayers. Generally, tax shelter items of a corporation are considered in computing the amount of any understatement (i.e., the exception applicable for noncorporate taxpayers is generally not available to corporate taxpayers).

PENALTIES AND OTHER SANCTIONS

Taxpayer Penalties²⁷

A tax understatement attributable to a return position that does not meet the previously discussed standards can be subject to the accuracy-related penalty of 20% of the understated tax liability. However, this penalty is only imposed on a **substantial** understatement of income tax. The determination of whether an understatement is substantial is different for noncorporate and corporate taxpayers.

Noncorporate Taxpayers. A substantial understatement of income tax exists if the amount of the understatement for the tax year exceeds the **greater** of the following.

1. 10% of the tax required to be shown on the return for the tax year, or
2. \$5,000

Caution. When the tax return for the year in question includes the qualified business income deduction (QBID), the threshold percentage in the first condition is lowered to 5%.²⁸

Corporate Taxpayers. For C corporations, a substantial understatement of income tax exists if the amount of the understatement for the tax year exceeds the **lesser** of the following.

1. 10% of the tax required to be shown on the return for the tax year (or, if greater, \$10,000), or
2. \$10 million

Note. In the **unlikely** event that the corporate tax return for the year in question includes the QBID, the threshold percentage stated in the first condition is lowered to 5%.²⁹

²⁷ IRC §6662.

²⁸ IRC §§6662(d)(1)(C) and 199A.

²⁹ Ibid.

Reasonable Cause and Good Faith Exception.³⁰ The accuracy-related penalty does **not** apply when the taxpayer can show they acted in good faith and that there was reasonable cause for the understatement. This exception applies even in situations where the return position does not satisfy the reasonable basis standard.

Qualified Amended Return.³¹ The substantial understatement penalty can also be abated if the taxpayer files a qualified amended return (QAR) that corrects the omission or error before the IRS raises the matter with the taxpayer. For example, omitting income on a prior year's Form 1040, *U.S. Individual Income Tax Return*, usually generates a CP2000 notice about a year later. If a taxpayer amends the previous year's return to include the inadvertently omitted income, the IRS is required to abate substantial underpayment penalties because a QAR was filed. However, a QAR does not correct a fraudulent position taken on the originally filed return.

Preparer Penalties³²

As stated earlier, practitioners must relate the law to relevant facts. Besides being potentially subject to the §6662 accuracy-related penalty, a tax understatement attributable to a return position that does not meet the previously discussed standards could result in a preparer penalty. In fact, a practitioner who knows or reasonably should have known that a position understates a taxpayer's liability on a return or claim for refund is subject to a penalty that is the **greater** of the following.

1. \$1,000, or
2. 50% of the income derived (or to be derived) by the practitioner with respect to the return or claim

However, if the preparer engaged in **willful or reckless conduct**, the penalty is the **greater** of the following.

1. \$5,000, or
2. 75% of the income derived (or to be derived) by the tax return preparer with respect to the return or claim

For this purpose, willful or reckless conduct is one of the following.

- A willful attempt in any manner to understate the tax liability on the return or claim, or
- A reckless or intentional disregard of rules or regulations

Disciplinary Action.³³ The IRS Office of Professional Responsibility (OPR) can initiate proceedings if it suspects a violation of Circular 230 rules. Such proceedings can be initiated for incompetent or disreputable conduct, which includes “willfully assisting, counseling, encouraging a client or prospective client in violating, or suggesting to a client or prospective client to violate, any federal tax law, or knowingly counseling or suggesting to a client or prospective client an illegal plan to evade federal taxes or payment thereof.”³⁴

Failure to comply with regulations under the prohibited conduct standards is another violation for which disciplinary proceedings could be initiated (e.g., a reckless violation of standards by including a position on a return that lacks a reasonable basis).³⁵

Sanctions imposed by OPR for violation of Circular 230 rules include censure, suspension, or disbarment of the practitioner.

³⁰ Treas. Reg. §1.6664-4.

³¹ Treas. Reg. §1.6664-2.

³² IRC §6694.

³³ Circular 230, Subpart C.

³⁴ Circular 230, §10.51(a)(7).

³⁵ Circular 230, §§10.52 and 10.34.

2021 Workbook

ILLUSTRATIVE EXAMPLES

The following example illustrates when the §6694 preparer penalty and §6662 accuracy-related penalty **do not apply** to an understatement of a taxpayer's tax liability.³⁶

Example 5. Jeff, a CPA, prepares a client return including a position (unrelated to a tax shelter) for which there is a reasonable basis but **not** substantial authority. Included in the return is Form 8275 disclosing the position taken on the tax return. The client files the tax return. Later, the IRS audits the return. It disallows the position taken, and determines additional tax is due. Jeff is not subject to the §6694 penalty nor is his client subject to the §6662 accuracy-related penalty for the understatement of tax related to the disallowed position.

The next example illustrates when the §6694 preparer and §6662 accuracy-related penalties **do apply** for understatement of tax resulting from unreported income.

Example 6. Wanda, an enrolled agent, provides a 2020 tax organizer to her client Anne, a single, calendar-year taxpayer. Before preparing Anne's 2020 federal tax return, Wanda verifies with Anne that her completed organizer provides all information regarding Anne's 2020 income and deductions. Anne put a note in the organizer that she received \$30,000 from sales of virtual currency. Wanda assumes this income is not taxable and does not report the transactions. After her review, Anne signs and files the return prepared by Wanda. The return reflects \$40,000 of other income as reported by Anne in the tax organizer and shows a net tax liability of \$2,500. None of Anne's income qualifies for the QBID.

Later an IRS examination of Anne's 2020 return results in an adjustment for unreported income of \$30,000 and a \$5,500 increase in Anne's tax liability. Because the understatement exceeds the greater of \$800 (10% of the \$8,000 tax required to be shown on the return) or \$5,000, the understatement is considered substantial. Therefore, the IRS adds a \$1,100 ($\$5,500 \times 20\%$) §6662 accuracy-related penalty to the balance due. Wanda is subject to a §6694 penalty because she knew or reasonably should have known about the unreported income on Anne's 2020 return.

CLIENT ENGAGEMENT LETTERS

Circular 230 **best practices** include communicating clearly with the client regarding the terms of the engagement to ensure the practitioner achieves both of the following.³⁷

1. An understanding of the client's expected purpose for and use of the advice
2. An understanding of the form and scope of the advice or assistance to be rendered

To fulfill this Circular 230 **recommendation**, practitioners offering **compliance** services (e.g., tax return preparation) often use an engagement letter to formally specify the terms of the engagement. This enables the practitioner to do the following.

- Reduce potential for client misunderstandings
- Set expectations and responsibilities for both the practitioner and client
- Satisfy professional liability insurer requirements

³⁶ Based on Treas. Reg. §1.6694-2(d)(3)(v), Example 1.

³⁷ Circular 230, §10.33(a)(1).

Similarly, practitioners offering **representation** services should consider using an engagement letter to specify the terms of the engagement. Typically, such a letter addresses the following key items.

1. Scope of the engagement (included and excluded services)
2. Responsibilities and requirements (client and practitioner)
3. Fees and terms of payment
4. Disengagement

Practitioner Planning Tip

When drafting engagement letters, practitioners should be mindful of laws and professional rules and regulations that include, but are not limited, to the following.

- Circular 230
- IRC §7216 requirements for disclosure or use of information by return preparers
- The privacy rule of the Gramm-Leach-Bliley Act (GLBA)³⁸
- The GLBA safeguards rule³⁹
- American Bar Association Model Rules of Professional Conduct⁴⁰
- American Institute of Certified Public Accountants (AICPA) Code of Professional Conduct⁴¹
- National Association of Enrolled agents (NAEA) Code of Ethics and Rules of Professional conduct⁴²
- Relevant state laws (e.g., state licensing requirements, state board of accountancy rules, disclosure of finance charges, etc.)

³⁸ *Financial Privacy Rule*. FTC. [www.ftc.gov/enforcement/rules/rulemaking-regulatory-reform-proceedings/financial-privacy-rule] Accessed on Dec. 1, 2020.

³⁹ *Safeguards Rule*. FTC [www.ftc.gov/enforcement/rules/rulemaking-regulatory-reform-proceedings/safeguards-rule] Accessed on Dec. 1, 2020.

⁴⁰ *Model Rules of Professional Conduct*. 2020. ABA. [www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/model_rules_of_professional_conduct_table_of_contents.html] Accessed on Dec. 1, 2020.

⁴¹ *AICPA Code of Professional Conduct*. Aug. 31, 2016. AICPA. [www.aicpa.org/content/dam/aicpa/research/standards/codeofconduct/downloadabledocuments/2014december15contentasof2016august31codeofconduct.pdf] Accessed on Dec. 1, 2020.

⁴² *Code of Ethics and Rules of Professional Conduct*. Nov. 9, 2019. NAEA. [www.naea.org/wp-content/uploads/2020/05/Proposed-Revised-Code-of-Ethics-and-Rules-of-Professional-Conduct2019-25oct19-GSM-review-FINAL.pdf] Accessed on Aug. 27, 2021.

2021 Workbook

The four key items for a representation engagement are next explored in detail. However, the following analysis is not intended to be all-inclusive. Every professional is encouraged to do their own research to ensure compliance with relevant federal, state, and professional association laws and requirements.

For illustrative purposes, reference is made to an IRS audit engagement. However, the following content is equally relevant to other types of representation engagement (e.g., IRS Appeals and Collections).

SCOPE OF THE ENGAGEMENT

Services Included

Typically, an engagement letter begins by defining the scope of the engagement. For example, a practitioner retained by a client to represent them during an IRS audit indicates the specific tax form(s) being audited, the year(s) at issue, and the specific tax items under examination.

If appropriate, tax information authorization (discussed in the next section) is also sought from the client.

Services Excluded

In managing client expectations, practitioners should be careful to identify representation services that are **excluded** from the engagement. For example, if the audit defense is unsuccessful and the taxpayer wishes to pursue their case with the IRS Appeals division, services related to the next steps are separately contracted.

RESPONSIBILITIES AND REQUIREMENTS

Client

It is important that the practitioner clearly state what information or other assistance they require from their client. Because representation issues can be time sensitive, the practitioner should inform the client of relevant deadlines as well as the consequences for failure to comply with those deadlines. For example, a practitioner might require a client being audited on charitable contributions to provide them with donation receipts within a certain period and then inform the client that failure to do so could result in IRS disallowance of the charitable deductions claimed.

Practitioner

Negotiation and compromise may be necessary to arrive at a settlement that is agreeable to the client. The practitioner should seek input from their client on what constitutes an acceptable settlement.



Practitioner Planning Tip

It is wise to find out what the client sees as an acceptable settlement prior to accepting the engagement.

The practitioner should indicate whether the assistance of other tax professionals or other experts is needed to resolve the audit. In this context, practitioners should be mindful of the IRC §7216 disclosure requirements.

Note. See the 2019 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 5: Ethics in Tax Practice, for a detailed list of permitted disclosures as well as the procedure for obtaining client consent to disclosure. This can be found at [uofi.tax/arc](https://taxschool.illinois.edu/taxbookarchive) [taxschool.illinois.edu/taxbookarchive].

It may also be appropriate to state that the practitioner does not offer any guarantees concerning the outcome of the audit or on its impact on any other examination or investigation.

Conflicting Interests.⁴³ Generally, practitioners cannot represent a client before the IRS if the representation causes a conflict of interest. The following describe potential conflicts of interest.

1. The representation of one client is directly adverse to another client.
2. There is a significant risk that the client representation will be materially limited by the practitioner's responsibilities to another client, an ex-client, a third person, or by a practitioner's personal interests.

Practitioner Planning Tip

A taxpayer may be able to find relief from penalties because they relied on advice from a tax practitioner. Therefore, the preparer of the return may not be in the best position to represent the client because of inherent conflicts of interest.

However, a practitioner can nevertheless represent an affected client if the practitioner reasonably believes that they can provide competent and diligent representation to the client. The following conditions must also be satisfied.

- The representation is not prohibited by law.
- Each affected client waives the conflict of interest and gives informed consent.

Note. See the 2019 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 5: Ethics in Tax Practice, for more information on conflicting interests including professional association requirements, an example, and illustrative conflict of interest waiver forms. This can be found at uofi.tax/arc [taxschool.illinois.edu/taxbookarchive].

Privilege. Although IRC §7525 provides confidentiality privileges relating to taxpayer communications, in practice these privileges only concern **tax advice**. Advice on the matter must fall within the scope of a practitioner's authority to practice.⁴⁴ Information or communications concerning tax return preparation do **not** constitute **tax advice**.⁴⁵

IRC §7525 confidentiality privileges **only apply** “to civil administrative proceedings with the IRS (e.g., an examination or appeal), or to tax litigation before the Tax Court or other federal courts.”⁴⁶

⁴³ Circular 230, §10.29.

⁴⁴ IRC §7525(a)(3)(B).

⁴⁵ *The Sec. 7525 Privilege Relating to Taxpayer Communications*. Nebolsine, Nicholas. Aug. 1, 2018. The Tax Adviser. [www.thetaxadviser.com/issues/2018/aug/sec-7525-privilege-taxpayer-communications.html] Accessed on Dec. 14, 2020.

⁴⁶ *Ibid.*



Practitioner Planning Tip

During the initial interview with a new client, it is important to determine if any of the information is “privileged” and mark it accordingly in the client’s workpapers.

FEES AND PAYMENT TERMS

To avoid any misunderstanding, practitioners should clearly communicate their fee structure and payment terms. When a retainer is used, practitioners should indicate when it is payable, under what circumstances it is fully or partially refundable, and the amount and timing of invoices including those for fees exceeding the retainer. Practitioners should also consider any out-of-pocket costs they may incur for the representation (e.g., telephone, fax, photocopying, postage, research fees, mileage, travel, lodging, meals, etc.) and clearly communicate which of those costs the client is responsible for paying.

Finally, practitioners should be mindful of two Circular 230 regulations concerning fees.⁴⁷ First, practitioners are prohibited from charging unconscionable fees (also described as being exorbitant).⁴⁸ Second, certain contingent fees are prohibited. For this purpose, a contingent fee is any fee that depends, wholly or partly, on whether a position taken on a tax return or other filing avoids challenge by the IRS or is sustained either by the IRS or in litigation. Such fees include those based on any of the following.

1. A percentage of the refund reported on a return
2. A percentage of the taxes saved or that otherwise depends on a specific result
3. An arrangement to waive fees if a position taken on a tax return or other filing is challenged by the IRS, or is not sustained

Note. More information on contingent fees is included in the 2019 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 5: Ethics in Tax Practice, including the circumstances when contingent fees may be charged, and the *Ridgely*⁴⁹ case where the IRS’s authority to regulate contingency fee arrangements by tax preparers was called into question. This can be found at uofi.tax/arc [taxschool.illinois.edu/taxbookarchive].

DISENGAGEMENT

Disengagement describes the procedure for terminating the practitioner-client relationship so that each party is free to exit the relationship without further consequences. Practitioners should consider the circumstances under which either party to the relationship may wish to disengage (e.g., an unforeseen conflict of interest or practitioner/staff availability). It is recommended that the engagement letter also describe the disengaging party’s responsibilities to the other party when such a clause is triggered. For example, a disengaging practitioner’s responsibilities could include the following.

- Informing the client of the reason for and the effective date of the disengagement
- Providing a description of any work that is incomplete along with associated filing deadlines

⁴⁷ Circular 230, §10.27.

⁴⁸ See *U.S. v. Franklin, Wiggins, Brown, and Instant Tax Refund Service (d/b/a Instant Tax Service)*, No. 1:12-cv-00394-SEB-DKL (S.D. Ind. Mar. 28, 2011).

⁴⁹ *Ridgely v. Lew*, No. 1:12-cv-00565 (D.D.C. Jul. 16, 2014).

SAMPLE REPRESENTATION ENGAGEMENT LETTER

The following sample IRS audit engagement letter is provided for illustrative purposes. Practitioners should exercise their own judgment in determining the appropriate content for a client engagement letter.

Dear <Client Name>,

Representation of You Before the IRS Regarding the Audit of Your <Tax Year> Tax Return.

Thank you for choosing us to assist you with your tax affairs. This letter specifies the terms of our engagement with you and details the services that we will provide you.

As per your request, we will represent you before the IRS in connection with the IRS audit of your <Tax Year> Tax Return <Form XXXX>. The specific tax items under examination by the IRS are:

Our representation of you includes telephone conversations, correspondence, meetings, or other communications with the IRS and you regarding matters under examination.

To substantiate the above listed tax items claimed on your return, we require you to provide us with the following information by <Date>.

We also require the necessary information authorization from you to receive your tax information from the IRS on your behalf. In this regard, we enclose a completed Form 2848, *Power of Attorney and Declaration of Representative*, which you should sign, date, and return to us no later than <Date>.

Please note that if you do not provide us with the requested information or the signed Form 2848 by the stated dates, we may not be able to properly represent you before the IRS.

Our engagement should not be relied upon to disclose errors, fraud, or other illegal acts. However, we will inform you of any material errors, fraud, or other illegal acts we discover during our engagement. If we encounter instances of unclear tax law or of potential conflicts in the interpretation of the law, we will outline the reasonable courses of action and the risks and consequences of each. We will ultimately adopt, on your behalf, the alternative you select. The law imposes penalties when taxpayers underestimate their tax liability. Please contact us if you require further information.

We do not offer guarantees regarding the outcome of the audit or on its impact on any other examination or investigation. Negotiation and compromise may be necessary to arrive at a settlement that is agreeable to you. Should this be required, we will contact you to establish what would constitute an acceptable settlement.

If the audit defense is unsuccessful, there are remedies available to you including appeal of your case to the IRS Appeals division. Should this situation arise, our services will be available under a separate engagement.

2021 Workbook

Our fees for this engagement depend on the time spent and the staff working on your case. Attached is a schedule of our hourly fee rates by staff category. Before we begin work, we require a retainer of <SXXXX> from you. If our fees are less than the amount of the retainer, we reimburse the excess retainer to you at the conclusion of the engagement with our final invoice. Any fee exceeding the retainer is included on the final invoice that we provide you at the conclusion of the engagement. Our fees do not include out-of-pocket expenses (e.g., telephone, fax, photocopying, postage, research fees, mileage, travel, lodging, meals, etc.). You are responsible for paying these out-of-pocket expenses. These expenses are added to our final invoice.

At the present time, we are unaware of any conflict of interest which impedes us from properly representing you. However, we will inform you should a conflict of interest arise. You have the option to terminate this agreement unless a mutually agreeable remedy can be found. Moreover, we will notify you of termination of this engagement if, for any reason, we are unable to continue to properly represent you. In the event of early termination of the engagement, you are responsible for any fees or out-of-pocket expenses we incur until the time of termination and we provide you with a description of any work that is incomplete along with associated filing deadlines.

This representation engagement concludes when either an agreement is reached with the IRS agent conducting the audit, you decide to reject the IRS agent's redetermination of your tax liability, or upon early termination of the engagement for the reasons previously described.

To confirm that this letter correctly summarizes your understanding of the arrangements for this work, please sign the enclosed copy of this letter in the space indicated and return it to us in the envelope provided.

We appreciate your business. Please contact <Contact Name and Telephone> if you have questions.

Sincerely,

<Paid Preparer Name>

<Firm Name>

Enclosures: Form 2848, *Power of Attorney and Declaration of Representative* (both spouses must sign for representation of a jointly filed return.); fee schedule

Accepted By:

Taxpayer

Spouse

Date

Example 7. Use the same facts as **Example 4**. A few days after their first meeting, Sue contacts Paul and tells him that her firm is willing to represent him, assuming he can comply with the terms of the engagement. He must provide all bank statements from the past 10 years and allow Sue's firm to reconstruct his income and expenses based on this information. He will be charged an hourly rate of \$250. The firm requires a retainer of \$2,500. Sue tells Paul that if these terms are acceptable, he must sign an engagement letter that Sue provides to Paul via e-mail and to pay the retainer by debit or credit card.

After signing the engagement letter and paying the retainer, Sue explains to Paul that she wants him to sign Form 2848 to grant Sue permission to speak with the IRS on his behalf.

COMMUNICATING WITH THE IRS⁵⁰

Included in this section are Circular 230 responsibilities that practitioners have when communicating with the IRS, in addition to issues practitioners face when assisting clients on matters before the IRS. Taxpayers receive various types of notices and communications from the IRS. Some of the more common IRS notices are discussed in this section along with penalty relief available to taxpayers. To represent taxpayers, practitioners must have a valid POA. There are many resources available for assisting taxpayers and practitioners when trying to resolve tax issues.

CIRCULAR 230 RESPONSIBILITIES⁵¹

IRS representation is considered part of **practice before the IRS**, which includes a variety of activities such as corresponding and communicating with the IRS.⁵² Such practice is overseen by the OPR, whose mission is to ensure “all tax practitioners, tax preparers, and other third parties in the tax system adhere to professional standards and follow the law.”⁵³

Tax practitioners who receive a proper and lawful request for records or information from the IRS or the OPR must promptly submit the requested information unless they believe in good faith and on reasonable grounds that it is privileged. As mentioned earlier, §7525 confidentiality privileges relating to taxpayer communications only extend to tax advice.

If the requested information is not in the practitioner’s or their client’s possession, the practitioner must promptly inform the requesting IRS personnel of that fact. Additionally, the practitioner must provide any information they have regarding who is in possession of the requested information. However, the practitioner is **not** required to do either of the following.

1. Make inquiries of anyone other than their client
2. Independently verify information provided by their client regarding the person(s) in possession of the requested information

Regarding practitioner/client communications, Circular 230 states that practitioners may give written advice (including by means of electronic communication) concerning federal tax matters, which must adhere to the facts and relate applicable law to these facts.

Example 8. Sam, a CPA, prepares a 2020 individual tax return for his client, Angie. In 2022, Angie receives a notice from the IRS informing her of a mismatch between the income reported on her 2020 return and the income reported to the IRS. This income mismatch could result in an increase in Angie’s 2020 tax liability as well as penalties and interest. Angie asks Sam what to do. After reviewing the situation, Sam determines that there is a simple explanation for the income mismatch and, as a result, Angie’s 2020 tax liability should not change. Consequently, Sam writes a letter to the IRS providing the explanation and requests the IRS’s agreement that Angie’s income was correctly reported on her 2020 return.

Sam’s assistance to Angie constitutes practice before the IRS (i.e., corresponding with the IRS). If Sam’s intervention constitutes representation of Angie before the IRS, then Treasury regulations require Sam to submit a POA (Form 2848) to the IRS even though Sam does not personally appear before the IRS.⁵⁴

Note. In practice, the IRS generally accepts correspondence from a practitioner on behalf of a client without a POA.

⁵⁰ IRS Pub. 947, *Practice Before the IRS and Power of Attorney*.

⁵¹ Circular 230, §§10.20, 10.23, and 10.37.

⁵² Circular 230, §10.2(a)(4).

⁵³ *The Office of Professional Responsibility (OPR) At-a-Glance*. Jul. 23, 2020. IRS. [www.irs.gov/tax-professionals/the-office-of-professional-responsibility-opr-at-a-glance] Accessed on Dec. 16, 2020.

⁵⁴ Treas. Reg. §601.504(d).

2021 Workbook

TAX INFORMATION AUTHORIZATION

Representation of a client before the IRS usually results in an exchange of information between the parties, for which a POA is required. Before discussing the POA in more detail, it should be noted that there are two information authorization alternatives that practitioners can use when they are **not** representing their clients before the IRS. These are the tax return third-party designee and Form 8821, *Tax Information Authorization*.

Tax Return Third-Party Designee

Typically, IRS tax returns allow the filer to designate the preparer or another individual as a person authorized to discuss the return with the IRS (e.g., see the following excerpt of the bottom of page 2 of the 2020 Form 1040).

how to pay, see instructions. **38** Estimated tax penalty (see instructions) **38**

Third Party Designee Do you want to allow another person to discuss this return with the IRS? See instructions Yes. Complete below. No

Designee's name ▶ Phone no. ▶ Personal identification number (PIN) ▶

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true and correct. I understand that anyone who furnishes false or misleading information on a tax return or who omits material or information on a tax return is committing a federal tax crime.

This statutory disclosure authority is very limited in scope.⁵⁵ In practice, the third-party designee can only discuss the processing of the return in question (including the status of tax refunds) with the IRS and the disclosure authority generally lasts only **one year from the due date of the return**.⁵⁶

Note. A key point to note is that this “checkbox” third-party designee is a disclosure authority only. It is **not** a POA **nor** does it authorize the third-party designee to **represent** the taxpayer before the IRS.⁵⁷

Form 8821⁵⁸

Form 8821 allows a taxpayer to designate **any** individual, corporation, firm, organization, or partnership (appointee) to inspect and/or receive their confidential information verbally or in writing. It provides space to list the type of tax and the year(s) or period(s) on the form.

A taxpayer can designate anyone from a broad range of categories to receive their confidential tax information including an **unenrolled** (i.e., non-Circular 230) tax preparer. Although the appointee has a much broader taxpayer information disclosure authorization than a tax return third-party designee, the appointee does **not** represent the taxpayer before the IRS and **cannot** perform any of the following acts.

- Speak on the taxpayer’s behalf
- Advocate the taxpayer’s position with respect to federal tax laws
- Execute a request to allow disclosure of the taxpayer’s return or return information to another third party
- Execute waivers, consents, or closing agreements on behalf of the taxpayer
- Endorse or negotiate a taxpayer refund check or receive a taxpayer refund via direct deposit

⁵⁵ IRC §6103(c) and Treas. Reg. §301.6103(c)-1.

⁵⁶ *Topic No. 312 Disclosure Authorizations*. Mar. 5, 2021. IRS. [www.irs.gov/taxtopics/tc312] Accessed on Mar. 16, 2021.

⁵⁷ Program Manager Tax Advice 00695. Dec. 7, 2016. IRS. [www.irs.gov/pub/lanoa/pmta00695_7243.pdf]. Accessed on Mar. 16, 2021.

⁵⁸ Instructions for Form 8821.

2021 Workbook

Taxpayers can file Form 8821 with the IRS whenever they wish. However, if the form is used to authorize disclosure of their confidential tax information for a purpose other than addressing or resolving a tax matter with the IRS (e.g., for income verification required by a lender), the IRS must receive the Form 8821 within 120 days of the taxpayer's signature date on the form.

Note. The taxpayer can also revoke Form 8821 at any time.

3

Practitioner Planning Tip

Form 8821 is a useful tool at the beginning of an engagement to collect information about the taxpayer's situation for which IRS has record. It can also confirm or contradict client statements.

2021 Workbook

Form **8821**
 (Rev. January 2021)
 Department of the Treasury
 Internal Revenue Service

Tax Information Authorization

- ▶ Go to www.irs.gov/Form8821 for instructions and the latest information.
- ▶ Don't sign this form unless all applicable lines have been completed.
- ▶ Don't use Form 8821 to request copies of your tax returns or to authorize someone to represent you. See instructions.

OMB No. 1545-1165
For IRS Use Only
 Received by: _____
 Name _____
 Telephone _____
 Function _____
 Date _____

1 Taxpayer information. Taxpayer must sign and date this form on line 6.

Taxpayer name and address	Taxpayer identification number(s)
	Daytime telephone number
	Plan number (if applicable)

2 Designee(s). If you wish to name more than two designees, attach a list to this form. **Check here if a list of additional designees is attached** ▶

Name and address	CAF No. _____ PTIN _____ Telephone No. _____ Fax No. _____
Check if to be sent copies of notices and communications <input type="checkbox"/>	Check if new: Address <input type="checkbox"/> Telephone No. <input type="checkbox"/> Fax No. <input type="checkbox"/>
Name and address	CAF No. _____ PTIN _____ Telephone No. _____ Fax No. _____
Check if to be sent copies of notices and communications <input type="checkbox"/>	Check if new: Address <input type="checkbox"/> Telephone No. <input type="checkbox"/> Fax No. <input type="checkbox"/>

3 Tax information. Each designee is authorized to inspect and/or receive confidential tax information for the type of tax, forms, periods, and specific matters you list below. See the line 3 instructions.

By checking here, I authorize access to my IRS records via an Intermediate Service Provider.

(a) Type of Tax Information (Income, Employment, Payroll, Excise, Estate, Gift, Civil Penalty, Sec. 4980H Payments, etc.)	(b) Tax Form Number (1040, 941, 720, etc.)	(c) Year(s) or Period(s)	(d) Specific Tax Matters

4 Specific use not recorded on the Centralized Authorization File (CAF). If the tax information authorization is for a specific use not recorded on CAF, check this box. See the instructions. If you check this box, skip line 5 ▶

5 Retention/revocation of prior tax information authorizations. If the line 4 box is checked, skip this line. If the line 4 box isn't checked, the IRS will automatically revoke all prior tax information authorizations on file unless you check the line 5 box and **attach a copy** of the tax information authorization(s) that you want to retain ▶
 To revoke a prior tax information authorization(s) without submitting a new authorization, see the line 5 instructions.

6 Taxpayer signature. If signed by a corporate officer, partner, guardian, partnership representative (or designated individual, if applicable), executor, receiver, administrator, trustee, or individual other than the taxpayer, I certify that I have the legal authority to execute this form with respect to the tax matters and tax periods shown on line 3 above.

▶ IF NOT COMPLETED, SIGNED, AND DATED, THIS TAX INFORMATION AUTHORIZATION WILL BE RETURNED.

▶ DON'T SIGN THIS FORM IF IT IS BLANK OR INCOMPLETE.

Signature	Date
Print Name	Title (if applicable)

POA⁵⁹

A POA is required for a practitioner to **represent** a taxpayer before the IRS and perform the following acts.

- Speak on the taxpayer's behalf
- Advocate the taxpayer's position with respect to federal tax laws
- Execute waivers, consents, or closing agreements on behalf of the taxpayer
- Inspect and/or receive confidential tax information

At the discretion of the taxpayer, the POA can be used to permit the representative to perform the following acts on behalf of the taxpayer.

- Substitute or add another representative
- Sign certain returns on the taxpayer's behalf
- Execute a request for disclosure of tax returns or return information to a third party
- Access IRS records via an intermediate service provider (i.e., a privately owned company that can access tax return data)

Under no circumstances can a practitioner (even when representing a taxpayer via a POA) endorse or negotiate a taxpayer refund check or receive a taxpayer refund via direct deposit.

A POA can be executed using Form 2848, *Power of Attorney and Declaration of Representative*, shown on the following pages.

⁵⁹ IRS Pub. 216, *Conference and Practice Requirements*, and instructions for Form 2848.

2021 Workbook

Form **2848**
 (Rev. January 2021)
 Department of the Treasury
 Internal Revenue Service

Power of Attorney and Declaration of Representative

▶ Go to www.irs.gov/Form2848 for instructions and the latest information.

OMB No. 1545-0150

For IRS Use Only

Received by:
 Name _____
 Telephone _____
 Function _____
 Date / /

Part I Power of Attorney

Caution: A separate Form 2848 must be completed for each taxpayer. Form 2848 will not be honored for any purpose other than representation before the IRS.

1 Taxpayer information. Taxpayer must sign and date this form on page 2, line 7.

Taxpayer name and address	Taxpayer identification number(s)	
	Daytime telephone number	Plan number (if applicable)

hereby appoints the following representative(s) as attorney(s)-in-fact:

2 Representative(s) must sign and date this form on page 2, Part II.

Name and address	CAF No. _____ PTIN _____ Telephone No. _____ Fax No. _____
Check if to be sent copies of notices and communications <input type="checkbox"/>	Check if new: Address <input type="checkbox"/> Telephone No. <input type="checkbox"/> Fax No. <input type="checkbox"/>
Name and address	CAF No. _____ PTIN _____ Telephone No. _____ Fax No. _____
Check if to be sent copies of notices and communications <input type="checkbox"/>	Check if new: Address <input type="checkbox"/> Telephone No. <input type="checkbox"/> Fax No. <input type="checkbox"/>
Name and address	CAF No. _____ PTIN _____ Telephone No. _____ Fax No. _____
(Note: IRS sends notices and communications to only two representatives.)	Check if new: Address <input type="checkbox"/> Telephone No. <input type="checkbox"/> Fax No. <input type="checkbox"/>
Name and address	CAF No. _____ PTIN _____ Telephone No. _____ Fax No. _____
(Note: IRS sends notices and communications to only two representatives.)	Check if new: Address <input type="checkbox"/> Telephone No. <input type="checkbox"/> Fax No. <input type="checkbox"/>

to represent the taxpayer before the Internal Revenue Service and perform the following acts:

3 Acts authorized (you are required to complete line 3). Except for the acts described in line 5b, I authorize my representative(s) to receive and inspect my confidential tax information and to perform acts I can perform with respect to the tax matters described below. For example, my representative(s) shall have the authority to sign any agreements, consents, or similar documents (see instructions for line 5a for authorizing a representative to sign a return).

Description of Matter (Income, Employment, Payroll, Excise, Estate, Gift, Whistleblower, Practitioner Discipline, PLR, FOIA, Civil Penalty, Sec. 4980H Shared Responsibility Payment, etc.) (see instructions)	Tax Form Number (1040, 941, 720, etc.) (if applicable)	Year(s) or Period(s) (if applicable) (see instructions)

4 Specific use not recorded on the Centralized Authorization File (CAF). If the power of attorney is for a specific use not recorded on CAF, check this box. See Line 4. *Specific Use Not Recorded on CAF* in the instructions ▶

5a Additional acts authorized. In addition to the acts listed on line 3 above, I authorize my representative(s) to perform the following acts (see instructions for line 5a for more information):

Access my IRS records via an Intermediate Service Provider;

Authorize disclosure to third parties; Substitute or add representative(s); Sign a return; _____

Other acts authorized: _____

2021 Workbook

b Specific acts not authorized. My representative(s) is (are) not authorized to endorse or otherwise negotiate any check (including directing or accepting payment by any means, electronic or otherwise, into an account owned or controlled by the representative(s) or any firm or other entity with whom the representative(s) is (are) associated) issued by the government in respect of a federal tax liability.
List any other specific deletions to the acts otherwise authorized in this power of attorney (see instructions for line 5b):

6 Retention/revocation of prior power(s) of attorney. The filing of this power of attorney automatically revokes all earlier power(s) of attorney on file with the Internal Revenue Service for the same matters and years or periods covered by this form. If you **do not** want to revoke a prior power of attorney, check here
YOU MUST ATTACH A COPY OF ANY POWER OF ATTORNEY YOU WANT TO REMAIN IN EFFECT.

7 Taxpayer declaration and signature. If a tax matter concerns a year in which a joint return was filed, each spouse must file a separate power of attorney even if they are appointing the same representative(s). If signed by a corporate officer, partner, guardian, tax matters partner, partnership representative (or designated individual, if applicable), executor, receiver, administrator, trustee, or individual other than the taxpayer, I certify I have the legal authority to execute this form on behalf of the taxpayer.
▶ IF NOT COMPLETED, SIGNED, AND DATED, THE IRS WILL RETURN THIS POWER OF ATTORNEY TO THE TAXPAYER.

Signature	Date	Title (if applicable)
Print name	Print name of taxpayer from line 1 if other than individual	

Part II Declaration of Representative

Under penalties of perjury, by my signature below I declare that:

- I am not currently suspended or disbarred from practice, or ineligible for practice, before the Internal Revenue Service;
- I am subject to regulations in Circular 230 (31 CFR, Subtitle A, Part 10), as amended, governing practice before the Internal Revenue Service;
- I am authorized to represent the taxpayer identified in Part I for the matter(s) specified there; and
- I am one of the following:
 - a Attorney—a member in good standing of the bar of the highest court of the jurisdiction shown below.
 - b Certified Public Accountant—a holder of an active license to practice as a certified public accountant in the jurisdiction shown below.
 - c Enrolled Agent—enrolled as an agent by the IRS per the requirements of Circular 230.
 - d Officer—a bona fide officer of the taxpayer organization.
 - e Full-Time Employee—a full-time employee of the taxpayer.
 - f Family Member—a member of the taxpayer’s immediate family (spouse, parent, child, grandparent, grandchild, step-parent, step-child, brother, or sister).
 - g Enrolled Actuary—enrolled as an actuary by the Joint Board for the Enrollment of Actuaries under 29 U.S.C. 1242 (the authority to practice before the IRS is limited by section 10.3(d) of Circular 230).
 - h Unenrolled Return Preparer—Authority to practice before the IRS is limited. An unenrolled return preparer may represent, provided the preparer (1) prepared and signed the return or claim for refund (or prepared if there is no signature space on the form); (2) was eligible to sign the return or claim for refund; (3) has a valid PTIN; and (4) possesses the required Annual Filing Season Program Record of Completion(s). **See Special Rules and Requirements for Unenrolled Return Preparers in the instructions for additional information.**
 - k Qualifying Student or Law Graduate—receives permission to represent taxpayers before the IRS by virtue of his/her status as a law, business, or accounting student, or law graduate working in a LITC or STCP. See instructions for Part II for additional information and requirements.
 - r Enrolled Retirement Plan Agent—enrolled as a retirement plan agent under the requirements of Circular 230 (the authority to practice before the Internal Revenue Service is limited by section 10.3(e)).

▶ IF THIS DECLARATION OF REPRESENTATIVE IS NOT COMPLETED, SIGNED, AND DATED, THE IRS WILL RETURN THE POWER OF ATTORNEY. REPRESENTATIVES MUST SIGN IN THE ORDER LISTED IN PART I, LINE 2.

Note: For designations d–f, enter your title, position, or relationship to the taxpayer in the “Licensing jurisdiction” column.

Designation— Insert above letter (a–r).	Licensing jurisdiction (State) or other licensing authority (if applicable)	Bar, license, certification, registration, or enrollment number (if applicable)	Signature	Date

2021 Workbook

Unless specifically provided otherwise on Form 2848, line 5b, authorization of tax matters on line 3 **includes** representation for **penalties, payments, and interest** related to a specific tax return.

Example 9. Mary, an enrolled agent, has a POA allowing her to represent her client, Ben, in connection with the IRS’s examination of Ben’s 2019 Form 1040. Consequently, Mary is also authorized to represent Ben with respect to the accuracy-related penalty proposed by the examining revenue agent for the 2019 tax year.

A POA can be revoked by the taxpayer at any time. Similarly, the representative can withdraw from the taxpayer’s representation at any time. In order to do so, they must write “WITHDRAW” across the top of the first page of the POA with a current signature and date below the annotation and resubmit it to the IRS.⁶⁰

A substitute POA can be used if it satisfies the requirements for a POA,⁶¹ but it cannot be recorded in the IRS’s Centralized Authorization File (CAF) unless it is accompanied by a completed Form 2848 signed by the representative.

A unique CAF number⁶² is generally issued to:

- A recognized representative who files a POA and a written declaration of representative, or
- A designee authorized under a tax information authorization (e.g., using Form 8821).

Note. The purpose of a CAF number is to facilitate the IRS’s internal processing of the POA and to enable IRS personnel who do not have access to the POA to determine whether a person is authorized to represent the taxpayer and act on the taxpayer’s behalf.⁶³

Receipt of a CAF number does not indicate that a person is either recognized or authorized to practice before the IRS as this determination is made under Circular 230.

A POA that does not contain a CAF number will nevertheless be processed by the IRS.

Once a representative has been issued a CAF number it should be used on future POAs.⁶⁴

Practitioner Planning Tip

Periodically, it would be wise to pull up a record of all clients for whom POA forms are on file and withdraw from any clients for whom they no longer are engaged. This is done by making a Freedom of Information Act (FOIA) request. A sample CAF Client Listing Request can be found on **IRS.gov**.⁶⁵

⁶⁰ Instructions for Form 2848.

⁶¹ Treas. Reg. §601.503.

⁶² Treas. Reg. §601.506(d) — reproduced in IRS Pub. 216, *Conference and Practice Requirements*.

⁶³ *Ibid.*

⁶⁴ *Ibid.*

⁶⁵ *Freedom of Information Act (FOIA) Guidelines*. Apr. 19, 2021. IRS. [www.irs.gov/privacy-disclosure/freedom-of-information-act-foia-guidelines] Accessed on Jun. 4, 2021.

Limited Representation Before the IRS.⁶⁶ Unenrolled return preparers can provide limited representation to their clients if they satisfy the following.

1. Prepared and signed the return or claim for refund (or prepared if there is no signature space on the form),
2. Were eligible to sign the return or claim for refund,
3. Had a valid PTIN, and
4. Possessed the required Annual Filing Season Program (AFSP) record of completion for both the tax return year of examination and the year the examination is conducted.

Note. The AFSP is an 18-credit hour continuing education program designed to recognize the efforts of noncredentialed (unenrolled) return preparers who seek a higher measure of professionalism. More information on this program is available at: [uofi.tax/21a3x1](https://www.irs.gov/tax-professionals/annual-filing-season-program) [www.irs.gov/tax-professionals/annual-filing-season-program].

Individuals who meet the above-stated conditions may represent taxpayers only before revenue agents, customer service representatives, or similar officers and employees of the IRS (including the Taxpayer Advocate Service) and only during an examination of the tax year or period covered by the tax returns they prepared and signed. These limited representation rights do **not** extend to any of the following.

- Representation of taxpayers before Appeals officers, revenue officers, counsel or similar officers or employees of the IRS or the Department of the Treasury
- Executing closing agreements or waivers
- Extending the statutory period for tax assessments or tax collection
- Signing any document on behalf of a taxpayer

Additionally, individuals who have a relationship or special status with the taxpayer can represent them. This includes, but is not limited to, the following individuals.

- An officer of the taxpayer's entity
- A full-time employee of the taxpayer's entity
- A family member (i.e., spouse, parent, child, brother, sister) of the taxpayer

Note. It is not clearly specified what representative rights an unenrolled return preparer has with regard to the taxpayer although Circular 230 refers to them under the heading of "Limited Practice" and the IRM lists them as being authorized for limited taxpayer representation when using Form 2848.⁶⁷

Expanded Options for Filing Forms 8821 and 2848

Historically, the submission of these authorization forms was a paper operation. The completed and manually signed forms were mailed or faxed to the IRS pursuant to the filing instructions provided.⁶⁸ Following passage of the Taxpayer First Act of 2019, the IRS is required to provide digital signature options for submission of these forms.⁶⁹

⁶⁶ Treas. Reg. §601.502(b)(5) and IRS Pub. 947, *Practice Before the IRS and Power of Attorney*.

⁶⁷ See Circular 230, §10.7(c) and IRM 1.25.1.2.1(3) (2016).

⁶⁸ *Electronic Signature Options Will Simplify Third-Party Authorizations*. Nov. 19, 2020. IRS. [www.irs.gov/about-irs/electronic-signature-options-will-simplify-third-party-authorizations] Accessed on Dec. 21, 2020.

⁶⁹ *Taxpayer First Act of 2019*, PL 116-25, §2302.

2021 Workbook

Both the taxpayer and the tax practitioner must sign (either handwritten or electronically) Form 2848. Only the taxpayer needs to sign (either handwritten or electronically) Form 8821. A practitioner using the electronic signature option for a new client must authenticate the taxpayer's identity.⁷⁰

Practitioners may still mail or fax authorization forms to the IRS. All signatures must be handwritten. Electronic signatures are not permitted on mailed or faxed authorization forms.⁷¹

Example 10. Use the same facts as **Example 7**. After receiving the retainer and hand-signed POA from Paul, Sue faxes the completed POA to the appropriate IRS Service Center.

IRS NOTICES

The IRS is statutorily prohibited from subjecting taxpayers to unnecessary examinations or investigations and can only conduct one inspection of a taxpayer's books of account per tax year unless reexamination is requested.⁷² However, such human examination of a taxpayer's books (or audit) is not the only IRS scrutiny of taxpayer returns. For many years, the IRS has operated an automated underreporter (AUR) program in which the IRS matches tax return information with third-party information returns (e.g., Forms 1099). In some cases, taxpayers receive a notice of proposed changes from the IRS (e.g., Notice CP2000, discussed later).⁷³

Note. A recent court case ruled that if a taxpayer under audit for a tax year also receives an AUR program-generated notice for the same tax year, this notice is **not** unnecessary or duplicative and therefore does **not** violate IRC §7605(b).⁷⁴



Practitioner Planning Tip

Generally, practitioners representing taxpayers who have received an IRS notice must execute a POA before they are recognized by the IRS as the taxpayer representative. However, the IRS may permit a representative to speak on behalf of the taxpayer if the taxpayer is conferenced in on the call and provides oral disclosure consent.⁷⁵

There are many notifications that the IRS can send a taxpayer. Some of the more common IRS notices are discussed next.

⁷⁰ *New IRS "Submit Forms 2848 and 8821 Online" offers contact-free signature options for tax pros and clients sending authorization forms.* Jan. 25, 2021. IRS. [www.irs.gov/newsroom/new-irs-submit-forms-2848-and-8821-online-offers-contact-free-signature-options-for-tax-pros-and-clients-sending-authorization-forms] Accessed on Mar. 26, 2021.

⁷¹ *Ibid.*

⁷² IRC §7605(b).

⁷³ *IRS Automated Underreporter Initiative.* Schreiber Jr., Gerard H. Dec. 31, 2008. *The Tax Adviser.* [www.thetaxadviser.com/issues/2009/jan/irsautomatedunderreporter.html] Accessed on Dec. 21, 2020.

⁷⁴ *Richard Essner v. Comm'r*, TC Memo 2020-23 (Feb. 12, 2020).

⁷⁵ *Third Party Authorization Purpose.* Feb. 11, 2021. IRS. [www.irs.gov/businesses/small-businesses-self-employed/third-party-authorization-purpose] Accessed on Mar. 18, 2021.

Taxpayer Bill of Rights

Taxpayers have the following rights that apply whenever they have dealings with the IRS.

1. The right to be informed
2. The right to quality service
3. The right to pay no more than the correct amount of tax
4. The right to challenge the IRS's position and be heard
5. The right to appeal an IRS decision in an independent forum
6. The right to finality
7. The right to privacy
8. The right to confidentiality
9. The right to representation
10. The right to a fair and just tax system

Note. More information on taxpayer rights is available in IRS Pub. 1, *Your Rights as a Taxpayer*.

IRS Notice CP2000 (Letter 2030)⁷⁶

A Notice CP2000 or Letter 2030 informs a taxpayer of a discrepancy found during a comparison of tax return and payer information (pursuant to the AUR program). The CP2000 provides the following information.

- The amounts reported on the taxpayer's original or accepted amended return
- The amounts reported to the IRS by the payer
- The payer's name, identification number, the type of document issued (e.g., Form W-2, *Wage and Tax Statement*), and the tax identification number of the person to whom the document was issued
- The proposed changes to income, tax, credits, and/or payments
- A response form, payment voucher, and an envelope

If the taxpayer agrees with the proposed changes, then the taxpayer completes, signs, and dates the response form (both spouses' signatures are required when married filing jointly). The response form is then returned to the IRS. Generally, payment of the amount due within 30 days stops additional interest, and possibly, additional penalties from accruing.

The recourse available to taxpayers who disagree with the proposed IRS changes are summarized in the Taxpayer Bill of Rights⁷⁷ and are discussed in detail later in the section entitled IRS Examinations. These taxpayer rights are the same regardless of the tax issue.

⁷⁶ IRS Pub. 5181, *Tax Return Reviews by Mail CP2000, Letter 2030, CP2501, Letter 2531*; and *Topic No. 652 Notice of Underreported Income — CP2000*. Mar. 12, 2021. IRS. [www.irs.gov/taxtopics/tc652] Accessed on Mar. 18, 2021.

⁷⁷ IRS Pub. 1, *Your Rights as a Taxpayer*.

2021 Workbook

Taxpayer Identity Verification

Taxpayers may receive a letter requesting verification of their identity from the IRS. The procedure that taxpayers must follow to verify their identity depends on the type of letter received.

IRS Letters 5071C, 5747C, 5447C, and 6331C.⁷⁸ Taxpayers receiving one of these letters can choose to verify their identity either using ID Verify⁷⁹ (an IRS-provided online service) or by telephoning the IRS using the toll-free number shown in the letter.

To use ID Verify, taxpayers must have the following information available.

- A personal account number from a credit card, mortgage, student loan, home equity loan, home equity line-of-credit, or car loan
- A mobile phone associated with the taxpayer's name
- The taxpayer identification letter received from the IRS
- The income tax return (Form 1040, 1040-NR, *U.S. Nonresident Alien Income Tax Return*, 1040-SR, *U.S. Tax Return for Seniors*, etc.) for the year shown on the letter
- The mailing address from the taxpayer's previous year's tax return

Taxpayers choosing to telephone the IRS must have the following information available.

- The taxpayer identification letter received from the IRS
- The income tax return (Form 1040, 1040-NR, 1040-SR, etc.) for the year shown on the letter
- Any other prior year income tax return
- Any supporting Forms W-2, 1099, Schedule C, *Profit or Loss From Business*, Schedule F, *Profit or Loss From Farming*, etc.

Once taxpayer identity is verified, the IRS continues processing the tax return.

IRS Letters 4883C and 6330C.⁸⁰ Online ID Verify is **not** available for taxpayers in receipt of IRS Letters 4883C or 6330C. Instead, these taxpayers verify their identity by telephoning the IRS using the toll-free number shown in the letter. Again, taxpayers should ensure that they have the necessary information available.

Missing Information Notice (Letter 12C)⁸¹

The IRS sends Letter 12C to taxpayers whose tax returns are missing required information including the following.

- Missing forms or schedules to support entries on the taxpayer's individual tax return
- Verification of income, withholding, and credit amounts
- Documentation to reconcile advance payments of the premium tax credit

Upon receiving Letter 12C, taxpayers should respond to the letter and provide the missing information so the IRS can continue processing the return. A taxpayer who disagrees with the IRS's request for further information is nevertheless required to mail or fax a response to the IRS explaining why they disagree with the IRS request.

⁷⁸ *Identity Verification for IRS Letter Recipients*. Mar. 8, 2021. IRS. [www.irs.gov/identity-theft-fraud-scams/identity-verification-for-irs-letter-recipients] Accessed on Mar. 19, 2021.

⁷⁹ *Verify Your Identity Now*. IRS. [sa.www4.irs.gov/ola/id-verify/] Accessed on Dec. 23, 2020.

⁸⁰ *Understanding Your Letter 4883C or 6330C*. Mar. 12, 2021. IRS. [www.irs.gov/individuals/understanding-your-letter-4883c-or-6330c] Accessed on Mar. 19, 2021.

⁸¹ *Understanding Your Letter 12C*. Jan. 5, 2021. IRS. [www.irs.gov/individuals/understanding-your-letter-12c] Accessed on Mar. 19, 2021.

IRS Notice CP24⁸²

The IRS sends Notice CP24 to inform taxpayers of a difference between the estimated tax payments reported on the taxpayer's tax return and the amount the IRS posted to the taxpayer's account.

Upon receipt of Notice CP24, the taxpayer should compare the payments shown on the notice to their records and verify the IRS correctly posted all estimated tax payments made by the taxpayer along with any prior year tax overpayment applied to the year in question.

Taxpayers in agreement with the notice should correct their tax return copy as appropriate. No further taxpayer action is required.

Taxpayers or their authorized representative who **disagree** with the notice should contact the IRS within 60 days from the date of the notice. Contact can be made either by telephone or mail using the number or address shown in the notice. Supporting documentation (e.g., a cancelled check) can either be faxed to the IRS at the number provided in the notice or mailed in. Taxpayers responding by mail should remember to include a copy of the notice with their response. The IRS may require 30–60 days or more to resolve the case.



Practitioner Planning Tip

Reviewing IRS transcripts during filing season may eliminate many IRS Notices CP24.

PENALTY RELIEF⁸³

As stated earlier, normally a practitioner with a POA can represent their client before the IRS for the tax forms and years/periods stated on Form 2848, line 3. The POA can also represent the taxpayer regarding any **penalties**, payments, and interest related to those same years/periods.

The recourse available to taxpayers who disagree with proposed IRS changes (including penalty assessments), are summarized in the Taxpayer Bill of Rights⁸⁴ and are discussed in detail in the IRS Examinations section. This discussion is limited to information concerning penalties that are eligible for relief and the relief options available to taxpayers.

Note. Generally, interest does not qualify for relief. It is charged by law and continues until the taxpayer's account is fully paid.

Form 843

In certain circumstances, Form 843, *Claim for Refund and Request for Abatement*, is used to claim a refund or abatement of penalties assessed by the IRS. The IRS instructions to Form 843 list the instances where taxpayers should use this form (e.g., incorrect written advice from the IRS). Form 843 **is not** used to request an abatement of income, estate, or gift taxes.

Taxpayers in disagreement with an IRS notice assessing a penalty should follow the instructions provided in the notice to challenge the penalty. Filing of Form 843 may not be required.

⁸² *Understanding Your CP24 Notice*. Dec. 11, 2020. IRS. [www.irs.gov/individuals/understanding-your-cp24-notice] Accessed on Jan. 11, 2021.

⁸³ *Penalty Relief*. Sep. 23, 2020. IRS. [www.irs.gov/businesses/small-businesses-self-employed/penalty-relief] Accessed on Dec. 24, 2020.

⁸⁴ IRS Pub. 1, *Your Rights as a Taxpayer*.

2021 Workbook

Penalties Eligible for Relief

The penalties listed by the IRS as eligible for relief include the following.

- Failure to file (FTF) a tax return
- Failure to pay (FTP) on time
- Failure to deposit certain taxes as required
- Other penalties as applicable

There are three specific types of penalty relief available. These are administrative waiver and first-time penalty abatement, reasonable cause, and statutory exception.

Administrative Waiver and First-Time Penalty Abatement⁸⁵

The most common administrative waiver is the first-time penalty abatement (FTPA) which commenced in 2001. Only taxpayers who meet **all** the following conditions can qualify for FTPA relief.

1. There was no previous tax return filing requirement **or** the taxpayer had no penalties for the three tax years prior to the tax year of the FTPA penalty
2. The taxpayer either filed all currently required returns **or** an extension of time to file
3. The taxpayer paid, or arranged to pay, any tax due

A taxpayer who states that they have filed their currently due return or a valid extension is compliant if the return due date is no more than 45 days prior to the current date.⁸⁶ For returns or extensions to file that were due more than 45 days prior to the current date, the IRS agent must secure a processable copy of the return or get evidence that a valid and timely extension request was filed before considering an FTPA waiver.

Example 11. Stan files a valid extension for his 2020 Form 1040 on March 15, 2021. On May 18, 2021, Stan files his Form 1040 (due May 17, 2021) and receives an FTF penalty assessment from the IRS one month later. On June 25, 2021, he calls the IRS requesting FTPA relief stating that he filed a valid extension on March 15, 2021. Assuming Stan otherwise meets FTPA criteria, the responding IRS agent can administer FTPA relief to Stan even if no record of the return or filing extension can be found.⁸⁷

Another instance where an administrative penalty waiver could apply is when a taxpayer received incorrect oral advice from the IRS.

Reasonable Cause⁸⁸

A taxpayer (or their authorized representative) may make a reasonable request for the IRS to waive an assessed penalty based on all applicable facts and circumstances. The IRS considers any reason that establishes the taxpayer used all ordinary business care and prudence to meet their federal tax obligations but were nevertheless unable to do so.

⁸⁵ *Penalty Relief Due to First Time Penalty Abatement or Other Administrative Waiver*. Jun. 12, 2020. IRS. [www.irs.gov/businesses/small-businesses-self-employed/penalty-relief-due-to-first-time-penalty-abatement-or-other-administrative-waiver] Accessed on Dec. 24, 2020.

⁸⁶ IRM 20.1.1.3.3.2.1 (2020).

⁸⁷ See example at IRM 20.1.1.3.3.2.1 (2020).

⁸⁸ *Penalty Relief Due to Reasonable Cause*. Jan. 14, 2021. IRS. [www.irs.gov/businesses/small-businesses-self-employed/penalty-relief-due-to-reasonable-cause] Accessed on Mar. 19, 2021.

The IRS considers the following reasons to waive an eligible penalty.

- Fire, casualty, natural disaster, or other disturbances
- Inability to obtain records
- Death, serious illness, incapacitation, or unavoidable absence of the taxpayer or a member of the taxpayer's immediate family

Note. A lack of funds is not a reasonable cause for failure to file or pay on time, but the underlying reasons for the lack of funds may constitute reasonable cause criteria for the FTP penalty.

Reasonable cause can also result in the waiver of penalties caused by reliance on a tax advisor's opinion for technical or complicated issues.⁸⁹

Example 12. ABC Corporation uses contract labor. Concerned about the correct classification of these workers, ABC researches available IRS publications pertaining to contract labor before consulting their tax advisor Bob, a CPA. After providing Bob with clear and convincing documentation regarding their workers' duties, ABC requests Bob provide his guidance on the correct worker classification. Bob informs ABC that in his opinion their workers are contract labor. Later, the IRS determines that ABC's workers were employees and not contract labor.⁹⁰

ABC may be entitled to reasonable cause penalty relief from the incorrect worker classification on the basis that it is a complicated issue for which they relied upon their tax advisor's opinion.



Practitioner Planning Tip

Practitioners should carefully evaluate which avenues for penalty relief are available before choosing the best option. For example, if there is a choice between FTPA and reasonable cause based on advisor error, could the IRS initiate preparer sanctions if the latter option is chosen?

Statutory Exception⁹¹

Specific statutory exceptions are provided by certain penalty-related Code sections. For example, relief from FTF and FTP penalties is provided for returns and other documents postmarked by the due date but received by the IRS after that due date.⁹²

⁸⁹ IRC §6664(c) and IRM 20.1.1.3.3.4.3 (2017).

⁹⁰ Based on the example at IRM 20.1.1.3.3.4.3 (2017).

⁹¹ *Penalty Relief Due to Statutory Exception*. Mar. 23, 2021. IRS. [www.irs.gov/businesses/small-businesses-self-employed/penalty-relief-due-to-statutory-exception] Accessed on Mar. 26, 2021.

⁹² IRC §§7502(a) and (e); IRM 20.1.1.3.3.1 (2020).

2021 Workbook

Incorrect Written Advice from the IRS. Taxpayers who believe that they were assessed a penalty due to erroneous written advice received from IRS may qualify for a statutory exception. The following items may be needed when requesting penalty relief in these circumstances.

- A copy of the taxpayer's written request for advice
- The erroneous written advice received from the IRS that the taxpayer relied on
- The report, if any, of tax adjustments identifying the penalty or addition to tax, and the item(s) relating to the erroneous advice

Generally, penalty relief based on incorrect written advice from the IRS is claimed on Form 843.

TAXPAYER AND PRACTITIONER RESOURCES

Various taxpayer and practitioner resources are available to help resolve federal tax issues.

Taxpayer Transcripts and IRS Account Information⁹³

Taxpayers can obtain the following transcripts from the IRS for a specific tax year.⁹⁴

- Tax return transcript (shows most line items from the taxpayer's return)
- Tax account transcript (shows return type, marital status, adjusted gross income (AGI), taxable income, all payment types, and changes made after the original return was filed)
- Record of account transcript (a combination of the tax return and tax account transcripts)
- Wage and income transcript (shows data from information returns e.g., Forms W-2, 1099, 1098, and Form 5498, *IRA Contribution Information*)
- Verification of nonfiling letter (provides proof of nonfiling for the year specified)

Note. The specific tax years available for consultation can vary depending upon the type of transcript chosen.

Taxpayers can either obtain transcripts online or by mail. The information taxpayers must provide to obtain online access or to receive a mailed transcript is listed at **uofi.tax/21a3x6** [www.irs.gov/individuals/get-transcript]. Mailed transcripts generally arrive within five to 10 calendar days. Form 4506-T, *Request for Transcript of Tax Return*, can also be used to request a mailed transcript.

Taxpayers, or their authorized representative, may also obtain a full copy of the taxpayer's return(s) using Form 4506, *Request for Copy of Tax Return*. However, although taxpayer transcripts are generally free of charge, the IRS currently charges a \$43 fee for each full tax return copy requested.⁹⁵

⁹³ *Welcome to Get Transcript*. Nov. 25, 2020. IRS. [www.irs.gov/individuals/get-transcript] Accessed on Dec. 30, 2020.

⁹⁴ *Transcript Types and Ways to Order Them*. Oct. 19, 2020. IRS. [www.irs.gov/individuals/transcript-types-and-ways-to-order-them] Accessed on Dec. 30, 2020.

⁹⁵ See Form 4506, *Request for Copy of Tax Return*.

The IRS also offers taxpayers the ability to view the following information online.⁹⁶

- The amount the taxpayer owes, updated for the current calendar day
- Account balance details by year
- Payment history and any scheduled or pending payments
- Key information from the taxpayer's most recent tax return
- Payment plan details if applicable
- Select IRS Notices
- Economic impact payments

Additionally, taxpayers with an online account can make payments online, review payment plan options, request a plan via Online Payment Agreement, and get transcripts.⁹⁷ To register for an online account, taxpayers must provide the following.⁹⁸

- Full name
- Email
- Birthdate
- Social security number (SSN) or individual tax identification number (ITIN)
- Tax filing status
- Current address

Confidentiality of Taxpayer Information.⁹⁹ In order to better protect certain sensitive taxpayer data from identity theft, IRS taxpayer transcripts use the following data formats.

- Last four digits of any SSN listed on the transcript: XXX-XX-1234
- Last four digits of any employer identification number (EIN) listed on the transcript: XX-XXX1234
- Last four digits of any account or telephone number
- First four characters of the last name for any individual taxpayer (first three characters if the last name has only four letters)
- First four characters of a business name
- First six characters of the street address, including spaces

Beginning December 13, 2020, the IRS also began masking sensitive data on business tax transcripts.¹⁰⁰

⁹⁶ *View Your Account Information*. Mar. 19, 2021. IRS. [www.irs.gov/payments/view-your-tax-account] Accessed on Mar. 22, 2021.

⁹⁷ *Ibid.*

⁹⁸ IRS. [sa.www4.irs.gov/eauth/pub/es_icce.jsp] Accessed on Dec. 30, 2020.

⁹⁹ *About the New Tax Transcript: FAQs*. Feb. 24, 2021. IRS. [www.irs.gov/individuals/about-the-new-tax-transcript-faqs] Accessed on Mar. 22, 2021.

¹⁰⁰ *IRS to Mask Key Business Transcript Details; Protect Taxpayers from Identity Theft*. Nov. 15, 2020. IRS. [www.irs.gov/newsroom/irs-to-mask-key-business-transcript-details-protect-taxpayers-from-identity-theft] Accessed on Jan. 8, 2021.

2021 Workbook

Taxpayer Advocate¹⁰¹

The Taxpayer Advocate Service (TAS) is an independent organization within the IRS whose mandate is to ensure every taxpayer is treated fairly and that taxpayers know and understand their rights. Taxpayers who have been unable to resolve a problem with the IRS on their own can contact TAS for help if the following problems arise.

1. The problem is causing financial difficulties for the taxpayer, their family, or their business.
2. The taxpayer or their business faces an immediate threat of adverse action.
3. Despite repeated attempts to contact the IRS, no one has responded, or the IRS has not responded by the date promised.

Each state has at least one local taxpayer advocate. The office address, telephone, and fax by respective state are provided at **uofi.tax/21a3x2** [www.irs.gov/advocate/local-taxpayer-advocate].

Note. While TAS is committed to assisting taxpayers at all times, there may be limited taxpayer advocate services and delays due to the COVID-19 pandemic.

FOIA¹⁰²

The FOIA¹⁰³ permits any person establishing proof of identity and right of access to scrutinize federal agency records and information including records and other information possessed by the IRS. Although **all** IRS records are subject to FOIA requests, the IRS **may withhold** information pursuant to the following **nine exemptions** and **three exclusions** contained in the FOIA statute.

FOIA Exemptions:

1. Classified documents pertaining to national defense and foreign policy
2. Internal personnel rules and practices
3. Information exempt under other laws
4. Trade secrets and confidential commercial or financial information
5. Inter-agency or intra-agency memorandums or letters
6. Personal privacy
7. Law enforcement
8. Financial institutions
9. Geological information

FOIA Exclusions:

1. Requested information may interfere with an ongoing criminal investigation
2. Requested information may compromise a confidential informant
3. Classified Federal Bureau of Investigation records

¹⁰¹. *Local Taxpayer Advocate*. Feb. 23, 2021. IRS. [www.irs.gov/advocate/local-taxpayer-advocate] Accessed on Mar. 22, 2021.

¹⁰². *Freedom of Information Act (FOIA) Guidelines*. Jul. 7, 2020. IRS. [www.irs.gov/privacy-disclosure/freedom-of-information-act-foia-guidelines] Accessed on Jan. 4, 2021.

¹⁰³. 5 USC 552.

2021 Workbook

More information regarding these exemptions and exclusions along with details of the application process is available at **uofi.tax/21a3x3** [www.irs.gov/privacy-disclosure/freedom-of-information-act-foia-guidelines].

Frequently, FOIA requested documents include the listing of active IRS enrolled agents, the preparer tax identification number (PTIN) list, the automated lien system database listing, etc.¹⁰⁴

Note. Practitioners contemplating a FOIA request should be aware that IRS **routine access procedures** are available for quick and easy access to certain IRS records **without** a formal FOIA request.¹⁰⁵ Besides granting access to tax return copies and transcripts, these procedures grant access to **open case files**,¹⁰⁶ tax-exempt and political organization returns, Tax Court opinions, etc. It is appropriate to ask the IRS auditor for copies of their workpapers at the beginning of the engagement.

3

Practitioner Priority Service^{®107}

The practitioner priority service (PPS) is a hotline staffed by IRS customer service representatives specially trained to handle practitioners' account questions. Practitioners with valid third-party authorizations, i.e., Forms 2848 and 8821, can reach PPS at 866-860-4259 during weekday hours from 7 a.m. to 7 p.m. local time (Alaska and Hawaii follow Pacific time). If the inquiry concerns an international account, then practitioners should call the international line at 267-941-1000. PPS is also open to reporting agents with a valid Form 8655, *Reporting Agent Authorization*.

Services provided by PPS include answers to general tax law questions, providing a forgotten/lost CAF number, and the following taxpayer-specific services.

- Locating and applying payments
- Explaining IRS communications (i.e., notices and letters)
- Providing general procedural guidance and timeframes
- Making account adjustments
- Securing taxpayer income verification
- Providing transcripts of taxpayer accounts

Some service limitations apply (e.g., no more than five clients per call and no more than 10 transcripts per client.) Certain services are only available to practitioners with an e-services account (e.g., an unmasked taxpayer transcript can only be sent to the practitioner's e-Services Secure Object Repository, a secure electronic mailbox.)

Note. Taxpayer representatives contacting PPS should be prepared to provide their personal information to validate identity.

¹⁰⁴ *FOIA Library*. Nov. 16, 2020. IRS. [www.irs.gov/privacy-disclosure/foia-library] Accessed on Jan. 4, 2021.

¹⁰⁵ *Routine Access to IRS Records*. Oct. 1, 2020. IRS. [www.irs.gov/privacy-disclosure/routine-access-to-irs-records] Accessed on Jan. 1, 2021.

¹⁰⁶ Practitioners must have a valid POA to access IRS open case files of their clients.

¹⁰⁷ *Practitioner Priority Service*[®]. Jan. 22, 2021. IRS. [www.irs.gov/tax-professionals/practitioner-priority-service-r] Accessed on Dec. 30, 2020.

2021 Workbook

e-Services¹⁰⁸

e-Services is a suite of IRS web-based tools that permits **registered users** to conduct certain transactions online. Parties that can register for e-services access include tax professionals, reporting agents, mortgage industry payers, etc.

The following e-Services tools are available to registered users.

- Tax transcripts (authorized tax practitioners can request certain client transcripts be sent to their e-Services secure mailbox for retrieval)
- Taxpayer identification number (TIN) matching (validate TIN and name combinations prior to submitting information returns)
- E-file provider services (apply and participate in electronic tax return filing)
- Affordable Care Act (ACA) services (apply and participate in electronic filing of ACA information returns)
- State agency services (permits state agencies to access taxpayer transcripts and generate extract reports)

Registration.¹⁰⁹ To register for e-Services, a user must provide the following information.

- An accessible email address
- The user's SSN
- The user's filing status and address from their last-filed tax return
- The user's personal account number from a credit facility (e.g., credit card, student loan, home mortgage loan, home equity (second mortgage) loan, home equity line of credit, or car loan)

Users can choose to complete registration either by text to their mobile phone or by requesting an activation code by mail.



Practitioner Planning Tip

It is recommended that practitioners periodically log into e-Services because account recertification is required for accounts that are inactive for two years.¹¹⁰ Recertification requires all identity verification steps during initial registration to be recompleted.

Example 13. Use the facts as **Example 10**. After acceptance of the POA by the IRS, Sue accesses Paul's records via her firm's e-Services account. Once signed on, she discovers the IRS has prepared substitute returns for Paul for the last 10 years.

¹⁰⁸. *e-Services*. Sep. 28, 2020. IRS. [www.irs.gov/e-services] Accessed on Jan. 4, 2021.

¹⁰⁹. *FAQs about e-Services and Secure Access*. Nov. 19, 2020. IRS. [www.irs.gov/individuals/faqs-about-e-services-and-secure-access] Accessed on Jan. 4, 2021.

¹¹⁰. IRM 3.42.8.6.1 (2019).

IRS EXAMINATIONS¹¹¹

SELECTION FOR AUDIT

Methods used by the IRS for selecting taxpayer returns for audit include, but are not limited to, random selection/computer screening, related examinations, and third-party information.

Random Selection/Computer Screening

The IRS uses audits of a statistically valid random sample of returns to establish data “norms.” These “norms” are then compared to data from taxpayer returns resulting in some taxpayer returns being identified for further investigation based on that comparison.

Related Examinations

The IRS may also investigate a taxpayer return that involves issues or transactions with other taxpayers, (e.g., business partners or investors) whose returns were selected for audit.

Third-Party Information¹¹²

A return may be flagged for further investigation based on information received from third-party sources that suggests potential noncompliance with the tax laws or inaccurate filing. Such information can come from public sources (e.g., newspapers, public records) or from private individuals.

Once a return is selected for further investigation, it is reviewed by an experienced auditor. That auditor may either accept the return as filed or, if the auditor notes something questionable, forward the return for assignment to an examining group to pursue the items noted.

STATUTE OF LIMITATIONS¹¹³

The IRS can audit returns filed within the last three years. If warranted, the IRS must make an additional tax assessment within the later of **three years** from:

1. The return due date, or
2. The date the return was filed.

However, a 6-year statute of limitations on tax assessments applies to a substantial understatement of income which exceeds:

- 25% of AGI, or
- \$5,000 for certain assets attributable to foreign financial assets.

There is **no** statute of limitations when a taxpayer fails to file a return, files a false return, or otherwise willfully attempts to evade tax. Consequently, in such situations, the IRS is free to assess tax at **any** time.

Taxpayers may extend the statute of limitations date. For example, the IRS may ask the taxpayer to extend the statute if it looks like the audit will not be concluded in time. It is incumbent on the taxpayer and their representative to determine if an extension of the statute is in the taxpayer’s best interests.

¹¹¹ *IRS Audits*. Mar. 17, 2021. IRS. [www.irs.gov/businesses/small-businesses-self-employed/irs-audits] Accessed on Mar. 22, 2021; and IRS Pub. 1, *Your Rights as a Taxpayer*.

¹¹² IRS Pub. 556, *Examination of Returns, Appeal Rights, and Claims for Refund*.

¹¹³ IRC §6501.

2021 Workbook

Taxpayer Refund Claims¹¹⁴

The statute of limitations for IRS tax assessments is different from the statute applicable for taxpayers claiming tax refunds. Generally, the refund statute expiration date (RSED) for taxpayers claiming a credit or refund of an overpayment of any tax is the later of:

1. Three years from the time the return was filed, or
2. Two years from the time the tax was paid.

However, the amount of the credit or refund cannot exceed the portion of the tax paid within the period immediately preceding the filing of the claim, equal to three years **plus** the period of any extension of time for filing the return. If no return was filed, the taxpayer has two years from the time the tax was paid to claim a refund.

The following examples illustrate these rules.¹¹⁵

Example 14. Jacque made estimated tax payments of \$5,000. She filed an automatic extension of time to file her 2020 income tax return from May 17, 2021 (her normal tax return filing due date) to October 15, 2021. On October 15, 2021, Jacque filed her 2020 return and paid an additional \$1,600 tax. Three years later, on October 15, 2024, Jacque files an amended return claiming a refund of \$2,500. Because Jacque filed her refund claim within three years of **timely** filing her 2020 return, she is entitled to a refund of any tax paid prior to October 16, 2024.

Example 15. Use the same facts as in **Example 14**, except Jacque filed her 2020 return on November 15, 2021, one month after the extension period ended, paying an additional \$1,000 on that date. Three years later, on November 15, 2024, Jacque files an amended return claiming a refund of \$1,500.

Although Jacque filed her claim within three years from the filing date of her 2020 return, the refund is limited to \$1,000 because her \$5,000 estimated tax was paid during the period ending October 15, 2021. Consequently, Jacque can only receive a refund of taxes she paid within three years of filing the claim (i.e., taxes paid during the 3-year period ending November 15, 2024) due to the **late** filing of her original 2020 return.

Different statutes of limitation apply for claiming refunds in certain situations (e.g., net operating losses, foreign tax credits, etc.).

Example 16. Use the same facts as **Example 13**. Sue contacts the IRS Collections representative listed on Paul's IRS notice and explains her firm has been retained to represent Paul. She asks the representative for an extension of time to meet with the IRS and explains her firm intends to reconstruct income and expenses and file all missing years' returns for Paul. The IRS representative gives Sue 90 days to complete this process and puts a hold on any collection activity until this time has passed. The representative further instructs Sue to submit all prepared returns directly to the representative at their office address.

AMENDED RETURNS

The selection of an original return for audit is not affected by filing an amended return. Amended returns also go through an IRS screening process which can result in the amended return being selected for audit.

Note. An amended return claiming a refund is not necessarily a trigger for audit.

¹¹⁴. IRC §6511.

¹¹⁵. Based on examples in IRS Pub. 556, *Examination of Returns, Appeal Rights, and Claims for Refund*.

NOTIFICATION

Taxpayers under audit are always notified by mail. They are **never notified by telephone**.

TYPES OF AUDIT

There are three ways the IRS manages taxpayer audits.

1. Correspondence audit (conducted by mail)
2. Office audit (in-person interview at a designated IRS office)
3. Field audit (in-person interview at taxpayer's home, place of business, or representative's office)

Many taxpayer audits are conducted by correspondence. However, the considerations addressed in this section equally apply to office and field audits.

REQUEST FOR TAXPAYER RECORDS¹¹⁶

The law requires that taxpayers keep permanent books of account or records that are sufficient to establish the amount of gross income, deductions, credits, or any other information required to be reported on their tax return. **No time limit is specified for the retention of these records.**

Note. See the 2019 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 5: Ethics in Tax Practice, for NAEA recommended retention periods for specific taxpayer records. This can be found at uofi.tax/arc [taxschool.illinois.edu/taxbookarchive].

Following are examples of records the IRS can request during an audit.¹¹⁷

- Receipts
- Bills
- Cancelled checks
- Legal papers
- Loan agreements
- Logs or diaries
- Tickets
- Medical and dental records
- Theft or loss documents
- Employment documents
- Schedules K-1

More information regarding specific records the IRS may request is available at uofi.tax/21a3x4 [www.irs.gov/businesses/small-businesses-self-employed/audits-records-request]. In addition, there are examples of questionnaires that taxpayers under audit may be asked to complete.

¹¹⁶ *Recordkeeping*. Mar. 12, 2021. IRS. [www.irs.gov/businesses/small-businesses-self-employed/recordkeeping] Accessed on Mar. 22, 2021; and Treas. Reg. §1.6001-1.

¹¹⁷ *IRS Audits: Records We Might Request*. Jul. 31, 2020. IRS. [www.irs.gov/businesses/small-businesses-self-employed/audits-records-request] Accessed on Jan. 5, 2021.

2021 Workbook

Typically, taxpayers can either fax or mail the requested records to the number or address shown on the IRS letter they received within the time specified in the letter.¹¹⁸ The IRS ordinarily grants the taxpayer a one-time automatic 30-day extension to the time specified to respond provided a “Notice of Deficiency” (discussed later) was not already issued.

Example 17. Use the same facts as **Example 16.** After many long days, Sue’s firm reconstructs Paul’s income and expenses for the last 10 years. Sue submits all the returns to the IRS representative within the 90-day period outlined. If no changes are proposed by the IRS, Paul has a potential tax liability of \$125,000 without consideration of interest and penalties.

Practitioner Planning Tip

When addressing an IRS request, the practitioner should begin by providing the representative with the requested information, but **no more** than that. As the IRS review progresses, the representative may request further information which should be supplied within the time specified in the request.

Electronic Records¹¹⁹

Taxpayers who maintain electronic records (e.g., electronic accounting software records) should be aware that the IRS has the right to summon the records. To request electronic accounting software backup files, the IRS uses Form 4564, *Information Document Request*. The electronic files should be furnished to the IRS on a CD, DVD, or a flash/jump drive. Taxpayers are also required to provide the IRS with login details to access the files. The IRS accepts electronic data files from most accounting software programs.

Caution. To ensure security, e-mail must not be used to transmit electronic records to the IRS, a taxpayer, or their representative.

AUDIT OUTCOME¹²⁰

There are three possible audit outcomes.

1. **No change** (an audit where all items under review are substantiated and there are no changes proposed to the return under examination)
2. **Agreed or partially agreed** (an audit where the IRS proposes changes the taxpayer agrees with)
3. **Disagreed** (an audit where the IRS proposes changes the taxpayer disagrees with)

When no changes result from the audit, the taxpayer receives a letter from the IRS stating that the examiner proposed no changes to the return. Taxpayers should keep this letter with their tax records. No other taxpayer action is required. When the IRS issues proposed changes (e.g., using Form 4549, *Income Tax Examination Changes*) to the return under examination, the taxpayer then has the option to either agree or disagree as explained next.

¹¹⁸ Ibid.

¹¹⁹ IRC §7602(a); Treas. Regs. §§1.6001-1(a) and (e); *Use of Electronic Accounting Software Records; Frequently Asked Questions and Answers*. Jan. 6, 2021. IRS. [www.irs.gov/businesses/small-businesses-self-employed/use-of-electronic-accounting-software-records-frequently-asked-questions-and-answers] Accessed on Mar. 22, 2021.

¹²⁰ IRS Pub. 556, *Examination of Returns, Appeal Rights, and Claims for Refund*; IRS Pub. 5, *Your Appeal Rights and How To Prepare a Protest If You Don’t Agree*.

Agreement

Taxpayers who agree with the IRS examiner's proposed changes must sign the agreement form provided in the package sent by the IRS (the content of this package is described later). They must pay any additional tax owed including interest due. Interest is charged from the due date of the return (excluding any extension of time to file) to the date of payment of the amount owed.

Taxpayers who do not pay the additional tax when signing the agreement receive a bill including interest, which should be paid within 21 calendar days of the billing date (10 days if the amount due is \$100,000 or more).

Taxpayers who are due a refund receive the refund including any applicable interest after the IRS receives the signed agreement.

Disagreement

For audits taking place in an IRS office, the examiner explains the taxpayer's appeal rights. The taxpayer, or their authorized representative, can request an immediate meeting with the examiner's supervisor to explain their position. If an agreement is reached, the audit is concluded.

If an agreement cannot be reached with the supervisor, **or** the examination took place outside of an IRS office, the examiner writes up the case and forwards it for processing.

A few weeks after the conclusion of the audit, the taxpayer receives a package from the IRS containing the following.

- A letter (known as a **30-day letter**) notifying the taxpayer of their right to appeal the proposed changes within 30 days
- A copy of the examination report explaining the examiner's proposed changes
- An agreement or waiver form
- A copy of IRS Pub. 5, *Your Appeal Rights and How To Prepare a Protest If You Don't Agree*

Taxpayers generally have 30 days from the date of the **30-day letter** to **appeal** the proposed changes. Failure to respond to the IRS within the time allowed results in the IRS issuing a notice of deficiency (**90-day letter**). Taxpayers in disagreement with the notice of deficiency have 90 days from the date of the notice to file a petition with the Tax Court. They have 150 days if the notice is addressed to them outside the United States.

Note. The IRS also offers fast track mediation to resolve disputes resulting from examinations or collection actions. More information about mediation is provided later.

IRS APPEALS¹²¹

The right to challenge the IRS's position and be heard is part of the taxpayer bill of rights, as is the right to representation. Some practitioners may think that taking a case to Appeals means they have to participate in an Appeals conference. However, there are other avenues open to taxpayers choosing to appeal the outcome of an audit. These alternatives include fast track mediation and audit reconsideration.

FAST TRACK SETTLEMENT¹²²

Fast track settlement (FTS) is a voluntary appeal process available for certain taxpayers subject to an IRS **field** or **office** audit (including small business and self-employed (SB/SE) taxpayers). The goal of FTS is to conclude the case **within 60 days** of acceptance of the FTS Application in Appeals as compared to the standard appeals process which can take much longer to conclude. Taxpayers can be represented by their authorized representative (with a POA) during the FTS process.

Only after an issue has been fully developed can the FTS process be initiated. Preferably, FTS is initiated before a 30-day letter or equivalent is issued. It **must** be initiated prior to the issuance of a 90-day letter.

Eligibility

To be eligible for FTS, SB/SE taxpayers must meet all the following requirements.

1. The issues under audit must be fully developed.
2. The taxpayer must provide a brief, concise, and soundly written response to the IRS's position.
3. There must be a limited number of issues capable of being resolved within the 60-day goal.

Note. The dollar amount of taxes at issue is **not** a factor in determining FTS eligibility.

FTS is appropriate for factual and legal issues, and issues requiring a settlement based on the hazards of litigation (discussed later). If any issue under audit is determined to be ineligible for FTS, the taxpayer's case is ineligible for FTS.

Correspondence audits are **ineligible** for FTS. Practitioners should consult IRS Pub. 5022, *Fast Track Settlement — A Process for Prompt Resolution Of Small Business Self Employed Tax Issues*, for other circumstances when taxpayers under audit are ineligible for FTS.

¹²¹. IRS Pub. 556, *Examination of Returns, Appeal Rights, and Claims for Refund*.

¹²². IRS Pub. 5022, *Fast Track Settlement - A Process for Prompt Resolution Of Small Business Self Employed Tax Issues*; *Fast Track*. Dec. 22, 2021. IRS. [www.irs.gov/appeals/fast-track] Accessed on Jan. 13, 2021.

2021 Workbook

Application

Application for FTS is made jointly by the taxpayer and examiner using Form 14017, *Application for Fast Track Settlement*.

3

Form 14017 (March 2020)		Department of the Treasury - Internal Revenue Service Application for Fast Track Settlement					
Submitted to IRS Independent Office of Appeals			From			Type of tax	
Date _____		Location _____		<input type="checkbox"/> LB&I	<input type="checkbox"/> SB/SE	<input type="checkbox"/> TE/GE	
<input type="checkbox"/> Other _____							
Taxpayer name			Representative name (if applicable)				
Taxpayer TIN/EIN		Tax years		Name of firm			
Address			Address				
City	State	Zip code	City	State	Zip code		
Telephone number		Fax number		Telephone number		Fax number	
Examination Group/Team Manager					Source (FE/OE, etc.)		
City	State	Zip code	Telephone number		Fax number		
Other Participants (if applicable)							
Name		Position or Affiliation			Telephone Number		
Signatures							
The undersigned request assistance from the IRS Independent Office of Appeals in the Fast Track Settlement (FTS) process. The issues for which this assistance is requested are described in the Form(s) 5701, Summary of Issues, or Form 886-A, Explanation of Items, or similar documents and the taxpayer's written response, and are attached to this application. By signing this application, taxpayer consents, pursuant to section 6103(c) of the Code, to the disclosure of the taxpayer's returns and return information pertaining to the issues being considered in the FTS process to those persons named on the application as participants in the process. The prohibition against ex parte communications between Appeals personnel and other Service employees provided by section 1001(a) of the Internal Revenue Service Restructuring and Reform Act of 1998 does not apply to the communications arising in FTS because Appeals personnel, in facilitating an agreement between the taxpayer and the other Service Operating Division, are not acting in their traditional Appeals settlement role. IRS employees, taxpayer and persons invited to participate by the IRS or taxpayer will not voluntarily disclose information regarding any communication made during the FTS session, except as provided by statute.							
Taxpayer signature					Date signed		
Taxpayer Spouse's signature (if related to a joint return)					Date signed		
Taxpayer(s) Representative signature					Date signed		
IRS Group/Team Manager Signature					Date signed		
Approving Operating Division Official (signature and title)					Date signed		
Accepted by Appeals Official (Appeals Team Manager signature)					Date signed		
Accepted by Appeals Official (Appeals Program Manager signature)					Date signed		
MFT _____	PBC _____	Potential Joint Committee <input type="checkbox"/> Yes <input type="checkbox"/> No			Listed transaction <input type="checkbox"/> Yes <input type="checkbox"/> No		
LB&I practice area _____		Preferred conference site _____			Fast Track end date _____		

Catalog Number 51767Y

www.irs.gov

Form **14017** (Rev. 3-2020)

2021 Workbook

Outcomes

Application Accepted. Once accepted for FTS, the taxpayer and/or their authorized representative meet with an IRS FTS Appeals official and the IRS audit examiner. The FTS Appeals official serves as a neutral party whose role is to facilitate an agreement between the IRS and the taxpayer using dispute resolution techniques.

Application Rejected. When an application is denied, the taxpayer is informed of the reason for the rejection. A taxpayer cannot appeal the IRS decision to reject their FTS application.

Appeal Rights

Because use of FTS is not considered a formal appeal of the audit by the taxpayer, traditional taxpayer appeal rights are unaffected by the FTS process. Therefore, if the FTS application is rejected or agreement is not reached during the FTS process, the taxpayer may still make a formal appeal within the timeframe permitted.

AUDIT RECONSIDERATION¹²³

Certain taxpayers who disagree with the results of an IRS audit of their tax return or a substitute for return (SFR) can request audit reconsideration.

- Eligibility
- Valid reasons for IRS audit reconsideration include the following.
- The taxpayer did not appear for the audit.
- The taxpayer moved and did not receive IRS audit correspondence.
- The taxpayer has new documentation pertaining to the audited issue(s) to present.
- The taxpayer disagrees with the audit assessment.

Additionally, the requesting taxpayer must meet the following criteria.

1. The taxpayer must have filed a tax return **or** the IRS prepared a SFR.
2. The assessment remains unpaid **or** the IRS reversed tax credits the taxpayer disputes.
3. The taxpayer believes the IRS made a computational or processing error when assessing the tax.
4. When appropriate, the taxpayer provides new information for the audited issue(s) not considered during the original examination.

¹²³. IRM 4.13.1.1 (2006); IRS Pub. 3598, *What Should You Know About The Audit Reconsideration Process*.

2021 Workbook

Application

The taxpayer must explain the issues they disagree with and the IRS recommends using Form 12661, *Disputed Issue Verification*, to do this. Applications for audit reconsideration should include supporting documentation and be sent to the address of the IRS campus shown on the IRS Examination Report received by the taxpayer.

3

Form 12661 (October 2015)	Department of the Treasury - Internal Revenue Service	
Disputed Issue Verification		
Taxpayer name		
Tax period	Social Security Number	
Instructions for completing disputed issues		
Please complete a separate block for each issue or adjustment with which you disagree.		
Attach photocopies of supporting information for each issue or adjustment marked. Number the supporting information with the same number as its disputed issue. If you need additional blocks, photocopy additional sheets and number accordingly.		
1. Disputed issue or adjustment		
Reason why you disagree with the audit results		
Amount claimed on original return	Amounts allowed on Audit report	
2. Disputed issue or adjustment		
Reason why you disagree with the audit results		
Amount claimed on original return	Amounts allowed on Audit report	
3. Disputed issue or adjustment		
Reason why you disagree with the audit results		
Amount claimed on original return	Amounts allowed on Audit report	
Do not send original documents — Send photocopies only		
For Privacy Act Notice see the instructions for your return.		
Catalog Number 29360J	www.irs.gov	Form 12661 (Rev. 10-2015)

2021 Workbook

Typically, the IRS responds to audit reconsideration requests within 30 days of submission.

Outcomes

The following are possible audit reconsideration outcomes.

1. The information provided is accepted and the additional tax assessed is abated.
2. The information provided is partially accepted and the additional tax assessed is partially abated.
3. The information provided is rejected and the additional assessment is reconfirmed.

Appeal Rights

Taxpayers disagreeing with the audit reconsideration nevertheless preserve their traditional appeal rights and can still make a formal appeal of the tax assessment within the timeframe permitted.

RISK ANALYSIS OF AN APPEAL

Hazards of Appeal

The combined IRS examination and appeals process can take one year or more.¹²⁴ Therefore, when weighing whether to appeal an IRS audit outcome, a taxpayer should consider the following hazards of appeal.

- A potential increase in penalties and interest if the taxpayer loses the appeal
- The time and energy to appeal the case
- The potential cost of employing a representative
- The IRS can learn more about the taxpayer's case, which could provide an advantage to the IRS in case of litigation

Benefits of Appeal

An Appeals conference is an informal process that allows the taxpayer the possibility of finding agreement with the IRS without necessarily resorting to potentially lengthy and costly litigation. However, a taxpayer contemplating litigation may first wish to appeal the case to derive the following advantages.

- More time to negotiate the issue
- The opportunity to evaluate the strength of the government's arguments
- Better flexibility to obtain information compared to court discovery procedures
- The opportunity to obtain a favorable settlement if the government determines the hazards of litigation are too high

IRS HAZARDS OF LITIGATION¹²⁵

The IRS considers the following broad categories in evaluating the government's risk in pursuing litigation.

1. Facts — What facts would the court find?
2. Law — How would the court interpret and apply the law?
3. Evidence — What evidence would be admissible and what weight would the court give it?

After weighing these factors, the IRS Appeals office may determine an appropriate settlement range for the issue rather than risk litigation.

¹²⁴. IRS Pub. 5022, *Fast Track Settlement - A Process for Prompt Resolution Of Small Business Self Employed Tax Issues*.

¹²⁵. IRM 8.11.1.2.7.5 (2019); *Working with IRS Office of Appeals: What Happens in an Examination Appeals Hearing?* 2018. IRS. [www.irs.gov/pub/irs-utl/2018ntf-what-happens-in-an-examination-appeals-hearing.pdf] Accessed on Jan. 14, 2021.

APPEALS CONFERENCE

While the taxpayer's right of appeal is guaranteed by the taxpayer bill of rights, the appeal must come within the scope of the tax laws (i.e., appeals cannot be based only on moral, religious, political, constitutional, conscientious, or other similar grounds).

An appeal can be made directly to the courts (discussed later). However, many taxpayers may prefer to first take their appeal to the IRS Appeals office for the reasons stated earlier.

Note. Most appeals are settled at IRS Appeals office level.¹²⁶

Taxpayers make their appeal to a local IRS Appeals office as instructed with the proposed tax deficiency. Generally, the appeal must be made within 30 days of the date of the 30-day letter. An Appeals conference can be conducted by correspondence, telephone, in-person, or virtually.¹²⁷ The taxpayer need not be present for the Appeals conference. Instead, they can be represented by their authorized representative.

Letter of Appeal or Protest¹²⁸

Generally, a formal written protest should be made except for small case requests discussed next. A formal written protest appealing the 30-day letter including the proposed deficiency should include the following.

1. The taxpayer's name, address, and daytime telephone number
2. A statement that the taxpayer wants to appeal the IRS findings to the IRS Appeals office
3. A copy of the IRS letter (or the date and symbols from the letter) showing the proposed changes and findings with which the taxpayer does not agree
4. The tax periods or years involved
5. A list of the changes the taxpayer disagrees with and the reasons for disagreement
6. Facts supporting the taxpayer's position on disputed issues
7. Laws or other authorities upon which the taxpayer relies
8. The following statement signed by the taxpayer under penalties of perjury

Under the penalties of perjury, I declare that I examined the facts stated in this protest, including any accompanying documents, and, to the best of my knowledge and belief, they are true, correct, and complete.

Protests prepared by the taxpayer's authorized representative should include a substitute declaration stating the following.

1. The representative submitted the protest and accompanying documents.
2. Whether the representative knows personally that the facts stated in the protest and accompanying documents are true and correct.

¹²⁶ IRS Pub. 556, *Examination of Returns, Appeal Rights, and Claims for Refund*.

¹²⁷ *Appeals Virtual Conferences*. Mar. 8, 2021. IRS. [www.irs.gov/appeals/appeals-virtual-conferences-webex] Accessed on Mar. 23, 2021.

¹²⁸ IRS Pub. 5, *Your Appeal Rights and How to Prepare a Protest if You Don't Agree*.

2021 Workbook

Small Case Procedure. An appeal can be made under the small case procedure if the total amount due for any tax period is not more than **\$25,000**. The total amount includes unpaid taxes, penalties, and interest if the taxpayer makes an offer in compromise (discussed later). The taxpayer or their authorized representative can make an appeal under this procedure by sending a letter that includes the following.

1. Request for appeals consideration
2. Indicate the changes with which the taxpayer disagrees
3. Indicate the reasons why the taxpayer does not agree

Alternatively, taxpayers or their authorized representatives can make their appeal using Form 12203, *Request for Appeals Review*.

Tips to Prepare for the Conference

Practitioners representing clients at an Appeals conference should ensure they are adequately prepared for the meeting. The following are some points to consider in this regard.

- Bring a copy of the POA (which should have been previously submitted to the IRS).
- Obtain all relevant IRS and taxpayer correspondence related to the audit as well as the relevant tax returns and/or transcripts.
- Request the IRS examiner's workpapers (a FOIA request can be made for them if they are not otherwise available).
- Ascertain applicable facts by interviewing the client as necessary.
- Identify witnesses who can attend the Appeals conference and corroborate the taxpayer's position.
- Consider using social media to obtain relevant publicly available information.
- Research relevant law and other authoritative sources.
- Determine what is privileged information.
- Ascertain ahead of time what settlement the client is prepared to accept.

Conference¹²⁹

The IRS Appeals officer is committed to being fair, impartial, courteous, and professional. They are required to explain the taxpayer's appeal rights, the appeals process, and be responsive to taxpayer concerns. If further information is needed, the Appeals officer should allow reasonable time for taxpayer response.

The taxpayer can produce new information for consideration at the conference. Depending on the significance of the information, the Appeals officer may request the IRS examiner who conducted the audit to review the new information and provide their analysis and opinion in writing. This feedback is shared with the taxpayer and their representative, and their response is considered by the Appeals officer. If the Appeals officer requires further clarification from the IRS examiner on the substance of the issues in the case, then a conference call is arranged at which the taxpayer and their authorized representative can participate.

The taxpayer or their authorized representative is expected to list all IRS positions on which there is disagreement, explain the facts and law for each issue, and how the issue should be resolved. The Appeals officer then reviews the strengths and weaknesses of the respective positions and tries to reach a settlement acceptable to both parties considering the hazards of litigation when appropriate.

¹²⁹ IRS Pub. 4227, *IRS Independent Office of Appeals*.

SETTLEMENT AGREEMENTS¹³⁰

No settlement can be made based on nuisance value to either party (i.e., any concession made solely to eliminate the inconvenience or cost of further negotiations or litigation that is unrelated to the merits of the issues.)

The IRS Appeals officer may use Form 870, *Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment*, to document an agreed settlement.

The following three settlement agreement types are available for the Appeals officer to conclude with the taxpayer.

Mutual Concession

A mutual concession agreement is one involving concessions by both the government and the taxpayer. The relative strengths of each party's position on each issue in dispute is weighed and appropriate concessions are made to reach a settlement. This settlement approach may be pursued when there is substantial uncertainty in the event of litigation as to how the courts may interpret and apply the law, or as to what facts the courts may find.

Split-Issue

The distinguishing feature of a split-issue settlement is that the agreed result would not be reached if tried. This is because it is expected that a court decision would be completely in favor of the government or the taxpayer. Thus, a split-issue settlement of an issue is for a percentage or a stipulated amount of the tax in question. Split-issue settlements are inappropriate for cases involving issues affecting prior or subsequent tax periods that are outside the period of the settlement (e.g., adjustments to depreciation/depletion, carryovers, carrybacks, etc.).

Specific-Dollar

A specific-dollar settlement is one in which the case is settled for a percentage or stipulated amount of the tax in question. Specific-dollar settlements are appropriate in all the following circumstances.

1. It is a small tax case.
2. There are nonrecurring issues.
3. The settlement only affects years under Appeals' jurisdiction.
4. There is a single entity/taxpayer.

Changes to AGI and taxable income are **not** determined for specific-dollar settlements.

Like split-issue settlements, specific-dollar settlements are inappropriate for cases involving issues affecting prior or subsequent tax periods.

Example 18. At the conclusion of the audit of Adam's 2020 tax return, the revenue agent proposes an additional tax assessment of \$10,000. Adam appeals the finding within the time permitted. After evaluating the hazards of litigation, the IRS Appeals officer assigned to the case determines that the issues involved might be resolved 70% in favor of the government and 30% in favor of Adam. Therefore, the Appeals officer proposes a \$7,000 settlement (70% of the proposed \$10,000 deficiency.)¹³¹

¹³⁰ IRM 8.6.4.2 (2020).

¹³¹ Based on IRM 8.6.4.2.3(5) (2020).

2021 Workbook

CLOSING AGREEMENTS¹³²

IRC §7121 empowers the Secretary of the Treasury to enter into closing agreements. This power is delegated to the IRS Commissioner.¹³³ Closing agreements are used when it is advantageous to have a tax matter permanently and conclusively resolved.

In this regard, Treasury regulations provide that:¹³⁴

A closing agreement may be entered into in any case in which there appears to be an advantage in having the case permanently and conclusively closed, or if good and sufficient reasons are shown by the taxpayer for desiring a closing agreement and it is determined by the Commissioner that the United States will sustain no disadvantage through consummation of such an agreement.

Following are examples of acceptable reasons for entering a determination of tax liability by closing agreement.

- The taxpayer wishes to **definitively** establish their tax liability in order that a transaction may be facilitated, such as a sale of its stock.
- The fiduciary of an estate desires a closing agreement so the fiduciary can be discharged by the court.
- A corporation in the process of liquidation or dissolution desires a closing agreement in order to conclude its affairs.
- A taxpayer wishes to fulfill creditors' demands for authentic evidence of the status of their tax liability.

Collateral Agreements¹³⁵

Collateral agreements are used in compromise cases, estate tax cases and related income tax valuations, gift tax cases, and in other Appeals cases under appropriate circumstances.

Collateral agreements do not bind the IRS. They are one-sided commitments made by the taxpayer. The IRS does not enter into or sign these agreements.

For example, a trustee or beneficiary receiving estate assets may, by signing a collateral agreement, commit to using the same valuation for income tax purposes that was used for estate tax purposes.

POST APPEALS MEDIATION¹³⁶

Following receipt of the taxpayer's formal written protest, the taxpayer is provided with a copy of IRS Pub. 4167, *Appeals — Introduction to Alternative Dispute Resolution*, which explains the post appeals mediation (PAM) process. The taxpayer is made aware of the availability of PAM if a mutually agreeable settlement cannot be reached at the appeals conference.

PAM is a non-binding process whose goal is to assist the taxpayer and the IRS to reach a negotiated settlement using a mediator(s), as a neutral third party. To accomplish this goal, the mediator acts as a facilitator to assist with defining the issues and with promoting settlement negotiations between the parties. The mediator does not have settlement authority in the mediation process nor does the mediator render decisions regarding the issues in dispute.

¹³² IRM 8.13.1.1 (2018).

¹³³ See Treasury Order No. 150-07 (Nov. 18, 1953).

¹³⁴ Treas. Reg. §301.7121-1(a).

¹³⁵ IRM 8.13.1.2.3 (2018).

¹³⁶ IRM 8.26.5.1 (2015), and Rev. Proc. 2014-63, 2014-53 IRB 1014.

LITIGATION¹³⁷

As stated earlier, taxpayers who disagree with an IRS notice of deficiency have 90 days from the date of the notice to file a court petition (150 days if addressed to them outside the United States). This right applies both to taxpayers who are unable to reach agreement on all issues at the Appeals conference as well as taxpayers who skip the IRS appeals process entirely.

Note. The prevailing party at a court hearing may be able to recover their reasonable litigation and administrative costs. More information on this is available from IRS Pub. 5, *Your Appeal Rights and How to Prepare a Protest if You Don't Agree*.

Courts accepting a petition include the U.S. Tax Court, the U.S. Court of Federal Claims, or the applicable U.S. District Court. A brief discussion of some of the procedural and jurisdictional requirements follows.

U.S. Tax Court¹³⁸

The Tax Court schedules the case for trial at a location convenient for the taxpayer. The taxpayer may represent themselves or be represented by anyone permitted to practice before the court.

Note. A non-attorney may be admitted to practice before the U.S. Tax Court. More information on qualifications and the application process is available at [uofi.tax/21a3x5](https://www.ustaxcourt.gov/resources/forms/Admission_Nonattorney_Info.pdf) [www.ustaxcourt.gov/resources/forms/Admission_Nonattorney_Info.pdf].

Small Case Procedures. A taxpayer may elect simplified “small case procedures” when the amount in dispute (including tax, additions to tax, and penalties) is \$50,000 or less for each tax period involved. However, the IRS has the right to oppose this election.

Remote Proceedings.¹³⁹ Due to the COVID-19 pandemic, court proceedings were conducted remotely. See Administrative Order 2020-02 regarding remote proceedings and Administrative Order 2020-03 regarding Limited Entries of Appearance.

District Court and Court of Federal Claims

A U.S. District Court or the U.S. Court of Federal Claims may be petitioned regarding a refund of any type of tax. Certain types of cases (e.g., those involving some employment tax issues or manufacturers' excise taxes) can be heard **only** by these courts.

Note. Generally, the relevant District Court and the Court of Federal Claims only hear tax cases **after** the taxes have been paid and the taxpayer has filed a claim for refund with the IRS. This contrasts with a Tax Court petition where the taxes in dispute are not required to have already been paid.

Taxpayers who file a formal refund claim with the IRS and do not receive a response within six months of the filing date, may file suit for a refund in their District Court or the Court of Federal Claims. These courts can also be petitioned regarding an IRS letter disallowing a refund claim.

More information about procedures for filing suit in either court is available from the clerk of the applicable District Court or the clerk of the Court of Federal Claims.

¹³⁷ IRS Pub. 5, *Your Appeal Rights and How to Prepare a Protest if You Don't Agree*.

¹³⁸ *Guidance for Petitioners: Starting a Case*. United States Tax Court. [www.ustaxcourt.gov/petitioners_start.html] Accessed on Mar. 23, 2021.

¹³⁹ *COVID-19 Resources*. United States Tax Court. [www.ustaxcourt.gov/covid.html] Accessed on Mar. 23, 2021.

IRS COLLECTIONS¹⁴⁰

Various payment options are available to taxpayers. Taxpayers who do not pay are subject to collection actions including liens, levy, and seizure. Collection appeals, debt resolution, and other relief are also available.

Taxpayers have the same right to be represented during the collection process as they do during IRS examinations. Authorized representatives (with a POA) include practitioners and immediate family members. Businesses can also be represented by full-time employees, general partners, or bona fide officers.

TAXPAYER BILLING AND PAYMENT

Once a taxpayer has filed their tax return and/or a final decision is reached regarding their correct tax, the amount due is reflected in the IRS's records. This may include penalties and interest. The IRS then sends the taxpayer a bill for the amount due. If this does not result in payment, the IRS issues at least one more bill before beginning collection actions. The IRS applies payments first to the tax debt, then any penalty, then any interest due.

Interest and Penalties¹⁴¹

The three most common additions to tax due are interest, the FTP, and FTF penalties.

Interest. Generally, interest accrues on unpaid tax from the return due date until the date of payment. Interest compounds daily. The interest rate is the federal short-term rate plus 3% and is determined quarterly. For the first two quarters of 2021, the rate applicable to individual taxpayers is **3%** (for both underpayments and refunds).¹⁴²

FTP Penalty. Generally, the FTP penalty applies to taxpayers who file a return but do not pay all tax owed on time. This penalty is usually **0.5%** for each month, or part of a month the tax remains unpaid after the due date of the return. The maximum FTP penalty is **25%**. There are two instances when the FTP penalty accrual rate changes. First, the accrual rate increases to **1%** for tax remaining unpaid 10 days after the IRS issues a notice of intent to levy property (see later discussion). Second, the accrual rate decreases to **0.25%** for any month in which an installment agreement is in effect (i.e., for taxpayers who file by the due date and request an installment agreement.)

FTF Penalty. Taxpayers who owe tax but do not file on time are subject to the FTF penalty. This penalty is usually 5% of the tax owed for each month, or part of a month the return is late, up to a maximum of 25%. A **minimum** FTF penalty applies to a return that is over 60 days late which is the **lesser** of:

1. \$435 (for tax returns required to be filed in 2021), or
2. 100% of the tax owed.

Note. For purposes of determining the FTF or minimum FTF penalty, a return is regarded as timely filed and therefore not subject to this penalty if filed by the extended due date.¹⁴³

Example 19. Use the same facts as **Example 17**. The IRS processes all the returns Sue submitted on Paul's behalf. In accepting the late returns, the IRS assesses FTP and FTF penalties and interest. Paul's total liability is now more than \$190,000. Paul is severely overextended in his business and has little cash or equity in assets. He begins to reconsider his dream of expanding his landscaping business.

¹⁴⁰ IRS Pub. 594, *The IRS Collection Process*.

¹⁴¹ *Topic No. 653 IRS Notices and Bills, Penalties, and Interest Charges*. Mar. 19, 2021. IRS. [www.irs.gov/taxtopics/tc653] Accessed on Mar. 24, 2021.

¹⁴² Rev. Rul. 2021-6, 2021-12 IRB 946.

¹⁴³ IRC §6651.

Taxpayer Payment Options

Taxpayers who agree with the amount requested in the bill should pay the amount stated by the specified due date to avoid accrual of further penalties and interest. Collection appeal options for taxpayers who disagree with the amount requested are discussed later as well as various types of relief that are also available.

Payment options include the following.

- Electronic payments (online and by telephone)
- IRS Direct Pay (direct payment from the taxpayer's checking or savings accounts without any fees or pre-registration)
- Debit or credit card (via authorized debit and credit card processors — fees apply)
- IRS2Go app
- Electronic Federal Tax Payment System (free service to pay taxes by phone or online)
- Cash (at participating 7-Eleven stores in 34 states)
- Pay by check (mail to the address listed in the notice or bring to the local IRS office)

Note. More information on these payments options is available at www.irs.gov/payments and in IRS Pub. 594, *The IRS Collection Process*.

Alternative payment options exist for taxpayers who are unable to pay the entire amount due currently. Three common alternatives are discussed next.

Installment Agreement. Taxpayers can enter into an installment agreement (IA) with the IRS allowing them to make smaller periodic payments over time. A setup fee applies to an IA for a period over 120 days.

There are several ways a taxpayer can apply for an IA including:

- Online, using the Online Payment Agreement (OPA) application at www.irs.gov/OPA — a reduced setup fee applies if the amount owed (i.e., taxes, penalties, and interest) by an individual taxpayer is \$50,000 or less. Business owners owing \$25,000 or less in combined payroll taxes, penalties, and interest for the current and prior calendar year can also use the OPA to apply for an IA;

Practitioner Planning Tip

Preparers may want to advise their clients to pay down the balance to a level below the OPA threshold to maximize the benefits of an IA.

- By phone at 1-800-829-1040, or the phone number shown on the IRS bill;
- By mail using Form 9465, *Installment Agreement Request* to the address shown on the IRS bill. In addition to Form 9465, employees wanting to make payments by payroll deduction should complete Form 2159, *Payroll Deduction Agreement*. Taxpayers owing more than \$50,000 must also complete Form 433-F, *Collection Information Statement* (Form 433-F is discussed further shortly); or
- In person at their local IRS office (not currently a practical option).

2021 Workbook

Part II Additional Information

Complete this Part only if all three conditions below apply:

1. You defaulted on an installment agreement in the past 12 months;
2. You owe more than \$25,000 but not more than \$50,000; and
3. The amount on line 11a (or 11b, if applicable) is less than line 10.

Note: If you owe more than \$50,000, also complete and attach Form 433-F.

15 In which county is your primary residence? _____

16a Marital status:

- Single. Skip question 16b and go to question 17.
 Married. Go to question 16b.

b Do you share household expenses with your spouse?

- Yes.
 No.

17 How many dependents will you be able to claim on this year's tax return? **17** | _____

18 How many people in your household are 65 or older? **18** | _____

19 How often are you paid?

- Once a week.
 Once every 2 weeks.
 Once a month.
 Twice a month.

20 What is your net income per pay period (take home pay)? **20** | \$ _____

Note: Complete lines 21 and 22 only if you have a spouse and meet certain conditions (see instructions). If you don't have a spouse, go to line 23.

21 How often is your spouse paid?

- Once a week.
 Once every 2 weeks.
 Once a month.
 Twice a month.

22 What is your spouse's net income per pay period (take home pay)? **22** | \$ _____

23 How many vehicles do you own? **23** | _____

24 How many car payments do you have each month? **24** | _____

25a Do you have health insurance?

- Yes. Go to question 25b. No. Skip question 25b and go to question 26a.

b Are your health insurance premiums deducted from your paycheck?

- Yes. Skip question 25c and go to question 26a. No. Go to question 25c.

c How much are your monthly health insurance premiums? **25c** | \$ _____

26a Do you make court-ordered payments?

- Yes. Go to question 26b. No. Go to question 27.

b Are your court-ordered payments deducted from your paycheck?

- Yes. Go to question 27. No. Go to question 26c.

c How much are your court-ordered payments each month? **26c** | \$ _____

27 Not including any court-ordered payments for child and dependent support, how much do you pay for child or dependent care each month? **27** | \$ _____

2021 Workbook

OPA applicants receive immediate notification if the IA is approved. Payments under an IA can be made by direct debit, through payroll deductions, electronic funds transfer, or check.

The setup fee can be taken from the initial payments made once the IA is accepted. A reduced set-up fee applies if IA payments are made by direct debit. Taxpayers meeting low-income guidelines can also qualify for a reduced setup fee. See Form 13844, *Application for Reduced User Fee for Installment Agreements*, for more information.

To be eligible for an IA, the taxpayer must file all required tax returns. Completion of a collection information statement (Forms 433-F, 433-A and/or Form 433-B) and proof of financial status may also be required. These forms serve to obtain current taxpayer financial information to determine how an employee or self-employed individual can satisfy their outstanding tax liability (for more information, see IRS Pub. 1854, *How to Complete a Collection Information Statement (Form 433-A)*).

Interest and penalties continue to accrue until the balance due is paid in full. The IRS may also file a notice of federal tax lien (discussed later).

Taxpayers can appeal a rejected IA request (see Collection Appeals later).

Partial Pay IA. A partial payment IA allows a taxpayer to ultimately pay less than the full amount due by making smaller payments over a longer time period. At the end of the collections statute expiration date, the unpaid balance will be forgiven. To qualify the taxpayer will have to submit a collection information statement (Form 433-A or 433-B).¹⁴⁴

Offer in Compromise.¹⁴⁵ Taxpayers who cannot pay the amount due in full or through installments may be eligible for an offer in compromise (OIC) to settle for an amount less than that owed. Reasons the IRS may accept an OIC include the following.

- The IRS agrees that the taxpayer's tax debt may not be accurate.
- The taxpayer has insufficient assets and income to pay the amount due.
- Due to the taxpayer's exceptional circumstances, payment of the full amount due causes the taxpayer economic hardship or is unjust.

Usually, for an OIC to be considered by the IRS, the taxpayer must pay an application fee and make an initial or periodic payment for all OIC submissions. A waiver of the application fee and initial or periodic payment is available for low-income taxpayers (see the Low-Income Certification form found in Form 656-B, *Offer in Compromise Booklet*).

Otherwise-eligible taxpayers must meet the following conditions.

- File all legally required tax returns
- Make all required estimated tax payments for the current year
- Make all required federal tax deposits for the current quarter
- Not be in bankruptcy
- Not be currently undergoing an audit

¹⁴⁴. See IRM 5.1.19.4 (2013) and IRM 5.14.2.2 (2019).

¹⁴⁵. See Form 656-B, *Offer in Compromise Booklet* and Form 656, *Offer in Compromise*. Nov. 23, 2021. IRS. [www.irs.gov/Individuals/Offer-in-Compromise-1] for more information. Accessed on Mar. 24, 2021.

Practitioner Planning Tip

An online pre-qualifier tool is available from the IRS at [irs.treasury.gov/oic_pre_qualifier] that taxpayers can use to determine if they **may** qualify for an OIC. For more information on the pre-qualifier tool and an example, see the 2021 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 2: Financial Distress.

Taxpayers apply for an OIC by completing one of the following forms.

- Form 656-L, *Offer in Compromise (Doubt as to Liability)* — applicable when there is a genuine dispute as to the existence or amount of the correct tax debt under the law
- Form 656, *Offer in Compromise* — applicable for taxpayers who cannot pay the amount due, have an economic hardship, or have another special circumstance that causes paying the amount due to be unjust

Example 20. Use the same facts as **Example 19**. Paul meets with Sue to discuss what remedy could be considered for this terrible tax dilemma. Sue asks Paul to list his assets, liabilities, and income. She concludes Paul may be a candidate for an OIC. After calculating his equity in assets and monthly net income, Sue prepares an offer proposing a cash settlement of \$2,000. Paul is thrilled with the possibility of settling his tax debt for pennies on the dollar. Paul anxiously awaits the IRS's response.

Collection Delay Request. Taxpayers who cannot pay the amount due because payment prevents them from meeting basic living expenses can request a delay in collection until they are able to pay. The IRS requires completion of a collection information statement and proof of the taxpayer's financial status before approving the request. Penalties and interest nevertheless continue to accrue until the debt is fully paid. The IRS may still file a notice of federal tax lien at their discretion.

COLLECTION ACTIONS

Collection actions the IRS can take include unannounced visits from a revenue officer to the taxpayer's home or business, applying subsequent tax year refunds to tax due (until paid in full), and seizing taxpayer property and assets. Additionally, the IRS can notify the Department of State that the taxpayer has a seriously delinquent tax debt (\$53,000 for 2020¹⁴⁶ and \$54,000 for 2021¹⁴⁷), possibly resulting in revocation of the taxpayer's passport.¹⁴⁸

The taxpayer's tax debt can also be assigned to a private collection agency.

Federal Tax Lien/Seizure

A federal tax lien is a legal claim against all the taxpayer's current and future property (e.g., house, car, wages, and bank accounts) that automatically comes into existence when taxpayers do not pay the amount due after receiving their first IRS bill. The IRS can then file a notice of federal tax lien with local or state authorities, such as the county recorder of deeds or Secretary of State offices. Besides providing public notice to creditors, it also establishes the priority of the IRS's claim versus the claims of other creditors.

¹⁴⁶. Rev. Proc. 2019-44, 2019-47 IRB 1093.

¹⁴⁷. Rev. Proc. 2020-45, 2020-46 IRB 1016.

¹⁴⁸. IRC §7345; §32101 of the Fixing America's Surface Transportation (FAST) Act of 2015 (Dec. 4, 2015).

2021 Workbook

Notice of Intent to Levy. Generally, before property is seized, the IRS must provide the taxpayer with notice of intent to levy and the taxpayer's right to request a collection due process hearing (discussed later under "Collection Appeals") within 30 days of the notice. After 30 days from the notice, the IRS may proceed with the levy if the taxpayer has not settled or arranged to settle the tax debt or requested a hearing.

Note. IRS Pub. 594, *The IRS Collection Process*, provides details of IRS publications and online resources dealing with federal tax liens including information concerning withdrawal, discharge, and subordination of these liens to other taxpayer creditors.

COLLECTION RELIEF AVAILABLE

Innocent Spouse Relief

Generally, both spouses are jointly and individually responsible for paying any tax, interest, or penalties on their joint return. However, a spouse may be eligible for innocent spouse relief if they believe their current or former spouse should be solely responsible for an incorrect item or an underpayment of tax on their joint tax return.

Requests for innocent spouse relief can be made using Form 8857, *Request for Innocent Spouse Relief*. Normally, Form 8857 should be filed no later than two years from the date of the IRS's first attempt to collect the outstanding debt, except for requests for equitable relief under IRC §6015(f).

Note. See IRS Pub. 971, *Innocent Spouse Relief*, and the 2018 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 5: Divorce, for detailed information on innocent spouse relief. This chapter can be found at uofi.tax/arc [taxschool.illinois.edu/taxbookarchive].

COVID-19 Relief¹⁴⁹

In November 2020, the IRS introduced the following relief to help taxpayers impacted by COVID-19 and struggling to pay their tax debts.

- Taxpayers who qualify for a short-term payment plan option may now have up to 180 days to resolve their tax liabilities instead of 120 days.
- Taxpayers who are temporarily unable to meet the payment terms of an accepted OIC may be offered flexibility by the IRS.
- The IRS automatically adds certain new tax balances to existing IAs, for individual and out-of-business taxpayers, to avoid default of the IA.
- Certain qualified individual taxpayers owing less than \$250,000 may now set up IAs without providing a financial statement or substantiation, provided their monthly payment proposal is enough.
- Individual taxpayers who only owe for the 2019 tax year and no more than \$250,000, may qualify to set up an IA without the IRS filing a notice of federal tax lien.
- Qualified taxpayers with existing direct debit IAs can now use the OPA system to propose lower monthly payment amounts and change their payment due dates.

¹⁴⁹ *IRS Makes It Easier to Set Up Payment Agreements; Offers Other Relief to Taxpayers Struggling with Tax Debts*. Dec. 16, 2020. IRS. [www.irs.gov/newsroom/irs-makes-it-easier-to-set-up-payment-agreements-offers-other-relief-to-taxpayers-struggling-with-tax-debts] Accessed on Mar. 24, 2021.

COLLECTION STATUTE EXPIRATION DATE¹⁵⁰

Generally, the IRS can only attempt collection of taxes for up to 10 years from the date they were assessed. Thus, any levy or court proceeding must have begun within this 10-year collection statute of limitations.

However, it is important to note that the 10-year collection statute is **suspended** in the following situations.

- During the period the IRS is considering an IA or OIC request
- For 30 days after rejection of an IA or OIC request
- During the period the IRS Appeals office is considering an appeal
- For the entire period of residence abroad for taxpayers living continuously outside the United States for at least six months
- For the tax periods included in a bankruptcy with an automatic stay, collection is suspended for the period of the automatic stay, plus six months
- From the date of a taxpayer request for a collection due process hearing until a notice of determination is issued or the Tax Court's decision is final
- From the date of a taxpayer request for innocent spouse relief until 90 days after a notice of determination is issued
- If the taxpayer files a timely petition to the Tax Court, until 60 days after the Tax Court's final decision
- If the taxpayer appeals the Tax Court's decision to a U.S. Court of Appeals, until 60 days after the appeal is filed, unless a bond is posted

COLLECTION APPEALS¹⁵¹

Taxpayers or their authorized representatives (with a POA) have the right to appeal many IRS collection actions to the IRS Office of Appeals. Generally, the time for appeal is within 30 days of receipt of certain collection notices. Two procedures taxpayers can utilize to make their appeal are **collection due process** and the **collection appeals program**.

Collection Due Process

A collection due process (CDP) hearing is an opportunity to discuss alternatives to enforced collection and allows the taxpayer to dispute the amount owed if they did not have a prior opportunity to do so.¹⁵² The CDP procedure is available to taxpayers receiving one of the following notices.

- Notice of Federal Tax Lien Filing and Your Right to a Hearing under IRC §6320
- Final Notice — Notice of Intent to Levy and Notice of Your Right to a Hearing
- Notice of Jeopardy Levy and Right of Appeal
- Notice of Levy on Your State Tax Refund — Notice of Your Right to a Hearing
- Post Levy Collection Due Process (CDP) Notice

Form 12153, *Request for a Collection Due Process or Equivalent Hearing* can be used to appeal collection actions under the CDP procedure.

Taxpayers can contest a CDP determination in the U.S. Tax Court.

¹⁵⁰. IRS Pub. 594, *The IRS Collection Process*.

¹⁵¹. IRS Pub. 1660, *Collection Appeal Rights*.

¹⁵². *Collection Due Process (CDP) FAQs*. Feb. 9, 2021. IRS. [www.irs.gov/appeals/collection-due-process-cdp-faqs] Accessed on Mar. 26, 2021.

2021 Workbook

Collection Appeals Program

The collection appeals program (CAP) provides an administrative appeal for certain collection actions. The appealable actions were initially limited to liens, levies, and seizures.¹⁵³ The CAP procedure is currently available to taxpayers for the following actions.

- Before or after the IRS files a notice of federal tax lien
- Before or after the IRS levies or seizes taxpayer property
- Termination or proposed termination of an IA
- Rejection of an IA
- Modification or proposed modification of an IA

Form 9423, *Collection Appeal Request*, can be used to request appeals consideration under CAP.

Note. Although the CAP procedure is usually **quicker**, the resulting appeals decision **cannot** be contested in court.

Appeals Hearing

An Appeals hearing/conference can be held either by telephone, correspondence, or face-to-face. To qualify for a face-to-face conference, the taxpayer cannot raise issues that are frivolous or solely designed to impede or delay collection. A collection alternative can be proposed. It may then be necessary for the taxpayer to submit financial information or tax returns to support the proposal. Generally, IRS Appeals asks Collections to review, verify, and provide their opinion on any new information the taxpayer submits. Comments received from Collections are shared with the taxpayer who can then respond.

Fast Track Mediation¹⁵⁴

An alternative dispute resolution process is available for taxpayers with issues concerning an OIC or who have been charged a trust fund recovery penalty.¹⁵⁵ The goal of fast track mediation (FTM) is to aid the taxpayer and IRS Collections to resolve the dispute. A trained Appeals officer acts as the mediator.

A formal written protest does not need to be filed for these taxpayers to utilize FTM. An FTM request can be initiated by either the taxpayer or the IRS. However, both parties must agree to participate in the process and sign an agreement to mediate prior to attending the FTM session.

Note. The 2021 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 2: Financial Distress, offers more information and worked examples of IA requests, compilation of collection information statements, OIC requests, and federal tax liens, levies, and their withdrawal or discharge.

¹⁵³. IRM 8.24.1.1.1 (2019).

¹⁵⁴. IRS Pub. 3605, *Fast Track Mediation — Collection*.

¹⁵⁵. A penalty for the willful failure to collect, account for, and pay to the IRS the employment taxes of a business under IRC §6672(a).

CRIMINAL INVESTIGATIONS

The role of the IRS Criminal Investigation Division (CID) is to investigate potential criminal violations of the Code and related financial crimes.¹⁵⁶ Examples of such crimes include, but are not limited to, the following.¹⁵⁷

- Abusive return preparer enforcement
- Abusive tax schemes
- Bankruptcy fraud
- Corporate fraud
- Employment tax enforcement
- Financial institution fraud
- Illegal gaming operations
- General fraud investigations
- Healthcare fraud
- Identity theft schemes
- International tax compliance investigations
- Money laundering crimes
- Narcotics-related investigations
- Nonfiler enforcement
- Paycheck Protection Program (PPP) loan fraud¹⁵⁸
- Public corruption crimes
- Questionable refund program

Caution. In fiscal year 2020, CID identified **\$2.3 billion** of tax fraud. Fraud, cybercrimes (particularly involving virtual and cryptocurrencies), traditional tax investigations, international tax enforcement, employment tax, refund fraud, and tax-related identity theft all received particular attention.¹⁵⁹ Additionally, CID quickly adapted to investigate COVID-19 crimes (e.g., fraudulent claims for economic impact payments, PPP loans, and refundable payroll tax credits under the Coronavirus Aid, Relief, and Economic Security (CARES) Act).

Tax practitioners who suspect criminal conduct by their client should **immediately recommend referral of the client to an attorney experienced in Criminal Investigations (CI) issues.** This is because communications between a practitioner and their client are **not** privileged communications for criminal tax matters or proceedings.¹⁶⁰

¹⁵⁶ *Criminal Investigation*. Dec. 22, 2020. IRS. [www.irs.gov/compliance/criminal-investigation] Accessed on Jan. 26, 2021.

¹⁵⁷ *Program and Emphasis Areas for IRS Criminal Investigation*. Mar. 5, 2021. IRS. [www.irs.gov/compliance/criminal-investigation/program-and-emphasis-areas-for-irs-criminal-investigation] Accessed on Mar. 24, 2021.

¹⁵⁸ *IRS Criminal Investigation (CI) Pledges Continued Commitment to Investigating COVID-19 Fraud as CARES Act Reaches One-Year Anniversary*. Mar. 25, 2021. IRS. [www.irs.gov/newsroom/irs-criminal-investigation-ci-pledges-continued-commitment-to-investigating-covid-19-fraud-as-cares-act-reaches-one-year-anniversary] Accessed on Jun. 10, 2021.

¹⁵⁹ *IRS Criminal Division Identified \$2.3 Billion in Tax Fraud in 2020*. Nov. 18, 2020. CPA Practice Advisor. [www.cpapracticeadvisor.com/tax-compliance/news/21163355/irs-criminal-division-identified-23-billion-in-tax-fraud-in-2020] Accessed on Jan. 26, 2021.

¹⁶⁰ IRC §7525(a)(2).

2021 Workbook

ATTORNEY VERSUS PRACTITIONER ROLE¹⁶¹

One of the most important reasons why a criminal suspect should employ an attorney to represent them is attorney-client privilege. Consequently, confidential communications made between the attorney and their client are protected from disclosure. For attorney-client privilege to exist, the following must be present in the communication.

1. Made between privileged persons
2. Made in confidence
3. Made for the purpose of seeking, obtaining, or providing legal assistance to the client

Privileged persons can also include certain third parties. For example, courts have held that an accountant working for an attorney representing a criminal defendant can be covered by attorney-client privilege. More specifically, third-party communications (i.e., with the accountant) are covered if they are interpretive and serve to translate information between the client and the attorney to improve the attorney's understanding of client data.¹⁶² For example, a practitioner who provides advice to an attorney regarding a position taken on the attorney's client's tax return is likely a communication protected by attorney-client privilege.

STATUTE OF LIMITATIONS¹⁶³

There are periods of limitation on criminal prosecutions. Generally, no person can be prosecuted, tried, or punished for any offense under the Code or Regulations unless the indictment is found, or the information instituted within **three years** of commission of the offense. However, this period of limitation becomes **six years** when the offense involves **fraud** or **willful tax evasion** as specified by IRC §6531.

NONFILERS¹⁶⁴

Simply put, a **nonfiler** is anyone (individual, corporation, estate, trust, or partnership) who, having exceeded the required income filing threshold, has not filed a tax return by the statutory or extended due date. As stated earlier, there is no statute of limitations when a taxpayer fails to file a return, files a false return, or otherwise willfully attempts to evade tax.¹⁶⁵ Consequently, in such situations, the IRS is free to assess tax at any time.

TYPES OF NONFILER

There are three common types of nonfiler.

1. Habitual — One who has never filed a tax return that is due
2. Skipper — One who files, skips one or more years, files outstanding years, then repeats the process
3. Dropout — Compliant taxpayers who suddenly stop filing returns that are due

Reasons for nonfiling can include health issues, economic problems, and procrastination. In addition, there are tax protestors who believe they should not have to file tax returns for various self-serving reasons, or file frivolous returns. Generally, the reason for nonfiling does not influence the IRS's actions unless willfulness, fraud, or other criminal behavior is involved.

¹⁶¹ *The Attorney-Client Privilege and Information Disclosed to an Attorney with the Intention That the Attorney Draft a Document To Be Released to Third Parties: Public Policy Calls for at Least the Strictest Application of the Attorney-Client Privilege*. Northrop, Daniel. 2009. *Fordham Law Review*. [ir.lawnet.fordham.edu/flr/vol78/iss3/14] Accessed on Jan. 26, 2021.

¹⁶² *Dahl v. Bain Capital Partners, LLC*, 714 F. Supp. 2d 225, 227-28 (D. Mass. 2010); *U.S. v. Chevron Texaco Corp.*, 241 F. Supp. 2d 1065, 1071 (N.D. Cal. 2002)

¹⁶³ IRC §6531.

¹⁶⁴ IRM 4.19.17.1 (2010).

¹⁶⁵ IRC §6501.

DEFINITION OF A RETURN

While the IRS does not define a tax return, IRC §6011(a) provides a general rule when a taxpayer is required to file.

When required by regulations prescribed by the Secretary any person made liable for any tax imposed by this title, or with respect to the collection thereof, shall make a return or statement according to the forms and regulations prescribed by the Secretary. Every person required to make a return or statement shall include therein the information required by such forms or regulations.

A noncompliant taxpayer risks being investigated by the IRS pursuant to the **nonfiler program**, also known as the SFR program.

IRS SFR PROGRAMS¹⁶⁶

When a taxpayer appears to have a filing requirement but is noncompliant, the IRS is authorized to send that taxpayer a notice of deficiency¹⁶⁷ based on an IRS-prepared SFR.¹⁶⁸

Typically, an SFR is prepared after an IRS compliance check reveals filing delinquencies with potential for tax assessment. The compliance check includes scrutiny of taxpayer information in the IRS's possession (e.g., income reflected on Forms W-2 and 1099).

Practitioner Planning Tip

When preparing the SFR, the IRS will likely not give the taxpayer the full amount of deductions and exemptions to which they may be entitled. Practitioners should assist their clients in preparing their own returns to claim all available deductions, credits, and exemptions. Generally, then the IRS will adjust the taxpayer's account to reflect the accurate amounts.

Although the SFR is not a tax return filed by the taxpayer, it is the taxpayer who is **legally held responsible for the correctness** of the SFR.¹⁶⁹

Example 21. JKL Corp. fails to file a second quarter 2020 Form 941, *Employer's Quarterly Federal Tax Return*. Subsequently, the IRS prepares a second quarter Form 941, stating JKL's name, address, and EIN before completing Part 1 of the Form 941 to compute the tax due. The IRS-prepared Form 941 constitutes an IRC §6020(b) tax return because it reflects JKL's name and EIN and includes the information necessary to compute JKL's tax liability for the second quarter of 2020.¹⁷⁰

Upon receipt of an SFR and associated notice of deficiency (90-day letter), the taxpayer has 90 days from the date of the notice of deficiency to file the following.

1. The delinquent tax return, or
2. A petition in Tax Court appealing the notice of deficiency

¹⁶⁶ *Filing Past Due Tax Returns*. Sep. 23, 2020. IRS. [www.irs.gov/businesses/small-businesses-self-employed/filing-past-due-tax-returns] Accessed on Jan. 27, 2021; *Substitute-for>Returns Procedure*. Marchbein, Joe B. Oct. 1, 2019. The Tax Adviser. [www.thetaxadviser.com/issues/2019/oct/substitute-returns-procedure.html] Accessed on Jan. 27, 2021.

¹⁶⁷ IRC §6212.

¹⁶⁸ IRC §6020.

¹⁶⁹ Treas. Reg. §301.6020-1(a)(2).

¹⁷⁰ Based on Treas. Reg. §301.6020-1(b)(6), Example 4.

2021 Workbook

If a taxpayer believes that any income shown in the SFR is incorrect, they can take the following actions.

- Inform the IRS by calling 1-866-681-4271
- Contact the payer of the income and request a corrected Form W-2 or 1099
- Attach corrected Forms W-2 and/or 1099 to the delinquent tax returns

Note. The Taxpayer Bill of Rights (including the right to representation) also applies to nonfilers.

Penalties and Interest

Penalties the IRS can assess on the unpaid tax include the FTF and FTP penalties and the estimated tax penalty.¹⁷¹ Other penalties the IRS can assess include the accuracy penalty¹⁷² and the fraudulent failure-to-file penalty (FFTF).¹⁷³ The FFTF substitutes for FTF penalty and is 15% of the tax owed for each month or part month the return is late, up to a maximum of 75%. However, the burden of proof is on the IRS to establish fraud for purposes of the FFTF.

Statutory interest¹⁷⁴ also accrues on the tax debt until paid.

Penalty relief is available to qualifying nonfilers.

STATUTE OF LIMITATIONS

As stated previously, there is no statute of limitations for the taxes due on delinquent tax returns. However, if an SFR shows an overpayment or the taxpayer then files a return showing an overpayment, the IRS can refund the overpayment only if the RSED is unexpired.

VOLUNTARY DISCLOSURE PRACTICE¹⁷⁵

When violations of the law are not willful, the IRS recommends that taxpayers correct past mistakes by filing amended or past due returns.

For taxpayers who have committed tax or tax-related crimes, the IRS instituted a voluntary disclosure practice (VDP) which allows these taxpayers to become tax compliant and potentially avoid criminal prosecution.

Note. Taxpayers making voluntary disclosure are not guaranteed immunity from prosecution, but it is considered a factor in the taxpayer's favor.

A voluntary disclosure must be truthful, timely, and complete. Taxpayers participating in a VDP must also fulfill all the following.

- Cooperate with the IRS in determining their tax liability and compliance reporting requirements
- Cooperate with the IRS in investigating any professional enablers who aided in the noncompliance
- Submit all required returns, information returns, and reports for the disclosure period
- Make good faith arrangements with the IRS to pay the tax, interest, and applicable penalties in full

¹⁷¹. Under IRC §§6654 or 6655.

¹⁷². IRC §6662(a).

¹⁷³. IRC §6651(f).

¹⁷⁴. IRC §6601.

¹⁷⁵. IRM 9.5.11.9 (2020).

A timely voluntary disclosure must be made with Form 14457, *Voluntary Disclosure Practice Preclearance Request and Application*, to participate in the VDP. For this purpose, timely means received by the IRS **before** the IRS takes the following action.

- Commences either a civil examination or criminal investigation of the taxpayer or has notified the taxpayer of its intention to begin such an examination or investigation
- Receives information from a third party (e.g., informant, other governmental agency, or the media) informing the IRS of the taxpayer's noncompliance
- Acquires information directly related to the noncompliance of the taxpayer from an enforcement action (e.g., search warrant, summons, grand jury subpoena)

The VDP is **not** available to taxpayers with illegal source income (including income from activities legal under state law but illegal under federal law.)

Practitioner Planning Tip

As mentioned earlier, communications between a practitioner and client are not privileged communications for criminal tax matters or proceedings. Therefore, practitioners who suspect criminal conduct by their client should immediately recommend their client seek an attorney experienced in criminal investigation issues to represent them.

Streamlined Filing Compliance Procedures¹⁷⁶

Streamlined filing compliance procedures (SFCP) are available for taxpayers who failed to report foreign financial assets and pay all tax due in respect of those assets. This is the case provided this failure did not result from willful conduct on their part. Again, these procedures only apply to years in which the IRS has **not** initiated a civil examination of the taxpayer's returns.

The procedure to follow depends on where the taxpayer resides. The SFCP for a **U.S. resident** taxpayer requires them to voluntarily take the following actions.¹⁷⁷

1. File amended tax returns, including required information returns for the last three years the U.S. tax return due date (or extended due date) has passed.
2. File any delinquent reports of foreign bank and financial accounts (FBAR) (FinCEN Form 114, *Report of Foreign Bank and Financial Accounts*, previously Form TD F 90-22.1) for the last six years for which the FBAR due date has passed.
3. Pay a miscellaneous offshore penalty (i.e., 5% of the highest aggregate balance/value of the taxpayer's foreign financial assets during the period in question).
4. Pay the tax, interest, and miscellaneous offshore penalty due with the amended tax returns.

¹⁷⁶ *Streamlined Filing Compliance Procedures*. Feb. 17, 2021. IRS. [www.irs.gov/individuals/international-taxpayers/streamlined-filing-compliance-procedures] Accessed on Mar. 25, 2021.

¹⁷⁷ *U.S. Taxpayers Residing in the United States*. Dec. 7, 2020. IRS. [www.irs.gov/individuals/international-taxpayers/u-s-taxpayers-residing-in-the-united-states] Accessed on Feb. 1, 2021.

2021 Workbook

A complying U.S. resident taxpayer is only subject to the miscellaneous offshore penalty (i.e., no accuracy-related, information return, or FBAR penalties).

By contrast, the SFCP for a U.S. taxpayer **residing overseas** requires them to voluntarily take the following actions.¹⁷⁸

1. File **delinquent** or amended tax returns, including required information returns for the last three years the U.S. tax return due date (or extended due date) has passed.
2. File any delinquent FBARs (FinCEN Form 114, previously Form TD F 90-22.1) for the last six years for which the FBAR due date has passed.
3. Pay the tax and interest due with the delinquent or amended tax returns.

A complying overseas resident U.S. taxpayer is not subject to the FTF, FTP, accuracy-related, information return, or FBAR penalties.

Example 22. Pamela, a U.S. citizen, resides overseas. In 2011, she receives a gift of \$100,000 from her parents who are not U.S. taxpayers. This is deposited in a newly opened securities account at XYZ bank (a foreign bank). This account generates \$1,500 of investment income annually. In 2018, 2019, and 2020, the account also generates \$20,000 of capital gains for each year. Pamela has no other income in the years 2011 through 2020 and never filed a tax return or FBAR.

In February 2021, Pamela contacts Bill Wheeler, CPA for advice. Bill informs Pamela that she should file all tax returns that she is required to file for prior years. Additionally, she should also file FBARs for every year the balance in her foreign bank account exceeded \$10,000. Bill then explains that there are penalties for late filing an FBAR — a minimum civil penalty of \$12,921 for nonwillful violations and possible criminal penalties for willful violations.¹⁷⁹

Realizing that Pamela's situation may warrant the assistance of an attorney, Bill recommends Pamela contact an experienced tax attorney to explain her situation and request counsel on the appropriate course of action. Pamela then contacts Martha, a tax attorney, who presents Pamela with two options.

- **Option 1.** Use the SFCP for overseas taxpayers including the necessary certification on Form 14653, *Certification by U.S. Person Residing Outside of the United States for Streamlined Foreign Offshore Procedures*. However, because the IRS could open a civil fraud or CI, it is recommended that a legal representative handle the SFCP application. Martha's fee for such representation is \$6,000 (excluding tax return and FBAR preparation).
- **Option 2.** "Quiet Disclosure" (i.e., file delinquent returns, including required information returns for the last three years and file the 2020 FBAR by the October 15, 2021 extended due date).

In Martha's opinion, because of the amount in the foreign bank account, it is unlikely that a quiet disclosure would result in the IRS assessing penalties for nonfiled FBARs. Therefore, Pamela returns to Bill and asks him to make the quiet disclosure. Before fulfilling Pamela's request, Bill informs Pamela of the following.

1. Despite Martha's recommendation, Option 1 is the correct procedure to follow and by following Option 2, Pamela may expose herself to penalties and possible IRS examination.¹⁸⁰
2. Bill does not accept any responsibility for any IRS penalties arising from Pamela's decision to opt for a quiet disclosure.

^{178.} *U.S. Taxpayers Residing Outside the United States*. Dec. 3, 2020. IRS. [www.irs.gov/individuals/international-taxpayers/u-s-taxpayers-residing-outside-the-united-states] Accessed on Feb. 1, 2021.

^{179.} 31 USC §5321(a).

^{180.} Pursuant to Circular 230, §10.21.

BANKRUPTCY¹⁸¹



Practitioner Planning Tip

Bankruptcy law is complex. Therefore, taxpayers who may wish to seek bankruptcy protection should consult an experienced bankruptcy attorney.

3

An important consideration for nonfilers is that a tax debt discharge is **not** available in the following circumstances.¹⁸²

- Tax returns were not filed.
- The only “return” filed was an IRS-prepared SFR.
- Tax returns were filed late **and** after two years before the filing of the bankruptcy petition.
- A fraudulent tax return was made or the taxpayer willfully attempted to evade tax.

Therefore, these rules are a good incentive for nonfilers wishing to obtain tax debt relief in bankruptcy to file outstanding returns.

Note. The rules for determining what constitutes dischargeable tax debt are complex and beyond the scope of this chapter. More information is available in the 2021 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 2: Financial Distress.

Example 23. Use the same facts as **Example 20**. Six months after submission of the OIC, both Sue and Paul are excited to learn the IRS has approved the offer. Paul must pay \$2,000 to the IRS immediately and Sue’s firm has agreed to establish a payment plan for him to pay the fees owed to her firm.

After going through his tax experience, Paul is no longer self-employed. He now works for a large landscaping company as an employee. He claims no dependents and files a simple tax return annually and enjoys a small refund. He uses free versions of commercially available software to file his returns because he can no longer afford to continue his relationship with Sue’s firm.

¹⁸¹. *Discharging Taxes in Bankruptcy*. Ariail, Donald L., Smith, Michael M., Deiningner, Neil, and Wingfield, Reba M. Aug. 1, 2010. Journal of Accountancy. [www.journalofaccountancy.com/issues/2010/aug/20102591.html] Accessed on Jan. 29, 2021.

¹⁸². See also USC §523.

2021 Workbook