LEARNING OBJECTIVES
After completing this session, participants will be able to do the following:

✔ Identify and avoid the 12 most common tax scams
✔ Know how to alert clients to potential tax scams
✔ Understand who is responsible for the trust fund recovery penalty
✔ Explain when penalties may be abated
✔ Assist a client to file a request for penalty abatement
✔ Understand when a tax debt may be discharged in bankruptcy
✔ Advise a client about the need to check his or her withholding

✔ Explain tax dispute resolution programs and procedures

INTRODUCTION
Tax practitioners must protect themselves from cybercriminals, and they must be aware of common tax scams. This section reviews the most common tax scams so that tax practitioners and their clients can recognize and report the scams.

A responsible person can be held liable for the trust fund recovery penalty. This section explains who is a responsible person, and it reviews some common defenses against the penalty. It also discusses defenses to other penalties, such as the failure-to-file and failure-to-pay penalties.

A taxpayer with significant debt may wish to file bankruptcy. This section provides an overview of the types of bankruptcy actions, and it explains when a tax debt may be discharged in a bankruptcy proceeding.
Due to significant changes in the tax law, taxpayers may need to review their withholding, and adjust that withholding so that they do not over or under pay taxes. This section lists the situations where the taxpayer may want to do a paycheck checkup, and it reviews how to check and adjust withholding.

Finally, this section reviews several dispute resolution programs, including early appeals, fast track settlements, and fast track mediation. For each program it discusses eligibility to participate, and the procedure for hearing and resolving disputed issues.

**ISSUE 1: CYBERSECURITY**

Cybercriminals are targeting tax practitioners, and practitioners must recognize and avoid scams to protect sensitive tax data.

With increased use of email, mobile devices, online applications, and data networks, tax practitioners are at risk for exploitation. Cyberattacks cause unintended access, change, or destruction of information. They include data breaches, security breaches, privacy intrusion, and identity theft. A cyberattack may cause financial harm, disrupt business, and lead to lawsuits or regulatory claims.

Data breach thefts have given thieves millions of identity data points including names, addresses, social security numbers (SSNs), and email addresses. Criminals increasingly target tax professionals, and they must be alert to unusual activity, particularly during the tax-filing season.

Compiled annually, the IRS Dirty Dozen lists a variety of common scams that taxpayers and tax practitioners may encounter. Many of these scams take place during filing season, as taxpayers prepare their returns or hire someone to help with their taxes. The Dirty Dozen scams are as follows:

1. Phishing schemes
2. Phone scams
3. Identity theft
4. Tax return preparer fraud
5. Promises of inflated tax refunds
6. False income or documents
7. Inflated deductions or credits
8. Fake charities
9. Improper claims for business credits
10. Offshore tax avoidance
11. Frivolous tax arguments
12. Abusive tax shelters

This section explains how tax practitioners can recognize these scams and how to report them. It also reviews steps that a taxpayer and tax practitioner can take to avoid becoming the victim of one of these scams, and it discusses the Security Summit initiative to combat identity theft refund fraud.

**Practitioner Note**

*Continuing Education*

Information about cybersecurity and protecting against a cyberattack is essential for all tax practitioners. In a June 7, 2017, letter, the IRS stated that identity theft and data security programs that focus on enhancing tax professional awareness about how to protect client data can qualify for continuing education credit in the federal tax law category.

**Phishing Schemes**

In IR-2019-26, March 4, 2019, the IRS alerts taxpayers and tax practitioners to internet phishing scams that lead to tax-related fraud and identity theft. The IRS warns taxpayers, businesses, and tax professionals to be alert for a continuing surge of fake emails, text messages, websites, and social media attempts to steal personal information. These attacks tend to increase during tax season and are a major cause of identity theft.
The IRS has also seen more advanced phishing schemes targeting information in the files of tax professionals, payroll professionals, human resources personnel, schools, and other organizations. Scammers seek personal or financial information, such as Form W-2 information. These targeted scams are known as business email compromise (BEC) or business email spoofing (BES) scams.

Depending on the variation of the scam, criminals will pose as

- a business asking the recipient to pay a fake invoice;
- an employee seeking to reroute a direct deposit;
- someone the recipient trusts or recognizes, such as an executive, to initiate a wire transfer.

Criminals may use the email credentials from a successful phishing attack, known as an email account compromise, to send phishing emails to the victim’s email contacts. Tax return preparers should be wary of unsolicited emails from personal or business contacts, especially the more commonly observed scams, like new client solicitations.

**Practitioner Note**

**Malware**

Malicious emails and websites can infect a taxpayer’s computer with malware without the user knowing it. The malware downloads in the background, giving the criminal access to the device, enabling them to access any sensitive files or even track keyboard strokes, and exposing login victim’s information.

**Reporting Phishing**

Tax practitioners should forward the direct deposit and other BEC/BES variations to the Federal Bureau of Investigation Internet Crime Complaint Center (IC3) [www.ic3.gov/default.aspx]. If a taxpayer or tax practitioner receives an unsolicited email or social media attempt that appears to be from either the IRS or an
organization closely linked to the IRS, such as the electronic federal tax payment system (EFTPS), they should report it by sending it to phishing@irs.gov.

How the Scams Work

Criminals make unsolicited calls and leave voicemails with urgent callback requests claiming to be IRS officials. They demand that the victim pay a fake tax bill by sending cash through a wire transfer, prepaid debit card, or gift card. Many phone scammers use threats to intimidate and bully a victim into paying.

IR-2019-44, March 15, 2019, warns the public about a new twist on the IRS impersonation phone scam in which criminals fake calls from the Taxpayer Advocate Service (TAS), an independent organization within the IRS. Like other IRS impersonation scams, thieves make unsolicited phone calls to their intended victims fraudulently claiming to be from the IRS. In this most recent scam variation, callers spoof the telephone number of the IRS tax office in Houston or Brooklyn. Calls may be robocalls that request a call back. Once the taxpayer returns the call, the con artist requests personal information, including SSNs or individual taxpayer identification numbers (ITINs).

In other variations of the IRS impersonation phone scam, fraudsters demand immediate payment of taxes by a prepaid debit card or wire transfer. The callers are often hostile and abusive. Alternately, scammers may tell would-be victims that they are entitled to a large refund but must first provide personal information. Other characteristics of these scams include the following:

- Scammers use fake names and IRS badge numbers to identify themselves.
- Scammers may know the last four digits of the taxpayer’s SSN.
- Scammers spoof caller ID to make the phone number appear as if the IRS or another local law enforcement agency is calling.
- Scammers may send fake IRS emails to victims to support their scam telephone calls.
- Victims hear background noise of other calls to mimic a call site.
- After threatening victims with jail time or with a driver’s license or other professional license revocation, scammers hang up. Others soon call back pretending to be from local law enforcement agencies or the Department of Motor Vehicles, and caller ID again supports their claim.

Phone Scams

IR-2019-28, March 5, 2019, warns taxpayers to be alert to tax time phone scams where aggressive criminals pose as IRS agents to try to steal money or personal information. Phone scams or “vishing” (voice phishing) continue to pose a major threat. The scams have cost thousands of people millions of dollars in recent years, and the IRS continues to see variations on these aggressive calling schemes. The Treasury Inspector General for Tax Administration (TIGTA), the federal agency that investigates tax-related phone scams, says these types of scams have cost 14,700 victims a total of more than $72,000,000 since October 2013.

The IRS cautions that taxpayers should be on the lookout for unexpected and aggressive phone calls purportedly coming from the IRS. These scam artists aggressively make threats and order immediate payment.

Beginning early in the filing season, the IRS generally sees an upswing in scam phone calls threatening arrest, deportation, or license revocation, if the victim does not pay a fake tax bill. These calls most often are a robocall (a text-to-speech recorded voicemail with instructions to call back a specific telephone number), but in some cases a real person may make the call. These con artists may have some of the taxpayer’s information, including his or her address, the last four digits of his or her SSN, or other personal details.

Practitioner Note

Lien Notification Scam

A new tax scam involves the mailing of a letter threatening an IRS lien or levy. The lien or levy is based on delinquent taxes owed to a nonexistent agency, the Bureau of Tax Enforcement. The lien notification scam also likely references the IRS to confuse potential victims into thinking the letter is from a legitimate organization.
Identity Theft

Identity Theft

In IR-2019-30, March 6, 2019, the IRS warns taxpayers and tax practitioners that tax-related identity theft is still a serious concern. Tax-related identity theft occurs when someone uses a stolen SSN or ITIN to file a fraudulent tax return claiming a refund. Thieves also steal identities by taking and using EFINs and PTINs. There are various scams and schemes used for individual data theft, but an estimated 91% of all data breaches and cyberattacks begin with a spear phishing email that targets an individual. The criminal poses as a trusted source, such as IRS e-Services, a tax software company, or a cloud-storage provider; or the criminal poses as a potential client or professional colleague. Cybercriminals also use stolen business identities to file fraudulent Forms 1120, U.S. Corporate Income Tax Return.

Signs of Identity Theft

For individual taxpayers, signs of tax-related identity theft include the following:

1. The return is rejected from electronic filing, and the IRS reject codes indicate the taxpayer’s SSN has already been used.
2. The taxpayer receives IRS notices regarding a tax return after all tax issues have been resolved, refunds have been received, or account balances have been paid.
3. An IRS notice indicates the taxpayer received wages from an employer unknown to the taxpayer.

For business taxpayers, signs of tax-related identity theft include the following:

1. The return is accepted as an amended return, but the taxpayer has not yet filed a return for that year.
2. The taxpayer receives IRS notices about fictitious employees.
3. The taxpayer receives notices regarding a defunct, closed, or dormant businesses after all accounts have been settled.

Recognize a Scam

The IRS reminds taxpayers and tax practitioners that the IRS will never do the following:

- Call to demand immediate payment using a specific payment method such as a prepaid debit card, gift card, or wire transfer. Generally, the IRS will first mail a bill to any taxpayer who owes taxes.
- Threaten to immediately bring in local police or other law enforcement groups to have the taxpayer arrested for not paying.
- Demand that taxes be paid without giving taxpayers the opportunity to question or appeal the amount owed.
- Ask for credit or debit card numbers over the phone.
- Call about an unexpected refund.

Reporting

Taxpayers and tax practitioners can report IRS or Treasury-related fraudulent calls to phishing@irs.gov (Subject: IRS Phone Scam). They should also report the call to TIGTA using the TIGTA IRS Impersonation Scam Reporting web page [www.treasury.gov/tigta/contact_report_scam.shtml]. Alternatively, they can call 800.366.4484. Taxpayers and tax practitioners can also report phone scams to the Federal Trade Commission (FTC). They should use the FTC Complaint Assistant on FTC.gov and add “IRS Telephone Scam” in the notes [www.ftccomplaintassistant.gov/GettingStarted?NextQID=216&Selected=t#crnt].

Practitioner Note

The SSN Hustle

In another new scam, callers claim to be able to suspend or cancel the victim’s social security number. In this variation, the social security cancellation threat is similar to and often associated with the IRS impersonation scam. Scammers may mention overdue taxes and threaten to cancel the person’s SSN to frighten people into returning robocall voicemails.
have a paid professional prepare their tax returns. While most tax professionals provide honest, high-quality service, a minority of dishonest preparers perpetrate refund fraud, identity theft, and other scams.

Abusive preparers may not understand taxes or may mislead people into taking credits or deductions they are not entitled to claim. Scam preparers often do this to increase their fees.

Types of Preparer Fraud

Tax return preparer misconduct includes the following:

1. Filing an individual Form 1040 series return without the taxpayer’s knowledge or consent
2. Altering tax return documents
3. Using an incorrect filing status to generate a larger refund
4. Creating false exemptions or dependents to generate a larger refund
5. Creating or omitting income to generate a larger refund
6. Creating false expenses, deductions, or credits to generate a larger refund
7. Misdirecting a refund

Reporting Preparer Fraud

Tax practitioners and taxpayers should report abusive tax preparers to the IRS on Form 14157, Complaint: Tax Return Preparer. If a return preparer is suspected of filing or changing the return without the client’s consent, the taxpayer should also file Form 14157-A, Return Preparer Fraud or Misconduct Affidavit. Forms are available on IRS.gov. The IRS website has additional information to help taxpayers including tips on choosing a preparer, the differences in credentials and qualifications, and how to submit a complaint regarding an unscrupulous tax return preparer [www.irs.gov/chooseataxpro].

Inflated Tax Refund Claims

IR-2019-33, March 8, 2019, alerts taxpayers that unscrupulous tax return preparers promise inflated tax refunds. These preparers frequently target older Americans, low-income taxpayers,
non-English speakers, and people who do not have a filing requirement.

Scam artists use flyers, advertisements, fake storefronts, or word-of-mouth to attract victims. They may make presentations through community groups or churches. These unscrupulous individuals may dupe others into making claims for fictitious rebates, benefits, or tax credits. They may also file a false return in the client’s name, and the client never knows that a refund was paid.

Cons may also target those with a filing requirement who are due a tax refund. They promise larger refunds based on fake social security benefits and false claims for education credits or the earned income tax credit (EITC). They may also file a fake information return, such as Form 1099 or W-2, or use self-prepared, “corrected,” or otherwise incorrect forms that improperly report taxable income as zero or reduce the amount of wages reported by a third-party payer to the IRS. In one version of the scam, the preparer assists the client to make a refund claim based on the theory that the federal government maintains secret accounts for U.S. citizens and that taxpayers can gain access to the accounts by issuing Forms 1099-OID to the IRS. The fraudulent tax refund may be deposited into the scammer’s bank account, and the scammer deducts a large “fee” before paying the victim.

The IRS cautions that if an unscrupulous return preparer provides incorrect income information to the IRS, victims could lose their federal benefits, such as social security, veterans payments, or low-income housing benefits. See the earlier discussion of reporting preparer fraud.

**False Income or 1099s**

IR-2019-35, March 11, 2019, warns taxpayers to avoid schemes involving falsifying income, including the creation of fake Forms 1099 to erroneously claim tax credits. This scam involves inflating or including income on a tax return that was never earned, either as wages or self-employment income, usually to maximize refundable tax credits, such as the EITC.

Another variation of the scam involves filing Form 1099-MISC, Miscellaneous Income; and/or fake financial instruments such as bonds, bonded promissory notes, or worthless checks to falsely income or get access to funds in a “hidden account.” Unscrupulous promoters of these scams claim that the proper way to redeem or draw on a fictitious “held-aside” account is to use a made-up financial instrument, such as a bonded promissory note, that purports to be a debt payment method for credit cards or mortgage debt. These con artists provide fraudulent Forms 1099-MISC that appear to be issued by a large bank, loan service, or mortgage company with which the taxpayer may have had a prior relationship. They may also use Form 56, Notice Concerning Fiduciary Relationship, to assign fiduciary responsibilities to the lenders.

**Inflated Deductions or Credits**

IR-2019-36, March 12, 2019, warns taxpayers to avoid falsely inflating deductions or credits on tax returns. Unscrupulous tax return preparers overstate deductions such as charitable contributions, medical expenses, or business expenses. They may advise the taxpayer to falsely claim the EITC, child tax credit, and other tax benefits. Some taxpayers who prepare their own returns, as well as those who use unscrupulous preparers, may also overstate their deductions and credits to inflate their refund or lower their tax bill.

**Fake Charities**

IR-2019-39, March 13, 2019, adds fake charities to the Dirty Dozen list. Scam groups pose as charitable organizations. These fake charities offer a tax deduction as bait, and lure victims into making ineligible donations and disclosing sensitive personal information. These scams often occur after a significant natural disaster. The scam artists impersonate charities to get money or private information from well-intentioned taxpayers.

**How the Scam Works**

Some scammers operating fake charities may contact people by telephone or email to solicit money or financial information. Fake websites may solicit funds for disaster victims. Scam artists may directly contact disaster victims and claim to be working for or on behalf of the IRS to help
Improper Claims for Business Credits

In IR-2019-42, March 14, 2019, the IRS warns taxpayers to avoid improperly claiming various business tax credits. This common scam used by unscrupulous tax preparers often targets the research credit and the fuel tax credit. Each of these credits has specific eligibility criteria.

Research Credit Scams

The I.R.C. § 41 research credit provides a credit for increasing research activities. Congress enacted the credit in 1981 to provide an incentive for US private industry to invest in research and experimentation. Improper claims for this credit generally involve a failure to participate in or substantiate qualified research activities and/or a failure to satisfy the requirements related to qualified research expenses.

Activities That Qualify for the Research Credit

To claim the research credit, a taxpayer’s research activities must, among other things, involve a process of experimentation using science with a goal of improving a product or process the taxpayer uses in his or her business or holds for sale, lease, or license. Activities specifically excluded from qualifying for the credit include research after commercial production, adaptation of an existing business product or process, foreign research, and research funded by the customer. Qualified research activities also do not include activities where there is no uncertainty about the taxpayer’s method or capability to achieve a desired result.

The IRS often sees expenses for nonqualified activities included in claims for the research credit. In addition, qualified research expenses include only in-house wages and supply expenses and a portion, typically 65%, of payments to contractors. Qualified research expenses do not include expenses without a proven nexus between the claimed expenses and the qualified research activity.

How to Claim the Research Credit

Eligible taxpayers may claim up to 20% of qualified expenses above a base amount by completing and attaching Form 6765, Credit for Increasing Research Activities, to their tax return. For tax years beginning in 2016, eligible small businesses may use the research credit to offset the alternative minimum tax. Also, qualified small businesses may elect to use a portion of the research credit as a payroll tax credit against the employer’s portion of the social security tax. They make this election on Form 6765 and must complete and attach Form 8974, Qualified Small Business Payroll Tax Credit for Increasing Research Activities, to their Form 941, Employer’s Quarterly Federal Tax Return.

To claim the research credit, taxpayers must evaluate and document their research activities contemporaneously (when the research occurs) to establish the amount of qualified research.
expenses paid for each qualified research activity. While taxpayers can estimate some expenses, they must have a factual basis for the assumptions used to create the estimates.

Unsupported claims for the research credit may subject taxpayers to penalties. The IRS recommends that taxpayers carefully review any reports or studies prepared by third parties to ensure they accurately reflect their activities.

**Fuel Tax Credit Scams**

The fuel tax credit is generally limited to off-highway business use or use in farming. For that reason, it is not available to most taxpayers. Still, the IRS routinely finds unscrupulous tax return preparers who have enticed large groups of taxpayers to inflate their refunds by erroneously claiming the credit.

**Imperfect Fuel Tax Credit Claims**

Imperfect claims for the fuel tax credit generally come in two forms. First, an individual or business may make an erroneous claim on an otherwise legitimate tax return. Second, identity thieves file false claims, often as part of a broader fraudulent scheme.

**How to Claim the Fuel Tax Credit**

The federal government taxes gasoline, diesel fuel, kerosene, alternative fuels, and certain other types of fuel. Certain commercial uses of these fuels are nontaxable. Taxes paid for fuel to power vehicles and equipment used off-road may qualify for the credit and may include farm equipment, certain boats, trains, and airplanes. Individuals and businesses that purchase fuel for one of those purposes can claim the credit by filing Form 4136, Credit for Federal Tax Paid on Fuels.

**Offshore Tax Avoidance**

In IR-2019-43, March 15, 2019, the IRS adds offshore tax avoidance schemes to the Dirty Dozen list. In these schemes, individuals evade US taxes by attempting to hide income in offshore banks, brokerage accounts, or nominee entities. They then access the funds using debit cards, credit cards, or wire transfers. Others have used foreign trusts, employee-leasing schemes, private annuities, or insurance plans for the same purpose.

**Frivolous Tax Arguments**

In IR-2019-45, March 18, 2019, the IRS warns taxpayers against using frivolous tax arguments to avoid paying taxes. Promoters of frivolous schemes encourage taxpayers to make unreasonable and outlandish legal claims to avoid paying their taxes. Courts have repeatedly rejected these schemes to avoid paying taxes.

In “The Truth about Frivolous Tax Arguments,” the IRS outlines some of the more common frivolous arguments, explains why they’re wrong, and cites relevant court decisions. Examples of these common myths include the following:

- The First Amendment allows taxpayers to refuse to pay taxes on religious or moral grounds.
- The only employees who are subject to federal income tax are those who work for the federal government;
- Only foreign-source income is taxable.


A list of more than 40 such positions is in Notice 2010-33, 2010-17 I.R.B. 609. The list is not all inclusive, and the IRS and the courts may add to it at any time.

**Abusive Tax Shelters**

In IR-2019-47, March 19, 2019, the IRS warns taxpayers about abusive trusts, abusive microcaptive insurance shelters, and abusive syndicated conservation easements. These three schemes all start with a legitimate tax-planning tool that is improperly distorted, almost always by a promoter, to produce benefits that are too good to be true and ultimately seriously compromise the taxpayer.
Abusive Trusts
Changes in bank secrecy laws of foreign jurisdictions have revealed several foreign tax evasion schemes involving trusts. There are also several tax evasion schemes involving the use of domestic trusts.

Abusive trust arrangements often use multiple layers of trusts, offshore shell corporations, and entities that are disregarded for US tax purposes to attempt to hide the true ownership of assets and income or to disguise the substance of transactions. These schemes give the appearance of separating responsibility and control from the benefits of ownership by using purported mortgages or rental agreements, false invoices, fees for services never performed, purchase and sale agreements, and distributions. However, the taxpayer continues to control the structures and directs any benefits received from them.

The IRS cautions taxpayers to be aware of these abusive tax evasion arrangements involving trusts, that will not produce the tax benefits advertised by their promoters. US taxpayers engaged in transactions with foreign trusts may be subject to significant information reporting penalties for failure to file Forms 3520/3520A, as applicable.

Tax practitioners can report abusive trusts using Form 14242, Report Suspected Abusive Tax Promotions or Preparers, and should send information about such abusive trusts to the Internal Revenue Service Abusive Schemes Lead Development Center.

Abusive Micro captive Insurance Tax Shelters
Tax law generally allows businesses to create captive insurance companies to insure against risks. The insured business claims deductions for insurance premiums. Those amounts are paid, either as insurance premiums or reinsurance premiums, to a captive insurance company owned by the insured or related parties, and the premiums are used to fund losses incurred by the insured business. Traditional captive insurance typically allows a taxpayer to reduce the total cost of insurance and loss events.

Abusive Microcaptive Insurance Tax Shelters
Insurers that qualify as small insurance companies can elect to be treated as exempt organizations or to exclude limited amounts of annual net premiums from income so that the captive insurer pays tax only on its investment income. In certain “microcaptive” structures, promoters, accountants, or wealth planners persuade owners of closely held entities to participate in schemes that lack many of the attributes of insurance.

In recent years, the IRS has been successful in litigating these transactions. In 2017, the U.S. Tax Court disallowed the “wholly unreasonable” premium deductions the taxpayer claimed under an I.R.C. § 831(b) microcaptive arrangement, concluding that the arrangement was not insurance under long established law [Avrahami v. Commissioner, 149 T.C. No. 7 (2017)]. In 2018, the Tax Court concluded that the transactions in a second microcaptive arrangement were not insurance [Reserve Mechanical Corp. v. Commissioner, T.C. Memo. 2018-86].

Syndicated Conservation Easements
Generally, a charitable contribution deduction is not allowed for a charitable gift of property consisting of less than the donor’s entire interest in that property. However, a deduction is allowed for a qualified conservation contribution that meets certain criteria, including exclusive use for conservation purposes. The amount of the deduction is equal to the FMV of the donated conservation easement.

Some promoters are syndicating conservation easement transactions that purport to give investors the opportunity to obtain charitable contribution deductions and corresponding tax savings that significantly exceed the amount an investor invested. Typically, promoters of these schemes identify a pass-through entity that owns real property or form a pass-through entity to acquire real property. The promoters syndicate ownership interests in the pass-through entity or tiered entities that own the real property. They suggest to prospective investors that the investors may be entitled to a share of a charitable contribution deduction that greatly exceeds the amount of an investor’s investment. The promoters obtain an inflated appraisal of the conservation easement.
based on unreasonable factual assumptions and conclusions about the development potential of the real property.

In Notice 2017-10, the IRS advises that certain of these transactions are tax avoidance transactions and identifies them and similar transactions as listed transactions. The notice applies to transactions in which the promotional materials suggest to prospective investors that they may be entitled to a share of a charitable contribution deduction that equals or exceeds two and one-half times the amount invested. Individuals entering into these and substantially similar transactions must disclose them to the IRS. In addition, material advisors in those transactions may have disclosure and list maintenance obligations. A typical transaction covered by Notice 2017-10 involves the advertised investment in a pass-through entity that owns real property or acquires real property for the purpose of encumbering the property with a conservation easement.

In December 2018, the Department of Justice sued to shut down promoters of a conservation easement syndicate scheme. The defendants allegedly organize, promote, and sell ownership interests in limited liability entities, referred to in the complaint as conservation easement syndicates. According to the complaint, at the time defendants organize, promote, and sell ownership interests in a conservation easement syndicate, the syndicate plans to donate a conservation easement on land it owns, and then claims a corresponding tax deduction for the “qualified conservation contribution.”

The government alleges that these syndicates lack economic substance and are shams. They only serve as a conduit to transfer overvalued and otherwise improper federal tax deductions to customers. Additionally, the complaint alleges that the conservation easements promoted by the defendants do not meet the requirements for a qualified conservation contribution.

The suit alleges that the defendants have organized, promoted, and sold at least 96 conservation easement syndicates resulting in over $2.0 billion of tax deductions from overvalued and improper “qualified conservation contributions.”

**Reporting Abusive Tax Shelters**

The IRS maintains an abusive tax shelter hotline that tax practitioners can use to provide information (anonymously, if preferred) about abusive tax shelter transactions. The Office of Tax Shelter Analysis is primarily interested in potentially abusive transactions that may be employed by many taxpayers and could pose a significant compliance risk to the IRS. The hotline can be reached by fax at 844.201.5535, email at irs.tax.shelter.hotline@irs.gov, or mail to Internal Revenue Service, 1973 North Rulon White Blvd, LB&I:OTSA - M/S 4916, Ogden, UT, 84201.

### Recommended Practices

A tax practitioner has a duty to safeguard taxpayer data. The following recommended practices can help to protect computers, networks, programs, and data from a cyberattack.

1. Be cautious when communicating solely by email with potential or existing clients, especially if the client makes unusual requests.
2. Do not click on links or download attachments from unknown or suspicious emails.
3. Be aware that an unsolicited email with a request to download an attachment or click on a URL could appear to come from someone that you know like a friend, work colleague, or tax professional if their email has been spoofed or compromised.
4. If in doubt, call to confirm the sender’s identity.
5. Learn to recognize and avoid phishing emails and threatening phone calls and texts from thieves posing as legitimate organizations such as banks, credit card companies, and government organizations, including the IRS.
6. For telephone scams, do not give out any information. Hang up immediately. The longer the con artist is engaged; the more opportunity he or she believes exists, potentially prompting more calls.
7. Continue to protect sensitive tax and financial data to help protect against identity thieves.
8. Always use security software with firewall and antivirus protections.
9. Make sure security software is turned on and can automatically update.
10. Invest in good antisyware and antimalware software protection.
11. Encrypt sensitive files such as tax records stored on the computer.
12. Protect personal data. Do not routinely carry a social security card. Protect credit card numbers, bank account numbers, and even utility account numbers.
13. Each time you receive a request for personal information, think about whether the request is truly necessary.
14. Do not assume internet advertisements, pop-up ads, or emails are from reputable companies. If an ad or offer looks too good to be true, take a moment to investigate the company behind it. Type the company or product name into a search engine with terms like “review,” “complaint,” or “scam.”
15. Never download security software from a pop-up ad.
16. Provide personal information over reputable, encrypted websites only. Shopping or banking online should be done only on sites that use encryption. Look for “https” at the beginning of a web address (the “s” stands for secure) and be sure “https” is on every page of the site.
17. Use strong passwords. Use at least 10 characters; 12 is ideal for most home users. Mix letters, numbers, and special characters. Try to be unpredictable. Do not use names, birthdates, or common words. Do not use the same password for many accounts and do not share them on the phone, in texts, or by email. Consider using a passphrase versus a password.
18. Keep passwords in a secure place or use password management software.
20. Backup important files.

Keep Clients Informed

Identity thieves are increasingly becoming more sophisticated. Tax practitioners must keep informed about the latest scams and may want to help their clients to avoid identity theft. Figure 10.1 is a sample letter to clients alerting them about potential tax scams.
Dear Client:

I am writing to caution you about several scams that are targeting taxpayers this filing season. Cybercriminals use these scams to obtain names, social security numbers, and addresses, which they then use to file fraudulent returns.

In one version of the scam, criminals steal personal data and file fraudulent tax returns. They then use taxpayers’ bank accounts to direct deposit tax refunds and use various tactics to reclaim the refund from the taxpayer, including falsely claiming to be from a collection agency or the IRS.

In another version of the scam, con artists target information in the files of tax professionals, payroll professionals, human resources personnel, schools and other organizations. Scammers seek personal or financial information, such as Form W-2 information. These targeted scams are known as business email compromise (BEC) or business email spoofing (BES) scams. Depending on the variation of the scam, criminals will pose as

- a business asking the recipient to pay a fake invoice;
- an employee seeking to re-route a direct deposit; or
- as someone the recipient trusts or recognizes, such as an executive, to initiate a wire transfer.

Criminals may use the email credentials from a successful phishing attack, known as an email account compromise, to send phishing emails to the victim’s email contacts. Thus, you should be wary of unsolicited emails from personal or business contact because their email may have been spoofed or compromised. If in doubt, call to confirm the sender’s identity.

You should always use security software with firewall and antivirus protection and encrypt tax records stored on computers. Consult with your information technology (IT) consultant about the best way to protect your sensitive data and systems.

Remember that the IRS will never initiate contact with taxpayers via email about a bill or tax refund. If you have any questions about your tax account, if you receive a suspicious email, or if you think that you have been the victim of identity theft, please do not hesitate to contact us for assistance.

For the latest information visit the IRS Tax Scams and Consumer Alerts page at www.irs.gov/newsroom/tax-scams-consumer-alerts.

Sincerely,
Kathy Kruse
Kruse and Associates
The IRS Security Summit

The IRS has joined with representatives of the software industry, tax preparation firms, payroll and tax financial product processors, tax professional organizations, financial institutions, and state tax administrators to combat identity theft refund fraud to protect the nation’s taxpayers. Total membership in the Security Summit includes 42 state agencies, 20 industry offices, and the IRS.

In 2018, the IRS and its Security Summit partners made major progress in the fight against tax-related identity theft and added protection for thousands of taxpayers and billions of dollars. Key improvements between 2015 and 2018 include the following:

- The number of taxpayers reporting they were identity theft victims fell 71%.
- The number of confirmed identity theft returns stopped by the IRS declined by 54%.
- The IRS protected a combined $24 billion in fraudulent refunds by stopping the confirmed identity theft returns.

ISSUE 2: TRUST FUND RECOVERY PENALTY

Responsible parties may be individually liable for employment taxes.

Under I.R.C. § 7501, whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the government, the tax that is collected or withheld must be held in a special trust fund for the government. Under I.R.C. § 6672(a) any person who is required to collect, account for, and pay over any tax who willfully fails to collect, or account for and pay over such tax is liable for a penalty equal to the total amount of tax not paid. In addition, I.R.C. § 7202 imposes criminal penalties for willful nonpayment of employment taxes.

- Financial industry partners recovered an additional $1.4 billion in fraudulent refunds.

IRS Commissioner Rettig said,

Despite these major successes, more work remains . . . Identity thieves are often members of sophisticated criminal syndicates, based here and abroad. They have the resources, the technology and the skills to carry on this fight. The IRS and the Summit partners must continue to work together to protect taxpayers as cyberthieves continue to evolve and adjust their tactics [IR-2019-66, April 8, 2019].

Despite the work of the Security Summit, the number of businesses reporting that they were victims of tax-related identity theft increased by 10% for 2018, with 2,450 reports compared to 2,233 reports in 2017. Security Summit partners, having reduced individual identity theft, have enacted similar protection for business returns.

The IRS generally asserts criminal charges in only the most egregious cases, such as when the defendant shifts assets to avoid collection, is involved in multiple acts of wrongdoing, diverts funds for personal purposes, or has been assessed the civil penalty several times.

This trust fund recovery penalty (TFRP) is an alternative way to collect unpaid trust fund taxes when the taxes are not fully collectible from a business. However, the IRS does not have to first attempt to collect the tax from the business before assessing a TFRP.

The TFRP can arise from unpaid liabilities on the following:
Under I.R.C. § 6671(b) a person includes any officer or employee of a corporation, or member or employee of a partnership, who has the duty to collect or account for and pay withheld amounts to the government. Responsibility is a matter of status, duty, and authority. A responsible person may be any of the following:

- A corporate director or shareholder
- A member of a board of trustees of a non-profit organization
- Another person with authority and control over funds to direct their disbursement
- Another corporation or third-party payer
- A payroll service provider (PSP) or responsible parties within a PSP
- A professional employer organization (PEO) or responsible parties within a PEO
- Responsible parties within the common law employer (client of PSP or PEO)
- Employee of a sole proprietorship
- LLC member manager or employee
- Surety lender with control over funds
- Business entities (including corporations, S corporations, and LLCs) that are determined to be the collection agency for certain collected excise taxes

The IRS determination of responsibility is based on all facts and circumstances, considering whether an individual may exercise independent judgment with respect to the business finances, and whether the individual actually exercised such control. If the employee solely pays bills as directed by a superior without the ability to determine which creditors to pay (ministerial duties only), the employee is not a responsible person [I.R.M. § 1.2.14.1.3, Policy Statement 5-14].

Example 10.1 Ministerial Authority
Maria Diego is the bookkeeper of Acme, Inc. She is not an owner and is not related to an owner. She has check signing authority and pays all the bills the treasurer gives her. She is not allowed to pay any other bills, and when there are not enough funds in the bank account to pay all of the bills, she must ask the treasurer which bills to pay. Maria is performing a ministerial act and should generally not be held responsible for the TFRP.
Determination Factors

Common factors applied by the courts and the IRS in making the determination of responsibility include the following:

- Position of the person as an officer, director, or owner of the corporation; or a partner in a partnership or a member of an LLC
- Duties of the officer as set forth in the bylaws
- Authority to hire and fire
- Authority to sign checks
- Control of the financial affairs of the business
- Authority to determine which creditors to pay and exercise of that authority
- Control of payroll disbursements
- Control of the voting stock of the corporation
- Responsibility for signing and filing the excise tax or employment tax returns
- Responsibility for making the federal tax deposits

The courts have generally determined a person’s responsibility based on the individual’s control over payments. Control means the ability to exercise significant control over funds, such as the authority to determine who to pay, or the authority to obtain financing. Delegation of the duty to pay to another does not necessarily negate the existence of control. If a responsible person delegates the duty to pay the IRS to another person, the individual may still be a responsible person (but see the later discussion of willfulness).

Third-Party Payers

The use of a third-party payer such as a PSP or PEO does not always relieve the responsible person from the duty to ensure that all federal employment tax obligations are met. Additional factors to consider when there are third-party payers include the following:

- Whether the responsible person had knowledge of a pattern of noncompliance by the third-party payer at the time the delinquencies were occurring
- Whether the third-party payer used fraud or deception to conceal the noncompliance from detection by the responsible party
- Whether the responsible person had received prior IRS notices indicating that employment tax returns had not been filed, or were inaccurate, or that employment taxes had not been paid
- Whether the responsible party took action to ensure the federal employment tax obligations were met after becoming aware of the deficiencies (timely reported and paid current amounts owed, and worked with the IRS on a reasonable basis to resolve past debts)

Cross-Reference

Certified Professional Employer Organization

In some cases, the use of a certified professional employer organization (CPEO) can relieve the employer from responsibility for withholding, depositing, and reporting requirements. See the “IRS Issues” chapter in the 2018 National Income Tax Workbook for a discussion of CPEOs.

Volunteers

I.R.C. § 6672(e) provides an exception to the TFRP for any unpaid, volunteer member of a board of trustees or directors of a tax-exempt organization if the member

1. is solely serving in an honorary capacity,
2. does not participate in the day-to-day or financial operations of the organization, and
3. does not have actual knowledge of the failure on which the penalty is imposed.

However, if this exception results in no person being liable for the penalty, the exception does not apply.

Multiple Responsible Persons

The IRS can assess the TFRP for the same amount against multiple responsible persons. All parties are jointly and severally liable for the unpaid tax until the full amount is paid. There is no requirement that the government collect a pro rata amount from each responsible party. However, the government can only collect the trust funds once—from the business, from one or more responsible persons, or a combination of the business and any number of responsible persons.
**Observation**

**Right of Contribution**

I.R.C. § 6672(d) provides the right of contribution where more than one person is liable for the penalty. Any person who pays more than his or her proportional share of the penalty can recover the amount paid in excess of the individual’s proportionate share from other responsible persons. The proceeding to recover the excess amount collected must be separate from and cannot be joined with the IRS collection proceeding. Tax practitioners may have a conflict of interest if more than one client is responsible for the TFRP.

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**Willfulness**

As stated earlier, the TFRP applies to a responsible person who willfully fails to collect or pay over trust funds to the government. *Willful* is defined as intentional, deliberate, voluntary, or reckless. Willfulness does not require evil intent or bad faith. For willfulness to exist, the IRS must show that the responsible person was or should have been aware of the outstanding taxes and either intentionally disregarded the law or was plainly indifferent to its requirements.

Willfulness exists if either:

1. the responsible person was aware that the taxes were unpaid and, with the power to pay them with funds of the business, signed checks paying another creditor; or
2. the responsible person acted with gross negligence or in reckless disregard of the fact that taxes were due and would not be paid.


Using available funds to pay other creditors when the business is unable to pay the employment taxes is a clear indication of willfulness. The payment of net wages (wages minus trust fund taxes) to employees when funds are not available to pay withholding taxes is a willful failure to collect and pay. If funds are not enough to cover both net wages and withholding taxes, a responsible person has the duty to prorate the available funds so that the taxes on the wages are paid [Hochstein v. U.S., 900 F.2d. 543 (2d Cir. 1990)].

**TFRP Assessment Procedure**

A revenue officer (RO) in the Collection Division conducts the TFRP investigations. An outside collection agency cannot make a TFRP determination.

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**Planning Pointer**

**Avoid a TFRP Investigation**

If possible, responsible persons should work directly with the business to resolve the trust fund taxes paid before the IRS initiates a TFRP investigation. One or more responsible persons could loan or contribute money to the business to pay the taxes. In certain situations, the IRS may decide to withhold assertion of the TFRP if the employer is attempting to resolve the liability through an in-business installment agreement (discussed later). If the IRS enters into a compromise for a portion of the trust fund tax liability, the remainder of the trust fund taxes may still be collected from a responsible person.
Examine Records
The RO has the initial duty to determine the identity of officers, partners, members, or employees who had the duty to collect or pay over the taxes. The RO begins with a request for corporate and bank records, which may include the following:

- Articles of incorporation or articles of organization
- Bylaws of the corporation or operating agreements
- Minute books
- Payroll records
- Bank records such as canceled checks, bank statements, signature cards, financial statements provided to the banks, loan applications, and electronic PIN or password assignment information
- Tax returns
- Copy of the contract or agreement for service between the taxpayer and a third-party payer

The RO will examine these records to determine the names and duties of all officers and directors; who is responsible for filing returns and paying taxes; and who has authority to sign checks, deposit money or make loans on behalf of the business. The RO may also look for evidence of diversions of corporate funds, alleged loans, excessive salaries or expenses, financial solvency of the business, and payment of other obligations.

Interview Witnesses
The RO will interview potentially responsible persons. The RO may also interview non-responsible persons who have knowledge of the business and its decision-making process to obtain information to determine who is a responsible and willful individual. The RO will take the following actions during the interview:

1. Provide IRS Publication 1, Your Rights as a Taxpayer.
2. Explain the TFRP.
3. Present a copy of the TFRP calculation to all potentially responsible persons and advise them that the IRS can personally assess the TFRP against those it determines liable for the penalty for the unpaid trust fund amount and collect the liability from their personal income and assets.
4. Explain how the TFRP was calculated.
5. Provide Notice 784, Could You Be Personally Liable for Certain Unpaid Federal Taxes?, to the person interviewed and provide sufficient copies of Notice 784 to allow distribution to all other persons associated with the business who, based on the interview and other preliminary investigation, may be liable.
6. Advise the person being interviewed of the proper actions to take to avoid such liability.
7. Begin asking questions and securing documentation from the taxpayer in support of assertion of the penalty or establish deadlines for the information and documents.
8. Attempt to secure at least one Form 4180, Report of Interview with Individual Relative to Trust Fund Recovery Penalty or Personal Liability for Excise Taxes, from a potentially responsible person.
9. Generally, if a taxpayer states during an interview that he or she wishes to consult with an authorized representative, suspend the interview to permit such consultation.

[I.R.M. § 5.7.4.2.3]

Form 4180 is a record of the personal interview with the potentially responsible person. It is used to secure direct, detailed information regarding a person’s involvement in the business, and to determine if the person meets the criteria for responsibility and willfulness. At the end of the interview the IRS will ask the individual to sign the Form 4180. The RO will also sign the form.

Practitioner Note
Review Form 4180
Form 4180 becomes part of the case file and a basis for assessment of the penalty. Thus, the tax practitioner should attend the interview with the client and carefully review the Form 4180 before the taxpayer signs it.

Form 4180 can be updated later if the changes are initialed by the RO and the person interviewed.
Figure 10.2 shows pages 1 and 2 of Form 4180. Page 3 contains information about PSPs or PEOs.

**FIGURE 10.2 Form 4180, Pages 1 and 2**

<table>
<thead>
<tr>
<th>Form <strong>4180</strong> (August 2012)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Report of Interview with Individual Relative to Trust Fund Recovery</strong></td>
</tr>
<tr>
<td><strong>Penalty or Personal Liability for Excise Taxes</strong></td>
</tr>
<tr>
<td><strong>Instructions:</strong> The interviewer must prepare this form either in person or via telephone. Do not leave any information blank. Enter “N/A” if an item is not applicable.</td>
</tr>
</tbody>
</table>

### Section I - Person Interviewed

<table>
<thead>
<tr>
<th>1. Name</th>
<th>2. Social Security Number (SSN)</th>
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<tbody>
<tr>
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</table>

<table>
<thead>
<tr>
<th>3. Address (street, city, state, ZIP code)</th>
<th>4. Home telephone number</th>
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<tr>
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<td></td>
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</table>

<table>
<thead>
<tr>
<th>5. Work telephone number</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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</table>

<table>
<thead>
<tr>
<th>6. Name of Business and Employer Identification Number (EIN)</th>
<th>7. Did you use a third-party payer, such as a payroll service?</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Yes (If yes complete Section VI A) No (If no)</td>
</tr>
</tbody>
</table>

8. What was your job title and how were you associated with the business? (Describe your duties and responsibilities and dates of employment.) If person being interviewed is a payroll service provider or a professional employer organization, complete Section VI B

### Section II - Responsibilities

1. State whether you performed any of the duties / functions listed below for the business and the time periods during which you performed these duties.

<table>
<thead>
<tr>
<th>Did you...</th>
<th>Yes</th>
<th>No</th>
<th>Dates</th>
</tr>
</thead>
<tbody>
<tr>
<td>From</td>
<td>To</td>
<td></td>
<td></td>
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</table>

<table>
<thead>
<tr>
<th>a. Determine financial policy for the business?</th>
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<table>
<thead>
<tr>
<th>b. Direct or authorize payments of bills/creditors?</th>
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<tr>
<th>c. Prepare, review, sign, or authorize transmit payroll tax returns?</th>
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<tr>
<th>d. Have knowledge withheld taxes were not paid?</th>
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</table>

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<tr>
<th>e. Authorize payroll?</th>
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</table>

<table>
<thead>
<tr>
<th>f. Authorize or make Federal Tax Deposits?</th>
</tr>
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</table>

<table>
<thead>
<tr>
<th>g. Authorize the assignment of any EFTPS or electronic banking PINS/passwords?</th>
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<tr>
<th>h. Could other individuals do any of the above? (Complete Section IV and V)</th>
</tr>
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<tbody>
<tr>
<td>Name</td>
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<tr>
<td>------</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>i. Have signature authority or PIN assignment on business bank accounts?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank Name(s)</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

### Section III - Signatures

I declare that I have examined the information given in this interview and to the best of my knowledge and belief, it is true, correct, and complete.

<table>
<thead>
<tr>
<th>Signature of person interviewed</th>
<th>Date</th>
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</thead>
<tbody>
<tr>
<td></td>
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</table>

<table>
<thead>
<tr>
<th>Signature of Interviewer</th>
<th>Date</th>
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<tbody>
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<td></td>
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</tbody>
</table>

Date copy of completed interview form given to person interviewed

Taxpayer Statement on Page 4: Yes No Interview Continued on subsequent pages? Yes No

Interview Handouts (*X* if given or explain why not in case history)

Notice 609, Privacy Act Notice Notice 784, Could You Be Personally Liable for Certain Unpaid Federal Taxes?
### Section IV - Business Information

1. List corporate positions below, identifying the persons who occupied them and their dates of service.

<table>
<thead>
<tr>
<th>Position (e.g. president, director)</th>
<th>Name</th>
<th>Address</th>
<th>Dates</th>
</tr>
</thead>
<tbody>
<tr>
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</tbody>
</table>

2. Did the business use the Electronic Federal Tax Payment System (EFTPS) to make Federal Tax Deposits (FTD’s) or payments?

- [ ] No
- [ ] Yes

If yes, to whom are the PINS or passwords assigned

3. Other than the EFTPS, does the business do any other banking electronically?

- [ ] No
- [ ] Yes

Where

To whom are the PINs/passwords assigned

4. Does the business file Form 941 electronically?

- [ ] No
  - Who is authorized to sign Form 941

- [ ] Yes
  - Who files the returns electronically

### Section V - Knowledge / Willfulness

1. During the time the delinquent taxes were increasing, or at any time thereafter, were any financial obligations of the business paid? (such as rent, mortgage, utilities, vehicle or equipment loans, or payments to vendors)

- [ ] No
- [ ] Yes

Which obligations were paid?

Who authorized them to be paid?

2. Were all or a portion of the payrolls met?

- [ ] No
- [ ] Yes

Who authorized

3. Did any person or organization provide funds to pay net corporate payroll?

- [ ] No
- [ ] Yes

(explain in detail and provide name)

4. When and how did you first become aware of the unpaid taxes?

5. What actions did you attempt to see that the taxes were paid?

6. Were discussions ever held by stockholders, officers, or other interested parties regarding nonpayment of the taxes?

- [ ] No
- [ ] Yes

Identify who attended, dates, any decisions reached, and whether any documentation is available.

7. Who handled IRS contacts such as phone calls, correspondence, or visits by IRS personnel?

When did these contacts take place, and what were the results of these contacts?
Terminating the Investigation
The potential responsible person can pay the trust fund balance, which will cancel the interview and terminate the TFRP investigation. The potential responsible person may also agree to an assessment by signing Form 2751, Proposed Assessment of Trust Fund Recovery Penalty. However, the IRS requirement to conduct Form 4180 interviews is not waived by the securing of a signed Form 2751 [I.R.M. § 5.7.4.2.7].

Nonassertion Based on Collectability
Under I.R.M. § 5.7.5.1(2) and I.R.M. § 5.7.5.3.1, the IRS will not usually assess the TFRP if there is no present or future collection potential. The taxpayer must submit Form 433-A, Collection Information Statement for Wage Earners and Self-Employed Individuals, to demonstrate that he or she lacks the capacity to pay. The RO will consider the taxpayer’s current financial condition, income history and future income potential, and the likelihood that the taxpayer’s equity in assets will increase or the taxpayer may acquire other assets in the future. If there is no present or future collection potential after reviewing and verifying the financial information, the RO will not recommend assertion of the TFRP.

Statute of Limitations on Assessment
Generally, the IRS has 3 years from the date the return was filed to make a TFRP assessment. However, if the business filed a fraudulent return or filed no return, there is no statute of limitations for assessment. Under I.R.C. § 6672(b)(3), the assessment statute may be extended when the IRS mails or hand delivers the Letter 1153, Notice of Proposed Trust Fund Recovery Penalty, to the taxpayer. If the assessment statute is open when the IRS mails or personally delivers the Letter 1153 to a responsible person, the assessment statute does not expire before the later of the following dates:

- 90 days after the Letter 1153 and supporting documents were mailed or hand-delivered to the responsible person
- If the person files a timely protest of the proposed TFRP, 30 days after Appeals makes a final administrative determination regarding the proposed penalty

TFRP Assessment
After the RO completes the examination of records and conducts all necessary interviews, the RO submits a recommendation to the group manager for review. The manager must approve the recommendation for assessment of the TFRP (or any nonassertion due to collectability). Upon approval, the RO contacts the taxpayer regarding the proposed TFRP assessment.

Notice of Assessment
Unless the collection of a TFRP is in jeopardy, the RO issues Letter 1153, which is a 60-day notice of the proposed assessment. The letter advises the taxpayer of the proposed penalty and of his or her appeal rights. The IRS also sends Form 2751, Proposed Assessment of Trust Fund Recovery Penalty. If the taxpayer agrees with the proposed penalty, he or she will return a signed Form 2751. If the taxpayer disagrees, he or she may discuss the proposed penalty with the RO group manager, request fast track mediation, or file a timely written protest. If the taxpayer fails to respond, the IRS will assess the penalty and send a notice and demand for payment.

Calculating the Assessment
The TFRP amount is the unpaid income taxes withheld and the employee’s portion of the withheld FICA taxes. The employer’s share of employment taxes is never part of a TFRP.

Appeal
The taxpayer has 60 days from the mailing date of Letter 1153 (75 days if outside the United States) to submit a written protest to challenge the assessment. IRS Appeals hears the case. If Appeals upholds the TFRP the penalty is assessed, and the IRS issues a notice and demand for payment. After assessment, the taxpayer can file a request for abatement or a request for a refund. The taxpayer can also file a request for an installment agreement or an offer in compromise.
Resignation

Resignation is a defense only to liabilities that arise after the resignation. If the individual was a responsible person prior to resignation, he or she can be liable for unpaid trust fund liabilities that arose prior to resignation. Liability arises at the time that wages are paid and taxes are withheld, not the date the employment tax returns are filed [Davis v. U.S., 961 F.2d 867 (9th Cir. 1992); Vinick v. U.S., 205 F.3d 1 (1st Cir 2000)].

Delegation

If an otherwise responsible person delegates responsibility to another and the delegator retains absolutely no authority, the delegator may not be a responsible person. Also, if a responsible person delegates authority, and does not know about the tax liability, willfulness may be negated [Levy v. U.S., 140 F. Supp. 834 (D. La. 1956)].

Lack of Knowledge

Several courts have found that a responsible person was not willful where the individual lacked actual knowledge that the liability existed or lacked actual knowledge that the trust fund taxes had not been paid. Lack of knowledge that is not the result of a reckless disregard of the situation may negate willfulness.

Embezzlement

The embezzlement of funds by an employee is not a defense against willfulness. An embezzlement often causes the shortage of funds in the business, but it is not related to the determination that a responsible person neglected to pay the delinquent trust fund taxes before paying any other creditor.

Illness

Drug addiction or alcoholism do not negate willfulness [U.S. v. Landau, 155 F. 3d 93 (2d Cir. 1998)]. However, a physical illness or hospitalization may provide a defense if the condition is an involuntary condition and the individual is incapacitated.
Reasonable Cause

The circuit courts are split on whether reasonable cause is a defense for willfulness. The Eighth and First Circuits have determined that reasonable cause is not a defense. The Ninth Circuit has not directly stated that it is not a defense but has determined that conduct motivated by a reasonable cause may, nonetheless, be willful. The Ninth Circuit allowed a reasonable cause defense where an accountant and a tax collector advised the responsible person that taxes were not due [Gray Line Co. v. Granquist, 237 F.2d 390 (9th Cir. 1956)].

The Tenth, Eleventh, Second, and Fifth Circuits have determined that the reasonable cause defense applies but the defense is limited and must be narrowly construed. The Second Circuit allowed a reasonable cause defense when the responsible person reasonably believed that the taxes were being paid. The Fifth Circuit has found reasonable cause where the responsible party relied upon advice of counsel. In the Tenth Circuit reasonable cause was held to be limited to those situations where the taxpayer made reasonable efforts to protect the trust funds, but those efforts were frustrated by circumstances beyond the taxpayer’s control.

In-Business Installment Agreement

A business that currently has employees can qualify for an in-business trust fund express installment agreement (IBTF-Express IA) and eliminate the need for a TFRP investigation. Generally, a financial statement and a financial statement verification are not part of the application. To qualify, the business must meet the following requirements:

- The business owes $25,000 or less at the time of the agreement.
- The debt must be fully paid within 24 months or prior to the collection statute expiration date (CSED), whichever is earlier.
- The business must enroll in a direct debit installment agreement if the amount is between $10,000 and $25,000.
- The business must comply with all filing and payment requirements.
- The business can apply online at www.irs.gov/payments/online-payment-agreement-application.

If the agreement will not fully pay all balances due at least 1 year prior to the earliest assessment limitation date, the RO will interview all potentially responsible persons to determine responsibility and willfulness and will request that each potentially responsible person execute Form 2750, Waiver Extending the Statutory Period For Assessment of Trust Fund Recovery Penalty to the end date of the agreement plus 1 year [I.R.M. § 5.7.4.8.1]. The TFRP will be assessed against any responsible person who does not execute the waiver (but the IRS may withhold collection, if appropriate).

If the business owes more than $25,000, the business must voluntarily pay down the liability before the agreement is finalized. To make a designated payment, the memo on the check should state “Trust Fund Taxes Only,” and it should be submitted with a cover letter specifically requesting that the funds be applied to the trust fund tax liability of the business (with all identifying information of the business and periods involved). If there is an RO involved at the time of the payment, the business should send the payment and cover letter directly to the RO.

If the business enters into a standard installment agreement, the IRS will assess the TFRP against responsible persons. The individual assessments and the installment agreement will be cross-referenced to suspend collection activity on the personal assessment. However, the responsible individuals may still be subject to a federal tax lien or their income tax refunds may be applied to the amounts owed. If the business has defaulted in the past on installment agreements, enters into a partial payment installment agreement, or is in currently-not-collectible status, the IRS will actively collect the TFRP assessment(s) from the responsible parties.
Practitioner Note

Bankruptcy
A trust fund recovery penalty is not dischargeable in a responsible party's chapter 7 or chapter 11 bankruptcy. If the business is in bankruptcy, the automatic stay does not bar the assessment of the TFRP. In a chapter 7 bankruptcy of the business, the trustee is a potential responsible person if the trust funds are not paid.

ISSUE 3: TAXPAYER ADVOCATE SERVICE  The Taxpayer Advocate Service is an independent organization within the IRS that helps taxpayers and protects taxpayer rights.

Congress created the current Office of the National Taxpayer Advocate (NTA) through the IRS Restructuring and Reform Act of 1998. The Taxpayer Advocate Service (TAS) works with taxpayers and their representatives to resolve their tax issues. The TAS does the following:

1. Provides tax law updates and guidance
2. Sponsors Problem Solving Days throughout the country to assist taxpayers with unresolved tax issues [see https://taxpayeradvocate.irs.gov/news/taxpayer-advocate-service-to-conduct-problem-solving-day-events for the schedule]
3. Holds focus groups at the Nationwide Tax Forum (NTF) to hear tax practitioners’ thoughts, experiences, and ideas about tax administration
4. Conducts educational seminars at the NTF
5. Meets one-on-one with tax practitioners at the NTF to resolve the practitioners’ most difficult IRS cases
6. Issues taxpayer assistance orders for hardship cases in which the TAS does not have authority to act
7. Provides taxpayer assistance on matters within the authority of the TAS
8. Administers the Low Income Taxpayer Clinic Program
9. Works to identify and find solutions to systemic tax issues
10. Administers the Taxpayer Advocacy Panel, which is a group of volunteers that help the IRS identify ways to improve customer service
11. Submits two reports to Congress every year
12. Publishes the Taxpayer Bill of Rights

The TAS maintains a geographic presence in each state, the District of Columbia, and Puerto Rico. There are 9 area offices (7 for field, 2 for campuses) that provide program guidance and direction to the local taxpayer advocates (LTAs). The LTAs are responsible for resolving all TAS cases and serve as a liaison with practitioner communities and congressional staffs. Each LTA office operates independently of the local IRS office.

This section discusses the sources of the TAS authority, and several of the services and programs offered and administered by the TAS. For a complete list, see https://taxpayeradvocate.irs.gov/.

TAS Authority

The TAS has two types of authority: statutory and delegated. Statutory authority comes from I.R.C. §§ 7803(c) and 7811. Delegated authority comes from delegation orders. If the TAS does not have authority, it prepares an operations assistance request (OAR).
Statutory Authority

I.R.C. § 7803(c) defines the primary purposes and functions of the TAS, and grants the TAS, at its discretion, the right to not disclose taxpayer information to the IRS. Section 7803(c) also provides for the operation and local TAS offices and the requirement for each local office to maintain a separate phone, facsimile, and other electronic communication access, as well as a separate post office address.

I.R.C. § 7811 authorizes the TAS to issue taxpayer assistance orders (TAOs) if the taxpayer is suffering or is about to suffer significant hardship as a result of how the IRS administers the internal revenue laws. A significant hardship includes the following:

- An immediate threat of adverse action
- A delay of more than 30 days in resolving taxpayer account problems
- The incurring by the taxpayer of significant costs (including fees for professional representation) if relief is not granted
- Irreparable injury to, or a long-term adverse impact on, the taxpayer if relief is not granted

Delegated Authority

Delegated authority allows the TAS to resolve routine cases the same way that other functions within the IRS exercise the same authority. Routine is defined as cases generally resolved through the application of standard procedures and guidelines to a given set of facts and circumstances. Such cases are usually customer service problems with clear compliance issues. Delegated authority includes the power to do the following:

1. Make credits or refunds within the applicable period of limitations including manual refunds
2. Abate interest on erroneous refunds
3. Issue, modify, or rescind TAOs for cases under TAS jurisdiction
4. Approve replacement checks for lost or stolen refunds without a credit balance on an account where hardship or unreasonable delay exists
5. Substantiate credits to taxpayer accounts where a taxpayer furnishes proof of payment, but the IRS cannot locate the payment within a reasonable time
6. Abate for reasonable cause Form W-4 civil penalties assessed under I.R.C. § 6682 ($500 penalty for making a statement on Form W-4 that has no reasonable basis at the time made)
7. Abate for reasonable cause all automatically assessed penalties
8. Correct administrative errors and service errors, including decimal point errors, transposition errors, and input errors
9. Make determinations on claims and amended returns
10. Report certain delinquent accounts as currently-not-collectible
11. Release liens in cases not currently open in another IRS function if the account is fully paid and there is substantiation that there are no other balances owed
12. Release levies in systemically generated cases
13. Make trust fund recovery penalty adjustments in certain cases
14. Accept certain installment agreements
15. Perform certain duties assigned to accounts management employees

All rules and procedures that apply to the IRS exercising the same authority apply to the TAS (including the I.R.M. and any dollar tolerances or thresholds). However, TAS employees cannot act on cases that are open in another IRS function or overrule determinations made by employees of other IRS functions who have been delegated comparable authority.

The TAS website provides examples of what the TAS has done for taxpayers in the past [https://taxpayeradvocate.irs.gov/about/how-weve-helped].

Operations Assistance Request

If the TAS does not have delegated authority to act on a case, the case advocate prepares an operations assistance request (OAR) to request action by another IRS division or function. I.R.M. § 13.1.19 describes the TAS OAR process. The OAR requests that the IRS take specific action (or refrain from taking specific action). The case
The TAS has established case criteria that qualify taxpayers for TAS assistance [I.R.M. § 13.1.7.2], which includes an independent review by a case advocate of actions that have been taken or need to be taken to resolve the problems taxpayers are experiencing. The criteria for TAS case acceptance do not govern whether a taxpayer is entitled to relief and do not govern whether the TAS can issue a TAO. If the taxpayer qualifies for TAS assistance, he or she can submit a request for assistance by phone, in person, or by completing Form 911 Request for Taxpayer Advocate Service Assistance (and Application for Taxpayer Assistance Order).

**Case Criteria**

TAS acceptance criteria fall into four main categories: economic burden, systemic burden, best interest of the taxpayer, and public policy.

**Economic Burden**

Economic burden cases involve financial difficulty for the taxpayer. An IRS action or inaction has caused or will cause negative financial consequences or have a long-term adverse effect on the taxpayer. There are the following economic burden criteria:

1. **Criteria 1: The taxpayer is experiencing economic harm or is about to suffer economic harm.**

   Economic harm may be the result of actions by the IRS or a result of personal circumstances in the taxpayer’s life. Economic harm is not the same as economic hardship.

2. **Criteria 2: The taxpayer is facing an immediate threat of adverse action.**

   Adverse action may be the filing of a notice of federal tax lien, serving a notice of levy, or seizing property. Threat of adverse action can also include utility cutoffs or evictions that may result in negative financial consequences or economic burden. A threat is a warning of impending action that will have a negative impact on the taxpayer, and immediate means “in the very near future.”
Criteria 3: The taxpayer will incur significant costs if relief is not granted.
Situations where the IRS is unable to immediately make adjustments, process returns, or release a lien could result in the taxpayer having to incur significant costs. Significant costs could include professional fees for representation.

Criteria 4: The taxpayer will suffer irreparable injury or long-term adverse impact if relief is not granted.
The taxpayer may lose assets, income, or potential income if no relief is granted. There may be a loss of the ability to be licensed or bonded as part of the taxpayer’s occupation, or loss of borrowing power or clients because of the filing of a notice of federal tax lien. Damage to a taxpayer’s credit rating that results in denial of a loan to pay an outstanding tax liability may be an irreparable injury.

Systemic Burden
Systemic burden cases involve an IRS process, system, or procedure that has failed to operate as intended, and as a result the IRS has failed to timely respond to resolve a taxpayer issue. There are the following systemic burden criteria:

Criteria 5: The taxpayer has experienced a delay of more than 30 days to resolve a tax account problem.
Criteria 5 is met if the taxpayer’s problem or inquiry is delayed more than 30 days beyond the usual response time. If there is no established time frame for a specific action based on an I.R.M. provision, IRS form, or other official document, Criteria 5 is met when the problem or inquiry is delayed more than 30 days after the initial date the taxpayer made a request for IRS assistance. Delays due to the taxpayer’s unresponsiveness do not meet Criteria 5.

Criteria 6: The taxpayer has not received a response or resolution to the problem or inquiry by the date promised.
The taxpayer was promised a response by a certain date and has not received that response.

Criteria 7: A system or procedure has either failed to operate as intended or failed to resolve the taxpayer’s problem or dispute within the IRS.
Examples include the IRS’s failure to reverse a refund freeze or to properly apply a credit elect to another period.

Best Interest of the Taxpayer
The NTA accepts “best interest of the taxpayer” cases to ensure that taxpayers receive fair and equitable treatment and that their rights are protected.

Criteria 8: The way that the tax laws are being administered raises considerations of equity or has impaired or will impair the taxpayer’s rights.
Case Criteria 8 is used if the case does not fit into any other TAS case criteria. The NTA refers to the section 7811 hardship determination (discussed earlier) in determining when to accept a case based on Criteria 8. Criteria 8 applies to the impairment of a taxpayer’s rights, such as the right to be informed, the right to quality service, and the right to pay no more than the correct amount of tax.

Public Policy
The National Taxpayer Advocate (NTA) determines case acceptance under this category. Acceptance is generally based on a unique set of circumstances warranting assistance for certain taxpayers.

Criteria 9: The NTA determines that compelling public policy warrants assistance to an individual or group of taxpayers.
The NTA designates the issues that qualify for acceptance under this criterion by a memo that the NTA issues at least annually.
Form 911

The taxpayer can complete Form 911 and mail or fax it to the local TAS office. The taxpayer must complete Section I, Taxpayer Information, and Section II, Representative Information (if appropriate). The taxpayer describes the problem on line 12a and describes the requested relief on line 12b. **Figure 10.3** shows Form 911, Sections I and II. The IRS completes Section III.

The taxpayer should include the details of the tax issue, the difficulties it is creating for the taxpayer, and what the IRS did or did not do to resolve the issue. If there has been an IRS delay of more than 30 days, the taxpayer should include the date that he or she contacted the IRS for assistance. The problem must meet the TAS acceptance criteria (discussed earlier). The taxpayer can submit supporting documentation with Form 911.

Requesting TAS Assistance

A taxpayer makes a request for TAS assistance by phone, in person, or by completing Form 911, Request for Taxpayer Advocate Service Assistance (and Application for Taxpayer Assistance Order). If the TAS accepts the request, it assigns a case advocate to the taxpayer. The case advocate independently reviews the issue, updates the taxpayer and his or her representative on resolution progress, and provides an anticipated timeline for action. The case advocate also advises the taxpayer on how to avoid future federal tax problems.

Contact by Phone or in Person

The taxpayer can call 1.877.777.4778. The taxpayer can also call or visit the local TAS office to discuss the taxpayer’s problem. The addresses and phone numbers for the local TAS offices are available at https://www.irs.gov/advocate/local-taxpayer-advocate or in IRS Publication 1546, Taxpayer Advocate Service: We Are Here to Help You.

**Practitioner Note**

Cases the TAS Does Not Accept

The TAS does not accept cases if the taxpayer’s complaint or inquiry only questions the constitutionality of the tax system, or the taxpayer focuses on frivolous tax strategies intended to avoid or delay the filing or paying of federal taxes. The TAS usually will not assist taxpayers under the systemic burden criteria if the case involves identity theft, processing original returns, unpostable or rejected returns, processing amended returns, or injured spouse claims.
## Section I – Taxpayer Information
(See Pages 3 and 4 for Form 911 Filing Requirements and Instructions for Completing this Form.)

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1a. Your name as shown on tax return</td>
<td>1b. Taxpayer Identifying Number (SSN, ITIN, EIN)</td>
</tr>
<tr>
<td>2a. Spouse’s name as shown on tax return (if applicable)</td>
<td>2b. Spouse’s Taxpayer Identifying Number (SSN, ITIN)</td>
</tr>
<tr>
<td>3a. Your current street address (Number, Street, &amp; Apt. Number)</td>
<td></td>
</tr>
<tr>
<td>3b. City</td>
<td>3c. State (or Foreign Country)</td>
</tr>
<tr>
<td>4. Fax number (if applicable)</td>
<td>5. Email address</td>
</tr>
<tr>
<td>6. Tax form number (1040, 941, 720, etc.)</td>
<td>7. Tax year(s) or period(s)</td>
</tr>
<tr>
<td>8. Person to contact if Section II is not being used</td>
<td>9a. Daytime phone number</td>
</tr>
<tr>
<td>10. Best time to call</td>
<td>□ Check if Cell Phone</td>
</tr>
<tr>
<td>11. Preferred language (if applicable)</td>
<td></td>
</tr>
<tr>
<td>□ TTY/TDD Line</td>
<td>□ Interpreter needed - Specify language other than English (including sign language)</td>
</tr>
<tr>
<td>□ Other (please specify)</td>
<td></td>
</tr>
</tbody>
</table>

12a. Please describe the tax issue you are experiencing and any difficulties it may be creating.  
(If more space is needed, attach additional sheets.)  
(See instructions for completing Lines 12a and 12b)

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

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

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>13a. Signature of Taxpayer or Corporate Officer, and title, if applicable</td>
<td>13b. Date signed</td>
</tr>
<tr>
<td>14a. Signature of spouse</td>
<td>14b. Date signed</td>
</tr>
</tbody>
</table>

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

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Name of authorized representative</td>
<td>2. Centralized Authorization File (CAF) number</td>
</tr>
<tr>
<td>3. Current mailing address</td>
<td>4. Daytime phone number</td>
</tr>
<tr>
<td>5. Fax number</td>
<td></td>
</tr>
<tr>
<td>6. Signature of representative</td>
<td>7. Date signed</td>
</tr>
</tbody>
</table>
A tax practitioner may submit Form 911 for the taxpayer. He or she should also submit Form 2848, Power of Attorney and Declaration of Representative. By filing Form 911, the taxpayer authorizes the TAS to contact third parties as necessary to respond to the request for assistance. If the taxpayer or his or her representative does not receive a response within 1 week of the submission of Form 911, the taxpayer or the representative should call the TAS office where the form was filed.

**CROSS-REFERENCE**

**Statute of Limitations**

Filing Form 911 suspends the statutory periods of limitation for assessment or collection of taxes. However, it does not affect any applicable periods during which the taxpayer must act, such as petitioning the Tax Court or requesting a collection due process hearing. See pages 517–518 in the 2017 *National Income Tax Workbook* for a discussion of the suspension of the statute of limitations.

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**FIGURE 10.4 2019 Poverty Guidelines (250%)**

<table>
<thead>
<tr>
<th>Size of Family</th>
<th>48 Contiguous States, Puerto Rico, and DC</th>
<th>Alaska</th>
<th>Hawaii</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$31,225</td>
<td>$39,000</td>
<td>$35,950</td>
</tr>
<tr>
<td>2</td>
<td>$42,275</td>
<td>$52,825</td>
<td>$48,650</td>
</tr>
<tr>
<td>3</td>
<td>$53,325</td>
<td>$66,650</td>
<td>$61,350</td>
</tr>
<tr>
<td>4</td>
<td>$64,375</td>
<td>$80,475</td>
<td>$74,050</td>
</tr>
<tr>
<td>5</td>
<td>$75,425</td>
<td>$94,300</td>
<td>$86,750</td>
</tr>
<tr>
<td>6</td>
<td>$86,475</td>
<td>$108,125</td>
<td>$99,450</td>
</tr>
<tr>
<td>7</td>
<td>$97,525</td>
<td>$121,950</td>
<td>$112,150</td>
</tr>
<tr>
<td>8</td>
<td>$108,575</td>
<td>$135,775</td>
<td>$124,850</td>
</tr>
<tr>
<td>For each additional person, add</td>
<td>$11,050</td>
<td>$13,825</td>
<td>$12,700</td>
</tr>
</tbody>
</table>

A taxpayer whose income is below a certain level may get help from a Low Income Taxpayer Clinic (LITC) for free or a small fee. A taxpayer may qualify for LITC assistance if his or her income does not exceed 250% of the federal poverty level or if the taxpayer speaks English as a second language. Generally, the disputed amount must be less than $50,000. **Figure 10.4** shows the 2019 poverty guidelines.
Systemic Advocacy Management System

The Office of Systemic Advocacy is part of the TAS. This office advocates systemic and procedural changes, focusing on tax issues that impact multiple taxpayers. A systemic issue involves systems, processes, policies, procedures, or legislation that impacts a segment of the taxpayer population. The office studies issues, analyzes their root causes, and recommends corrective action. Corrective action may include a change to IRS policy, procedures, or processes; or a legislative change.

The Office of Systemic Advocacy has a web-based method to receive and prioritize systemic issues and problems. Taxpayers or tax practitioners can submit a systemic issue at www.irs.gov/advocate/systemic-advocacy-management-system-sams. The online system does not allow attachments.

The taxpayer or tax practitioner can also submit an issue by completing Form 14411, Systemic Advocacy Issue Submission Form, and faxing it to 855.813.7412. The submitter should not include taxpayer information.

Each LITC has at least one staff member who is authorized to represent taxpayers before the IRS and one staff member or a pro bono panel member who is admitted to practice before the United States Tax Court. For more information on LITCs see IRS Publication 5066, *LITC Program Report, December 2018* at www.irs.gov/pub/irs-pdf/p5066.pdf. IRS Publication 4134, *Low Income Taxpayer Clinic List*, provides the location, name, phone number, and languages served (in addition to English) of all current LITCs. An interactive map to locate an office is available on the TAS website at https://taxpayeradvocate.irs.gov/about/litc.

Cross-Reference

Referral to LITC

The Taxpayer First Act of 2019 authorizes IRS employees to advise taxpayers of the availability of, and eligibility requirements for the LITC and to provide contact information for the clinics. See the “New and Expiring Legislation” chapter for a discussion of the Taxpayer First Act.

LITCs receive partial funding from the IRS but the clinics, their employees, and their volunteers are completely independent of the IRS. Each year the LITC program grants up to $100,000 to qualifying organizations for development, expansion, or continuation of an LITC. These clinics provide the following services:

- Represent individual low-income taxpayers in controversies with the IRS
- Educate low-income taxpayers and those who speak English as a second language about their rights and responsibilities as taxpayers
- Identify and advocate for issues that impact these taxpayers

Each LITC has at least one staff member who is authorized to represent taxpayers before the IRS and one staff member or a pro bono panel member who is admitted to practice before the United States Tax Court. For more information on LITCs see IRS Publication 5066, *LITC Program Report, December 2018* at www.irs.gov/pub/irs-pdf/p5066.pdf. IRS Publication 4134, *Low Income Taxpayer Clinic List*, provides the location, name, phone number, and languages served (in addition to English) of all current LITCs. An interactive map to locate an office is available on the TAS website at https://taxpayeradvocate.irs.gov/about/litc.
The Taxpayer Advocacy Panel (TAP) is a demographically and geographically diverse group of approximately 75 volunteers. TAP members represent each state, the District of Columbia, and Puerto Rico. Based on feedback from the public, TAP members are dedicated to helping taxpayers improve IRS customer service and responsiveness to taxpayer needs. To develop recommendations, TAP members conduct outreach and solicit suggestions from citizens. TAP also serves as a focus group for the IRS to provide input on strategic initiatives.

Current TAP issues include the following:

- **Form 1040, Schedule A and Schedule B:** Evaluate Form 1040, Schedule A, Itemized Deductions; and Schedule B, Interest and Ordinary Dividends, to determine if the form and instructions clearly communicate appropriate guidance to the taxpaying public.
- **IRS2Go App:** Recommend improvements to the IRS2Go mobile application to accommodate users and increase traffic to the IRS.gov website and other IRS social media platforms.
- **Identity Theft:** Provide suggestions to the IRS that would enhance the Identity Theft section of IRS.Gov and make the content more user-friendly by allowing users to quickly find a topic of interest and see all the related documents in one place.
TAP submits annual reports to the secretary of the Treasury and the IRS commissioner. Its reports, events, meeting agendas, and minutes, as well as the procedure to join TAP, are on the TAP website at https://improveirs.org.

TAS Reports

The National Taxpayer Advocate (NTA) submits two annual reports to Congress. The Annual Report analyzes the most serious problems encountered by taxpayers, gives legislative and administrative recommendations for solving these problems, and includes a discussion of the year’s 10 most frequently litigated tax issues. The Objectives Report is a description of the goals and activities of the NTA for the next fiscal year. [See https://taxpayeradvocate.irs.gov/reports for current and past NTA reports.]

ISSUE 4: PENALTY ABATEMENT

This section discusses when and how a taxpayer can get relief from a penalty.

Penalties exist primarily to deter taxpayer non-compliance. Some penalties are applied automatically, such as the failure-to-pay penalty, the failure-to-file penalty, and the estimated tax penalty. Other penalties require an action by an IRS employee, such as the accuracy-related and substantial underpayment penalties.

Cross-Reference
Penalties

See the “Penalties and Defenses” chapter in the 2016 National Income Tax Workbook for an explanation of penalties that are commonly assessed against individuals and businesses.

Generally, there are four categories of relief from penalties, which are applied in the following order:

1. Correction of an IRS error
2. Statutory and regulatory exceptions
3. Administrative waivers
4. Reasonable cause

Practitioner Note
IRS Guidance

I.R.M. Part 20 provides guidance on evaluating requests for penalty abatements. It includes general procedures, procedures for specific penalties, reasonable cause relief, and first-time penalty abatement. Tax practitioners should review the relevant portion of the manual before submitting a request for penalty abatement.

Taxpayer Bill of Rights

The IRS has adopted a Taxpayer Bill of Rights, as proposed by the NTA. It applies to all taxpayers in their dealings with the IRS. The Taxpayer Bill of Rights groups the existing rights in the tax code into the following 10 fundamental rights:

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 retain representation
10. The right to a fair and just tax system

**Correction of an IRS Error**

If the IRS makes an error in processing a return or payment that results in a penalty assessment, the penalty may be automatically abated when the processing error is corrected. For example, if the IRS misapplies a taxpayer’s payment, the tax account for which the payment was intended will have a balance due on which the failure-to-pay penalty will be assessed. When the mistake is corrected, the IRS will remove the penalties without a formal request from the taxpayer for penalty relief.

**Statutory and Regulatory Exceptions**

The Internal Revenue Code and Treasury Regulations provide statutory exceptions to penalties. Legislation with retroactive provisions may provide guidance on associated penalties. Other IRS guidance may also address penalty relief. Figure 10.6 lists the applicable law and where guidance can be found in the Internal Revenue Manual.

**FIGURE 10.6 Statutory Penalty Relief**

<table>
<thead>
<tr>
<th>Topic</th>
<th>Legal Reference</th>
<th>I.R.M. Reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Failure to file small partnership return</td>
<td>I.R.C. § 6231</td>
<td>§ 20.1.2.3.3.1</td>
</tr>
<tr>
<td>Estimated tax penalties</td>
<td>I.R.C. § 6654(e)</td>
<td>§ 20.1.3</td>
</tr>
<tr>
<td>Timely mailing treated as timely filing and paying</td>
<td>I.R.C. § 7502(a) and (e)</td>
<td>§ 20.1.2, 20.1.4</td>
</tr>
<tr>
<td>Information return penalties</td>
<td>I.R.C. § 6724(a) or (c)</td>
<td>§ 20.1.7</td>
</tr>
<tr>
<td>Erroneous written advice from the IRS</td>
<td>I.R.C. § 6404(f)</td>
<td>§ 20.1.1.3.3.4.1</td>
</tr>
<tr>
<td>Service in combat zone</td>
<td>I.R.C. § 7508</td>
<td>§ 20.1.2.1.2.1</td>
</tr>
<tr>
<td>Presidentially declared disaster or terroristic or</td>
<td>I.R.C. § 7508A</td>
<td>§ 25.16</td>
</tr>
<tr>
<td>military action</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Erroneous Advice from the IRS**

Under I.R.C. § 6404(f) and Treas. Reg. § 301.6404-3, the IRS must abate any portion of a penalty that is attributable to erroneous written advice furnished by an officer or employee of the IRS acting in his or her official capacity. The taxpayer must have reasonably relied on advice that was in response to a specific written request of the taxpayer, and the taxpayer must have provided adequate and accurate information.

**Requesting Relief**

To request relief, the taxpayer files Form 843, Claim for Refund and Request for Abatement, with copies of the taxpayer’s written request for advice, the erroneous written advice furnished by the IRS, and the report (if any) of the tax adjustments that shows the penalty or other additions to tax related to the erroneous written advice.

If the IRS does not grant penalty relief based on the erroneous written advice, the taxpayer can appeal the denial. The taxpayer may also qualify for reasonable cause relief (discussed later) if he or she exercised ordinary business care and prudence in relying on the IRS’s written advice.

**Oral Advice**

Administratively, the IRS has extended the section 6404(f) relief to include oral advice, when appropriate. The taxpayer should submit documentation of the oral advice including notes of the taxpayer’s question to the IRS, the IRS advice given, information regarding the office and method by which the advice was obtained, the date the advice was provided, and the name of the employee (and identification number if known) who provided the advice.
Practitioner Note
Advice from a Tax Adviser
Reliance on the advice of a tax adviser may meet the reasonable cause exception for the accuracy-related penalty. Generally, the responsibility to file, pay, or deposit taxes cannot be excused by reliance on the advice of a tax adviser.

Waiver of Estimated Tax Penalty
Under I.R.C. § 6654(e)(3)(A), the IRS can waive the estimated tax penalty if the failure to make payments was due to casualty, disaster, or other unusual circumstances and the imposition of the penalty would be against equity and good conscience. Such unusual circumstances could include destruction of the taxpayer’s records by flood or fire, or serious illness or injury that renders a taxpayer incapable of managing his or her affairs.

Example 10.2 Waiver of Estimated Tax Penalty
Seth Smith’s house was destroyed in a fire. He must use all his available funds to cover basic living expenses while he is waiting for the insurance settlement, and he cannot make his estimated tax payment. Seth would qualify for a waiver. However, if Seth used his available funds for a vacation (nonessentials luxury items), the waiver would not apply. When Seth receives his insurance settlement, he must make the missed estimated tax payment.

Under I.R.C. § 6654(e)(3)(B), the IRS can waive the penalty if the taxpayer retired (at age 62 or older) or became disabled during the year, and the underpayment of estimated taxes was due to reasonable cause and not willful neglect.

Requesting Relief
To request relief, the taxpayer generally files Form 2210, Underpayment of Estimated Tax by Individuals, Trusts, and Estates. The taxpayer must attach a statement explaining why he or she was unable to meet the estimated tax requirements and the time period for which he or she is requesting a waiver. If the taxpayer is requesting a waiver due to retirement or disability, he or she should attach documentation that shows the retirement date (and the taxpayer’s age on that date) or the date the taxpayer became disabled. If the taxpayer is requesting a waiver due to a casualty, disaster (other than a federally declared disaster), or other unusual circumstance, the taxpayer must attach documentation such as copies of police and insurance company reports.

The IRS automatically identifies taxpayers located in a federally declared disaster area (by county or parish) and applies the appropriate penalty relief. These taxpayers do not have to file Form 2210 if their underpayment was due to a federally declared disaster. An individual or a fiduciary for an estate or trust not in a covered disaster area but whose books, records, or tax professionals’ offices are in a covered area is also entitled to relief. Relief workers affiliated with a recognized government or charitable organization assisting in the relief activities in a covered disaster area are also eligible. These taxpayers must call the IRS disaster hotline at 1.866.562.5227 to request relief.

Practitioner Note
2018 Waivers
The Tax Cuts and Jobs Act included a broad array of tax changes. On February 28, 2018, the IRS released an updated withholding calculator and a new version of Form W-4. However, some individual taxpayers may have been unable to accurately calculate the amount of their required estimated income tax payments for 2018 and would be liable for a penalty. The IRS will waive the estimated tax penalty if the total of the taxpayer’s withholding and estimated tax payments made on or before January 15, 2019, is at least 80% of the tax shown on the 2018 return [Notice 2019-11 and Notice 2019-25].

Abatement of the Penalty
If the IRS denies the waiver and applies the penalty, the taxpayer can request abatement. The penalty for underpayment of estimated tax cannot be removed or waived for reasonable cause alone. However, the taxpayer can request abatement if he or she demonstrates that the IRS made an error or that calculating the penalty under a different method reduces or eliminates the penalty.
Administrative Waivers

An administrative waiver grants penalty relief in designated circumstances. Administrative relief may be set forth in an IRS policy statement, news release, or other formal communication. An administrative waiver may be necessary when there is a delay by the IRS in printing or mailing of forms or publishing guidance.

Examples of administrative relief include the first-time penalty abatement (discussed later); temporary waiver of the failure-to-deposit penalty for certain taxpayers who are first required to make federal tax deposits electronically beginning on or after July 1, 1997 [see Notice 98-30, 1998-22 I.R.B. 9]; and waiver of certain penalties if the interest-free employment tax adjustment provisions of I.R.C. § 6205 apply [see I.R.M. § 20.1.1.3.3.2].

First-Time Penalty Abatement

I.R.M. § 20.1.1.3.3.2.1 provides administrative relief from failure-to-file (FTF), failure-to-pay (FTP), and failure-to-deposit (FTD) penalties. First-time abate (FTA) is available the first time the taxpayer is subject to one or more of the penalties on a single return.

Criteria for FTA

To qualify, the taxpayer (and possibly the taxpayer’s spouse if filing jointly) must meet the following requirements:

- **Filing compliance**: The taxpayer has filed all required returns or filed a valid extension for all returns currently due.
- **Payment compliance**: The taxpayer has paid or made payment for any tax currently due. If the taxpayer is paying by an installment agreement, the taxpayer must be current with payments.
- **No penalty history**: The taxpayer must have no penalties (other than estimated tax penalty) on the same type of tax form for the 3 preceding tax years (or was not required to file that same return in the past).

The 3-year lookback for penalty history is not penalty-specific. The taxpayer is not eligible for FTA if there is any unreversed penalty (except the estimated tax penalty) or a reversed penalty in the lookback period based on a prior FTA or tolerance criteria.

If FTA criteria are met, the FTA waiver will be applied before reasonable cause relief. The relief applies only to a single tax period.

**Example 10.3 FTA for Single Tax Period**

Ever Late, Inc. was compliant for calendar years 2013, 2014, and 2015, but it made late deposits and was assessed FTD penalties on all four 2016 tax periods. The FTA waiver could apply only to the tax period ending March 2016. Ever Late could try to request reasonable cause relief on the other three quarters. However, if Ever Late, Inc. was not compliant in calendar years 2013, 2014, and 2015, but did not request penalty relief in those years, it is not eligible for an FTA waiver for any of the 2016 quarters [I.R.M. § 20.1.1.3.3.2.1(9)].

The FTA waiver does not apply to the following:

- Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return; and Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return
- The daily delinquency penalty applicable to employee plans and exempt organizations under I.R.C. § 6652(c)(2)(A) and penalties discussed in I.R.M. § 20.1.8, Employee Plans and Exempt Organization Penalties
- Information reporting that is dependent on another filing

**Requesting FTA**

The taxpayer can request FTA before or after assessment of a penalty. The taxpayer can request nonassertion of penalties on an attachment to a return. The request should clearly state that the requirements for FTA have been met and should reference those met requirements in a cover letter accompanying the return.

A tax practitioner who has a power of attorney can call the IRS Practitioner Priority Service at 866.860.4259 to request FTA. However, if a specific compliance unit is handling the case, the practitioner should request FTA from that unit. If the penalty amount is too high to be abated by phone, the practitioner must submit a written
reason. The written request should include client information; state that the client meets the criteria for FTA; and, if available, include transcripts to prove compliance and no penalty history. If the client has already paid the penalties, the tax practitioner can assist him or her to file Form 843, Claim for Refund and Request for Abatement.

**PLANNING POINTER**

**Penalty Accrual**

The FTP penalty will continue to accrue until the taxpayer pays the tax in full. Thus, it may be advantageous to wait until the taxpayer fully pays the tax owed before he or she requests FTA. If the IRS files a substitute for return, the FTF and FTP penalties are included in the calculation of the amount due and will continue to accrue until paid. However, if the taxpayer files an original return that decreases the tax owed, the FTF and FTP penalties are automatically adjusted, and the taxpayer may not need to request FTA.

Upon approval of the FTA, the IRS issues a letter explaining that the penalties were removed and stating that this relief is available only one time. The IRS may also include an explanation that educates the taxpayer about how to be compliant in the future.

**Reasonable Cause**

Reasonable cause provides penalty relief based on the facts and circumstances. Relief based on reasonable cause is available for most penalties but not for fraud, fraudulent failure-to-file, the estimated tax penalty, or any portion of an underpayment or understatement attributable to a transaction lacking economic substance.

**Reasonable Cause Assistant**

To ensure consistent and equitable determinations, the IRS uses an automated system, the Reasonable Cause Assistant (RCA), when considering reasonable cause relief from FTF and FTP on individual returns and FTD on Forms 941, 940, 944, and 945. The IRS uses RCA for requests made by phone or in writing.

The IRS employee can override the RCA determination in limited situations where there are unique individual facts and circumstances that the RCA cannot consider. The determination to override must be justified and cannot conflict with the law or IRS policy. Managerial approval is not required for an RCA override, but it is recommended.

**Standard for Relief**

A taxpayer who exercised ordinary business care and prudence but was nonetheless unable to comply with the law may be eligible for reasonable cause relief from FTF, FTP, and FTD penalties. Taxpayers have reasonable cause when their conduct justifies the nonassertion or abatement of a penalty. Taxpayers cannot have reasonable cause if after the factors that caused the noncompliance cease to exist, the taxpayer fails to comply with the tax obligation within a reasonable time.

Some code sections also require that the taxpayer acted in good faith (I.R.C. § 6662 accuracy-related penalty) or that the taxpayer’s failure to comply was not due to willful neglect (I.R.C. § 6724 failure to file information returns). Figure 10.7 shows reasonable cause citations.

**FIGURE 10.7 Reasonable Cause Citations**

<table>
<thead>
<tr>
<th>Penalty</th>
<th>Regulation</th>
<th>I.R.M.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accuracy-related penalties</td>
<td>Treas. Reg. § 1.6664-4</td>
<td>I.R.M. § 20.1.5</td>
</tr>
<tr>
<td>Failure-to-file/failure-to-pay penalties</td>
<td>Treas. Reg. § 301.6651-1(c)</td>
<td>I.R.M. § 20.1.2</td>
</tr>
<tr>
<td>Information returns penalties</td>
<td>Treas. Reg. § 301.6724-1</td>
<td>I.R.M. § 20.1.7</td>
</tr>
<tr>
<td>Tax return preparer penalties</td>
<td>Treas. Reg. § 1.6694-2(e)(1)-(6)</td>
<td>I.R.M. § 20.1.6</td>
</tr>
</tbody>
</table>

[Adapted from I.R.M. § 20.1.1.3.2.1]
Ordinary Business Care and Prudence
A taxpayer is considered to have exercised ordinary business care and prudence if he or she made reasonable efforts to conserve sufficient assets in marketable form to satisfy his or her tax liability and nevertheless was unable to pay all or a portion of the tax when it became due. In determining whether the taxpayer exercised ordinary business care and prudence the IRS reviews all available information, including the taxpayer’s reason for the noncompliance, the taxpayer’s compliance history, the length of time between the event causing the noncompliance and the subsequent compliance, and circumstances beyond the taxpayer’s control.

- **Taxpayer’s reason**: The given reason should address the penalty imposed. Dates and explanations should clearly correspond with events on which the penalties are based.
- **Compliance history**: The same penalty previously assessed may indicate the taxpayer is not exercising ordinary business care. A lack of prior penalty assessments does not by itself establish reasonable cause but is a factor to be weighed in the overall determination.
- **Length of time**: The IRS will look at when the act was required by law, the time during which the taxpayer was unable to comply with the law due to circumstances beyond the taxpayer’s control, and when the taxpayer eventually complied.
- **Circumstances beyond the taxpayer’s control**: The IRS will consider whether the taxpayer could have anticipated the event that caused noncompliance. Reasonable cause can be established when the taxpayer exercises ordinary business care and prudence but is unable to comply due to circumstances beyond the taxpayer’s control.

Reasonable cause for FTF, FTP, or FTD penalties may include the following:
- Death or serious illness of the taxpayer; a member of the taxpayer’s immediate family; or the responsible person in a corporation, estate, or trust who had sole authority to file, deposit, or pay tax
- Unavoidable absence of the taxpayer or the responsible person in a corporation, estate, or trust who had sole authority to file, deposit, or pay tax
- Destruction by fire or other casualty of the taxpayer’s place of business or business records
- Inability to determine amount of deposit or tax due for reasons beyond the taxpayer’s control (for trust fund deposits, the taxpayer must be unable to access his or her records)
- The taxpayer’s ability to make deposits or payments was materially impaired by civil disturbances
- Lack of funds that prevented deposit or payment (but only if the taxpayer can demonstrate the lack of funds occurred despite the exercise of ordinary business care and prudence)

Death, Illness, or Absence
Death, serious illness, or unavoidable absence of the taxpayer, or a death or serious illness in the taxpayer’s immediate family, may establish reasonable cause for filing, paying, or depositing late. Immediate family includes a spouse, sibling, parents, grandparents, and children. For a corporation, estate, or trust, the IRS will focus on the events and relationship to the taxpayer who had sole authority to execute the return, make the deposit, or pay the tax.

Information to consider when evaluating a request for penalty relief based on reasonable cause due to death, serious illness, or unavoidable absence includes, but is not limited to, the following:

1. The relationship of the taxpayer to the other parties involved
2. The date of death
3. The dates, duration, and severity of illness
4. The dates and reasons for absence
5. How the event prevented compliance
6. If other business obligations were impaired
7. If tax duties were attended to promptly when the illness passed, or within a reasonable time after a death or return from an unavoidable absence
**Mistake**

By itself, claiming that a mistake was made does not provide a basis for reasonable cause. However, if other facts and circumstances support the determination that the taxpayer exercised ordinary business care and prudence but was unable to comply within the prescribed time, reasonable cause may exist. The IRS will consider when and how the taxpayer became aware of the mistake, what was done to correct the mistake, and whether steps to correct the mistake were taken timely after the mistake was discovered.

**Undue Hardship**

An undue hardship may support the extension of time for paying a tax or deficiency if the undue hardship is more than an inconvenience to the taxpayer [Treas. Reg. § 1.6161-1(b)]. The taxpayer must show that he or she would sustain a substantial financial loss if required to pay a tax or deficiency on the due date. Funds on hand may have been required to cover an unanticipated event that prevented payment of the taxes. If the taxpayer filed bankruptcy, inability to pay is a factor if the insolvency occurred before the tax payment due date.

Undue hardship, however, does not support an employer’s relief from penalties on trust funds or a responsible person’s relief from the TFRP under I.R.C. § 6672. Undue hardship is generally not a defense for failure to file.

**Ignorance of the Law**

Ignorance of the law may provide reasonable cause if the taxpayer made a reasonable and good-faith effort to comply with the law or the taxpayer was unaware of a requirement and could not reasonably be expected to know of the requirement. The IRS will consider

- the taxpayer’s education,
- if the taxpayer was previously subject to the tax,
- if the taxpayer was penalized before,
- recent changes in the forms or law that the taxpayer could not reasonably be expected to know, and
- the level of complexity of a tax or compliance issue.

**No Records**

If the taxpayer was unable to obtain records necessary to comply with a tax obligation, the taxpayer may be able to establish reasonable cause. Reasonable cause may be established if the taxpayer exercised ordinary business care and prudence, but due to circumstances beyond the taxpayer’s control, he or she was unable to comply. Information to consider when evaluating such a request includes, but is not limited to, the following:

- Why the records were needed for compliance
- Why the records were unavailable and what steps were taken to secure the records
- When and how the taxpayer became aware that he or she did not have the necessary records
- If other means were explored to secure needed information
- Why the taxpayer did not estimate the information
- If the taxpayer contacted the IRS for instructions on what to do about missing information
- If the taxpayer promptly complied once the missing information was received
- What supporting documentation the taxpayer received to get the needed information
- What supporting documentation the taxpayer received to get the needed information

**Requesting Penalty Relief**

A taxpayer can request penalty relief prior to assessment, or as an abatement request after the penalty is assessed. The taxpayer can send a preemptive request with a late filed return, or request abatement and a refund after payment is made. A request for relief based on reasonable cause generally must be in writing and signed by the taxpayer under penalty of perjury. However, unsigned or oral requests are allowed in some circumstances [see I.R.M. § 20.1.1.3.1].

Taxpayers can use Form 843, Claim for Refund and Request for Abatement, for abatement of certain penalties or a refund of penalties paid. Generally, the taxpayer must file a separate Form 843 for each tax period or type of tax. The taxpayer checks the box on line 5, “Reasonable cause or other reason allowed under the law.
Practitioner Note

Time-Barred Refund

I.R.C. § 6404(a)(1) allows the IRS to abate the unpaid portion of an assessment that is excessive in amount. The IRS has found that this authority may allow abatement of paid amounts. Although a refund of tax reported on an amended return is time-barred, the IRS may still abate the penalties and interest that exceed the true amount of penalties and interest the taxpayer owes. An amended return may be treated as a claim for refund of the penalties and interest paid in the 2 years prior to the date the amended return was filed, to the extent those amounts exceed what the taxpayer owed [C.C.A. 2015-20-010 (April 23, 2015)].

ISSUE 5: BANKRUPTCY AND TAX DEBT

This section reviews when tax debt is dischargeable in a bankruptcy action.

The Bankruptcy Code (11 U.S.C.) provides an orderly method for the debtor’s financial rehabilitation or the liquidation and distribution of a debtor’s assets. The Bankruptcy Code is divided into chapters. Chapter 7 deals with liquidating bankruptcies, chapter 11 provides information on reorganizations of individuals and businesses, and chapter 13 deals with reorganizations of individuals with regular income. This section provides an overview of these chapters.

In certain bankruptcy cases, tax debt may be discharged. This section explains when a taxpayer can obtain a discharge of tax debt in a bankruptcy action.

Bankruptcy Chapters

For individuals, the most common type of bankruptcy is a chapter 13. Partnerships and corporations file bankruptcy under chapter 7 or chapter 11 of the bankruptcy code. Individuals may also file under chapter 7 or chapter 11. This section provides a basic overview of each chapter.

Chapter 7

Chapter 7 is a liquidation bankruptcy. It is available to individuals who cannot make regular, monthly payments toward their debts. Businesses choosing to terminate their enterprises may also file chapter 7. The bankruptcy estate in a chapter 7 case is represented by a trustee. The trustee sells the debtor’s nonexempt assets, if any, and distributes the proceeds to creditors in accordance with the Bankruptcy Code priorities. Chapter 7 will eliminate most of an individual debtor’s unsecured debts, but discharge of debt is not available to partnerships or corporations under chapter 7.

If an individual debtor’s current monthly income exceeds the state median, the debtor must meet a means test to be eligible for chapter 7. Current monthly income is defined as the average monthly income received over the 6 calendar months before the start of the bankruptcy case. It includes regular contributions to household expenses from nondebtors. Income does not include social security or certain payments made because the debtor is the victim of certain crimes.
If a debtor is eligible for chapter 7, relief is available regardless of the level of debt or whether the debtor is solvent or insolvent. Filing a petition under chapter 7 automatically stays (stops) most collection actions against the debtor or the debtor’s property. The debtor must continue to file an individual tax return on Form 1040. The bankruptcy trustee files a Form 1041 for the bankruptcy estate.

Chapter 11
Chapter 11 is a reorganization bankruptcy. Chapter 11 is typically used to reorganize a business, which may be a corporation, sole proprietorship, or partnership. However, an individual can also file under chapter 11. The debtor uses the time between the bankruptcy filing and the confirmation of the debt repayment plan to reorganize its finances. If the debtor fails to successfully reorganize and get a debt repayment plan approved, the case may be converted to a liquidating chapter 7.

In chapter 11 cases, the debtor often remains in control of the assets as a debtor-in-possession and acts as the bankruptcy trustee. However, the bankruptcy court, for cause, may appoint a trustee if such appointment is in the best interests of the creditors and the estate.

As part of their reorganization, businesses must ensure that they are capable of meeting all financial obligations, including federal income and payroll taxes. Individuals may need to increase their withholding and/or estimated tax payments.

There are no discharges in liquidating chapter 11 bankruptcies.

Chapter 13
Chapter 13 is referred to as the wage earner’s plan. The debtor proposes a repayment plan to make installment payments to creditors over 3 to 5 years. If the debtor’s monthly income is under the state median, the plan generally will be for 3 years. If the monthly income is greater than the state median, the plan generally must be for 5 years. During this time creditors are prohibited from starting or continuing collection efforts.

A debtor is eligible for chapter 13 (as of April 1, 2019) if his or her unsecured debts do not exceed $419,275 and secured debts do not exceed $1,257,850 (debt limitations may be adjusted every 3 years). An individual whose debts exceed the limitations must file under chapter 11. The debtor must also be current on tax filings for tax periods ending within 4 years of the bankruptcy filing and must continue to file all required tax returns and pay all amounts currently due. Only individuals may file under chapter 13 (but the individual may be self-employed or own an unincorporated business).

Unlike under chapter 7, a debtor may be able to keep nonexempt property by paying unsecured creditors the nonexempt amount that would otherwise be generated by the sale of the property. Chapter 13 allows a debtor who is behind in mortgage or car payments to catch up on the arrearages over the term of the bankruptcy payment plan.

Dischargeable Tax Debt
Secured tax debts and certain unsecured tax debts are generally considered priority debts in bankruptcy. However, certain tax debt is dischargeable nonpriority debt that is treated like general unsecured debt. Income tax debt that is unsecured and meets all the following five tests may be dischargeable:

1. A return was filed.
2. The return was filed more than 2 years before the bankruptcy filing date.
3. The return was due (with extensions) more than 3 years before the bankruptcy filing date.

Practitioner Note
Exempt Property
The Bankruptcy Code allows exemptions for certain property. Each state has its own exemptions and some states do not allow filers to use the federal amounts. The federal amounts as of April 1, 2019, include, but are not limited to, a $25,150 homestead exemption, a $4,000 exemption for a motor vehicle, and $13,400 in the aggregate ($625 per item) for household goods and furnishings. Certain types of income are also exempt, such as compensation for loss of future earnings necessary for support and social security benefits, unemployment compensation, veteran’s benefits, public assistance, and disability or illness benefits.
4. The taxes were assessed more than 240 days before the bankruptcy filing date.

5. There was no fraud or willful evasion in connection with the return.

If the debt is discharged, the related interest and penalties are also discharged.

**Secured Debts**

A tax debt is secured if the IRS properly filed a notice of federal tax lien (NFTL) before the bankruptcy filing date. The IRS will have a secured claim in the bankruptcy case to the extent the lien attached to equity in the debtor’s assets. Unsecured tax debt is tax debt for which no NFTL has been filed or if an NFTL has been filed, the taxpayer’s equity in the property is insufficient. A properly filed NFTL will secure personal property located anywhere, but it will secure real property only if the property is in the county where the NFTL was filed.

**Filed Return**

A dischargeable tax debt must relate to a filed return. The return must be filed more than 2 years before the bankruptcy filing date. A substitute for return (SFR) prepared by the IRS under I.R.C. § 6020(b) is not considered a return filed by the debtor unless the debtor signed the return. If the return is not considered filed, the tax is not dischargeable in bankruptcy.

In all but the Eighth Circuit, if a taxpayer files a return after the SFR assessment, only the portion of the tax that was not previously assessed (an increase in the tax due to the filed return) is subject to discharge. The assessment prior to the taxpayer’s filing of the return is a debt for which a return was not filed and therefore is not subject to discharge. The tax debt created by the SFR does not become dischargeable by the taxpayer’s filing a return.

The Eighth Circuit (North Dakota, South Dakota, Nebraska, Iowa, Missouri, Minnesota, and Arkansas) follows In re Colson, 446 F.3d 836 (8th Cir. 2006). When the debtor files a tax return that on its face evinces an honest and reasonable attempt to satisfy the tax laws, it qualifies as a tax return whether or not it was filed after an SFR assessment. As a result, if the debtor files a return after an SFR and more than 2 years prior to the bankruptcy petition date, the entire liability (including the SFR assessment) is discharged. If the return was filed within 2 years of the petition date, the entire tax liability is nondischargeable. [See I.R.M. § 5.9.17.7.1 and Chief Counsel Notice C.C. 2010-016, Litigating Position Regarding the Dischargeability in Bankruptcy of Tax Liabilities Reported on Late Filed Returns and Returns Filed After Assessment.]

**Due Date**

To be dischargeable, the tax must relate to a return that was due, including extensions, more than 3 years before the bankruptcy filing date.

**Example 10.4 Return Due Date**

Suzanne Moore lives in North Carolina. Her 2015 return was due April 18, 2016, because of Emancipation Day in Washington, DC. (For a taxpayer in Maine or Massachusetts, the 2015 return was due April 19, 2016, because of Patriot’s Day.) The 3-year test for allowing discharge of debt on a 2015 return filed by the original due date is met if Susan files her bankruptcy petition on or after April 19, 2019 (or April 20, 2019, for taxpayers in Maine or Massachusetts).

If Susan had requested a 6-month extension of the time to file her 2015 return, the due date would have been October 17, 2016 (because October 15 was a Saturday). Susan’s bankruptcy filing could be no earlier than October 18, 2019.

**Planning Pointer**

**Adjusted Due Dates**

Adding a 5-day time period to the original and extended due dates provides a safe, quick, and easy method to determine if the taxpayer meets the 3-year due date rule.

**Assessment Date**

To be dischargeable, the tax must have been assessed more than 240 days before the bankruptcy filing. If there are multiple assessments in one year, the taxpayer must test each assessment.
Practitioner Note

Transcripts

To determine the date of assessments, the taxpayer should request transcripts of master file accounts and nonmaster file accounts, which will show a separate assessment against a spouse. Document 6029 can help to interpret transcripts [www.irs.gov/privacy-disclosure/document-6209-adp-and-idrs-information].

Aging Debt

Installment agreements do not suspend the assessment period for dischargeable tax debt. An installment agreement can allow a taxpayer to buy time while existing liabilities age and become dischargeable. The aging of taxes for bankruptcy purposes is tolled while a timely CDP hearing and appeal is pending, plus 90 days. The aging of taxes is not tolled for an equivalency hearing. If bankruptcy is being considered, an equivalency hearing may allow some taxes to “age” to dischargeable where the CDP with the tolling of the aging would not.

Fraud or Willful Evasion

Tax debt is not dischargeable if there was fraud or willful evasion. Courts consider factors such as

- large understatements of income,
- failure to keep adequate records,
- failure to file,
- concealing assets,
- failure to cooperate with the IRS, and
- the illegal nature of the income generating activity.

Nondischargeable Tax Debt

Tax debt that cannot be discharged in bankruptcy generally includes the following:

- Secured debt
- Trust fund taxes, including the TFRP
- Taxes for which returns have not been filed
- Taxes for which returns were filed late and within 2 years of the bankruptcy filing
- Tax arising from returns that were fraudulently filed or for which the debtor willfully attempted to evade or defeat the tax due and owing
- Nonpunitive penalties on nondischargeable taxes if the transaction that created the penalty occurred less than 3 years before the bankruptcy filing
- Employer share of employment taxes on any compensation item that is a priority claim
Example 10.6 LateFiled Return
John Jones filed chapter 13 bankruptcy on March 29, 2019. The date that is 2 years before the bankruptcy petition date is March 29, 2017. He filed his 2014 income tax return on March 29, 2018. The return was due on April 15, 2015. The return was filed late and after March 29, 2017. The tax and interest on the tax is not dischargeable.

ISSUE 6: PAYCHECK CHECKUP  Following changes in the tax law, taxpayers should check their withholding.

The TCJA increased the standard deduction, eliminated personal exemptions, increased the child tax credit, limited or discontinued certain deductions, and changed the tax rates and brackets. As a result, all taxpayers should check their withholding. However, it is very important for the following taxpayers to check their withholding:

1. Two-income families
2. A taxpayer with multiple jobs
3. Taxpayers who are seasonally employed, or only work part of the year
4. Taxpayers who claim the child tax credit or the credit for other dependents
5. Taxpayers who itemized deductions in prior years
6. Taxpayers with high income
7. Taxpayers with complex returns
8. Taxpayers who had a large refund for the prior tax year
9. Taxpayers who owed additional tax when they filed their prior-year return
10. Taxpayers who have a major life change this year such as having a child or getting married

The IRS reports that the average tax refund was $2,729 for tax year 2018. They recommend that taxpayers who adjusted their tax withholding in the middle or later part of 2018 should check their withholding in 2019 to make sure that overwithholding or underwithholding is not occurring.

The IRS Withholding Calculator

Taxpayers can perform a quick "paycheck checkup" using the IRS withholding calculator [www.irs.gov/individuals/irs-withholding-calculator]. The calculator helps determine if an employee needs to give his or her employer a new Form W-4. The employee can use the results from the calculator to help fill out the form and adjust income tax withholding. If the taxpayer receives pension income, he or she can use the results from the calculator to complete Form W-6, Withholding Certificate for Pension or Annuity Payments.

The calculator asks the user to estimate annual income. It asks the number of children the user will claim for the child tax credit and earned income tax credit, and other items that affect taxes.

Practitioner Note

Sensitive Data
The Withholding Calculator does not ask the user to provide sensitive personally identifiable information such as the user’s name, SSN, address, or bank account numbers. The IRS does not save or record the information entered in the calculator.
The following should not use the withholding calculator:

- Taxpayers who owe self-employment tax
- Taxpayers who owe alternative minimum tax
- Taxpayers who owe tax on unearned income of dependents
- Taxpayers with long-term capital gains or qualified dividends
- Taxpayers who have taxable social security benefits

Employees with more complicated tax situations should use the worksheets and special instructions in Publication 505, *Tax Withholding and Estimated Tax*.

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**Practitioner Note**

**Employment Tax Crimes**

Payroll taxes withheld by employers account for almost 72% of all revenue collected by the IRS, and the IRS is making payroll taxes a priority. In two weeks in 2019, IRS revenue officers visited nearly 100 businesses around the country suspected of having serious issues with employment tax compliance. The IRS informed business owners about ways to catch up with back payroll taxes and how to stay current. The IRS also worked with the Department of Justice Tax Division and US attorneys to focus on approximately 50 law enforcement actions related to employment tax crimes. During the two weeks, the IRS indicted 12 individuals and executed four search warrants, while six individuals or businesses were sentenced for crimes associated with payroll taxes. The IRS plans additional action to enforce payroll tax compliance.

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**Changing Withholding**

Employees who need to change their withholding should fill out a new Form W-4 and submit it to their employer. Similarly, recipients of pensions and annuities can change their withholding by filling out Form W-4P and giving it to their payer.

**New Form W-4**

The Treasury Department and the IRS have issued a draft of the 2020 Form W-4, Employee’s Withholding Allowance Certificate. The IRS plans to issue a final draft in November 2019. Figure 10.8 shows the draft Form W-4.
**FIGURE 10.8 Draft Form W-4**

**Employee’s Withholding Allowance Certificate**

- Complete Form W-4 so that your employer can withhold the correct federal income tax from your pay.
- Give Form W-4 to your employer.
- Your withholding is subject to review by the IRS.

<table>
<thead>
<tr>
<th>Step 1: Enter Personal Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>1a First name and middle initial</td>
</tr>
<tr>
<td>Last name</td>
</tr>
<tr>
<td>Home address (number and street)</td>
</tr>
<tr>
<td>City or town, state, and ZIP code</td>
</tr>
<tr>
<td>Single or Married filing separately</td>
</tr>
<tr>
<td>Head of household (Check only if you’re unmarried and pay more than half the costs of keeping up a home for yourself and a qualifying individual.)</td>
</tr>
</tbody>
</table>

**Step 2: Account for Multiple Jobs**

**Caution:** The correct amount of withholding depends on income earned from all jobs in the household. If you:
- Hold more than one job at a time, or
- Are married filing jointly and both you and your spouse work, account for this below or you may owe additional tax when filing your tax return.

(If you and/or your spouse have income from self-employment, see page 2.)

2. **Multiple jobs. Do only one of the following:**
   - Use the calculator at [www.irs.gov/W4App](http://www.irs.gov/W4App) for most accurate withholding; or
   - Use Worksheet 1 on page 3 and enter the result on line 4c below for roughly accurate withholding; or
   - If there are only two jobs in your household, you may check here. Do the same on Form W-4 for the other job. With this option, more tax than necessary may be withheld from your wages, but you generally won’t have too little tax withheld.

**Step 3: Claim Dependents**

| 3 Dependents. If your income will be $200,000 or less ($400,000 or less if married filing jointly) (see instructions): |
| Multiplying the number of qualifying children under age 17 by $2,000 ★ $ |
| Multiplying the number of other dependents by $500 ★ $ |
| Add the amounts above and enter the total here | 3 $ |

**Step 4: Other Adjustments (optional)**

| 4a Other income. If you want tax withheld for other income you expect this year that will not have withholding, enter the amount of other income here. This may include interest, dividends, and retirement income. You should not include income from any jobs: |
| 4b Deductions. If you expect to claim deductions other than the standard deduction and want to reduce your withholding, use Worksheet 2 on page 3 and enter the result here |
| 4c Exemption. You can claim exemption from withholding for 2020 if: |
| For 2019, you had no federal income tax liability; and |
| For 2020, you expect to have no federal income tax liability. |
| If you meet both of these conditions, certify by writing “Exempt” here | 4d |

**Step 5: Sign Here**

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

**Employee’s signature** (This form is not valid unless you sign it.)

**Date**

**Employers Only**

| 5 Employer’s name and address | 6 First date of employment | 7 Employer identification number (EIN) |

For Privacy Act and Paperwork Reduction Act Notice, see page 2.
Self-employed workers must pay taxes directly to the IRS. One way to pay taxes directly to the IRS is by making estimated tax payments during the year. See pages 223–227 in the 2018 National Income Tax Workbook for a discussion of how to calculate estimated tax payments and when to make the payments. Form 1040-ES includes the income tax rate schedules and a worksheet to calculate the right amount to pay.


To improve service to taxpayers and resolve tax controversies at the earliest opportunity, the IRS has several alternatives for dispute resolution. This section discusses the following IRS voluntary programs:

- Early referral to Appeals
- Small Business/Self Employed (SB/SE) Fast Track Settlement (SB/SE FTS)
- Large Business and International (LB&I) Fast Track Settlement (LB&I FTS)
- Tax Exempt and Government Entities (TE/GE) Fast Track Settlement (TE/GE FTS)
- Fast Track Mediation – Collection (FTMC)
- Post-Appeals Mediation (PAM)
- Rapid Appeals Process (RAP)

The Taxpayer First Act of 2019 formally establishes the Office of Appeals and calls it the Internal Revenue Service Independent Office of Appeals. See the “New and Expiring Legislation” chapter for a discussion of the Act.
Early Referral to Appeals

A taxpayer can request the transfer of a developed but unagreed issue to Appeals while the IRS continues to develop other issues in the case. There is no user fee for this request. Rev. Proc. 99-28, 1999-29 I.R.B. 109, provides the procedure for early referral. Early referral issues may involve an exam, involuntary change in accounting method, employment tax, collection, and employee plans or exempt organizations.

Initiating the Request

The taxpayer submits a request for an early referral in writing to the case/group manager. It must be signed under penalties of perjury by the taxpayer or the taxpayer’s representative. The request must identify the taxpayer (and all related persons involved in the issues), the tax periods involved, identify the issue(s), and include a statement of the taxpayer’s position on the early referral issues. The statement should briefly describe the material facts and analyze the facts and law as they apply to each issue.

Processing the Request

The case/group manager will, where feasible, notify the taxpayer of the decision to accept or reject an issue in the early referral request within 14 days of receiving the request. If the request is denied in whole or in part, there is no formal appeal, but the taxpayer can request a conference with the case/group manager who denied the request. The taxpayer has the right to a traditional appeal on any issue denied early referral.

Within 30 days of the early referral acceptance, Examination completes and sends to the taxpayer a Form 5701, Notice of Proposed Adjustment, or an equivalent form (Notification Form) for each issue accepted for early referral. The taxpayer has 30 days (or more if an extension is granted) to respond in writing with an explanation of the taxpayer’s position on each adjustment proposed in the Notification Form. As with the initial request, this response must be signed under penalties of perjury. If the taxpayer does not submit a timely response, the early referral request is considered withdrawn.

Appeals Process

Once the taxpayer has responded to the Notification Form, Appeals takes jurisdiction over the early referral issues. The taxpayer’s written response to the Notification Form generally serves as an Appeals protest. If the taxpayer and Appeals reach an agreement, Appeals prepares a Form 906, Closing Agreement on Final Determination Covering Specific Matters. The closing agreement is used to compute the corrected tax as a partial agreement prior to or concurrently with the resolution of any other issues in the case.
If the taxpayer and Appeals do not reach an agreement with respect to an early referral issue, the taxpayer may request mediation for the issue if it meets the requirements for mediation (discussed later). If the taxpayer does not request mediation, Appeals returns jurisdiction to Examination. Appeals will not reconsider an unagreed early referral issue if the entire case is later protested to Appeals unless there has been a substantial change in circumstances regarding the early referral issue.

**Exam Conclusion**
At conclusion of the audit, the IRS issues a 30-day letter for any unagreed issues, including early referral issues that are still pending in Appeals. If the only unagreed issues are those that were considered by Appeals under the early referral process, the IRS issues a 90-day letter (statutory notice of deficiency) rather than a 30-day letter. If a taxpayer withdraws an issue from the early referral process after Appeals has taken jurisdiction the issue is treated as if no agreement had been reached in the early referral process (statutory notice and no 30-day letter).

**Involuntary Change in Accounting Method Early Referral**
If the IRS initiates a change in accounting method, appropriate issues for early referral include whether

1. the taxpayer’s practice is a method of accounting,
2. the IRS is precluded from changing the taxpayer’s method of accounting (e.g., audit protection due to a voluntary accounting method change),
3. the taxpayer’s present method of accounting clearly reflects income under I.R.C. § 446,
4. the method of accounting proposed by the IRS clearly reflects income under I.R.C. § 446,
5. the methodology used by the IRS to compute the I.R.C. § 481(a) adjustment is correct, or
6. the methodology used by the IRS to compute the I.R.C. § 481(a) adjustment is appropriate.

The early referral procedures for examination apply to early referral for issues involving an IRS-initiated change in accounting method.

**Employment Tax Early Referral**
Employment tax issues that are appropriate for early referral include the following:

1. Worker classification issues
2. Liability issues include whether section 530 of the Revenue Act of 1978 applies, whether I.R.C. § 3509 rates are appropriate, and whether the taxpayer qualifies for an interest-free adjustment
3. Other issues including whether certain payments are excepted from the definition of wages and whether certain services are excepted from the definition of employment

In general, the early referral procedures for examination apply to the early referral for employment tax issues. However, the closing procedure differs. If the taxpayer reaches an agreement with Appeals on the early referral issues, Appeals issues Form 2504, Agreement to Assessment and Collection of Additional Tax and Acceptance of Overassessment (Excise or Employment Tax), which is labeled a “partial agreement.” Appeals prepares a closing agreement if the settled issues are complex or affect subsequent years.

If the taxpayer and Appeals do not reach an agreement, and the employment tax depends on a section 530 or worker classification issue, the IRS issues a Notice of Determination Concerning Worker Classification Under Section 7436. The taxpayer can file a petition for US Tax Court review before the assessment is made. If an unagreed early referral issue involves employment tax that does not depend on a section 530 or worker classification issue, the IRS processes the case for assessment and does not issue a 30-day letter.
Collection Early Referral

Collection issues appropriate for early referral to Appeals include proposed

- notices of federal tax liens,
- levies,
- seizures, and
- denials or termination of installment agreements.

The process for early referrals is different than the I.R.C. §§ 6320 and 6330 due process procedures in that denial of relief under the early referral procedures is not reviewable in Tax Court or in a US District Court. The early referral procedures also apply to a broader range of collection issues than the due process procedures.

Employee Plans and Exempt Organizations Early Referral

In general, the early referral procedures for examination apply to the early referral for employee plan and exempt organization issues. The following issues are excluded from early referral:

1. Procedural employee plan issues relating to matters that may be eligible for certain administrative policies or programs, such as the Voluntary Correction Program
2. Employee plan issues relating to excise taxes in I.R.C. § 4975
3. Issues concerning employee plan qualification not covered by published precedent or for which there may be nonuniformity between offices
4. Exempt organization issues subject to I.R.C. § 7428, including those related to exemption or private foundation status
5. Issues arising in church tax inquiries and examinations subject to I.R.C. § 7611
6. Issues relating to exempt organization excise taxes in I.R.C. § 507 and I.R.C. chapters 41 and 42
7. Issues relating to the revocation of exempt status

SB/SE Fast Track Settlement

Rev. Proc. 2017-25, 2017-14 I.R.B. 1039, formally establishes the Small Business/Self Employed Fast Track Settlement Program (SB/SE FTS). The goal of SB/SE FTS is to provide an expedited format to resolve disputes with SB/SE taxpayers. It is a goal of SB/SE FTS that the entire process be completed within 60 days after acceptance into the program. FTS is available for SB/SE cases if

1. the case contains disputed factual or legal issues,
2. issues are fully developed, and
3. the issues remain unresolved after group manager involvement.

If any issue in a case is not eligible for SB/SE FTS, no issues in the case are eligible. SB/SE FTS is not available for the following:

1. Cases where FTS is not appropriate under either 5 U.S.C. § 572 or 5 U.S.C. § 575 (authority for use of alternative dispute resolution in the administrative process)
2. Cases where the taxpayer did not act in good faith during the audit process, such as failing to cooperate or unduly delaying the process
3. Correspondence cases worked solely in a campus/service center site
4. Partnership cases under the Tax Equity & Fiscal Responsibility Act (TEFRA)
5. Collection cases
6. Issues designated for litigation
7. Issues docketed in any court
8. Issues precluded from settlement by previous closing agreements, res judicata, or controlling Supreme Court precedent
9. Issues for which FTS is not in the interest of sound tax administration
10. Frivolous issues
11. Whipsaw issues or issues where resolution for one party might result in inconsistent treatment in the absence of participation of another party
12. Issues for which the taxpayer has requested competent authority assistance
13. Issues outside SB/SE jurisdiction
14. Other issues that IRS guidance has excluded from the SB/SE FTS process

**Application Process**

Either the taxpayer, examiner, or group manager can initiate the process. The taxpayer and the examiner must consent to participate by jointly completing and signing Form 14017, Application for Fast Track Settlement. By signing Form 14017 the taxpayer agrees to disclosure of tax returns and return information to all participants and the parties agree to waive certain restrictions on communication between Appeals and other IRS employees. The parties also agree to nondisclosure. **Figure 10.9** shows the acknowledgment portion of Form 14017.

**FIGURE 10.9 Form 14017 Acknowledgment**

The undersigned request Appeals assistance 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 Examination Re-Engineering Lead Sheets 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.

The form, workpapers supporting the examiner’s position, and the taxpayer’s written response are submitted to the group manager. If the manager determines that the case is complete and eligible for SB/SE FTS, the manager forwards the package to the Appeals team manager. If the group manager determines that the application package is incomplete, or that the taxpayer does not meet the eligibility requirements or otherwise does not qualify, the group manager will deny the application. The Appeals manager decides whether to accept the case. If the manager rejects the application, the Appeals manager notifies the taxpayer and the group manager. The rejection is not subject to administrative appeal or judicial review.

**Settlement Process**

An Appeals officer trained in mediation (FTS Appeals official) serves as a neutral party, acts as a mediator, and uses dispute resolution techniques to facilitate an agreement between the parties. A conference (FTS session) is held with the taxpayer, SB/SE representatives, and the Appeals official. Participants in the session should include persons with decision-making authority and those with information and expertise necessary to assist the parties. The Appeals official may hold separate meetings with each party or a conference with all the parties.

**Practitioner Note**

**Conference**

Appeals will use its best efforts to schedule an in-person conference on a date and at a location that is reasonably convenient for the taxpayer and Appeals. Appeals’ ability to hold an in-person conference in the taxpayer’s preferred location may be limited due to regulatory requirements or resource constraints.
Either the taxpayer or the team manager may suggest participation in the FTS program. The taxpayer applies for LB&I FTS on Form 14017, which is signed by the taxpayer and the team manager. The parties must include the Notice of Proposed Adjustment (Form 5701) and the written response from the taxpayer. The Fast Track Program Manager reviews the package and either approves or denies the request for FTS. The decision not to approve the application is final and is not subject to administrative appeal or judicial review.

The LB&I FTS settlement process is generally the same as the FTS process for the SB/SE FTS. There is an FTS Session Report, and an FTS session at which the FTS Appeals official considers the disputed issues and may propose settlement terms.

**Conclusion of Settlement**

The Appeals official has the authority to offer settlement terms for any or all issues. Any settlement that the Appeals official recommends is subject to the procedures that are generally applicable to any issue considered by Appeals. Any of the parties may also offer settlement terms; and SB/SE and the taxpayer may agree to resolve the issue independent of the FTS and close the case on those terms. If the parties resolve any disputed issues by the end of the FTS, both parties and the Settlement Official must sign the Session Report, acknowledging acceptance of the settlement terms.

The Appeals official uses standard case closing procedures and agreement forms that may include Form 906, Closing Agreement on Final Determination Covering Specific Tax Matters. If the parties do not resolve the disputed issues, the taxpayer may request that the issues be heard through the traditional Appeals process. However, post-Appeals mediation is not available for any issue considered during the SB/SE FTS process.

Withdrawal of any issue from FTS withdraws all issues. If withdrawal occurs prior to the start of the FTS session, the taxpayer will not be treated as having participated for purposes of qualifying for post-Appeals mediation.

### LB&I Fast Track Settlement

Rev. Proc. 2003-40, 2003-1 C.B. 1044, formally establishes the LB&I Fast Track Settlement Program (LB&I FTS). The goal of FTS is to reach agreement within 120 days of the FTS application acceptance. Generally, all issues within LB&I jurisdiction are eligible for FTS. The exclusions from LB&I FTS are like those for SB/SE FTS (discussed earlier).
Cases in which the taxpayer has failed to respond to IRS communications or has not submitted for consideration by TE/GE
Cases in which Appeals does not have jurisdiction
Cases involving listed transactions or abusive tax avoidance
Cases involving potential for civil or criminal fraud
Rebate claim cases
TEFRA partnership cases
Issues designated for litigation or under consideration for designation for litigation
Frivolous issues
Whipsaw issues
Issues that have been identified in a Chief Counsel Notice, or equivalent publication, as excluded from the FTS process

The TE/GE FTS application and settlement process is generally the same as the FTS process for the SB/SE and LB&I FTS.

Fast Track Mediation – Collection

Rev. Proc. 2016-57, 2016-49 I.R.B. 786, creates the Fast Track Mediation – Collection (FTMC). This program provides taxpayers with an opportunity to resolve certain OIC and TFRP disputes on an expedited basis with an Office of Appeals mediator. The goal of FTMC is to reach an agreement within 40 days of the application acceptance.

FTMC may be used only when all other collection issues are resolved (except for the issue for which FTMC is requested). Participation is optional both for the taxpayer and for Collection.

FTMC Issues
Issues to be mediated must be fully developed and both parties (the taxpayer and Collection) must have clearly defined positions. FTMC is generally appropriate for the following:

1. Legal and factual issues
2. Certain OIC cases or issues if the parties know all the relevant facts:
   a. Value of a taxpayer’s assets, including those held by a third party
   b. Amount of dissipated assets to be included in reasonable collection potential (RCP)
   c. Whether the taxpayer meets the criteria for deviating from national and/or local expense standards
   d. Taxpayer’s proportionate interest in jointly held assets
   e. Projections of future income based on calculations other than current income
   f. Calculation of a taxpayer’s future ability to pay when sharing living expenses with a non-liable person
   g. Doubt as to liability cases worked by Collection
   h. Other factual determinations, such as whether a taxpayer’s contributions to a retirement savings account are discretionary or mandatory as a condition of employment

3. Certain TFRP cases or issues if the parties know all the relevant facts:
   a. Whether a person is a responsible person for the TFRP
   b. Whether a responsible person willfully failed to collect, account for, or pay over tax or willfully attempted to evade or defeat payment of tax
   c. Whether a taxpayer properly designated a payment to the trust fund portion of the unpaid tax
   d. Whether the taxpayer provided corporate payroll records to establish that a corporate tax deposit was a designated payment to be applied to both trust and non–trust fund portions

The following issues are not appropriate for FTMC:

1. Issues requiring assessment of hazards of litigation or use of delegated settlement authority
2. Cases referred to the Department of Justice
3. Cases worked at an SB/SE campus site
4. Collection Appeals Program (CAP) cases
5. Collection Due Process (CDP) cases
6. Frivolous issues
7. Cases in which the taxpayer has failed to respond or submit documentation
8. Certain OIC cases:
   a. Taxpayer has the ability to pay in full, except where an effective tax administration (ETA) OIC is based on economic hardship and the assessed liability is less than $250,000
   b. Taxpayer declines to amend or increase an offer even though the taxpayer has no specific disagreement with the numbers used by Collection in determining the RCP
   c. Disputed issue is explicitly addressed by IRS guidance or authority (e.g., tuition for private schools not part of OIC expense calculation)
   d. Cases in which Delegation Order 5-1 requires a level of approval higher than that of a Collection group manager

9. Issues for which mediation would be inconsistent with sound tax administration

10. Issues that other guidance has excluded from FTMC

Application Process

Either the taxpayer or Collection can initiate a request to participate in FTMC. The taxpayer and the Collection group manager must jointly complete and sign Form 13369, Agreement to Mediate. By signing Form 13369, the parties acknowledge confidentiality and disclosure requirements, and the taxpayer agrees to disclosure of tax return and return information. **Figure 10.10** shows the acknowledgment portion of Form 13369.

**FIGURE 10.10 Form 13369 Acknowledgment**

IRS and Treasury employees who participate in any way in the mediation process and any person under contract to the IRS invited to participate, will be subject to the confidentiality and disclosure provisions of the Internal Revenue Code, including I.R.C. sections 6103, 7213, 7213A, and 7431. See also 5 U.S.C. section 574. The parties also acknowledge that IRS and all other Treasury employees involved in the mediation are bound by I.R.C. section 7214(a)(8) and must report information concerning violations of any revenue law to the Secretary. The Mediator will have the right to ask either party for additional information if deemed necessary for a full understanding of the issues being mediated. A copy of any submission a party gives to the mediator will be provided simultaneously to the other party. The Taxpayer consents to the disclosure by the IRS of the Taxpayer’s returns and return information incident to the mediation to any participant or observer for the Taxpayer, including persons providing expert assistance for the IRS. If the mediation agreement is executed by a person pursuant to a power of attorney executed by the Taxpayer, that power of attorney must clearly express the Taxpayer’s grant of authority to consent to disclose the Taxpayer’s returns and return information by the IRS to third parties, and a copy of that power of attorney must be attached to this agreement.

The parties must complete one Form 13369 for all OIC or TFRP issues in a taxpayer’s case that are submitted for FTMC. The taxpayer must submit a written summary of its position. Collection must also submit a written summary of its position. The Appeals team manager reviews the request and confers with the Appeals Office of Tax Policy and Procedure regarding acceptance of the request. If Appeals denies the request for FTMC, the Appeals manager notifies the taxpayer and the Collection group manager. The denial is final and not subject to administrative appeal or judicial review.
Post-Appeals Mediation

Rev. Proc. 2014-63, 2014-53 I.R.B. 1014, consolidates prior procedures for Post-Appeals Mediation (PAM) of examination or collection cases and issues into a single procedure. The procedure is used only after Appeals settlement discussions are unsuccessful and generally all other issues are resolved (except for the issues for which mediation is requested). Mediation is an optional method to resolve disputes. The goal is to reach a resolution in 60 to 90 days.

PAM is available for the following:

1. Legal issues
2. Factual issues
3. Compliance coordinated issues (CCI) or Appeals coordinated issues (ACI) if the taxpayer did not decline a meeting with the CCI or ACI coordinator during the regular Appeals discussions
4. An unagreed early referral issue
5. Issues for which a request for competent authority assistance has not yet been filed
6. Unsuccessful attempts for a closing agreement under I.R.C. § 7121
7. Certain OIC issues (same as OIC issues allowed for FTMC)
8. Certain TFRP issues (same as TFRP issues allowed for FTMC)

PAM is not available for issues like those excluded from SB/SE FTS. It is also not available for OIC or TFRP issues (other than those allowed for FTMC), and it excludes cases that were previously mediated through a different alternative dispute resolution program within Appeals, such as FTS or FTMC [see Rev. Proc. 2014-63 § 4].

Mediation is not available for issues that were submitted as an alternative to collection in a CDP or equivalent hearing case, cases that involve an issue of liability that was previously determined by Appeals, or cases worked solely at an Appeals campus/service center site. Mediation is not available to resolve issues regarding whether the TFRP penalty is collectible.

Settlement Process

An Appeals team manager assigns an Appeals officer who is trained in mediation (FTS Appeals official) to serve as facilitator, assist in defining issues, and assist Collection and the taxpayer to reach a mutually satisfactory resolution consistent with applicable law. The Appeals mediator holds a mediation session, which may include joint sessions with both parties, or separate sessions with each party. Any submission by one party is made available to the other. Each party must have at least one participant with decision-making authority present during the mediation session as well as those persons with information and expertise necessary to assist the parties.

If meaningful progress toward resolution has stopped, the mediator may terminate the session. The mediator may also terminate the session if certain actions taken by either party would substantially delay the session. Any issue that is the subject of a terminated mediation session is treated as mediated for purposes of determining post-Appeals mediation eligibility. If either party withdraws prior to the start of the mediation session, the taxpayer will not be treated as having participated in mediation for purposes of post-Appeals mediation eligibility.

Conclusion of Settlement

At the conclusion of the mediation session, the Appeals mediator prepares a brief written report by completing Form 13370, Fast Track Mediator’s Report. If the issues are resolved, Collection secures the appropriate closing documents and closes the case through the established closing procedures for OIC or TFRP cases. If there are any unresolved issues, Collection closes the case in accordance with established unagreed closing procedures. If the parties do no reach agreement, the taxpayer can request a hearing before Appeals. Post-Appeals mediation is not available.
Application Process

As with the previously discussed programs, both parties must agree to participate in the process. To request mediation, the taxpayer sends a written request to the appropriate Appeals team manager and to the Appeals area director. The request should include all taxpayer identifying and contact information; the name of the team case leader, Appeals officer, or settlement officer; the tax periods involved; a description of each issue and the amount in dispute; and a representation that the issue is not excluded under Rev. Proc. 2014-63.

The Appeals team manager confers with the Appeals Office of Tax Policy and Procedure before accepting or rejecting the application. If the request is denied, the taxpayer may request a meeting with the Appeals team manager, but the denial is not subject to judicial review.

If the application is approved, the taxpayer and Appeals enters into a written agreement to mediate, which should be as concise as possible and include the following:

1. The issue(s) to be mediated
2. An initial list of witnesses, attorneys, representatives, and observers for each party
3. The location and proposed date of the mediation session
4. A statement prohibiting ex parte contact between the mediator and the parties

The taxpayer must also consent under I.R.C. § 6103(c) to the disclosure of the taxpayer’s returns and return information to the mediator, any participant or observer identified in the initial list, and any other person subsequently designated in writing by the parties.

Settlement Process

The taxpayer and the Appeals team manager select the Appeals mediator from a list of trained employees. Appeals pays all the expenses of the mediator. At the taxpayer’s expense, the taxpayer may elect to use a co-mediator who is not employed by the IRS. Suggested criteria for this co-mediator include completion of mediation training, previous mediation experience, substantive knowledge of tax law, or knowledge of industry practices. The mediators serve as facilitators, to assist in defining the issues and promote settlement negotiations between the parties.

The parties submit discussion summaries to the mediator who then conducts a mediation session. The mediation process is confidential. All information concerning any dispute resolution communication is confidential and may not be disclosed by any participant, observer, or mediator. Confidential communications include all oral or written communications prepared for the purposes of the proceeding.

Conclusion of Settlement

At the conclusion of the mediation process, the mediator prepares a brief written report and provides each party with a copy. If there is agreement on all or some of the issues, Appeals will use established procedures to close the case, including preparation of a Form 906. A statutory notice of deficiency is issued for the remaining unagreed issue(s).

Rapid Appeals Process

I.R.M. § 8.26.11 contains the procedures for an elective alternative dispute resolution method available to taxpayers who appealed either

- an LB&I sourced case, except international individual compliance (IIC) cases; or
- SB/SE estate and gift cases.

Appeals administers this Rapid Appeals Process (RAP) under which taxpayers may be able to elect mediation at the start of their appeal. RAP enables taxpayers and Exam to work together to expedite the resolution of unagreed issues in Appeals. It is a voluntary process that allows Appeals to convert the preconference meeting between the taxpayer and the IRS examiners into a mediation session where Appeals helps the parties resolve disputed issues. If mediation is unsuccessful, the traditional Appeals process continues.
RAP is not available for the following:

1. Constitutional issues
2. Issues designated for litigation, under consideration for designation for litigation, or docked in a court
3. Issues for which a taxpayer requests the simultaneous Appeals/competent authority procedure
4. IIC cases
5. Whipsaw issues
6. Issues excluded by other IRS guidance
7. Issues for which mediation is inconsistent with sound tax administration

**RAP Session**

Exam, the taxpayer, and Appeals are parties to the RAP. Others who have knowledge and expertise to contribute to issue resolution, such as technical specialists, can also participate. To facilitate the progress of the RAP, the taxpayer is asked to sign Form 14525, Waiver of Restrictions on Ex Parte Communications in Rapid Appeals Process.

Appeals leads the RAP session, but all three parties are active participants. Appeals uses an interest-based approach to resolve disputed issues. After an initial joint session, Appeals may meet with the parties separately (subject to the ex parte waiver).

**Concluding the RAP**

If after a reasonable time, it is apparent that no further benefit will be derived from the process and an agreement cannot be reached, any party may jointly or separately terminate the RAP. If terminated, the taxpayer is entitled to traditional Appeals consideration. If a settlement is reached, Appeals provides a copy of the Schedule of Adjustments notated with the basis of settlement. All parties sign the schedule to indicate agreement with the settlement. The Appeals officer may follow up with a brief memorandum of understanding for the parties to acknowledge or the officer may have the parties provide a letter or email confirming the terms of the settlement. Appeals closes the case under normal Appeals closing procedures.