

- 4.19.15 Discretionary Programs
 - 4.19.15.1 Program Scope and Objectives
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Part 4. Examining Process

Chapter 19. Liability Determination

Section 15. Discretionary Programs

4.19.15 Discretionary Programs

Manual Transmittal

May 20, 2019

Purpose

(1) This transmits revised IRM 4.19.15, *Liability Determination, Discretionary Programs*.

Material Changes

(1) IPU 19U0343 issued 03-15-2019 IRM 4.19.15.3.1(4), *Lifetime Learning Credit and American Opportunity Tax Credit (AOTC)*, Evaluating Responses, Lifetime Learning Credit ONLY table, editorial change to correct a typographical error for the modified AGI amount for 2017.

(2) Removed Exhibit 4.19.15-1, *Form 886-A2 - For Information Purpose Only*, it is obsolete.

(3) Removed Exhibit 4.19.15-2, *Form 886-A - Underreported Tip Income*, it is obsolete.

(4) Removed Exhibit 4.19.15-3, *EBE Questions*, it is now Form 13825 available in the Electronic Publishing Product Catalog.

(5) Exhibit 4.19.15-4, *Schedule C - General Questionnaire*, has been renumbered as Exhibit 4.19.15-1.

(6) Removed Exhibit 4-19-15-5, *Form 886-A - Schedule C - Car and Truck Expenses*, it is obsolete.

(7) Exhibit 4.19.15-6, *Schedule C - Car and Truck questionnaire*, has been renumbered as Exhibit 4.19.15-2.

(8) Removed Exhibit 4.19.15-7, *Form 886-A - Schedule C - Travel, Meals and Entertainment Expenses*, it is obsolete.

- Tax Credit (AOTC)** (9) Exhibit 4.19.15-8, *Schedule C - Travel, Meals and Entertainment Expense Questionnaire*, has been renumbered as Exhibit 4.19.15-3.
- **4.19.15.3.1.1 Education Tax Credits** (10) Removed Exhibit 4.19.15-9, *Form 886-A - Schedule C - Interest Expense*, it is obsolete.
 - **4.19.15.3.1.2 - Evaluating Taxpayer Responses** (11) Removed Exhibit 4.19.15-10, *Form 886-A - Schedule C - Legal and Professional Fees*, it is obsolete.
 - **4.19.15.3.2 Tuition and Fees Deduction** (12) Removed Exhibit 4.19.15-11, *Form 886-A - Schedule C - Repairs and Maintenance*, it is obsolete.
 - **4.19.15.4 Mortgage Interest Credit** (13) Exhibit 4.19.15-12, *Schedule C - Repairs and Maintenance Questionnaire*, has been renumbered as Exhibit 4.19.15-4.
 - **4.19.15.4.1 Initial Contact** (14) Removed Exhibit 4.19.15-13, *Form 14810 - Schedule A - Taxes You Paid*, it is available in the Electronic Publishing Product Catalog.
 - **4.19.15.4.2 Conducting the Examination** (15) Removed Exhibit 4.19.15-14, *Form 886-A - Schedule A - Other Miscellaneous Deductions*, it is now Form 14983 available in the Electronic Publishing Product Catalog.
 - **4.19.15.4.3 Evaluating Taxpayer Responses** (16) Removed Exhibit 4.19.15-15, *Form 14978 - Moving Expenses Deduction Supporting Documents*, it is available in the Electronic Publishing Product Catalog.
 - **4.19.15.4.4 Form 886-A Explanations and Tax Resources** (17) Removed Exhibit 4.19.15-16, *Form 14808- Schedule A Medical and Dental Expenses*, it is available in the Electronic Publishing Product Catalog.
 - **4.19.15.5 Adoption Credit and Qualified Adoption Expenses (QAE)** (18) Removed Exhibit 4.19.15-17, *Form 14809 - Schedule A - Interest You Paid*, it is available in the Electronic Publishing Product Catalog.
 - **4.19.15.5.1 Eligible Child Claiming the Credit** (19) Removed Exhibit 4.19.15-18, *Form 14804 - Schedule A - Gifts to Charity*, it is available in the Electronic Publishing Product Catalog.
 - (20) Removed Exhibit 4.19.15-19, *Form 14805 - Schedule A - Casualty and Theft Loss*, it is available in the Electronic Publishing Product Catalog.
 - (21) Removed Exhibit 4.19.15-20, *Form 886-A - Schedule A - Job Expenses and Other Miscellaneous*, it is obsolete.
 - (22) Editorial changes to update referenced forms, correct referenced IRMs, correct forwarding mail stops, and their links throughout IRM 4.19.15. Exhibits for published forms have been removed with all corresponding links and references corrected.
- Effect on Other Documents**
- This IRM supersedes IRM 4.19.15, *Liability Determination, Discretionary Programs*, dated March 11, 2019. The following IRM Procedural Updates have been incorporated into this IRM: 19U0343.
- Audience**

- or
Exclusion This IRM is intended for the use of SB/SE (Small Business/Self-Employed) and W&I (Wage and Investment) Campus Examination
- 4.19.15.5.1.1 **Effective Date**
Determining the Year a Foreign Adoption Becomes Final (05-20-2019)
Maha Williams
Director, Examination - Field and Campus Policy
Small Business Self Employed
 - 4.19.15.5.1.2 **4.19.15.1 (12-01-2017)**
Non-Hague Adoptions **Program Scope and Objectives**
 1. This section is used by Small Business/Self Employed (SB/SE) and Wage and Investment (W&I) Campus Examination to review and process taxpayers' correspondence received in response to examination notices. Other IRM chapters will be referenced throughout this IRM to provide specific guidance for individual topics. Examination employees are responsible for researching and utilizing information contained in all reference materials.
 - 4.19.15.5.1.3 Hague Adoptions
for individual topics. Examination employees are responsible for researching and utilizing information contained in all reference materials. Legal citations, form and letter references, and IRM references were reviewed and updated as necessary.
 - 4.19.15.5.1.4 Custodial Agreements Followed by Adoption in the United States
2. **Purpose:** This transmits revised IRM 4.19.15, *Liability Determination, Discretionary Programs*
 - 4.19.15.5.1.5 Hague Adoption Convention
3. **Audience:** This IRM is intended for the use of the SB/SE and W&I Campus Examination.
 - 4.19.15.5.2 Research and Initial Contact **4.19.15.1.1 (12-01-2017)**
1. This section contains information on examination procedures and administrative matters relative to the Discretionary Programs and provides a reference for common issues and related items that might be found on tax returns.
 - 4.19.15.5.3 Evaluating Responses **4.19.15.1.2 (12-01-2017)**
Authority
 - 4.19.15.5.4 Special Needs Adoptions
1. There are various code sections providing IRS authority to examine individual tax returns for correctness. See IRM 1.2.13, *Policy Statements for the Examining Process*.
 - 4.19.15.5.5 Carry Forwards **4.19.15.1.3 (12-01-2017)**
 - 4.19.15.5.6 Credit Limitations **Roles and Responsibilities**

- 4.19.15.6 Tax Benefits for Kidnapped Children
 - 4.19.15.7 Questionable Refund Cases
 - 4.19.15.8 Alternative Minimum Tax
 - 4.19.15.8.1 Alternative Minimum Tax Procedures
 - 4.19.15.9 Estate and Gift Tax
 - 4.19.15.10 Math/Clerical Error
 - 4.19.15.11 Non-Earned Income Tax Credit Duplicate TIN (Non-EITC DUP TIN)
 - 4.19.15.11.1 Initial Contact
 - 4.19.15.11.2 Processing Taxpayer Replies
 - 4.19.15.11.3 Related Taxpayer(s)
 - 4.19.15.12 Self-Employment Tax (SET)
 - 4.19.15.12.1 Self-Employment Tax Procedures
1. Liability Determination - Discretionary Programs is used in Campus Examination Operations by managers, coordinators, examiners, and clerical staff to work, control, and monitor inventory for discretionary tax issues in both SB/SE and W&I
- 4.19.15.1.4 (12-01-2017)**
- Program Management and Review**
1. **Program Reports:** See IRM 4.4.27 , *Reports*.
- 4.19.15.1.5 (12-01-2017)**
- Program Controls**
1. See IRM 4.19.20, *Automated Correspondence Exam (ACE) Processing Guidelines*.
- 4.19.15.1.6 (12-01-2017)**
- Terms/Definitions/Acronyms**
1. Acronyms used within IRM 4.19.15 are shown in the table below:
- | Acronym | Definition |
|----------------|---|
| AAR | Administrative Adjustment Request |
| ACA | Affordable Care Act |
| ACE | Automated Correspondence Examination |
| AGI | Adjusted Gross Income |
| AIMS | Audit Information Management System |
| AM | Accounts Management |
| AMT | Alternative Minimum Tax |
| AOTC | American Opportunity Tax Credit |
| APTC | Advance Premium Tax Credit |
| ARC | Aging Reason Code |
| ARRA | American Rebate Recovery Act |
| ASED | Assessment Statute Expiration Date |
| ATAA | Alternative Trade Adjustment Assistance |
| ATTI | Abusive Transactions and Technical Issues |
| AVS | ACA Verification System |

- 4.19.15.13 SS-8 Determination of Worker Status
- 4.19.15.14 TEFRA (Tax Equity and Fiscal Responsibility Act)
 - 4.19.15.14.1 Form 8082, Notice of Inconsistent Filers
- 4.19.15.15 Unallowable Code (UA) Program
 - 4.19.15.15.1 Unallowable Code Assignment and AIMS Opening
 - 4.19.15.15.2 Identifying Unallowable Inventory to be Classified
 - 4.19.15.15.3 Reviewing and Classifying Unallowable Inventory
 - 4.19.15.15.4 Initial Taxpayer Contact
 - 4.19.15.15.5 Processing Reply/No Reply

Acronym	Definition
BMF	Business Master File
BOD	Business Operating Division
CAS	Customer Accounts Service
CDR	Coverage Data Repository
CEAS	Correspondence Examination Automation Support
CHIP	Children's Health Insurance Program
CI	Criminal Investigation
CIS	Correspondence Imaging System
COBRA	Consolidated Omnibus Budget Reconciliation Act
CRN	Credit Reference Number
CSED	Collection Statute Expiration Date
CSEO	Compliance Services Examination Operations
DC	Disposal Code
DDb	Dependent Database
DEBR	Discretionary Examination Business Rules
DFAS	Defense Finance and Accounting Services
DIF	Discriminate Information Function
DOL	Department of Labor
EBE	Employee Business Expenses
EC	Error Code
ECID	Examination Closing Input Document
EGC	Employee Group Code
EIN	Employer Identification Number
EITC	Earned Income Tax Credit
ERS	Error Resolution System
ERSED	Erroneous Refund Statute Expiration Date
ETNF	Employment Tax Non Filer

- Unallowable Cases
- 4.19.15.15.6 Transcripts
 - 4.19.15.15.6.1 Resolving the -Q Freeze
- 4.19.15.15.7 Unallowable Program and Alternative Motor Vehicle, Electric Plug In Credit or Electric Drive Motor Vehicle Credit
- 4.19.15.15.8 Unallowable Program and First Time Homebuyer Credit
- 4.19.15.15.9 Unallowable Program and Health Coverage Tax Credit
- 4.19.15.15.10 Unallowable Program and the District of Columbia First-Time Homebuyer Credit Carryforward

Acronym	Definition
EUP	Employee User Portal
FCR	Federal Case Registry
FEHBP	Federal Employees Health Benefits Program
FICA	Federal Insurance Contributions Act
FITW	Federal Income Tax Withholding
FMV	Fair market Value
FPL	Federal Poverty Line
FAFSA	Federal Student Aid
FSA	Flexible Spending Account
FTC	Fuel Tax Credit
FTD	Failure to Deposit
FTF	Failure to File
FTHBC	First-Time Home Buyer Credit
FTP	Failure to Pay
FUTA	Federal Unemployment Tax Act
HSA	Health Savings Account
HCTC	Health Coverage Tax Credit
HHS	Health and Human Services
HOH	Head of Household
HQ	Headquarters
ICL	Initial Contact Letter
ICM	Inventory Control Manager
IDT	Identity Theft
IMF	Individual Master File
ITIN	Individual Taxpayer Identification Number
LB&I	Large Business & International
LDC	Lead Development Center

- [4.19.15.16 Fuel Tax Credit Claimed on Form 4136](#)
- [4.19.15.17 Erroneous Refunds](#)
- [4.19.15.18 Alimony](#)
 - [4.19.15.18.1 Initial Contact and General Processing](#)
 - [4.19.15.18.2 No Reply](#)
 - [4.19.15.18.3 Processing Taxpayer Replies](#)
 - [4.19.15.18.4 Workpapers](#)
 - [4.19.15.18.5 Research](#)
 - [4.19.15.18.6 Documentation](#)
 - [4.19.15.18.7 Legal Terminology](#)
 - [4.19.15.18.8 Death Contingency](#)
 - [4.19.15.18.9 Pension Income](#)
- [4.19.15.19 What is DIF CORR \(Source Code 06\)](#)
 - [4.19.15.19.1 Procedures for DIF CORR \(Source Code 06\)](#)

Acronym	Definition
LUQ	Large Unusual Questionable
MAGI	Modified Adjusted Gross Income
MCC	Mortgage Credit Certificate
MeF	Modernized Electronically Filed
NRA	Non Resident Alien
OASDI	Old Age, Survivors, and Disability Insurance
OPM	Office of Personnel Management
OPR	Office of Professional Responsibility
PBC	Primary Business Code
PBGC	Pension Benefit Guaranty Corporation
PC	Project Code
PCS	Partnership Control System
PTC	Premium Tax Credit
QAE	Qualified Adoption Expenses
QDRO	Qualified Domestic Relations Order
QFM	Qualifying Family Member
QRP	Questionable Refund Program
RA	Revenue Agent
RC	Reasonable Cause
RGS	Report Generation Software
RO	Revenue Officer
RPAT	Return Preparer Analysis Tool
RPP	Return Preparer Program
RRTA	Railroad Retirement Tax Act
RURT	Railroad Unemployment Repayment Tax
SB/SE	Small Business/Self Employed
SC	Source Code

- 4.19.15.20
Schedule A
 - 4.19.15.20.1
Nondeductible
Medical
Expenses
 - 4.19.15.20.2
Taxes Paid
 - 4.19.15.20.3
Home
Mortgage
Interest
Deductions
 - 4.19.15.20.3.1
General
Requirements
 - 4.19.15.20.3.2
Evaluating
Taxpayer
Responses
 - 4.19.15.20.3.3
Limits
on the
Home
Mortgage
Interest
Deduction
 - 4.19.15.20.3.4
Excess
Mortgage
Interest
Deduction
IRC
163
 - 4.19.15.20.3.4.2
Evaluating
Excess
Mortgage
Interest
Deduction

Acronym	Definition
SCHIP	State Children’s Health Insurance Program
SDC	Scheme Development Center
SEHID	Self-Employment Health Insurance Deduction
SFR	Substitute For Return
SLCSP	Second Lowest Cost Silver Plan
SNOD	Statutory Notice of Deficiency
SP	Submission Processing
SPC	Special Processing Code
SQPs	State-Qualified Plans
SSA	Social Security Administration
SSIVL	Statistical Sampling Inventory Validation
SSN	Social Security Number
TAA	Trade Adjustment Assistance
TC	Tracking Code
TCO	Tax Compliance Officer
TEFRA	Tax Equity and Fiscal Responsibility Act
TETR	Telephone Excise Tax Refund
TIN	Taxpayer Identification Number
TPA	Third party Administrator
UA	Unallowable Code
VEBA	Voluntary Employees’ Beneficiary Association
W&I	Wage and Investment
WHBAA	Worker Homeownership and Business Assistance Act
WSD	Workload Selection and Delivery

4.19.15.1.7 (12-01-2017)

References

1. Other IRMs referenced within IRM 4.19.15 are:

- Interest
 - IRM 1.2.13 , *Policy Statements for the Examining Process*
 -
 - Taxpayer Responses
 - IRM 1.2.43, *Delegations of Authority for the Examining Process*
 - IRM 4.4.29, *Social Security Administration Adjustments*
- 4.19.15.21 Charitable Contributions
 - IRM 4.10, *Examination of Returns*
 - 4.19.15.21.1 Qualifying Payments
 - IRM 4.19.6, *SSA Correspondence, Minister/Religious Waivers, and Information Return Penalties (IRP)*
 - 4.19.15.21.2 Qualifying Organizations
 - IRM 4.19.10, *Examination General Overview*
 - IRM 4.19.11, *Examination Classification of Work*
 - 4.19.15.21.3 Cash and Non-cash Contributions
 - IRM 4.19.13, *General Case Development and Resolution*
 - IRM 4.19.14, *EITC/Revenue Protection Strategy*
 - 4.19.15.21.4 Amount of Contribution Deduction
 - IRM 4.19.16, *Claims*
 - IRM 4.19.17, *Non-Filer Program*
 - 4.19.15.21.4.1 Acceptable Documentation for Charitable Contributions
 - IRM 4.23.7, *Employment Tax on Tip Income*
 - IRM 4.25, *Estate and Gift Tax*
 - IRM 21.1.3, *Operational Guidelines Overview*
 - 4.19.15.21.4.2 Limitations on Contributions
 - IRM 21.4.5, *Erroneous Refunds*
 - IRM 21.6.3, *Credits*
 - 4.19.15.21.4.3 Additional Research Material
 - IRM 25.6.1, *Statute of Limitations Processes and Procedures*
 - 4.19.15.21.4.4 Charitable Contribution Rules - Project Code 0391, Project Code 0392 and Project
 - **4.19.15.2 (03-11-2019) Child and Dependent Care Credit**
 1. The following guidelines are used to determine if the taxpayer qualifies for the Child and Dependent Care Credit:
 - The limit on the amount of qualifying expenses that can be taken into account in computing the credit is \$3,000 for one qualifying person or \$6,000 for two or more qualifying persons. The amount of qualifying expenses after applying the limit is reduced by the aggregate amount of dependent care assistance excludable from gross income for the tax year.

Code 0629 • The credit can be as much as 35 percent of qualifying expenses. Refer to Form 2441, *Child and Dependent Care Expenses*, for computation.

- 4.19.15.21.4.4.1
Initial Contact 2. A standard Exam letter will be issued requesting verification of items claimed on the return. Cases will be assigned the following project codes
 - 4.19.15.21.4.4.2
No Response Cases (PC): PC 0393 Child Care Credit and the taxpayer is filing Married Filing Separately; PC 0394 Child turned age 13 during the first half of the year; PC 0400 Child Care Credit/Dependent age greater than 12 years, and PC 0628 duplicate dependent for child tax credit, child and dependent care credit or education credit. See IRM 4.19.15.11, *Non-Earned Income Tax Credit Duplicate Taxpayer Identification Number (Non-EITC DUP TIN)*, for additional guidance on PC 0628 duplicate dependent cases.

Processing Taxpayer Replies to Letter 566-S 3. The charts below will be helpful in determining what can be accepted to verify amounts claimed for the Child and Dependent Care Credit.

A Qualifying Person is:	Verifying Information:
<p>The taxpayer's dependent qualifying child who was under age 13 when the care was provided. Generally, the taxpayer must claim a dependency exemption for the child to claim the credit. However, if a non-custodial parent claims a dependency exemption for the child under the special rule regarding a child of divorced or separated parents or parents who live apart at all times during the last six months of the year, the child is treated as a qualifying person of the custodial parent, not the non-custodial parent for purposes of the credit. The custodial parent must meet the other requirements for claiming the credit.</p>	<p>Age verification - Birth certificate, school records, or baptismal certificate. Qualifying Child Verification - See IRM 4.19.14.6.5, <i>Personal Exemptions and Dependents</i>.</p>
<p>The taxpayer's spouse who was physically or mentally not able to care for himself/herself and who lived with the taxpayer for more than half of the year except for temporary absences.</p>	<p>Marriage certificate (proof of spouse). Proof of disability: doctor's statement or state certification.</p>

- 4.19.15.22
Casualty and Theft Losses
- 4.19.15.23
Employee Business Expense (EBE) Cases
 - 4.19.15.23.1
Evaluating EBE Taxpayer Responses
 - 4.19.15.23.2
Additional Information
- 4.19.15.24
Miscellaneous Deductions - IRC 67
- 4.19.15.25
Return Preparer Referrals
 - 4.19.15.25.1
Role of the

- Exam RPP Coordinator
- 4.19.15.25.2 Referral Process and AIMS Opening
- 4.19.15.25.3 Controlling RPP Returns
- 4.19.15.25.4 Procedures for Examining RPP Cases
- 4.19.15.25.5 Examining the Schedule A on Preparer Referrals
- 4.19.15.25.6 Examining the Schedule C on Preparer Referrals
- 4.19.15.26 Correspondence Exam Tip Program
 - 4.19.15.26.1 Commonly Used Terms
 - 4.19.15.26.2 Contents of Case File
 - 4.19.15.26.3 Case Processing General Information

A Qualifying Person is:	Verifying Information:
<p>The taxpayer’s dependent who was physically or mentally not able to care for himself/herself, who lived with the taxpayer for more than half of the year except for temporary absences, and for whom the taxpayer can claim an exemption (or for whom the taxpayer could claim an exemption except that:</p> <ul style="list-style-type: none"> a. The person had gross income of, \$3,650 or more for 2010, \$3,700 or more for 2011, \$3,800 or more for 2012, \$3,900 for 2013, \$3,950 or more for 2014, \$4,000 or more for 2015, and \$4,050 or more for both 2016 and 2017 b. The person filed a joint return, or c. The taxpayer, or spouse if married filing jointly, was a dependent of another taxpayer). 	<ul style="list-style-type: none"> a. Proof of the person's residence: school records, official mail, or local library card. b. If disabled, doctor's statement or state certification to verify the individual's disability.
<p>The Filing Status of the taxpayer must be Single, Head of Household, Qualifying Widow(er) With Dependent Child, or Married Filing Jointly. If married, a joint return must be filed unless the taxpayer meets the rules to be considered unmarried head of household.</p>	<p>Information is on the return and IMFOL.</p>

Eligibility Requirements Test:	Verifying Information:
<p>The taxpayer and the taxpayer's spouse, if the taxpayer is married, must have earned income during the year. However, a special rule applies to a spouse who is a full-time student or who is unable to care for himself/herself.</p>	<p>Form W-2, <i>Wage and Tax Statement</i>, or Form 1099. Schedule C, E, or F, if no Form 1099 income.</p>

- 4.19.15.26.3.1
Filed Returns Initial Contact
- 4.19.15.26.3.2
Non-Filers
- 4.19.15.26.4
Case Processing Revised Reports and Responses to 90 day Letters
- 4.19.15.26.5
Case Processing Closing Actions and Other Information

Eligibility Requirements Test:	Verifying Information:
<p>The taxpayer must pay child and dependent care expenses so that the taxpayer and the taxpayer's spouse, if the taxpayer is married, can work or look for work.</p>	<ul style="list-style-type: none"> a. Proof of payment includes receipts or cancelled checks. If the expenses claimed were incurred while looking for work, examine interview sheets, job placement letters/statements, calendar/log/statements showing interview appointments and dates, or places applied to for work. b. If the expenses claimed were for any month in which the taxpayer or the taxpayer's spouse was a full-time student, examine letters/ transcripts from the school showing full-time course load and the specific number of months of enrollment.

- 4.19.15.27 10 Percent Additional Tax on Early Distributions IRC 72(t) & IRC 72(q)
 - 4.19.15.27.1
Procedural Instructions
- 4.19.15.28
Gambling Issues (Income and Losses) - General
 - 4.19.15.28.1
Initial Contact for Gambling Income
 - 4.19.15.28.2
Evaluating

Payments	Verifying Information
<p>The identity of the care provider must be reported on the tax return.</p>	<p>The return must include the name, address, and Taxpayer Identification Number (TIN) of the care provider. If the care provider is an individual, the return must include a Social Security Number (SSN) or an ITIN. If the care provider is an organization/corporation, the return must include an Employer Identification Number (EIN). The EIN/TIN does not have to be provided if the care provider is a tax-exempt organization (such as a church or school). If the care provider information given is incorrect or incomplete, the credit may still be allowed if the taxpayer demonstrates due diligence in trying to supply the information.</p>

Gambling Issue Responses

- 4.19.15.28.2.1 Gambling Losses IRC 165(d)
- 4.19.15.28.2.2 Gambling Income
- 4.19.15.28.2.3 Replies General Processing
- 4.19.15.28.2.4 No Response Cases

- 4.19.15.28.3 Special Gambling Closing Procedures

- 4.19.15.29 Health Coverage Tax Credit IRC 35
 - 4.19.15.29.1 HCTC Case Selection & Classification
 - 4.19.15.29.2 Research for HCTC Cases
 - 4.19.15.29.3 Initial Contact & No Response Procedures
 - 4.19.15.29.4 HCTC Responses

Payments	Verifying Information
The taxpayer must pay child and dependent care expenses to a provider the taxpayer or spouse cannot claim as a dependent. If payments are made to a child of the taxpayer, the child cannot be the taxpayer's dependent and must be age 19 years or older by the end of the year. In addition, payments to the taxpayer's spouse or the parent of the taxpayer's qualifying person if that person is the taxpayer's child and under age 13 do not qualify for the credit.	Name on the receipts or cancelled checks. If the taxpayer and the care provider have the same surname, determine if the taxpayer claimed the care provider as a dependent. If the taxpayer did not claim the care provider as a dependent, verify the age of the care provider using INOLE.
Adjustment must be made for any dependent care assistance (payments or benefits) provided by the employers.	Form W-2 or letter from employer.

4. If the above conditions are met, compute the allowable credit.
5. Expenses for a child to attend kindergarten or a higher grade, do not qualify for the Child and Dependent Care Credit. Expenses for before-school or after-school care of a child in kindergarten or a higher grade may qualify for the credit.
6. Cases that are not initiated through ACE (Automated Correspondence Examination) must be worked as follows:
 - a. Issue Letter 566-B (combo letter) with Form 4549, *Income Tax Examination Changes*, if during initial research (DUPOL, DDBKD), it appears that a duplicate dependent was used to obtain a dependent care expense, or
 - b. Issue Letter 566-B if initial research indicates: 1) The credit is for a child who is over 12 years, or 2) The Filing Status is Married Filing Separately
 - c. If neither of the two conditions mentioned in (a) or (b) are met, issue Letter 566-S.

- 4.19.15.29.5 Case Closure
 - 4.19.15.30 Self-Employed Health Insurance Deduction IRC 162(l)
 - 4.19.15.30.1 Self-Employed Health Insurance Deduction
 - 4.19.15.30.2 Initial Contact Letter
 - 4.19.15.30.3 Evaluating Responses
 - 4.19.15.30.4 Potential Documentation
 - 4.19.15.30.5 Resources To Assist In Technical Determination
 - 4.19.15.30.6 Replies General Processing
 - 4.19.15.31 Form 1040, Schedule C - Correspondence Examination
 - 4.19.15.31.1 Schedule C - Car and Truck Expenses
 - 4.19.15.31.2 Schedule
 - d. Request applicable documentation.
 - e. Follow normal procedures to work the case.
 - f. If taxpayer is allowed the credit and a duplicate dependent exists, you must open the other duplicate dependent case and disallow the credit.
7. Additional information regarding the Child and Dependent Care Credit is found in:
- Publication 503, *Child and Dependent Care Expenses*
 - Publication 17, *Your Federal Income Tax (For Individuals)*
 - Instructions for Form 2441, Child and Dependent Care Expenses
- 4.19.15.3 (03-11-2019)**
- Education Tax Benefits - General Requirements and Exam Programs**
1. The IRS offers a number of tax incentives for taxpayers pursuing post-secondary (after high school) education:
- The Hope Credit was a non-refundable tax credit available for the first two years of post-secondary education only. The Hope Credit was replaced in the 2009 tax year by the American Opportunity Tax Credit (AOTC)
 - The AOTC is available for the first four years of post-secondary education only. Forty percent of the AOTC is refundable. The remainder is a non-refundable credit against the taxpayer's tax liability.
 - Congress extended the Tuition and Fees Deduction for 2017 in section 40203 of the Bipartisan Budget Act of 2018, Pub. L. 115-123, div. D, title I, §40203(a), Feb. 9, 2018, 132 Stat. 145. The Tuition and Fees Deduction is not available for Tax Year 2018 unless Congress extends it.
 - The Lifetime Learning Credit is a non-refundable tax credit available for any year of post-secondary education.
 - The Tuition & Fees Deduction reduces the taxpayer's adjusted gross income (AGI). It is available for any year of post-secondary education.
2. A taxpayer cannot claim the Lifetime Learning Credit, the Hope Credit/AOTC or the Tuition & Fees Deduction if any of the following apply:
- a. The taxpayer's filing status is married filing separately
 - b. The taxpayer is listed as a dependent on another taxpayer's return. **(The taxpayer is ineligible for the Tuition & Fees Deduction if the taxpayer**

- C - Travel Expenses
 - 4.19.15.31.3 Schedule C - Mortgage Interest
 - 4.19.15.31.4 Schedule C - Legal and Professional Fees
 - 4.19.15.31.5 Schedule C - Repairs and Maintenance
- 4.19.15.32 Schedule F Expenses
 - 4.19.15.32.1 Custom Hire
 - 4.19.15.32.2 Gasoline, Fuel and Oil
 - 4.19.15.32.3 Mortgage Interest
 - 4.19.15.32.4 Repairs & Maintenance
 - 4.19.15.32.5 Supplies
- 4.19.15.33 Return Preparer Analysis Tool (RPAT) Program
- 4.19.15.34 CI Education Credit Program

can be claimed as a dependent on someone else’s return, regardless of whether the taxpayer is actually claimed as a dependent.)

c. The taxpayer (or the taxpayer’s spouse) was a nonresident alien for any part of the tax year unless the taxpayer elected to be treated as a resident alien for tax purposes or a treaty applies. More information on nonresident aliens can be found in Publication 519, *U.S. Tax Guide for Aliens*.

Note:

Restrictions specific to each credit/deduction are addressed in the appropriate section.

3. Eligible educational institution An eligible educational institution is any college, university, vocational school, or other postsecondary educational institution eligible to participate in a student aid program administered by the U.S. Department of Education. It includes virtually all accredited public, nonprofit, and proprietary (privately owned profit-making) postsecondary institutions. Certain educational institutions located outside the United States also participate in the U.S. Department of Education’s Free Application for Federal Student Aid (FAFSA) programs. For additional information see the link to the irs.gov page, "What is an Eligible Education Institution?" under additional resources below.

4. The following table provides an overview of the Education Credit/Deduction Programs currently worked in Exam:

Project Code	Description	Initial Contact Letter	Document Request Form
0351	Hope Credit or AOTC: Taxpayers must demonstrate that they are eligible for the credit.	Letter 566-S	Form 886 H-AOC
0402	Duplicate Education Credit & Tuition Deduction	Letter 566-S	Form 14803
0405	Education Credit – Age Related: Taxpayers must demonstrate they are eligible for the credit.	Letter 566-S	Form 886 H-AOC or Form 14807
0406	Hope/AOTC claimed for more than 4 years	Letter 566-S with	Form 886 H-AOTC-MAX and Form 14807

Additional resources include:

- 4.19.15.35 Individual Taxpayer Identification Number (ITIN)
 - 4.19.15.35.1 ITIN Issuance and Expiration
 - 4.19.15.35.2 Resident Alien (RA)
 - 4.19.15.35.3 Child Tax Credit (CTC) and Additional Child Tax Credit (ACTC)
 - 4.19.15.35.4 Initiation
 - 4.19.15.35.5 Earned Income Tax Credit
 - 4.19.15.35.6 Acceptable Documentation
 - 4.19.15.35.7 Employment-Related Identity Theft
- 4.19.15.36 Conversion of Invalid Form 1120S Cases - Background
 - 4.19.15.36.1 Identifying the Form 1120S Return to be Examined
- Pub 970, *Tax Benefits for Education*
- "What is an Eligible Educational Institution" irs.gov page which includes a link to the Department of Education's list of accredited schools.
- Form 8863, *Education Credits (American Opportunity and Lifetime Learning Credits)*
- Form 8917 *Tuition and Fees Deduction* cannot be used if credit is taken on Form 8863.
- IRM 21.6.3.4.1.5, *Form 8863 Education Credits*

4.19.15.3.1 (03-15-2019)

Lifetime Learning Credit and American Opportunity Tax Credit (AOTC)

1. Overview of the Education Tax Credits:

Category	AOTC	Lifetime Learning Credit
Maximum Credit	For Tax Years 2009 and forward: Up to \$2,500 credit per eligible student (Calculated as 100% of first \$2,000 of qualified expenses and 25% on next \$2,000 of qualified expenses, per student).	Up to \$2,000 credit per return (Calculated as 20% of qualified expenses up to \$10,000) (For tax years 2008 & 2009, the maximum credit was \$4,000 per return if a student in a Midwestern disaster area –calculated as 40% of qualified expenses up to \$10,000).
Refundable or nonrefundable	40% of credit is refundable (limited to \$1,000 per student). The rest is nonrefundable.	Nonrefundable-credit limited to the amount of tax liability.
Number of years of postsecondary education	Available ONLY for the first 4 years of postsecondary education. Student must not have completed first 4 years of postsecondary education before the beginning of the tax year.	Student does not need to be pursuing a program leading to a degree or other recognized education credential if the course(s) is taken to acquire or improve job skills.

- 4.19.15.36.2
Examining
the
Converted
Form
1120S
Return
and
Adjusting
the
Shareholders
Returns
- 4.19.15.37
Moving
Expenses IRC
217
 - 4.19.15.37.1
Initial
Contact
Letter
 - 4.19.15.37.2
Evaluating
Responses
 - 4.19.15.37.2.1
Distance
Test
 - 4.19.15.37.2.2
Time
Test
 - 4.19.15.37.3
Additional
Information
- 4.19.15.38
First-Time
Homebuyer
Credit IRC 36
 - 4.19.15.38.1
Conditions
to Qualify
for the
Credit
 - 4.19.15.38.2
Special
Rule for
Long Time
Residents

Category	AOTC	Lifetime Learning Credit
Number of years credit available	Available starting in 2009, ONLY for 4 tax years per eligible student (including an year(s) Hope Credit was claimed).	Available for unlimited number of years.
Type of program required	Student must be pursuing a program leading to a degree or other recognized education credential.	Student does not need to be pursuing a program leading to a degree or other recognized education credential.
Number of courses	Student must be enrolled at least half time for at least one academic period that begins during the tax year.	Available for one or more courses.
Felony drug conviction	No felony drug convictions on student's records.	N/A
Qualified Expenses	Tuition, required enrollment fees, and course materials that the student needs for a course of study whether or not the materials were bought at the educational institution as a condition of enrollment or attendance.	Tuition and fees required for enrollment attendance (including amounts required to be paid to the institution for course-related books, supplies, and equipment). Additional expenses allowed for students in Midwestern disaster areas.

For additional information on tax years prior to 2008, refer to Publication 970, *Tax Benefits for Education*, for the appropriate year.

2. The Hope Credit was available for tax years 2003 through 2008. The American Opportunity Tax Credit (AOTC) replaced the Hope Credit for most taxpayers starting with the 2009 tax year. However, a larger Hope Credit (\$3,600 maximum) was available in 2009 for taxpayers meeting the special

- 4.19.15.38.3 [Research and Initial Contact](#)
 - 4.19.15.38.4 [Evaluating Responses](#)
 - 4.19.15.38.5 [Problem Correction Report](#)
 - 4.19.15.38.6 [Establishing Taxpayer Residency Status](#)
 - 4.19.15.38.7 [Accelerated Recapture of the First-Time Homebuyer Credit](#)
 - 4.19.15.38.8 [Procedures for TY 2008 FTHBC Returns](#)
 - 4.19.15.39 [Multiple Filers](#)
 - 4.19.15.39.1 [Initial Contact](#)
 - 4.19.15.39.2 [Responses](#)
 - 4.19.15.39.3 [Additional Closing Actions](#)
 - 4.19.15.40 [Alternative Motor Vehicle Credit, Qualified Electric Vehicle Credit, or Qualified](#)
- rules for the Midwestern disaster areas. In order to claim the Hope credit for 2009 a taxpayer had to:
- Claim the Hope Credit for at least one student attending an eligible institution in a Midwestern disaster area, and
 - Choose not to claim the AOTC for any student in 2009.
3. The American Opportunity Tax Credit (AOTC) was first available during the 2009 tax year.
- Note:**
The PATH Act made the AOTC permanent.
4. The Hope Credit, AOTC, and the Lifetime Learning credit are phased out (gradually reduced) if the taxpayer's Modified Adjusted Gross Income (MAGI), refer to Pub 970, *Tax Benefits for Education*, is as follows:

Hope Credit and Lifetime Learning Credit

Tax Year	MAGI
2008	Between \$48,000 and \$58,000 (joint return: \$96,000 and \$116,000)
2009	Between \$50,000 and \$60,000 (joint return: \$100,000 and \$120,000)

Lifetime Learning Credit ONLY

Tax Year	MAGI
2010	Between \$50,000 and \$60,000 (joint return: \$100,000 and \$120,000)
2011	Between \$51,000 and \$61,000 (joint return: \$102,000 and \$122,000)
2012	Between \$52,000 and \$62,000 (joint return: \$104,000 and \$124,000)
2013	Between \$53,000 and \$63,000 (joint return: \$107,000 and \$127,000)

Plug-In Electric Drive Motor Vehicle Credit

- 4.19.15.40.1 IRC 30D - Qualified Plug-In Electric Drive Motor Vehicle Credit

Tax Year	MAGI
2014	Between \$54,000 and \$64,000 (joint return: \$108,000 and \$128,000)
2015	Between \$55,000 and \$65,000 (joint return: \$110,000 and \$130,000)
2016	Between \$55,000 and \$65,000 (joint return: \$111,000 and \$131,000)
2017	Between \$56,000 and \$66,000 (joint return: \$112,000 and \$132,000)

- 4.19.15.40.2 IRC 30 Qualified Plug-In Electric and Electric Vehicle Credit

AOTC ONLY

Tax Year	MAGI
2009 forward	Between \$80,000 and \$90,000 (joint return: \$160,000 and \$180,000)

- 4.19.15.40.3 IRC 30B - Alternative Motor Vehicle Credit

4.19.15.3.1.1 (03-11-2019)

Education Tax Credits - Evaluating Taxpayer Responses

- 4.19.15.40.4 Special Situations and Replies
- 4.19.15.40.5 Taxpayer Explanations for Form 886-A

1. General guidelines:

- The two different education credits (the AOTC and the Lifetime Learning Credit) cannot be taken in the same year for the same student. Conversely, more than one credit may be taken on the same return if they are for different students. For instance, a taxpayer may claim the AOTC for an eligible student for whom they claim a dependency exemption, and also claim the Lifetime Learning Credit for themselves.
- Expenses are considered paid by the taxpayer who claims the dependency exemption for the student. If a taxpayer claims the dependency exemption for an eligible student, any expenses paid by the student or a third party are considered paid by the taxpayer. If a taxpayer does not claim a dependency exemption for an eligible student, then the student can claim the education credit on the student's return.
- Taxpayers may not take a double benefit for expenses paid. For instance, a taxpayer may not use excess expenses paid on behalf of a dependent

- 4.19.15.41 Residential Energy Credits
 - 4.19.15.41.1 Nonbusiness Energy Property Credit

- 4.19.15.41.2 Residential Energy Efficient Property Credit
- 4.19.15.41.3 Initial Contact Letter
- 4.19.15.41.4 Taxpayer Replies
- 4.19.15.42 Premium Tax Credit - IRC 36B
 - 4.19.15.42.1 Premium Tax Credit Eligibility
 - 4.19.15.42.2 Common Terms
 - 4.19.15.42.3 PTC Project Codes
 - 4.19.15.42.4 Case Selection
 - 4.19.15.42.5 Research and Initial Report Writing
 - 4.19.15.42.6 Creating the PTC Issue(s)
 - 4.19.15.42.7 Evaluating Responses
 - 4.19.15.42.8 Closing Procedures

student as the basis for an education credit or tuition and fees deduction that they claim for themselves.

Caution:

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2. Acceptable documentation of qualified expenses:

Qualified Expenses	Accepted Proof for: AOTC, HOPE, and Lifetime Learning
Expenses related to any course of instruction or other education that involves sports, games or hobbies, or any noncredit course, do not qualify unless the instruction or other education is part of the student’s degree program or is taken by the student to acquire or improve job skills.	Tuition receipts and transcripts to verify enrollment; proof of payment of expenditures via cancelled check or electronic funds payment confirmation, credit card statement, or paid receipt from the institution. Form 1098-T, Tuition Statement is also acceptable proof if the issuer completes Box 1 of that form. (Note: The educational institution is not required to complete Box 1. A different proof of payment is required if there is no amount in Box 1. See above.)

- 4.19.15.43
Campus
Employment
Tax Non-Filer
Program
 - 4.19.15.43.1
Employment
Tax Non-
Filer Initial
Contact
Letter
 - 4.19.15.43.2
Employment
Tax Non-
Filer
Responses
 - 4.19.15.43.3
Second
Contacts
 - 4.19.15.43.4
Complete
Form
13496
Certification
 - 4.19.15.43.5
Undeliverable
Mail
 - 4.19.15.43.6
Closures
 - 4.19.15.43.7
Penalties
 - 4.19.15.43.8
Request
for Penalty
Relief
 - 4.19.15.43.9
FUTA
Certification
 - 4.19.15.43.10
Return
Posted as
TC
976/977
 - 4.19.15.43.11
Missing
Signature

Qualified Expenses	Accepted Proof for: AOTC, HOPE, and Lifetime Learning
Fees for course-related books, supplies, and equipment.	<p>For AOTC: Receipts and documentation to support the need for the course of study. For instance: class outline, school program guide, and/or letter from institution. Fees do NOT have to be paid to the institution.</p> <p>For HOPE and Lifetime Learning: Receipts and documentation to support the requirement for enrollment in attendance. For instance: class outline, school program guide, and/or letter from institution -- only if the fees must be paid to the institution as a condition of enrollment or attendance</p>
Prepaid expenses paid in the prior year for an academic period that begins in the first three months of the next year are allowed as a part of the prior year's credit.	Tuition receipts and receipts for qualifying expenses as listed above.
Payments made with borrowed funds are allowed in the year that the expenses are paid, not in the year the loan is repaid.	Receipts and transcripts to determine the year applied.

3. Following are expenses that generally do not qualify for an education credit. Note that textbooks and supplies are qualifying expenses for the AOTC, even if they are not purchased from the institution as a requirement for enrollment:

Expenses which generally do not qualify for the credit include:	Accepted proof when allowable

- 4.19.15.43.12 Identity Theft - BMF Accounts
- 4.19.15.43.13 General Information
 - 4.19.15.43.13.1 Taxpayer Advocate Service (TAS) Cases
 - 4.19.15.43.13.1.1 Form 3870 Request for Adjustment
 - 4.19.15.43.13.1.2 Controlling the Case
 - 4.19.15.43.13.1.3 Examiner Procedures
 - 4.19.15.43.13.1.3.1 Unsigned Return
 - 4.19.15.43.13.1.3.2 Signed Return
 - 4.19.15.43.13.1.4 Closing Procedures
 - 4.19.15.43.13.1.5 Telephone Contact
 - 4.19.15.43.13.1.6 Replies to Disallowance Letters (105C, 106C)

Expenses which generally do not qualify for the credit include:	Accepted proof when allowable
Cost of insurance, medical expenses (including student health fees), room and board, transportation or similar personal, living or family expenses, even if the fee or expenses must be paid to the institution as a condition of enrollment or attendance.	N/A
Expenses related to any course of instruction or other education that involves sports, games or hobbies, or any noncredit course. However, if the instruction or other education is part of the student’s degree program or is taken by the student to acquire or improve job skills, these expenses can qualify.	School transcripts and curriculum or catalog demonstrating courses required for the degree program.
For Hope and Lifetime Learning: Textbooks and supplies, even though purchased at the school bookstore, are generally not allowable, unless they are paid to the institution as a requirement for enrollment or attendance. For AOTC: Textbooks and supplies qualify as expenses for the AOTC even if they are NOT required to be purchased from the institution as a condition or enrollment or attendance.	For AOTC: Receipts, cancelled checks, or other proof of payment. To qualify as expenses for the AOTC, textbooks and supplies do NOT have to be purchased from the institution as a condition of enrollment or attendance. For Hope and Lifetime Learning: In addition to proof of payment, documentation to support that textbooks and supplies are required as a condition of enrollment or attendance.

Note: Expenses paid with the tax-free portion of a distribution from a Coverdell educational savings account or qualified tuition program or with tax-free educational assistance, such as a scholarship, grant, or assistance provided by an employer, can not be used to figure the credit.

and 916C)

4. Additional qualifications and conditions for AOTC and Hope Credit (these restrictions do not apply to the Lifetime Learning credit):

- 4.19.15.43.13.7 Statute of Limitations
- 4.19.15.43.13.8 RSED on Original Return
- 4.19.15.43.13.9 Case Assembly

- Exhibit 4.19.15-1 Schedule C - General Questionnaire
- Exhibit 4.19.15-2 Schedule C - Car and Truck Questionnaire
- Exhibit 4.19.15-3 Schedule C - Travel, Meals and Entertainment Expense Questionnaire
- Exhibit 4.19.15-4 Schedule C - Repairs and Maintenance Questionnaire

Qualifications and conditions for AOTC and Hope credit	Accepted Proof
<p>For AOTC: The taxpayer did not claim an AOTC and/or Hope credit for 4 earlier tax years for the AOTC. For Hope Credit: The taxpayer did not claim a Hope Credit for two earlier tax years for this student.</p>	<p>For AOTC: All prior years' returns for tax years during which the first four academic years of post-secondary studies were not completed. For Hope Credit: All prior years' returns for tax years during which the first two academic years of post-secondary studies were not completed.</p>
<p>The student has not completed the first two years of postsecondary education if claiming a Hope Credit or the first four years of postsecondary education if claiming the AOTC.</p>	<p>School academic transcripts.</p>
<p>The student was enrolled at least half time in a program that leads to a degree, certificate, or other recognized educational credential, for at least one academic period that begins during the taxable year.</p>	<p>School transcripts or Form 1098-T , <i>Tuition Statement</i></p>
<p>The student was free of any federal or state felony conviction for possessing or distributing a controlled substance as of the end of the tax year in which the credit is claimed.</p>	<p>If any documentation indicates that this has occurred, the credit is not allowable.</p>

5. Effective for tax years after 2015, if the taxpayer’s claim for AOTC is due to reckless or intentional disregard of rules and regulations, a 2-year ban may apply. If the claim is fraudulent, a 10-year ban may apply. The 2 and 10-year bans do not apply to the Lifetime Learning Credit or the tuition and fees deduction. See IRC section 25A(i)(7), and IRM 4.19.14.7.1, *2/10 Year Ban - Correspondence Guidelines for Examination Technicians (CET)*.

4.19.15.3.2 (01-01-2017)

Tuition and Fees Deduction

1. Taxpayers may claim a Tuition and Fees Deduction as an adjustment to income on Form 1040. Beginning in TY 2004 the Tuition and Fees deduction can reduce income, depending on the amount of the taxpayer's AGI – if it does not exceed \$65,000 (\$130,000 for a joint return), \$4000. In the case of a taxpayer whose AGI is up to \$80,000 (\$160,000 for a joint return), \$2000. In all other cases, the reduction amount is 0.
 2. Generally, taxpayers can claim a deduction if all three of the following requirements are met:
 - a. Payments were for qualified education expenses for higher education.
 - b. Education expenses are for an eligible student.
 - c. The eligible student is the taxpayer, the taxpayer's spouse, or a dependent for whom the taxpayer may claim the exemption.
 3. An eligible educational institution is any college, university, vocational or other post secondary educational institution.
 4. Generally qualifying expenses are limited to tuition and fees.
 5. The taxpayer may not file married filing separately.
 6. The deduction is phased out between \$65,000 and \$80,000 (\$130,000 - \$160,000 for joint returns).
 7. No double benefit is allowed:
 - The taxpayer can not claim a Tuition and Fee expense for a student if he or anyone else claimed the Hope or Lifetime Learning Credit for that same student in the same tax year.
 - Taxpayer can not use the following expenses to claim the Tuition and Fee expense: expenses paid by tax-free portion of distribution from a Coverdell Educational Savings Account or a qualified tuition program, or expenses paid with tax-free interest on U.S. Savings Bonds, or expenses which have been paid by a tax-free scholarship, grant, or employer-provided educational assistance.
- For additional information, refer to Publication 970, *Tax Benefits for Education*.
8. Acceptable Documentation:
 - Transcripts showing name and identifying information of student and period of enrollment

- Proof of payment for tuition and fees, i.e., cancelled check and invoices from education institution

Note:

Form 1098-T, *Tuition Statement* is also acceptable as proof of payment if the issuer completes Box 1 of the form. (The educational institution is not required to complete Box 1. A different proof of payment is required if there is not an amount in Box 1. See above.)

9. Evaluating Taxpayer Responses:

- Review the name and SSN on transcripts and payment vouchers to ensure they are the same as those on the tax return.
- Ensure payments were made by taxpayer.

Note:

In contrast to the Education Credits, expenses used for claiming the Tuition & Fees Deduction must have been paid by the person claiming the deduction. Payments made by the student or on their behalf by a third party are not considered to have been paid by the person who claims an exemption for the student. Compare to IRM 4.19.15.3.1.1(1), *Education Tax Credits - Evaluating Taxpayer Responses*. So, for instance, if a student pays their own expenses but can be claimed as a dependent on their parent's tax return, then neither the student nor their parent may claim the Tuition & Fees Deduction.

- Ensure fees are for post-secondary courses.
- Review return to ensure the same expenses for the same student are not used to claim additional educational benefits such as the Hope/AOTC or Lifetime Learning Credit; with managerial approval to expand audit to apparent duplicated expenses if needed.
- Disallow all other expenses other than tuition and fees.

4.19.15.4 (12-01-2017)

Mortgage Interest Credit

1. The Mortgage Interest Credit helps lower-income taxpayers afford home ownership. The taxpayer must have received a qualified Mortgage Credit Certificate (MCC) from a state or local government unit or agency.
 - Certificates issued by the Federal Housing Administration, Department of Veterans Affairs, Farmers Home Administration and Homestead Staff Exemption Certificates do not qualify for the credit.

4.19.15.4.1 (03-14-2016)

Initial Contact

1. For the initial contact, send Letter 566-S with the audit report (Form 4549/ Form 4549-EZ, *Income Tax Examination Changes*) and (Form 14809,) *Interest you Paid* to the taxpayer.
2. The Form 14809 contains the following language: We need to verify that you are eligible to claim the deduction for **Interest You Paid** taken on Schedule *A-Itemized Deductions*. Please provide the following information to support the amounts claimed.
 - Send copies of mortgage interest statements, equity credit lines/loans, land and mortgage contracts, and amortization schedules for loan outstanding. Send copies of cancelled checks, receipts or other evidence of payments made for the year under examination.
 - Send copies of closing statement verifying points paid.
 - Send copies of statements from financial institutions, investment brokerages or persons to verify your total investment interest deductions.

4.19.15.4.2 (12-01-2017)

Conducting the Examination

1. If qualified, the taxpayer may claim the credit each year for part of the home mortgage interest paid. Form 8396, *Mortgage Interest Credit*, is used to compute the amount of the credit. If the certified indebtedness amount (loan) shown on the Mortgage Credit Certificate (MCC) is less than the total mortgage loan, the credit is figured on only the part of the interest paid that is applicable to the MCC loan.
2. The credit is an amount equal to the product of:
 - a. The certificate credit rate (which may not be less than 10 percent or more than 50 percent), and
 - b. The interest paid or accrued by the taxpayer for the year on the remaining principal of the certified indebtedness (plus a limited carry forward, if any).

If the credit rate exceeds 20 percent, the tax credit for any year may not exceed \$2,000 (IRC 25(a)(2)(A)).

3. A three-year carry forward is provided IRC 25(e)(1)(A) , for the unused portion of such credit caused by the limitation imposed by IRC 26(a), and IRC 25(a)(2)(A), as amended by Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L.107-16). In essence, the credit and carryover are limited to the tax less the following credits: Foreign Tax Credit, Credit for

Child and Dependent Care, Credit for the Elderly or Disabled, Education Credits, Retirement Savings Contributions Credit, Child Tax Credit and the Adoption Credit. Form 8396, *Mortgage Interest Credit*, should be used to assist in the calculation of the allowable credit amount.

4. If the taxpayer itemized on Schedule A, he must reduce his home mortgage interest deduction by the amount of the Mortgage Interest Credit shown on Line 3 of Form 8396. He must do this even if part of that amount must be carried forward.
5. If the taxpayer sells the home during the first nine years after the closing date, he may be required to recapture all or part of the benefit received from the program. See Publication 523, *Selling Your Home* for more information.

4.19.15.4.3 (01-01-2014)

Evaluating Taxpayer Responses

1. Use the following to evaluate taxpayer responses:
 - a. Determine that the taxpayer owns the home and is making the payments by reviewing the Mortgage Interest Statement from the lender on Form 1098, *Mortgage Interest Statement*, obtained from the taxpayer or through IRPTRL.
 - b. Review addresses, etc., to ensure the credit is taken on the taxpayer's primary residence.
 - c. Request and review the Mortgage Credit Certificate to ensure it was issued by the state or local government.
 - d. Review the certificate credit rate on the Mortgage Credit Certificate to ensure this is the rate applied in the computation and not the rate of interest listed on the mortgage statement from the lender.
 - e. Review the Schedule A and/or C to ensure the taxpayer has not duplicated the interest and that he has properly reduced the interest claimed there by the amount of mortgage interest credit.
 - f. Review originating year information if the credit is a carryover.
 - g. Review carryover amounts in subsequent years to ensure accuracy and requisition those returns if errors exist which are significant.
 - h. Review the computation to ensure the taxpayer is taking the correct amount of credit each year and that applicable credits are not carried over for more than 3 years.
 - i. If the taxpayer has actually claimed the District of Columbia First-Time Home buyer Credit as a Mortgage Interest Credit, see Form 8859, *District*

of *Columbia First-Time Homebuyer Credit*, for proper application of that credit and disallow the Mortgage Interest Credit.

4.19.15.4.4 (03-11-2019)

Form 886-A Explanations and Tax Resources

1. RGS Standard Paragraphs 6306 - 6309 should be used as applicable on Form 886-A, *Explanations of Items*.
2. Tax Resources:

Reference items (Publications, Regulations, existing training materials, existing IRM references, etc.)

- IRC 25, *Interest on Certain Home Mortgages*
- Publication 530, *Tax Information for Homeowners*
- Publication 936, *Home Mortgage Interest Deduction*
- Publication 17, *Your Federal Income Tax (For Individuals)*, Instructions to the Form 8396, *Mortgage Interest Credit*
- Publication 523, *Selling Your Home*

4.19.15.5 (03-12-2018)

Adoption Credit and Qualified Adoption Expenses (QAE)

1. The Adoption Credit is nonrefundable for most years but was refundable in 2010 and 2011. Regardless of the year involved, the rules for the Adoption Credit are generally the same. However, the income and dollar limitations change year to year based on inflation. Also, taxpayers who claim a refundable credit for 2010 or 2011 were required to file their returns on paper and to include substantiation when filing their returns.

Note:

For more information on the income and dollar limitations, see IRM 4.19.15.5.6, *Credit Limitations*, and IRM 4.19.15.5(7), *Adoption Credit and Qualified Adoption Expenses (QAE)*. For more information on substantiation, see IRM 4.19.15.5.3, *Evaluating Responses*.

2. The Adoption Credit was nonrefundable for all taxable years which began on or after January 1, 1997, and ended before January 1, 2010. The Adoption Credit also is nonrefundable for taxable years which begin after December 31, 2011.

- The Adoption Credit was refundable for taxable years which began after December 31, 2009 and ended before January 1, 2012. See the Patient Protection and Affordable Care Act (PL 111-148).
 - Adoption Credit carryforwards from taxable years 2005 - 2009 were also refundable in 2010. See Notice 2010-66, 2010-42 I.R.B. 437.
3. The credit is subject to an income limitation based on the taxpayer's modified adjusted gross income (MAGI). See IRM 4.19.15.5.6, *Credit Limitations*, for more information.
 4. The credit is also subject to a dollar limitation. See IRM 4.19.15.5.6, *Credit Limitations*, for more information.
 5. The Adoption Credit and any employer-provided adoption benefits that can be excluded from income are computed on Form 8839, *Qualified Adoption Expenses*. The credit then is entered on Form 1040.
 6. For refundable years, the Form 8839 instructions advise the taxpayer that he or she must include documentation, attached to the return, to substantiate the Adoption Credit. Because of the documentation requirement for refundable years, taxpayers must file a paper return when claiming an Adoption Credit for 2010 or 2011.
 7. The credit will post to Master File as a Transaction Code (TC) 766 with a Credit Reference Number (CRN) 261.
 8. Command Code (CC) DLITE identifies filters fired through Dependent DataBase (DDB) used in selecting the case for examination. Not all filters are shown, and the fact that a filter has been fired does not include that the credit is unallowable. Examiners should use this information in evaluating the information submitted by the taxpayer. *IRM 4.19.15.5.2, Research and Initial Contact*, for more information on CC DLITE.
 9. The Adoption Credit in SB/SE Campus Exam is worked under Project Code (PC) 0355.
 10. For further details regarding the Adoption Credit, see Publication 17, *Your Federal Income Tax (For Individuals)*, and the instructions for Form 8839. Additional information about the credit can also be found on <http://www.irs.gov>, and entering **adoption credit** in the search window. .

4.19.15.5.1 (03-12-2018)

Eligible Child – Claiming the Credit or Exclusion

1. An eligible child for the purposes of claiming Adoption credit is an individual who:

- Has not attained age 18, or
 - Is a disabled individual physically or mentally, unable to take care of him/herself
2. Taxpayers may claim the credit for as many children as qualify.
 3. The proper year for claiming the adoption credit or exclusion depends on whether the eligible child is a citizen or resident of the United States (including U.S. possessions) at the time the adoption effort begins and whether the adoption is final or in process. See the following tables.

Note:

If the eligible child is a U.S. citizen or resident, you can take the credit or exclusion even if the adoption never becomes final. See the following tables.

Child who is a U.S. Citizen or Resident

IF the qualified expenses are paid in:	THEN the credit is taken in:
Any year before the year the adoption becomes final	The year after the year of the payment
The year the adoption becomes final	The year the adoption becomes final
Any year after the year the adoption becomes final	The year of the payment

IF the employer paid for qualifying expenses under an adoption assistance program in:	THEN the exclusion is taken in:
Any year	The year of the payment

4. **NOTE:** If the eligible child is not a U.S. citizen or resident, you cannot take the adoption credit or exclusion unless the adoption becomes final. See the following tables. Generally, foreign adoptions are either non-Hague adoptions or Hague adoptions. *IRM 4.19.15.5.1, Eligible Child - claiming the Credit or Exclusion*, See the instructions for Form 8839, **Qualified Adoption Expenses**, for more information regarding foreign adoptions.

Foreign Child

IF the qualified expenses are paid in:	THEN the credit is taken in:
Any year before the year the adoption becomes final	The year the adoption becomes final
The year the adoption becomes final	The year the adoption becomes final
Any year after the year the adoption becomes final	The year of the payment

IF the employer paid for qualifying expenses under an adoption assistance program in:	THEN the exclusion is taken in:
Any year before the year the adoption becomes final	The year the adoption becomes final
The year the adoption becomes final	The year the adoption becomes final
Any year after the year the adoption becomes final	The year of the payment

4.19.15.5.1.1 (03-12-2018)

Determining the Year a Foreign Adoption Becomes Final

1. In general, the year of finality of a foreign adoption is determined either under Rev. Proc. 2005-31 (non-Hague Adoptions), or under Rev. Proc. 2010-31 (Hague Adoptions).

4.19.15.5.1.2 (01-01-2014)

Non-Hague Adoptions

1. In most non-Hague adoptions, there is an adoption proceeding in the foreign country (and the country is one that is not a party to the Hague Adoption Convention, discussed later) before the child is permitted to come to the United States. There may also be a re-adoption proceeding in the United States, either in the same year as the foreign adoption or in a later year.

2. Rev. Proc. 2005-31 generally allows taxpayers to choose as the year of finality:
 - the year of the foreign-sending country adoption proceeding; or
 - the year of the re-adoption, if the re-adoption occurs in either the first or second year following the year of the foreign-country proceeding.
3. The expenses of re-adoption are qualified adoption expenses in the year in which the expenses are paid, subject to the dollar limitation.

4.19.15.5.1.3 (01-01-2014)

Hague Adoptions

1. In Hague adoptions, there is usually an adoption proceeding in the sending country (and the country is one that is a party to the Hague Adoption Convention, discussed later) before the child is permitted to come to the United States. Rev. Proc. 2010-31 generally allows taxpayers to choose as the year of finality:
 - the year in which the sending country enters a final decree of adoption; or
 - the year in which the U.S. Secretary of State issues a certificate under section 301(a) of the Intercountry Adoption Act of 2000, 42 U.S.C. sections 14901-14954.

4.19.15.5.1.4 (12-01-2017)

Custodial Agreements Followed by Adoption in the United States

1. In a few cases, the sending country may permit the child to come to the United States under a custodial agreement. If so, the child will be adopted later in a state court in the United States. Both Rev. Proc. 2005-31 and Rev. Proc. 2010-31 allow the adoptive parent(s) to treat the year of the state-court adoption as the year of finality.

4.19.15.5.1.5 (03-12-2018)

Hague Adoption Convention

1. The Hague Convention on Protection of Children and Cooperation in Respect of Inter-country Adoption (Hague Adoption Convention) entered into force for the United States on April 1, 2008. The Hague Adoption Convention applies to a taxpayer who adopted a child from a country that is party to the Hague Adoption Convention and who filed his or her application and petition (Forms I-800A and I-800) with the U.S. Citizenship and Immigration Service after March 31, 2008.

2. See <https://travel.state.gov/content/travel/en/Intercountry-Adoption.html>, for more information on the Hague Adoption Convention, the application and petition, and a complete list of countries that are parties to the Convention.

4.19.15.5.2 (03-12-2018)

Research and Initial Contact

1. IDRS CC DLITE, using the primary SSN, may provide information and identify filters **fired**. Examiners should research CC DLITE to assist in identifying the selection criteria. Examiners should refer to the tracking codes displayed on DLITE as guidance in evaluating the taxpayer's documentation. Holding cursor over the rule, then hitting XMIT, will display the list of Adoption Credit rules. The tracking codes identifying the filters fired are:
 - 0379 - The Federal Case Registry (FCR) file indicates the taxpayer is the custodial parent, non-custodial parent, or putative father.
 - 0381 - 5 year look back period where the credit claimed and carried over to subsequent years exceeded the maximum allowable.
 - 0383 - The primary and/or secondary taxpayer is the father or mother of the child, the date of birth of the child listed on the Form 8839 is less than a year after the update date on the Data Master(DM1)/Kidlink.
2. Send Letter 566-S as the initial contact letter (ICL) with a fill-in issue box for Adoption Credit.
3. Form 14806, Adoption Credit Documentation Requirements, is sent with the ICL requesting Adoption Credit documentation.

4.19.15.5.3 (03-12-2018)

Evaluating Responses

1. Taxpayers being audited must verify that a legal adoption has either been finalized or is in process. In addition, taxpayers must provide verification either of their expenses or of any special needs determination. If part of the credit claimed is a carryforward from a prior year, the taxpayer must provide a worksheet explaining how the carryforward was computed. As the credit was refundable for tax years 2010 and 2011, no carryforward is allowable for tax years 2011 and 2012.

Note:

See IRM 4.19.15.5.5, *Carry Forwards*, for additional carry forward information.

2. Proper documentation must be provided for each child claimed. Follow the guidelines below for acceptable documentation:

Final Adoption

IF	THEN acceptable documentation is:
Domestic or Foreign adoption finalized in the United States	<ul style="list-style-type: none"> • Adoption certificate, report or final decree signed by a representative of the State Court, showing the names of the adoptive child and parent, or • Hague Adoption Certificate (Immigrating Child), or • IH 3 Visa
Foreign adoption from a country that is not party to the Hague Convention	<ul style="list-style-type: none"> • Translated decree of adoption from a foreign court or other document, issued by the competent authority establishing that a parent-child relationship has been created, or • IR 2 or IR 3 Visa
Special Needs Adoption	See IRM 4.19.15.5.4, <i>Special Needs Adoptions</i> .

In-Process Adoption

IF	THEN
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IF	THEN
In-Process Adoption (Applicable to the attempted or not-yet-finalized adoption of an eligible child who is a U.S. citizen or resident.)	Taxpayers will provide one or more of the following: <ul style="list-style-type: none"> • A copy of, or a receipt from, a home study completed by an authorized placement agency • A placement agreement with an authorized placement agency • A document signed by a hospital official authorizing the release of a newborn child from the hospital for legal adoption • A court document ordering or approving the placement of the child with the taxpayer for legal adoption • An affidavit or notarized statement signed under penalties of perjury from an adoption attorney, government official, or other authorized person. The documents must state that the signor either placed or is placing a child with you for legal adoption, or is facilitating the adoption process in an official capacity, with a description of the actions taken to facilitate the process.

3. Tax law requires the taxpayer to claim QAE that they pay for an In-Process adoption for the year after the expense is paid. Examiners need to be aware of the timing of the expense and that the documentation the taxpayer provides may be for a prior year.
4. Qualifying adoption expenses include:
 - Adoption fees
 - Court costs
 - Attorney fees
 - Travel expenses (including amounts spent for meals and lodging) while away from home
 - Other expenses directly related to, and whose principal purpose is for, the legal adoption of an eligible child

An expense may be a qualified adoption expense even if the expense is paid before an eligible child has been identified. For example, prospective adoptive parents who pay for a home study at the outset of an adoption effort may treat the fees as qualified adoption expenses.

5. Acceptable proof of expenses include checks and receipts showing proof of payment.
6. The following expenses are not allowable and do not qualify for the Adoption Credit:
 - That violate state or federal law
 - For the purpose of carrying out any surrogate parenting arrangement
 - For the adoption of a spouse's child
 - Paid using funds received from any federal, state, or local program
 - Allowed as a credit or deduction under any other provision of federal income tax law
 - Reimbursed by an employer
 - Any other expense that is not directly related to, and whose principal purpose is not for, the legal adoption of an eligible child

Caution:

Expenses incurred for the adoption of a spouse's child are not qualified adoption expenses and cannot be used for claiming the credit

4.19.15.5.4 (03-12-2018)

Special Needs Adoptions

1. If the adoption is domestic and final, and is of a special needs child (as determined by the state where the adoption occurs), the taxpayer is entitled to claim the maximum amount of the credit (minus any amounts claimed for that child in a previous year) even if the taxpayer paid no qualified adoption expenses.
2. A child meets the definition of special needs if **all of the following statements** are true:
 - The child was a citizen or resident of the United States or its possessions at the time the adoption process began **and**
 - A state (including the District of Columbia) has determined that the child cannot or should not be returned to his or her parents' home **and**

- The state has determined that the child is unlikely to be adopted unless assistance is provided to the adoptive parents
3. The taxpayer must provide **both** of the following documents when substantiating the credit for a special needs child. Do not request verification of any expenses:
 - a. Adoption certificate, report or final decree signed by a representative of the State Court showing the names of the adoptive child and parent and,
 - b. The state's determination of special need designation. See (4) for acceptable documentation of the state's determination of special needs.
 4. The following are acceptable documentation of the state's determination of special needs (this list not all inclusive)
 - A signed adoption assistance or subsidy agreement issued by the state or county
 - Certification from the state or county welfare agency verifying that the child is approved to receive adoption assistance
 - Certification from the state or county welfare agency verifying that the child has special needs

Caution:

For these purposes, an order or decree must include information establishing that the taxpayer's adoption of the eligible child has been finalized and the date it was finalized. A special needs determination must include information establishing that the state has made a determination of special needs for the eligible child.

5. Don't confuse "children with special needs" for purposes of the adoption credit with the definitions of "children with special needs" for other purposes. Foreign children aren't considered to have special needs for purposes of the adoption credit. Even U.S. children who have disabilities may not have special needs for purposes of the adoption credit. Generally, **"special needs adoptions"** are the adoptions of children whom the state's child welfare agency considers **difficult to place for adoption**.

4.19.15.5.5 (03-12-2018)**Carry Forwards**

1. The nonrefundable adoption credit allows any unused adoption credit to be carried forward for up to five years.
 - For taxable year 2010, a refund was allowed for all QAE properly carried forward from 2005 through 2009. However, no QAE carried forward from

2010 into 2011.

- QAE properly allowable for the first time in taxable year 2011 was refundable for that year. However, no QAE carried forward from 2011 to 2012.
 - In 2012, the adoption credit reverted to being nonrefundable. QAE properly allowable for the first time in 2012 will be allowed if the taxpayer has enough tax liability to use the credit. Any remaining allowable QAE will be carried forward to 2013 (the first year of the five-year carryforward period). Similarly, QAE first allowable in 2013 will be carried forward into 2014 if the taxpayer does not have enough tax liability to use all the allowable QAE in 2013. The same rule applies to later years. For example, QAE first allowable in 2104 will be carried forward into 2015 if the taxpayer does not have enough tax liability to use all the allowable QAE in 2014.
 - Taxpayers claiming a credit carryforward must provide the same documentation for the carryforward years as a current year adoption. In addition to an explanation or worksheet showing how the carryforward credit was calculated, verification of the adoption and verification of qualified adoption expenses for all years is required.
2. The year in which adoption expenses are first eligible to be claimed is the determining year for the maximum credit amount as well as the income limitation restriction. If the taxpayer qualifies for the full credit one year, they cannot increase that amount by carrying it forward to another year. Likewise, if they are limited or disqualified from taking the credit based on their MAGI, they cannot change that restriction, by moving the credit into another year. However, if the taxpayer pays additional QAE in a subsequent year, the allowable credit for those expenses is subject to the limitations for the year in which they are eligible to be claimed. Any allowable credit must always be reduced by prior credits taken for the same child.

Note:

Most individuals use the cash method of accounting. Therefore, the relevant date for determining whether QAE is allowable is the date the QAE is **paid**, rather than the date the QAE is incurred. The date QAE is incurred is relevant only if the taxpayer uses the accrual method of accounting.

3. QAE is allowable only if paid in connection with the adoption of an eligible child. Generally, an eligible child is an individual under the age of 18. The relevant date for determining a child's eligibility is when the QAE is paid. For example, suppose that QAE is paid in year 1, when the child is 16, and the QAE becomes allowable in year 2, when the child is 17. Suppose further that the adoptive parent has too little tax liability to use the credit in year 2 and that the credit carries forward into years 3 and 4. In year 5, the adoptive parent has enough tax liability to use the full carried-forward credit. The

entire carried-forward credit will be allowable in year 5, even though the child who was adopted is now 20 years old.

4. In order to claim QAE in the year it is first allowable, individuals must file as single, married filing jointly, head of household, or as qualifying widow(er). If the individual's filing status is married filing separately in the year that particular QAE first become allowable, the individual will never be eligible to claim a credit or exclusion for that QAE unless he or she files an amended return, using married filing jointly status, within the period of the statute of limitations. However, an individual who is married filing separately may claim an adoption credit carryforward from a prior year or years, provided that, if the individual was married in the year in which the QAE first became allowable, the individual filed a joint return for that year. For more information, see Topic 607, Adoption Credit and Adoption Assistance Programs, available at www.irs.gov/taxtopics/tc607.html.

4.19.15.5.6 (12-01-2017)

Credit Limitations

1. Adoption credit current and prior year limitations:

Current and Prior Year Credit Limitations

Year Range	Maximum Tax Credit (Dollar Limitation)	MAGI Phaseout
2017	\$13,570	\$203,540 - \$243,540
2016	\$13,460	\$201,920 - \$241,920
2015	\$13,400	\$201,010 - \$241,010
2014	\$13,190	\$197,880 - \$237,880
2013	\$12,970	\$194,580 - \$234,580
2012	\$12,650	\$189,710 - \$229,710
2011	\$13,360	\$185,210 - \$225,210
2010	\$13,170	\$182,520 - \$222,520

Year Range	Maximum Tax Credit (Dollar Limitation)	MAGI Phaseout
2009	\$12,150	\$182,180 - \$222,180
2008	\$11,650	\$174,730 - \$214,730
2007	\$11,390	\$170,820 - \$214,820
2006	\$10,960	\$164,410 - \$204,410
2005	\$10,630	\$159,450 - \$199,450

4.19.15.6 (12-01-2017)

Tax Benefits for Kidnapped Children

1. Following are guidelines to determine the allowance of tax benefits for kidnapped children for tax years ending after December 21, 2000.

Guidelines for Determining Allowance of Kidnapped Children Tax Benefits

If	And	Then, for all tax years during which the kidnapped child is missing and the treatment has not terminated
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If	And	Then, for all tax years during which the kidnapped child is missing and the treatment has not terminated
The child is presumed by law enforcement authorities to have been kidnapped by someone who is not a member of the family of the taxpayer or the child	<ul style="list-style-type: none"> a. The child was the taxpayer's qualifying relative for the part of the year before the kidnapping or b. The child had the same principal place of abode as the taxpayer for more than one half of the part of the year before the date of kidnapping 	<ul style="list-style-type: none"> a. Treat the child as the taxpayer's qualifying relative or b. Treat the child as meeting the residency test in the definition of qualifying child. <p>Note:</p> <p>The treatment in (a) or (b) applies for purposes of (1) the Dependency Exemption, (2) the Child Tax Credit, (3) Head of Household filing status, (4) Qualifying Widow(er) filing status, and (5) the Earned Income Tax Credit.</p>

2. Termination of treatment shall apply if there is a determination that the child is deceased, or that the child would have reached the age of 18.

4.19.15.7 (01-01-2010)

Questionable Refund Cases

1. See IRM 4.19.14.9, *Questionable Refund Program (QRP)*, for program procedures on Questionable Refund cases.

4.19.15.8 (01-01-2010)

Alternative Minimum Tax

1. The Alternative Minimum Tax (AMT) program cases are identified by Submission Processing as taxpayers who are liable for the AMT but have not completed or attached Form 6251, *Alternative Minimum Tax - Individuals*.

- 2. Submission Processing will notify the taxpayers that they appear to be liable for the AMT by issuing Letter 12C. The case is suspended for a response. If the taxpayer does not respond timely, the return is coded as an Audit Code P, generating the AIMS (Audit Information Management System) opening in Source Code 26.
- 3. AIMS will open in the Andover Campus (W&I) or Philadelphia Campus (SB/SE) based on the Master File Business Operating Division (BOD) Code for the return.
- 4. For W&I, the AMT cases are worked under Project Code 0631.

4.19.15.8.1 (01-01-2014)

Alternative Minimum Tax Procedures

- 1. Prepare Letter 2194, *Alternative Minimum Tax Proposal Letter*, and Form 4549/Form 4549-EZ, *Examination Report*, and issue to the taxpayer for the initial contact.
- 2. Based on the information reported on the return, the Examination Report (Form 4549/Form 4549-EZ) should include the largest determinable amount(s) as adjustments and tax preference items when computing the AMT on Form 6251, **Alternative Minimum Tax-Individuals**.

If	Then
Taxpayer responds agreeing to the AMT by signing exam report	Process assessment and close case agreed.
Taxpayer responds with tax preference items within 30 days from the issuance of Letter 2194	===== ===== ===== =====
No response	<ul style="list-style-type: none">• 30 day letter - after the suspense time has expired, issue Letter 3219, Notice of Deficiency.• 90 day letter - after the suspense time has expired, process assessment and close case as a default. <p>See IRM 4.19.10.1.5.2, <i>Standard Suspense Periods for Correspondence Examination</i>, for suspension periods for the various letters and time frames to issue letters/notices.</p>

4.19.15.9 (10-01-2001)**Estate and Gift Tax**

1. Refer to IRM 4.25, *Estate and Gift Tax*, for information on estate and gift tax audits and procedures.

4.19.15.10 (12-01-2017)**Math/Clerical Error**

1. General procedures for the establishment and processing of unsubstantiated math/clerical error cases are presented in IRM 4.19.14.10, *Math/Clerical Error Program*.
2. Unsubstantiated math/clerical error protest cases for which the original adjustment did not include a TC 764 will set up on AIMS under Project Code 0125. Campuses must review the cases to determine whether or not the math/clerical error protest involves the First-Time Homebuyer Credit (FTHBC) or the Long Time Resident Credit (LTR). If the protest involves one of these credits, assign a tracking code as indicated below:

If	Then
The protest relates to the Long-Time Resident Credit (LTR)	Assign Tracking Code 6215.
The protest relates to the First-Time Homebuyer Credit (FTHBC)	Assign Tracking Code 9216.

3. Taxpayer Notice Codes (TPNC) for the disallowance of the FTHBC are enumerated in IRM 21.6.3.4.2.10.6, *First-Time Homebuyer Math Error Responses*.
4. When initiating math/clerical error cases involving the FTHBC or the LTR credit, follow the procedures set forth in Paragraphs (6) through (9) of IRM 4.19.15.38.3, *Research and Initial Contact*, to initiate Letter 566-S. All other non-EITC math/clerical error cases should be started using Letter 566B, *ICL/30 Day Combo Letter*.

4.19.15.11 (03-11-2019)**Non-Earned Income Tax Credit Duplicate TIN (Non-EITC DUP TIN)**

1. The Non-EITC DUP TIN program includes a population of taxpayers who have claimed a dependent who has been claimed on another taxpayer's tax return. Generally these cases involve two or more uses of a TIN to claim a dependent.

Program	Duplication of TIN	Tracking Code
Duplicate TIN	2 - 3 times	None
Multi-Duplicate TIN	4 - 10 times	7669
Ten-plus Duplicate TIN	> 10 times	6450
Duplicate Dependent Used for CTC, CCC, Education Credit	1 or more times	6545

2. There are two types of the Non-EITC DUP TIN cases, the Dependent/Dependent and Dependent/Primary. For the Dependent/Dependent cases, the same individual is claimed as a dependent by two or more taxpayers. Dependent/ Primary cases involve an individual who claimed a personal exemption for himself or herself and another person who also claimed a dependency exemption for that same individual.
3. Definitions for the DUPTIN Program are as follows:
 - a. Non-entitled taxpayer - the taxpayer who is not entitled to claim the dependent or the personal exemption.
 - b. Entitled taxpayer - the taxpayer who is entitled to claim the dependent or the personal exemption.
 - c. Abused SSN - the SSN of the person who has been claimed as a dependent by more than one taxpayer in the same tax year or who has claimed a personal exemption and has been claimed as a dependent.
4. The Dependent/Dependent cases are assigned Project Code 0097 or 0628 and the Dependent/Primary cases are assigned Project Code 0098 on AIMS.
5. Whipsaw cases are established on AIMS under Project Code 0059.

4.19.15.11.1 (12-01-2017)

Initial Contact

1. Cases in Project Code 0097 and Project Code 0098 are systemically processed using Automated Correspondence Exam (ACE) processing. For the initial contact, Letter 566-S is issued to the taxpayers and the cases are updated to Status 10 on AIMS. For guidance on initiating PC 0628 cases that are not initiated using ACE, refer to IRM 4.19.15.2, *Child and Dependent Care Credit*, paragraph (6).

2. Whipsaw cases in Project Code 0059 are manually processed by preparing Letter 566-B, Form 4549 / Form 4549 *EZExamination Report* and Form 886-H-DEP. The package is issued to taxpayers and the cases are updated to Status 22 on AIMS. The adjustments in the Examination Report include the disallowance of all duplicated dependents claimed on the returns and any other tax benefits claimed attributable to the dependency exemption such as Child Care Credit, Child Tax Credit, Education Credit or Filing Status. Refer to IRM 4.19.15.11.3, *Related Taxpayer*, before issuing the Examination Report.
3. Refer to IRM 4.19.14.6.5, *EITC - Personal Exemptions and Dependents*, for rules on claiming a personal exemption or dependency exemption and for recommended supporting documentation.

4.19.15.11.2 (03-11-2019)

Processing Taxpayer Replies

1. Refer to IRM 4.19.13.10, *Taxpayer Replies*, for procedures for processing replies from the taxpayer
2. For a child of divorced or separated parents or parents who live apart at all times during the last 6 months of the calendar year, a noncustodial parent claiming a child as a dependent must file a Form 8332, *Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent*, or substantially similar statement with his or her return, if the special rule for divorced or separated parents or parents who live apart applies. See Residency Test - Children of divorced or separated parents (or parents who live apart), in Pub 501, *Standard Deduction and Filing Information*.
3. Form 8332, *Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent*, is a written declaration signed by the custodial parent releasing a claim to an exemption for the child to the noncustodial parent for a single year, a specified number of years, or all future years. The noncustodial parent must attach a copy of the signed Form 8332 or similar statement to his/her return for each year that the non-custodial parent is claiming an exemption for the child.

Note:

A copy of this form or similar statement must be requested during the audit since the return is not included in the examination case file. A Form 8332 executed after the return has been filed should be considered in the overall context of the examination when determining which parent is entitled to the exemption.

4. The filing requirements for attaching Form 8332 or similar statement to the noncustodial parent's return are based upon the year in which the divorce decree or separation agreement went into effect:

DECREE or AGREEMENT YEAR	IF	THEN
Post-1984 but pre-2009 decree or agreement.	<p>The decree/agreement:</p> <ul style="list-style-type: none"> a. States that the noncustodial parent can claim the child as a dependent without regard to any condition, such as the payment of support, and b. Specifies the year or years in which the noncustodial parent can claim the child as a dependent, and c. Is otherwise substantially similar to Form 8832, and d. Is signed by the custodial parent to indicate that the custodial parent agrees not to claim the child as a dependent for the year. 	<ul style="list-style-type: none"> a. If submitted in lieu of Form 8332, the noncustodial parent must attach certain pages of the decree or agreement to the tax return. b. For additional information, see <i>Custodial parent and noncustodial parent</i> in the chapter on <i>Personal Exemptions and Dependents</i> in Pub 17.

DECREE or AGREEMENT YEAR	IF	THEN
Post-2008 decree or agreement.		<ul style="list-style-type: none"> a. The noncustodial parent cannot attach pages from decree/agreement, in lieu of Form 8332. b. The noncustodial parent must attach a Form 8332 or similar statement to his or her return. c. The custodial parent must sign either Form 8332 or a similar statement whose only purpose is to release the custodial parent's claim to the dependency exemption for the child without any conditions.

5. Effective for tax years after 2015, if the taxpayer’s claim for ACTC or AOTC is due to reckless or intentional disregard of rules and regulations, a 2-year ban may apply. If the claim is fraudulent, a 10-year ban may apply. The 2- and 10-year bans do not apply to the Lifetime Learning Credit or the tuition and fees deduction. See IRC section 24(g)(1), section 25A(i)(7), and IRM 4.19.14.7.1, *2/10 Year Ban - Correspondence Guidelines for Examination Technicians (CET)*.

4.19.15.11.3 (01-01-2016)

Related Taxpayer(s)

1. The scope of the examination must be expanded to include returns for taxpayers who, from previous audits, have been determined not to be entitled to the dependency deduction. Consideration must also be given to expanding the examination to returns of taxpayers who, based on analysis of internal information, may not be entitled to the dependency exemption. These cases must ===== and be established on the Audit Information Management System (AIMS) under Project Code 0059 and started within 30 days from the closure

of the previous audit. For related returns claiming EITC, refer to IRM 4.19.14.8.12, *DUPTIN Related Taxpayers*.

- a. The workpapers on the initial audit must be document the reasons the examination was expanded or why it was not expanded.
- b. If opening the custodial TIN per Federal Case Registry (FCR) or the TIN of one of the child's parents per Kidlink, the initial audit must be closed as a “No Change” to tax.

4.19.15.12 (03-11-2019)

Self-Employment Tax (SET)

1. IRC 1401 establishes the legal authority for assessing Self-Employment Tax (SET), as defined in IRC 1402.
Refer to IRM 4.4.29, *AIMS Procedures and Processing Instructions, Social Security Administration (SSA) Adjustments*. Also see IRM 25.6.1.9.11, *Statute of Limitations Processes and Procedures*, for special case situations.
2. The Self-Employment Tax program identifies income that may be subject to self-employment tax. The income may be reported on Schedules C, C-EZ, or F. Compliance Services Examination Operations (CSEO) will have self-employment inventory identified by Discretionary Examination Business Rules, referrals from CAS, or Audit Code N cases.
3. Self-employment tax is required when
 - a. Net earnings from self-employment (excluding church employee income) is \$400 or more, or
 - b. Church employee income is \$108.28 or more (Church employee income is wages received as an employee (other than as a minister, a member of a religious order, or a Christian Science practitioner) or a church or qualified church-controlled organization which is exempt from social security and Medicare taxes).
4. The self-employment tax rate on net earnings is 15.3 percent (12.4 percent Social Security Tax plus 2.9 percent Medicare Tax). See *IRM 4.19.15.26, Correspondence Exam Tip Program*, paragraph (9), for information regarding Additional Medicare Tax to self-employment income.
Note:
For 2011 and 2012, the self-employment tax rate was reduced to 13.3% (10.4 % Soc. Security Tax plus 2.9% Medicare Tax).
5. Taxpayers may deduct half of the self-employment tax amount when determining their adjusted gross income.

Note:

For 2011 and 2012, taxpayers may deduct the employer-equivalent portion of the self-employment tax amount when determining their adjusted gross income. The amount that may be deducted varies based upon the amount of self-employment tax the individual paid. See Form 1040 (Schedule SE) for tax year 2012. For tax years beginning after 2012, the deduction for one-half of self-employment tax will be computed without regard to the 0.9% Additional Medicare Tax on self-employment income.

4.19.15.12.1 (03-11-2019)

Self-Employment Tax Procedures

1. Pull IRPTR (Information Returns Processing Transcript Requests) if available.
2. These are batch cases and all cases will start in AIMS Status 10.
3. The Letter 718 will be the initial contact letter.
4. The second letter will be the Letter 525 .
5. If the case needs to be pulled from batch due to a reject/filtering condition, prepare Form 3198, *Special Handling Notice for Examination Case Processing*, for the case file, along with the examination report. Show the applicable Reference Codes to adjust the self-employment income and tax.

Reminder:

This information is required for closing so that SSA records are updated accordingly.

6. Case processing:

a.	If	Then
	No response is received in 45 days to Letter 718	Prepare Letter 525 and report Form 4549.
	No response is received to Letter 525	Prepare Notice of Deficiency from the information available.
	Taxpayer responds to initial contact and income is determined to be self-employment income	Prepare Letter 525, Exam report and propose correct self-employment tax.
	Taxpayer responds to initial contact letter with a Form 1040X agreeing that the income is from Self Employment	Close Case agreed. See IRM 4.19.13.10, <i>Taxpayer Replies</i>

If	Then
Taxpayer substantiates the income is not from self-employment or the taxpayer is not liable for the employee share of FICA (Federal Insurance Contributions Act) tax	Close the case no change and issue Letter 590
Taxpayer claims an employee-employer relationship existed but the employer did not withhold FICA tax	Request further information to show employee status. Consider referral to SB/SE Compliance Area Office if warranted. <i>IRM 4.19.15.13, SS-8 Determination of Worker Status.</i>
Taxpayer claims to be exempt from self-employment tax due to a previous filing of Form 4361, <i>Application for Exemption From Self-Employment Tax for Use by Ministers, Members of Religious Orders and Christian Science Practitioners</i> , or Form 4029, <i>Application for Exemption From Social Security and Medicare Taxes and Waiver of Benefits</i>	Research Master File to verify if indicator is on file. If no indicator, request approved copy of Form 4361, or Form 4029 from taxpayer.

If	Then
<p>Taxpayer has not retained approved copy of Form 4361 or Form 4029 and there is</p> <ul style="list-style-type: none"> • No indicator on Master File • No verification of approval is available <p>For a list of indicators, see IRM 4.19.6.4. Introduction to Religious Waivers, paragraph (3)</p>	<p>Determine tax year form was filed. Research Master File entity information to verify indicator is on file.</p> <ul style="list-style-type: none"> • Pull return from files to see if exemption form is attached • Continue with the proposed self-employment tax and issue appropriate letter per IRM 4.19.13.10.1, <i>Taxpayer Responses - Additional Information Needed.</i>
<p>Reply is a copy of an approved Form 4361 but IDRS CC: ENMOD MIN-SE-TX-EXEMP-CD field displays a value other than "1", the Form 4361 has NOT been approved.</p>	<p>Route Form 4361 to Philadelphia Campus Mail Stop 4-G08.151 for processing. For general guidelines in the processing of Form 4361 see IRM 4.19.6.5.1, <i>General Guidelines for Form 4361.</i></p>
<p>Reply is a copy of an approved Form 4029 but IDRS CC: ENMOD MIN-SE-TX-EXEMP-CD field displays a value other than "4", the Form 4029 has NOT been approved.</p>	<p>Route Form 4029 to Philadelphia Campus, Mail Stop 4-G08, 151 for processing. For general guidelines in the processing of Form 4029 see IRM 4.19.6.6.1, <i>Form 4029-Procedures.</i></p>

If	Then
No response to Notice of Deficiency.	After the suspension period has expired, process the assessment and close case as a default.

4.19.15.13 (03-11-2019)

SS-8 Determination of Worker Status

1. The Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*, is used to request a determination or ruling letter regarding a worker's federal employment tax status. If a letter is received requesting a worker status determination, a Form SS-8 is sent to the taxpayer advising them to resubmit their request for determination to the appropriate office.
2. The SS-8 Program has been centralized at Brookhaven Campus, except for Form SS-8 requests involving agencies and instrumentalities of the Federal government. See IRM 7.50.1, *Form SS-8 Processing Handbook*. Form SS-8 requests involving agencies and instrumentalities of the Federal government are handled by the Associate Chief Counsel (CC:TEGE) at the address provided in IRM 7.50.1.1.1, *Overview*, paragraph (2).
3. Procedures for issuing rulings, determination letters, and information letters are found in the first revenue procedure of the calendar year. The procedure is updated each year.
4. If a determination is made that the worker involved is an employee, correct returns may be solicited from the business. If the business does not respond, an employment tax examination may be initiated depending on the criteria of the applicable Area Office where the business is located.
5. Any information related to other areas of employment tax noncompliance can be provided by Area Office management.

4.19.15.14 (12-01-2017)

TEFRA (Tax Equity and Fiscal Responsibility Act)

1. Refer to IRM 4.29, *Partnership Control System (PCS)*, and IRM 4.31, *Pass-Through Entity Handbook*, for additional information.

Note:

TEFRA was repealed as part of the Bipartisan Budget Act of 2015 and replaced with a new centralized partnership audit regime. The repeal of TEFRA will be effective for partnership tax years beginning after December 31, 2017.

4.19.15.14.1 (03-11-2019)

Form 8082, Notice of Inconsistent Filers

1. TEFRA Partners, under IRC 6222, and S corporation shareholders, under IRC 6037(c), are generally required to file their returns consistently with the partnership / S Corporation return. However, there may be reasons why a member wishes to report items differently. Form 8082, *Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR)*, is used for this purpose. (Note that a partner in an electing large partnership must report all partnership items in a manner consistent with the partnership. IRC 6241.)

Note:

TEFRA was repealed as part of the Bipartisan Budget Act of 2015 and replaced with a new centralized partnership audit regime. The repeal of TEFRA will be effective for partnership tax years beginning after December 31, 2017.

2. Refer to IRM 4.29, *Partnership Control System (PCS)*, and IRM 4.31, *Pass-Through Entity Handbook*, for additional information.

4.19.15.15 (03-11-2019)

Unallowable Code (UA) Program

1. The Unallowable Code (UA) Program is a pre-refund program that identifies items for potential audit during return processing. It is a Compliance initiative used to prevent the issuance of erroneous tax refunds on both Individual Master File (IMF) and Business Master File (BMF) tax returns. The program requires coordination between headquarters analysts in W&I Campus Examination, SB/SE Campus Examination, Large Business & International (LB&I) and Submission Processing (SP) to ensure the correct types of Unallowable Conditions are being identified.
2. During processing, returns are reviewed for unallowable issues. If there is an unallowable issue present on the return, the appropriate code is assigned to the return. The cases are systemically opened on Audit Information Management System (AIMS) to the appropriate campus based upon back-end state mapping.
3. For a complete listing of unallowable codes reference Document 6209, *IRS Processing Codes and Information*.

4.19.15.15.1 (03-11-2019)

for examination.

3. One of the data sources available to identify new UA inventory is the SSIVL (Statistical Sampling Inventory Validation).

4.19.15.15.3 (03-02-2018)

Reviewing and Classifying Unallowable Inventory

1. When new Unallowable returns are opened to campus examination inventory, Exam Tax Compliance Officers (TCOs) should classify them. See IRM 4.19.11.2, *Examination Classification of Work*, and IRM 4.19.13, *General Case Development and Resolution*.
2. TCOs should review the return using Command Codes RTVUE, BRTVU, or TRDBV. The Employee User Portal (EUP) can be used to view Modernized Electronically Filed (MeF) returns. (Detailed return information and attachments are often available on EUP). SP employees are not trained on all tax law issues, and it is possible that the unallowable condition was incorrectly identified or coded. Classifiers should verify the unallowable conditions on the return and look for any other large, unusual and questionable items.

Note:

Refer to Document 6209, IRS Processing Codes and Information, for a list of unallowable codes and explanations to ensure the unallowable code(s) was properly coded. Referrals should be made to the appropriate area when potentially-abusive preparers and/or fraud are identified.

3. Unallowable Codes and amounts are shown on the last page of RTVUE and on the Code and Edit Values section on EUP. RTVUE will also show if there is a change to adjusted gross income, itemized deductions, or a tax adjustment. If RTVUE "Per Return" side and "Per Computer" side are different, a math error notice should have been sent. If the math error resolved the unallowable issue, close the case per local procedures.
4. Process cases as follows:

If	Then
===== =====	===== ===== ===== =====
If the taxpayer is in an active combat zone	Refer to IRM 4.19.13.21, <i>Combat Zone</i> , for instructions.

If	Then
The unallowable code was coded incorrectly and no other unallowable issue is present on the return	Survey case with Disposal Code 20
===== ===== =====	===== ===== =====
===== ===== ===== ===== ===== ===== =====	===== ===== ===== ===== ===== ===== =====
No additional issues are identified for the return and the UA issue does not need additional clarification	Form 6754, <i>Examination Classification Checksheet</i> , is not required. Case is ready for initial contact letter.
No additional issues are identified for the return and the UA issue needs additional clarification (i.e. UA code is incorrect or EUP provides a description of the UA item)	Use Form 6754, <i>Examination Classification Checksheet</i> , to identify the unallowable item(s).
Additional issues are identified for the return	Use Form 6754, <i>Examination Classification Checksheet</i> , to identify the unallowable and additional issue(s). Change to Source Code 20. The Project Code will remain the same.

4.19.15.15.4 (01-11-2017)

Initial Taxpayer Contact

1. Workpapers should be updated to include the specific issue(s) being audited (including UA code and description) along with any research conducted. See IRM 4.19.13.6, *Workpapers for All Cases*, for additional requirements.
2. Issue Letter 566-S, *Initial Contact Letter (ICL)*, to notify taxpayer of issue(s) being examined on unallowable cases.

Note:

For UA 89, PC 0505 cases, see IRM 4.19.15.29 , *Health Coverage Tax Credit - IRC 35*, for examination instructions.

3. Initial contact must include Form 886-A, *Explanation of Items*, to explain the issue(s) being examined.
4. Update AIMS to Status 10 and suspend the case for 45 days.

4.19.15.15.5 (03-11-2019)

Processing Reply/No Reply Unallowable Cases

1. When processing replies or no reply cases, refer to IRM 4.19.13, *General Case Development and Resolution*. See below for additional requirements relating to the unallowable program that are not shown in the referenced IRM.

If	Then
Sending Letter 525, <i>General 30 Day Letter</i> , or Letter 3219, <i>Notice of Deficiency</i>	In addition to the attachments noted in IRM 4.19.13, <i>General Case Development and Resolution</i> , include: <ul style="list-style-type: none"> • Form 2297 , <i>Waiver of Statutory Notification of Claim Disallowance</i> OR • Include the following paragraph on Form 4549, <i>Income Tax Examination Changes</i>: I waive the requirement that a notice of claim disallowance be sent to me by certified mail to disallow the refund claimed on my income tax return as described above. I understand that waiving this requirement is irrevocable and it will begin the 2-year period for filing suit with the United States District Court or the United States Court of Federal Claims for refund of the disallowed claim as if the notice of disallowance had been sent by certified or registered mail.
Case is closed as unagreed	Issue Letter 105C , <i>Claim Disallowed</i> , or Letter 106C, <i>Claim Partially Disallowed</i> , as appropriate.

4.19.15.15.6 (02-06-2012)

Transcripts

1. Transcripts titled, – *QFRZALERT*, will be sent to the responsible campus when an unreleased TC 576 remains on a module longer than 6 months without open AIMS or 18 months for a module with open AIMS.

- The transcript should be resolved within 15 days of receipt.

4.19.15.15.6.1 (01-01-2017)

Resolving the -Q Freeze

- The -Q freeze is set by a TC 576. The TC 576 freezes an amount claimed on a return that appears to be unallowable by tax law.
- The amount will remain frozen until the exam is closed/surveyed, or the refund is manually released.
- To resolve the -Q freeze, the campus will need to identify the reason the unallowable was coded and take one of the following actions:

If	And	Then
There is no TC 420	The unallowable was identified correctly in processing	Establish AIMS using SC 06, PC 0000. Once the AIMS base is established, convert to SC 03. Refer to IRM 4.19.13.21, <i>Combat Zone</i> , for Combat Zone procedures.
There is no TC 420	The unallowable was identified incorrectly in processing	Release the TC 576 through a manual online adjustment using a TC 572. This will generate a TC 577, restoring the TC 576 Unallowable Tax into the tax module, releasing the TC 576 hold.
There is no TC 420	There is a TC 971/522 on ENMOD indicating ID Theft for the tax year	Refer to IRM 4.19.13.26, <i>Campus Exam Identity Theft</i> .
There is a TC 420	The examination has not started	Follow IRM 4.19.15.15.3, <i>Reviewing and Classifying Unallowable Inventory</i> , to see if it should be examined or surveyed.
There is a TC 420	The examination has started	See where the examination stalled and promptly take the appropriate actions to get the case into the next stage of the examination process.

If	And	Then
There is a TC 420	There is a TC 300 or TC 421	Make sure that the correct blocking series and Disposal Code were used at closure. Doc Code 47 is to be used with Disposal Code 20-25, 27, 29, 31-33, 35 or 36. If the incorrect Doc Code was used, then please correct or manually input the TC 572 to release the TC 576.

4.19.15.15.7 (03-11-2019)

Unallowable Program and Alternative Motor Vehicle, Electric Plug In Credit or Electric Drive Motor Vehicle Credit

1. UA 79 is used when a taxpayer claims the same vehicle more than once on a combination of Form 8834, *Qualified Electric Vehicle Credit*, Form 8910, *Alternative Motor Vehicle Credit*, and/or Form 8936, *Qualified Plug-In Electric Drive Motor Vehicle Credit*.
2. These cases open in Source Code 03 and PC 0000.
3. See *IRM 4.19.15.40*, *Alternative Motor Vehicle Credit, Qualified Plug-in Electric Drive Motor Vehicle Credit, or Qualified Electric Vehicle Credit*, for appropriate Form 886-A, *Explanation of Items*, paragraphs and substantiation requirements.

4.19.15.15.8 (03-11-2019)

Unallowable Program and First Time Homebuyer Credit

1. UA 84 is used when the taxpayer could not have transferred the home, which was claimed for the FTHBC, as part of a divorce settlement.
2. Refer to *IRM 3.12.3.13.7, Invalid Conditions (EC 126)*, for the specific unallowable information.
3. These cases open in Source Code 03 and PC 0000.
4. Refer to *IRM 4.19.15.38, First-Time Homebuyer Credit IRC 36*, for appropriate Form 886-A, *Explanation of Items*, paragraphs and substantiations requirements.

4.19.15.15.9 (03-02-2018)

Unallowable Program and Health Coverage Tax Credit

1. =====

=====

- 2. These cases will open in SC 03 and PC 0505
- 3. Refer to IRM 4.19.15.29, Health Coverage Tax Credit IRC 35, for specific unallowable conditions and examination procedures.

4.19.15.15.10 (03-11-2019)

Unallowable Program and the District of Columbia First-Time Homebuyer Credit Carryforward

1. =====

- 2. These cases open in Source Code 03 and PC 0000.
- 3. The DC First-Time Homebuyer Credit was available for the purchase or construction of a principal residence beginning August 5, 1997 through December 31, 2011. Any unused portion of the credit can be used to claim a carryforward until the maximum \$5,000 (\$2,500 MFS) has been used.
- 4. When a new UA 61 opens to the campus, Exam TCOs should research the taxpayer’s account to determine if the following unallowable conditions are present:
 - a. the taxpayer has taken a cumulative amount greater than the maximum credit of \$5,000 (\$2,500 MFS)
 - b. the taxpayer does not appear to have resided in Washington DC
 - c. other questionable conditions identified by the TCO
- 5. If there are no unallowable conditions present, survey the case with DC 20.

4.19.15.16 (03-11-2019)

Fuel Tax Credit Claimed on Form 4136

- 1. Form 4136, *Credit for Federal Tax Paid on Fuels*, is used to claim an income tax credit for certain nontaxable uses (or sales) of fuel during the tax year. Ultimate purchasers, credit card issuers, and in some cases, ultimate vendors of certain types of fuels may be able to claim a fuel tax credit (FTC). A claim cannot be made for personal use of any fuel on Form 4136, Line 1.
- 2. Form 4136 is often used to claim a credit for fuel used in an off-highway business. Off-highway business use is a use in a trade or business or in an income-producing activity described in section 212 otherwise than as a fuel in a highway vehicle (i) that is registered or required to be registered with a state department of motor vehicles, or (ii) in the case of a highway vehicle

owned by the United States, is used on the highway. The fuel tax credit for off-highway business use of gasoline does not apply to passenger cars or, generally, to other vehicles that are registered or required to be registered to drive on public highways. There is a credit for use in a separate, non-propulsion motor of a highway vehicle to power auxiliary equipment, if certain requirements are met. It also does not include non-business, off-highway use of fuel, such as use by minibikes, snowmobiles, power lawn mowers, chain saws and other yard equipment.

Example:

The taxpayer owns a landscaping business and uses power lawn mowers and chain saws in his business. The gasoline used in the power lawn mower and chain saws qualifies as fuel used in an off-highway business use. The gasoline used in the taxpayer's personal lawn mower at home does not qualify.

3. FTC returns are filtered and selected by Dependent Database (DDB) rules. Cases are opened pre-refund in PC 1505 with assigned tracking codes (TC):
 - TC 6560 - FTC cases (previously selected under PC 0000)
 - TC 6561 - cases with FTC and the American Opportunity Tax Credit
 - TC 6562 - cases with FTC and no Schedule C, E or F attached
 - TC 6563 - cases with FTC with specific NAICS codes present on Schedule C
4. The corresponding Credit Reference Number (CRN) applicable to the type of fuel tax paid is shown in column (e) of the Form 4136. Review the Form 4136 using Command Code (CC) TRDBV or view the Modernized Electronically Filed (MeF) return through the Employee User Portal (EUP).
5. Some of the most common documents the taxpayer can submit to verify their FTC claim are listed on Form 14811, *Substantiation for Fuel Tax Credit (FTC)*, and include:
 - A list of vehicles and equipment used, including proof of ownership
 - Copies of invoices or receipts for the fuel purchases that include: The purpose for which the fuel was used; The number of gallons used for each purpose; The dates of purchase, and the names and addresses of suppliers and amounts bought from each.

Note:

Additional documentation may be required for certain fuels and Form 14811 can be modified to request this documentation if needed. See available resources below for additional requirements.

6. Start cases with Letter 566-S, *Initial Contact Letter*, and Form 14811, *Substantiation for Fuel Tax Credit (FTC)*. If other issues are selected for examination, additional forms may be used to request needed documentation.
7. Generally, cases should be researched and worked following the procedures in IRM 4.19.13, *General Case Development and Resolution*. There are additional considerations related to the FTC that should be included in the examiner's research. Some of them are highlighted below.
 - a. Ensure there is a business activity reported on the return.
 - b. Review the credit to see if it appears to be unallowable or excessive based on the type of business shown on the return.
 - c. Check to see if the taxpayer claimed any amounts on Form 4136 that were claimed on; Form 8849, *Claim for Refund of Excise Taxes*, and/or Form 720, *Quarterly Federal Excise Tax Return*.
8. Other available resources which provide more detail on each type of fuel and the requirements to claim the credit are:
 - The instructions for Form 4136, *Credit for Federal Tax Paid on Fuels*
 - Pub 510, *Excise Taxes*
 - Pub 225, *Farmer's Tax Guide*

4.19.15.17 (12-01-2017)

Erroneous Refunds

1. The Erroneous Refund Program in Correspondence Examination involves cases that had incorrect refunds issued to taxpayers due to variety of reasons. The potential for erroneous refunds may occur in the following situations: misapplied payments, incorrect tax adjustments/assessments, incorrect credit refunds, taxpayers filing fraudulent returns, or taxpayers using incorrect TINs. For more information on Erroneous Refunds and causes refer to IRM 21.4.5, *Erroneous Refunds*, and IRM 5.1.8.7.1, *Recovery of Unassessable Erroneous Refunds*.
2. Erroneous refunds are processed according to categories based on characteristics on the tax module. Erroneous refunds are generally classified as either:
 - Assessable – Requires a recalculation of tax liability.
 - Unassessable – No Requirement for a recalculation of tax liability.

3. The Correspondence Examination program involves assessable erroneous refunds. These errors arise when the Service made a downward recomputation of the taxpayer’s tax liability based on a substantive determination and later discovers that the determination was incorrect. The adjustment to the tax liability or recapture of a refundable credit will require Statutory Notice of Deficiency processing.
4. The assessable erroneous refunds generally are referred to Examination as Category A1 or A2 referrals. There are situations in which Examination closes a case incorrectly and thereby creates an erroneous refund. If the case was closed with an erroneous refund, the case reopening criteria in Rev. Proc. 2005-32, and in IRM 1.2.13.1.1 , *Policy Statement 4-3*, must be followed. Also, see IRM 1.2.43.8, *Delegation Order 4-7*.
5. Before examination contact with the taxpayer and initiation of the Statutory Notice of Deficiency processing, each case will be screened to determine if the erroneous refund was correctly classified as assessable or non-assessable. Refer to IRM 21.4.5.5, *Erroneous Refund Categories and Procedures*, for more information on the categorizing of erroneous refunds.
6. Examination will determine if the statutory period for assessment has expired. Since Examination accepts only assessable erroneous refunds with tax liability changes, the ASED becomes the statute of limitations for the erroneous refund and is used in the selection criteria. For informational purposes, the following are the statute of limitations issues involved with erroneous refunds:
 - ASED – Assessment Statute Expiration Date
 - CSED – Collection Statute Expiration Date
 - ERSED – Erroneous Refund Statute Expiration Date
7. If the taxpayer did not cause the erroneous refund, and the amount of the erroneous refund is \$50,000 or less, under IRC 6404(e)(2), the Service must abate interest accruing from the date of the refund to date of notice and demand. If the amount of the erroneous refund is more than \$50,000, the Service may abate the interest accruing before the date of notice and demand in its discretion, see IRM 20.2.7.7, *Erroneous Refunds - IRC 6404(e)(2)*. The classifier or examiner must determine whether the taxpayer in any way caused the erroneous refund and the **work papers** must document this determination.
8. The following procedures should be used in erroneous refunds:

If	Then
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If	Then
Non-assessable erroneous refund or assessment statute period has expired	<ul style="list-style-type: none"> • Return transcripts back to initiator. • Non-assessable erroneous refunds are not worked by Examination.
Assessable and statute period of assessment has not expired	<ul style="list-style-type: none"> • Classification will submit Form 5345, <i>Examination Request Master File</i>, to obtain the examination assembly. • The cases should be opened with the following AIMS information: <p>Source Code: 20 Status Code: 08 Project Code: 0044 for Non-EITC Related or 0045 for EITC Related (EITC is the subject of the erroneous refund) Employee Group Code: 5000</p>

If	Then
Assessable Erroneous Refunds on Individual Income Tax Returns	<p>a. The initial contact letter should be issued as follows:</p> <ul style="list-style-type: none"> • Non-EITC Discretionary PC 0044 cases, issue Letter 566-B with examination report. • EITC PC 0045 cases, issue Letter 566-S. • On Letter 566-B for discretionary or Letter 566-S for EITC, include the following explanation "Erroneous Refund" and "See Form 886-A." Enclose Form 886-A with the following explanation titled <i>Erroneous Refund: "The refund check we mailed to you for your (tax year) overpayment was incorrect."</i> <p>Note:</p> <p>EITC case must follow the three letter exam process; i.e. ICL, 30 Day Letter, and Statutory Notice of Deficiency.</p> <p>b. When preparing Examination Report, Form 4549, <i>Income Tax Examination Report</i>, use the following suggested explanation: <i>"We are sorry but the refund we sent you is incorrect because we overpaid you by the amount shown in the attached report. We regret the error and thank you for helping us correct it. Since the erroneous overpayment was due to IRS error, no interest will be charged if you pay the amount refunded in error within 21 days from the date of this letter. If the amount due is not received within 21 days, interest will be assessed from the date of this letter demanding repayment."</i></p> <p>c. Include in the explanation to the taxpayer, on what line of the tax return or on what schedule the error occurred.</p> <p>d. Update case to the appropriate AIMS status following general examination procedures.</p>

If	Then
Assessable Erroneous Refunds on other Federal Tax Returns	<ul style="list-style-type: none"> • Business Master File (BMF) or Residual Master File (RMF) for deficiency procedures may be sent to recover an assessable erroneous refund. • General examination procedures will be followed • Refer to IRM 4.10, <i>Examination of Returns</i> and IRM 4.2, <i>General Examining Procedures</i>.

9. Complete Form 3198, *Special Handling Notice for Examination Case Processing*, identifying the Erroneous Refund. Special handling is required to abate all interest charges if erroneous refund is repaid with 21 days (when the unpaid amount is between \$50,001 and \$99,999) or within 10 days (when the unpaid amount is \$100,000 or more) of the request for repayment.

4.19.15.18 (01-01-2014)

Alimony

1. Alimony is a payment to or for a spouse or former spouse under a divorce or separation instrument. Refer to Publication 504, *Divorced or Separated Individuals*, for more comprehensive information regarding alimony.
2. The correspondence examiner should resolve discrepancies between the amount deducted as alimony by one taxpayer and the amount reported as income by the recipient on line 31(a) of Form 1040. For purposes of these procedures, the payer is defined as the taxpayer who claimed the alimony deduction. The recipient is the spouse or ex-spouse who the payer states received the alimony. The term taxpayer(s) refers to the recipient, the payer or both. The term alimony refers to all spousal support that meets the requirements of IRC 71. The term instrument refers to a decree of divorce or separate maintenance, a written separation agreement, a temporary decree, an interlocutory decree, or a decree of alimony pendente lite.
3. Two of the current Alimony Programs are referenced below.
 - a. Inventory for the Alimony SSN Program involves cases where the recipient of the alimony, as identified by the payer's return, apparently has an invalid SSN. The Project Code for the payer is 0141, and the Project Code for the recipient is 0142.
 - b. Inventory for the Alimony Matching Program involves cases where there is a substantial difference between the alimony deduction claimed by

the payer and alimony income reported by the payee. The Project Code for the payer is 0231, and the Project Code for the recipient is 0232.

4.19.15.18.1 (01-01-2014)

Initial Contact and General Processing

1. **Payers** - Payer cases are initiated through ACE (Automated Correspondence Exam) processing.
 - a. Payer cases are started in Status 10 with Letter 3541-A, *Initial Letter Asking For Verification on Alimony Deduction*.
 - b. Letter 3541-A solicits records supporting the deduction claimed by the payer including proof of alimony payment and a copy of the instrument(s) authorizing payment. It also requests identification of the alimony recipient(s).
 - c. Cases will be suspended for 45 days in Status 10.
 - d. When the case moves into Status 22 or when a tax examiner is responding to a reply to the Letter 3541-A, the Letter 3541 along with the Form 4549 will be mailed.
 - e. ACE generated reports include a substantial understatement penalty when applicable. Examiners should consider the application of accuracy penalties when processing responses.

2. **Recipients** - Open recipient cases on AIMS and initiate manually only upon verification by a payer of unreported alimony or pension income which would generate a deficiency for the recipient = = = = = . Refer to AIMS Processing IRM 4.4.23.6, *Preparation of Forms*, and the IDRS Command Code AM424 Job Aid.
 - a. Create the recipient case on AIMS no later than 30 days after closure of the related payer case.
 - b. Initiate recipient cases in Status 10 with Letter 3540-A, *Initial letter Inquiring about Unreported Alimony Income*.
 - c. Letter 3540-A, requests a copy of divorce or separation instruments if income is disputed as well as identification of any payers.
 - d. Cases will be suspended for 45 days.
 - e. After the suspense period, the case will be manually updated to Status 22 and Letter 3540 along with the Form 4549 will be mailed manually by the campus. The case can be introduced into ACE after the Status 22 action is completed.

- f. Recipient work papers must detail the supporting information for the unreported income provided by the payer and include the payer’s name and SSN from initial contact. Include both the ex-spouse’s SSN and the primary TIN of a joint payer return if the ex-spouse filed as the secondary taxpayer.
- g. Include a copy of all relevant supporting documents provided by the payer in the recipient’s case file.
- h. Examiners should consider the application of accuracy penalties from initial contact.
- i. Complete appropriately the *Related Return Information Section* of Form 5344, *Examination Closing Record*.

Form 5344 field:	Form 5344 entry should be: Note: Overwrite the default entries.
405	Payer’s SSN
406	Payer’s MFT (Master File Tax)
407	Payer’s tax period
408	S

- 3. **All** - Suspend all cases after initial contact for 45 days awaiting taxpayer response.
- 4. **Recipient Return Not Filed** - If the recipient has not filed a return, initiate manually only upon verification by a payer of unreported alimony or pension income which would generate a deficiency for the recipient = = = = . No later than 30 days after closure of the related payer case, open on AIMS per IRM 4.19.17.3.4, *Non-Filer Source and Project Codes*, and follow examination procedures per IRM 4.19.17, *Non-Filer Program*.

4.19.15.18.2 (01-01-2010)

No Reply

- 1. If the taxpayer does not respond to the letter, prepare the case for issuance of a Statutory Notice of Deficiency.
- 2. Close the case as a default if no response is received to the Statutory Notice of Deficiency after 105 days from its mail date.

4.19.15.18.3 (12-01-2017)**Processing Taxpayer Replies**

1. Use the following table when reviewing a taxpayer's reply.

If	Then
The taxpayer signs the report or, prior to the mailing of a Statutory Notice of Deficiency, pays the full amount	Close the case agreed using normal procedures.
The taxpayer submits documentation and you need additional information	Follow procedures in IRM 4.19.13.10.1, <i>Taxpayer Response – Additional Information Needed</i> . Note: Treat Letter 3540 and Letter 3541 the same as Letter 525.
The taxpayer appeals the determination	Follow relevant procedures in IRM 4.19.13.12, <i>No Response and Unagreed Cases</i> and IRM 4.19.13.15, <i>Transfers to Area Office Examination or Appeals</i> .
The taxpayer submits sufficient verification that the return is substantially correct.	Close using "no change" procedures.

Note:

If at any time during the examination of a Payer it is discovered that the Payer listed an incorrect Recipient TIN on their tax return, inform the taxpayer of this. Notification can be given at any time before closing and may be accomplished through correspondence or a phone call. Examiners must document on the workpapers that this has been done. Notifying the taxpayer of their TIN reporting error will help prevent them from making the same error year-to-year, and potentially triggering audit selection rules unnecessarily.

2. Open a recipient case under the conditions noted in IRM 4.19.15.18.1, *Initial Contact and General Processing*, paragraph (2). The related payer case needs not be closed first. For example, alimony payments may be resolved with respect to one recipient and not another, or the payer case remains open for expanded issues only. Monitor a payer case through default if necessary when the conditions to open a recipient case have been met but additional supporting records are required to resolve the remainder of payments

purported to be made to the same recipient. Copy all pertinent documents provided by the payer for inclusion in the recipient's file in case the latter files an appeal.

Note:

The burden of proof is on the Service for disputed income.

4.19.15.18.4 (11-29-2011)

Workpapers

1. While thorough workpaper documentation is important regardless of the issue, it is particularly critical for alimony deductions/income because the outcome of one taxpayer's case may impact one or more other taxpayers.
2. Examiners should note the following when applicable on Form 4700, *Examination Workpapers* (not all inclusive):
 - The type of each document received (e.g., divorce decree, separate maintenance agreement, QDRO (Qualified Domestic Relations Order), cancelled check, pay statement, etc.).
 - The date of an instrument, the state in which it was executed, and the parties who signed it.
 - The name and SSN of the other party affected by an instrument or QDRO. (Also if the other party filed as the secondary taxpayer on a joint return, note the primary TIN of that return.)
 - The nature of the payments ordered by an instrument (e.g., pension, periodic alimony, lump-sum alimony, unallocated family support, etc.) and the amounts specified by type.

Note:

It is not necessary to detail a property settlement unless the payer deducted it or to note any other type of payment if the taxpayer only claimed a pension split.

- The presence or absence of a child support order (not applicable for pension splits). If child support is ordered, it must be verified as paid before allowing deduction for any direct payments for alimony.
- The presence or absence of a death contingency (not applicable for pension splits). If there's a death contingency, explain whether it is specifically stated in an instrument or it applies by operation of state law.
- The presence or absence of a child-related contingency if unallocated support was ordered in an instrument.

3. Taxpayers often deduct payments made to more than one spouse/former spouse. Record documentation received concerning each recipient separately in the payer's workpapers.

Note:

Copy/paste can be used when creating the recipient's workpapers to transfer information from the payer's workpapers.

4. If the payer audit results in a no-change, audit consideration of the recipient taxpayer(s) must be documented in the payer's workpapers. The workpapers must indicate whether the audit was or was not expanded to the recipient taxpayer(s) and why.
5. Refer to IRM 4.19.13.3.3, *Standard 3 - Workpapers Support Conclusions* and IRM 4.19.13.5, *Work Papers for All Cases* for more information concerning workpapers.

4.19.15.18.5 (01-01-2010)

Research

1. **Payers** - Since payer cases are initiated systemically, it's important to thoroughly research IDRS when processing the first response.
 - a. Screen each recipient's RTVUE/TRDBV and IRPTR to determine if alimony income was substantially reported on any income line of a recipient's return.
 - b. Review each recipient's account to determine if an amended return was filed to report the alimony income.
 - c. Close the payer case as a "no change" if alimony income reported by the recipient(s) substantially matches the alimony deduction claimed by the payer.
 - d. Screen the payer's RTVUE/TRDBV and IRPTR to determine if there are large, unusual or questionable items (LUQs) other than the alimony deduction and revise the report if warranted. Do not introduce new deficiency issues when sending Letter 555.
2. **Recipients** - Perform IDRS research prior to establishing a recipient case on AIMS.
 - a. Review the recipient's account to determine if an amended return was filed. It is common for payers to inform recipients of their examinations, often prompting recipients to amend their returns.
 - b. Screen the recipient's RTVUE/TRDBV and IRPTR to determine if there are any LUQs other than the alimony income and expand the scope of the audit if warranted.

3. **All** - Review all related CEAS records including any for prior and subsequent years and for the cross-reference taxpayer(s) to determine if they contain pertinent information. However, do not "no change" a case solely because the same issue was examined for another tax year and not adjusted. Each year stands on its own merits.

4.19.15.18.6 (03-11-2019)

Documentation

1. Documentation must include the instrument that orders the payment of alimony with all amendments and proof of payment in the form of:
 - Copies of cancelled checks identifying who received the funds, the dollar amount and the date the payment cleared the bank, the front and back of money orders, or proof of direct deposit that specifically identifies the recipient by name;
 - Court receipts or statements from state or county agencies to which payments were made; or
 - Pay statements showing the name of the recipient or court document docket number.
2. The instrument may require payments to third parties that could qualify as alimony. Documentation can include, but is not limited to:
 - Copy of a deed to verify home ownership for mortgage, real estate taxes and home insurance payments;
 - Receipts, utility statements, lease agreement, etc., for living expenses;
 - Registration and receipts for education expenses;
 - Proof of recipient's ownership for life insurance premiums;
 - Bills and receipts for medical and dental expenses;
 - Statements for health insurance premiums;
 - Proof of ownership of other property such as car, boat, recreational vehicle, etc. The recipient must be the sole owner of said property.
3. Payments designated as not alimony can only be excluded from income if the recipient attaches a copy of the instrument designating the payments as not alimony to his/her return. The instrument must be attached to the return for each tax year for which the designation applies.
4. Unacceptable documentation includes but is not limited to:

- Unsigned (by either a judge or both affected parties), undated, or incomplete instruments,
- Letters testifying to verbal agreements,
- Retroactive instruments unless a judge indicates the correction was due to a clerical error made by the court or there is a nunc pro tunc order revising the original decree to conform to the intent of the court at the time of entry.

4.19.15.18.7 (01-01-2015)

Legal Terminology

1. Instruments of divorce or separation often contain legal terminology. Some frequently used terms relevant to alimony include:

- *Decree nisi* - a provisional decree that will become final unless cause is shown why it should not.

Note:

Some states grant divorces using decrees nisi. The decree nisi creates a time period (such as three months) allowing for possible reconciliation or for completion of various arrangements (such as custody).

- *Separation a mensa et thoro* - a separation of spouses which does not involve a dissolution of the marriage but in which certain arrangements (such as for maintenance and custody) are ordered by the court (also called legal separation, judicial separation).
- *Divorce a vinculo matrimonii* - a divorce that completely and permanently dissolves the marital relationship and terminates marital rights (such as property rights) and obligations (such as fidelity); absolute divorce.
- *Ex parte* - on behalf of or involving only one party to a legal matter and in the absence of and usually without notice to the other party.

Example:

an ex parte motion;

Example:

relief granted ex parte (used in citations to indicate the party seeking judicial relief in a case).

- *Nunc pro tunc* - now for then (used in reference to a judicial or procedural act that corrects an omission in the record, has effect as of an earlier date, or takes place after a deadline has expired).

Example:

a nunc pro tunc order;

Example:

permitted to file the petition nunc pro tunc.

- *Pendente lite* - during the suit: while litigation continues.

Example:

awarded joint legal custody of the child pendente lite;

Example:

pendente lite child support.

- *Interlocutory* - not final or definitive.

Example:

an interlocutory order.

- *Joint tenancy* - a tenancy in which two or more parties hold equal and simultaneously created interests in the same property and in which title to the entire property is to remain with the survivors upon the death of one of them (such as a spouse) and so on to the last survivor.

Example:

a right to sever the joint tenancy.

- *Tenants in common* - a tenancy in which two or more parties share ownership of property but have no right to each other's interest (such as upon the death of another tenant).
- *Tenants by the entirety* - a tenancy that is shared by spouses who are considered one person in law and have the rights of survivorship inherent in joint tenancy and that become a tenancy in common in the event of divorce.

Example:

Property subject to a tenancy by the entirety cannot be encumbered by one tenant acting alone.

4.19.15.18.8 (01-01-2011)

Death Contingency

1. Tax law states that for payments to be considered alimony, they must cease on the death of the recipient spouse. This "death contingency" can be stated in the instrument itself, codified in state law, or applied by operation of state or federal case law. The tax examiner must research state laws to reach a correct determination. The use of the word *alimony* in an instrument

does not necessarily mean that the payments in question meet the requirements to be considered alimony under IRC 71.

4.19.15.18.9 (11-29-2011)

Pension Income

1. **QDRO** - Although pension income paid to an alternative payee is not alimony, it is frequently deducted as such. Instruments can provide for the division of a pension between the plan participant and a non-participant spouse. This can be executed with a qualified domestic relations order (QDRO) that transfers the applicable percentage of distribution through the plan to a non-participant spouse.

Note:

A QDRO is not a divorce decree. It is the document used to authorize the employer to distribute funds.

However, the participant may be ordered to pay the required percentage directly to a non-participant spouse after distribution. Under a QDRO, separate Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*, should be issued to each individual, the plan participant and non-participant spouse, showing only the amount of their respective distributions. If the QDRO is to a non-spouse, such as a child, only one Form 1099-R is issued to the participant showing the entire distribution. Unlike other property settlements, pension distributions are taxable to the recipients because those distributions were based on amounts previously contributed on a tax-deferred basis.

2. **OPM Reporting** - Problems may arise in connection with Form 1099-R issued from Office of Personnel Management (OPM). Prior to the year 2000, OPM reported the gross pension distribution on Form 1099-Rs to the participant spouse. The participant spouse then reported the gross amount of distribution as pension income and deducted the amount apportioned to the non-participant spouse as alimony. In the year 2000, OPM started issuing separate Form 1099-Rs to the participant spouse and non-participant spouse showing their respective distributions. The plan participant spouse was not notified of the change. Consequently, the participant spouse continued to deduct the apportionment, thereby creating a double deduction. A copy of both the front and back of the Annuity Statement must be received to verify the taxpayer claimed the entire pension amount.
3. **DFAS Reporting** - Military retirees frequently under report pension income due to Defense Finance and Accounting Services (DFAS) practices. In some instances DFAS issues a Form 1099-R to the participant spouse for the full amount of the distribution paid to the participant spouse and the non-participant spouse. In other instances, separate Form 1099-Rs are issued to the participant spouse and non-participant spouse showing only the amount of their respective distributions. When the non-participant spouse

receives a Form 1099-R from DFAS, the participant spouse should not exclude the pension amount reported on the Form 1099-R that is issued to the non-participant spouse from taxable income. A copy of both the front and back of the Retiree Account Statement (DFAS-CL) must be received to verify the taxpayer claimed the entire pension amount. The plan participant can obtain the copies from **MyPay** at [HTTP://MYPAY.DFAS.MIL](http://MYPAY.DFAS.MIL)

4. **State and Local Government/Private Industry Pensions** - Total distributions from the plan must be verified to ensure the taxpayer claimed the full amount received by all parties.
5. **Disability Pensions** - The non-taxable nature of a disability pension does not transfer to the non-participant spouse. The disabled participant spouse cannot take a deduction for non-taxable distributions transferred to a non-participant spouse unless they are first reported in taxable income. The non-participant spouse is required to report the income on his/her tax return. DFAS began a two-tier disability pension in 2005. Only a disability or CSRS (Civil Service Retirement System) is non-taxable. This may account for a discrepancy in the participant's taxable income.

Note:

Do not use alimony language when adjusting pension income.

4.19.15.19 (03-10-2017)

What is DIF CORR (Source Code 06)

1. Discriminate Information Function (DIF) examines non-complex credits, deductions and/or expenses on Nonbusiness returns. Some examples are:
 - Interest
 - Taxes
 - Contributions
 - Medical Expenses
 - Simple miscellaneous expenses such as union dues, work clothes, and small tools
2. DIF order could be utilized to select high income taxpayers with high DIF score for audit.
3. DIF returns require classification.

4.19.15.19.1 (03-10-2017)

Procedures for DIF CORR (Source Code 06)

1. Use Initial Contact Letter 566-S to notify taxpayer of review.

2. Check off the issues on the back of Letter 566-S using classification check sheet.
3. Put a copy of the letter in the case file.

If	Then
Adjustment is required after information is submitted by the taxpayer	Send Letter 525 (SC), Form 4549 / Form 4549-EZ, and appropriate attachments, and retain copy of letter and report in the case file.
Case is a single issue information return	Send Letter 525 (SC) and Form 4549/Form 4549-EZ, and with adjustment and standard explanation(s).
Evaluating Taxpayer Replies/No Replies/Closing Procedures etc.	Refer to IRM 4.19.13, <i>General Case Development and Resolution</i> , for guidelines. IRM 4.19.15.20, <i>Schedule A</i> , for Schedule A issues.

4.19.15.20 (03-29-2016)

Schedule A

1. For all examined Schedule A items, the examiner should check for:

- Altered photocopies of paid bills.
- Bank statements or cancelled checks coinciding with the amount claimed as paid.

Reminder:

An altered document is an indicator of fraud and a fraud referral or civil fraud penalty should be considered. Refer to IRM 4.19.10.4, **Fraud Referrals**.

2. **Medical and Dental Expenses:** The examiner should have the taxpayer send in the following documentation (, Form 14808, *Schedule A - Medical and Dental Expenses*):
 - Copies of bank statements or cancelled checks, receipts or statements for all medical savings accounts, medical and dental expenses (including medical insurance) showing the person for whom each expense was incurred, the name and address of each person to whom payment was made, and the amount and date of payment in each case.
 - Any insurance or employer reimbursement records, and
 - Verification of medical and dental insurance premiums paid.

Note:

The Archer Medical Savings Account program expired on December 31, 2007.

3. When the requested documentation is received, the examiner should:
 - Ensure that insurance reimbursements are excluded from deductions. Ensure medical or dental insurance premiums were not paid pre-tax. Ensure the expenses are for the taxpayer, spouse, dependent, adopted child, child of divorced or separated parents, or a decedent who, when living, was the taxpayer, spouse, dependent, adopted child, or child of divorced or separated parents.
 - Ensure that the medical expenses are for a person.

Exception:

Costs of a guide dog or other animal to be used by a visually impaired or hearing impaired person are allowable. Also allowable are expenses to care for an animal trained to assist persons with any other physical disabilities.

- If there is a multiple support agreement, the taxpayer may be able to claim medical expenses even if the taxpayer cannot claim that person as a dependent (IRC 152 and IRC 213).

4.19.15.20.1 (01-01-2014)

Nondeductible Medical Expenses

1. This list is not all inclusive.

Nondeductible Purchases	Explanation
Baby-sitting, child care, and nursing services for a normal, healthy baby	Personal expenses are not allowable, even if the expenses enable the taxpayer to get medical treatment.
Controlled substances	Purchase of any substance in violation of federal law is not deductible, e.g., marijuana, laetrile, etc.
Cosmetic surgery, electrolysis or hair removal, hair transplant	Medical expenses paid for cosmetic surgery are deductible only if they are necessary to improve a deformity arising from, or directly related to, a congenital abnormality, or a personal injury resulting from an accident, trauma, or a disfiguring disease

Nondeductible Purchases	Explanation
Dancing lessons or swimming lessons	Not allowed, even if recommended by a doctor for the improvement of general health. These are deductible only if prescribed for a specific medical condition.
Diaper service	Allowed only if needed to relieve the effects of a particular disease.
Health club dues	A fee charged by a health club is deductible only if it is a fee for a specific service, such as a fee for a trainer service to treat a particular medical problem.
Household help	Allowed only if paid for nursing-type services. Certain maintenance or personal care services provided for qualified long-term care can be included in medical expenses.
Illegal operations and treatments	Not allowed, even if medically prescribed.
Insurance Premiums	<p>Not deductible if for the following insurance benefits:</p> <ul style="list-style-type: none"> • Payments for loss of life, limb, sight, etc. • Payments for loss of earnings. Guaranteed payment for each day of hospitalization. • Pre-tax insurance premiums.
Maternity clothes	Not allowable.
Medical Savings Accounts (MSA)	<p>Not allowed.</p> <ul style="list-style-type: none"> • Any expense paid from a medical savings account is not deductible. • The taxpayer cannot deduct medical expenses as itemized deductions that are included in the tax-free amount of a distribution from a Health Savings Account (HSA). If taxpayer has deducted medical expenses or insurance premiums elsewhere on the return, these expenses cannot be used again as a deduction on Schedule A.

Nondeductible Purchases	Explanation
Nonprescription drugs and medicines	Not allowed.
Nutritional supplements	Allowed if they are recommended by a medical practitioner as treatment for a specific medical condition diagnosed by a physician. See Publication 502.
Personal use items	Allowed only when an item is purchased in a special form primarily to relieve a physical defect. The excess of the cost of the special form over the cost of the normal form is a medical expense.
Weight-loss program	Allowed only if the program is undertaken to treat an existing disease (such as obesity) diagnosed by a physician.

4.19.15.20.2 (03-11-2019)

Taxes Paid

1. Taxpayers are allowed to deduct certain taxes when they itemize deductions on Schedule A (Form 1040). These taxes include:
 - State and local income taxes
 - General sales taxes
 - Real estate taxes
 - Personal property taxes
2. For additional information on deductible taxes refer to IRM 21.6.4.4.1.4, *Taxes and Fees –Deductible and Nondeductible*.
3. For taxes paid, the examiner should consider having the taxpayer send in the following documentation:

Category	Documentation
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Category	Documentation
For State and Local Income Tax deductions:	<ul style="list-style-type: none"> • Copies of state or local returns for the years involved. • Copies of cancelled checks and receipts for taxes paid during the year. • Form W-2 or other statement showing state and local income tax withheld during the year.
For State Sales Tax Deduction:	<ul style="list-style-type: none"> • Sales receipts for the year involved, if actual state and local general sales taxes are claimed. • Statements from the payer for non-taxable income which includes: tax exempt interest, veterans' benefits, non-taxable combat pay, workers' compensation, non-taxable part of Social Security and Railroad Retirement Benefits if the taxpayer used the Optional State Sales Tax Table, and indicates he/she had non-taxable income and the non-taxable income was not shown on the return. The General Sales Tax Tables are in the Form 1040 Instructions. • Sales receipts for motor vehicles, mobile and prefabricated homes, or home building materials. The actual sales tax paid on these items can be added to the amount in the Optional State Sales Tax Tables, but only include the amount of tax paid at the general sales tax rate.

Category	Documentation
For State and Local General Sales Tax Deduction:	<ul style="list-style-type: none"> • Documentation to support state and local sales taxes paid on a motor vehicle, aircraft, boat, home, or home building materials, if claimed in addition to table amount. This includes purchase contracts and bills of sale. If the taxpayer claimed actual sales taxes then the taxpayer needs to provide actual sales receipts and support for purchase of large items. • If the receipts are too numerous to photocopy, the taxpayer may provide an itemized list. The list should identify the item purchased, date, total cost, and the amount of sales tax paid.
For Taxes on Qualified Motor Vehicles- State or Local Sales or Excise	<ul style="list-style-type: none"> • Documentation to support state and local sales and excise taxes paid on a qualified new motor vehicle, include purchase contracts and bills of sale. <p>Note: This provision expired in 2009. The vehicle must have been purchased before the end of 2009. However, the vehicle sales taxes may still be deducted as a general sales tax if the taxpayer elects to deduct general sales taxes.</p>
For Real Estate and Personal Property Taxes deduction (list is not all inclusive):	<ul style="list-style-type: none"> • Verification of legal ownership of the property. • Copies of cancelled checks, mortgage statements or receipts for taxes paid. • Copy of property tax bill and documentation of any property tax rebates or refunds. • Copy of the settlement statement if real property was sold or purchased during the year. • Verification of any special assessments deducted as taxes and an explanation for their purpose.

Note:

See , Form 14810– *Schedule A - Taxes You Paid*.

4. The following is a list of nondeductible taxes (not all inclusive):
 - Federal Income and Excise taxes.
 - Social Security Taxes .
 - Medicare.
 - Federal Unemployment Tax (FUTA).
 - Railroad Retirement Taxes (RRTA).
 - Customs duties.
 - Tax on gasoline.
 - Car inspection fees.
 - Assessments for sidewalks or other improvements to property.
 - Tax paid for another taxpayer.
 - License fees (marriage, driver's, dog, etc.).
 - Penalties or interest.
 - Homestead Exemption – this is not a tax, but is used to reduce state or local real property taxes for qualified homeowners.
5. Taxpayers should not reduce their deduction by:
 - Any refund of, or credit for, prior year state and local income taxes received in the tax year of the return.
 - Tax refunds from prior year State returns, when the taxpayer has state and local taxes on the prior year Schedule A should be reported on the appropriate line of Form 1040.
 - Refunds of real estate taxes deducted in prior years should be reported on the "Other Income" line of the Form 1040.
6. Evaluating Taxpayer Responses:
 - For 2004 and subsequent tax years, taxpayers can elect to deduct either state and local general sales taxes, or state and local income taxes. The taxpayer cannot deduct both.
 - A taxpayer cannot deduct new motor vehicle taxes if his or her modified adjusted gross income (AGI) is \$135,000 or more (\$260,000 or more if

filing status is married filing jointly).

- A taxpayer's deduction for the new motor vehicle taxes is reduced if a taxpayer's AGI is \$125,001 to \$134,999 (\$250,001 to \$259,999 if married filing jointly).
- If the taxpayer deducts state and local income taxes, the taxpayer reports the sales or excise taxes for a new motor vehicle on line 7 of the Schedule A.
- If the taxpayer elects to claim a general sales tax deduction using the general sales tax table amount, the taxpayer can add the sales tax paid for a new motor vehicle to the general sales tax table amount, and report it on line 5(b) of Schedule A.
- Ensure the taxpayer has not duplicated the deductions elsewhere on the return such as on Schedule E or C.
- If taxpayer has a Schedule E, ensure taxes and interest related to that property have not been placed erroneously on Schedule A.
- State and Local Sales Tax Deduction:

If	Then
The state or locality imposes a general sales tax on the sale of a home,	The "closing statement" from the sale of the home should show the amount of sales tax due from the seller.
The state or locality imposes sales tax due to a major/substantial renovation,	The taxpayer should provide a statement from the state or locality for the sales tax paid.
A contractor was authorized by contract to act in the taxpayer's behalf to build or substantially improve the taxpayer's home,	The taxpayer should provide a copy of the contract designating the contractor, a statement from the contractor indicating the items purchased and amount of sales tax paid.

If	Then
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If	Then
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4.19.15.20.3 (12-01-2017)

Home Mortgage Interest Deductions

1. Taxpayers are allowed to deduct mortgage interest paid for their main home and a second home. The deduction is reported on Schedule A of the Form 1040 as an itemized deduction. Personal interest, i.e., for credit cards, unsecured loans, car loans, mortgage interest on a third home, and excess mortgage interest is not deductible. During examinations, tax examiners will need to determine the correct amount of mortgage interest allowable as a deduction. In some instances the mortgage interest deduction including deductible points is limited, as discussed below.

Note:

See , Form 14809, *Interest you Paid*

2. Use IDRS CC IRPTR to search for Form(s) 1098, *Mortgage Interest Statement(s)*, verifying that the taxpayer paid mortgage interest in the year under examination. If there is no data on IRPTR to indicate that mortgage interest was paid by the taxpayer, or if the taxpayer’s name is not on Form

1098, or if the transcribed Form(s) 1098 do not verify the amount deducted, the examiner should request copies of:

- mortgage interest statements for the year being examined
 - mortgage or loan contracts
 - equity line of credit agreements
 - amortization schedules for loans outstanding
 - cancelled checks, receipts, or other evidence of payments made for the year under examination
3. If the total mortgage interest and points deducted on Schedule A is greater than \$77,000.00 (\$38,500.00 if married filing separately), work the issue as an excess mortgage interest deduction. See IRM 4.19.15.20.3.4, *Excessive Mortgage Interest Deduction - IRC 163*.

4.19.15.20.3.1 (12-01-2017)

General Requirements

1. **Taxpayer Liable.** There must be a true debtor-creditor relationship between the taxpayer and the lender, and the taxpayer must be legally liable for the loan. If the taxpayer is not liable for the debt, the interest is not deductible. It is not necessary that the taxpayer be the party making the payments, but if the taxpayer is not filing a joint return, and is a co-owner with a party other than a spouse, the taxpayer may need to verify the specific amount he/she paid. (See IRM 4.19.15.20.3.2, *Evaluating Taxpayer Responses*.)
2. **Secured Debt.** The mortgage must be a secured debt, it usually is if reported on Form 1098. Generally, a secured debt is one for which an instrument is signed such as a mortgage, deed of trust, land contract, promissory note, security instrument, or home equity line of credit. The home must be collateral for the interest of the lender; if the loan is not repaid, the lender can foreclose on the mortgage and the home can then serve as payment for the debt.
3. **Qualified Home.** The taxpayer's debt must be secured by a main home or a second home. A home includes a house, condominium, cooperative, mobile home, house trailer, and boat, or similar property that has sleeping, cooking, and toilet facilities. The taxpayer can choose his second home, but special rules apply to rented homes, home offices, and homes under construction. (See Pub 936, *Home Mortgage Interest Deduction*.)
4. **Points** (also known as Loan Origination Fees, Loan Discount, Maximum Loan Charges, or Discount Points) are deductible as interest. Generally, points are

deducted ratably over the life of the loan. Points are deductible in full in the year of payment if all of the criteria in the following table are met:

If	AND all of the following are met	Then
<p>The points are paid to acquire a main home in connection with a loan that is secured by that home.</p>	<ul style="list-style-type: none"> a. Paying points is an established business practice in the area and the points were not more than points generally charged in the area, b. The taxpayer uses the cash method of accounting, c. The amount is clearly shown on the settlement statement (reported as points, loan origination fees, loan discount, discount points), d. The points are not paid in place of amounts ordinarily stated separately on the settlement statement for items such as real estate taxes, inspection, appraisal fee, e. The points are calculated as a percentage of the principal loan and, 	<p>The points are deductible in full for the year paid. However, if mortgage interest is limited then points will also be limited. See Pub 936, <i>Home Mortgage Interest Deduction</i> and IRM 4.19.15.20.3.3, <i>Limits on the Home Mortgage Interest Deduction</i> below.</p>

If	AND all of the following are met	Then
	f. The points are paid directly by the taxpayer and not derived from loan proceeds.	

4.19.15.20.3.2 (01-01-2017)**Evaluating Taxpayer Responses**

1. The documentation provided by the taxpayer must verify that all of the requirements listed under IRM 4.19.15.20.3.1, *General Requirements*, are met. Request additional documentation as needed using standard examination procedures.
2. The interest must have been paid in the year under examination. The taxpayer may not deduct prepaid interest. However, the allowable portion of interest deferred from a prior year may be deducted in the current year. Accept the amounts shown on Form(s) 1098, *Mortgage Interest Statement(s)* unless other documentation shows that all or part of the interest was prepaid.
3. The taxpayer may deduct interest only on a main home and a second home. If the taxpayer submits mortgage documentation for more than two qualifying residences, then the taxpayer may select which two properties meet this description.
4. Ensure that the taxpayer did not deduct the same interest on other Schedules such as Schedule C, E, or F, or as a Mortgage Interest Credit on Form 8396 in the Tax and Credits section of Form 1040. If there is a duplicate deduction, then the interest should be adjusted to reflect the correct amount. Duplicate Mortgage Interest is worked under PC 0049, Form 886-H-MIE, *Mortgage Interest Expense*, is sent with the ICL.
5. Taxpayers are allowed to deduct interest paid on a qualifying foreign home. Interest paid in foreign currency must be converted to U. S. Dollars. Ask the taxpayer to provide this computation. You will have to calculate the conversion yourself if the taxpayer does not provide one.
6. If the taxpayer is deducting mortgage interest and is also a co-owner of a qualified property, then accept the taxpayer's statement for the amount of interest paid. However, if there is a discrepancy in deductions by co-owners resulting in a combined deduction exceeding the amount of interest actually paid, the taxpayer will need to verify the amount he or she paid.

7. Even if the taxpayer meets all the general requirements for deducting home mortgage interest, their deduction may be limited. Refer to the following sections if:
- The total mortgage interest and points deducted on Schedule A is greater than \$77,000 (\$38,500 if married filing separately),
 - The documentation provided by the taxpayer indicates that the deduction is subject to the limits described in IRM 4.19.15.20.3.3 , *Limits on the Home Mortgage Interest Deduction*, or
 - You are processing a Project Code 0417 case for Excess Mortgage Interest Deduction.

4.19.15.20.3.3 (12-01-2017)

Limits on the Home Mortgage Interest Deduction

1. The following table describes when the taxpayer's home mortgage interest deduction is limited based on the type of mortgage debt:

If ...	Then ...
It is Grandfathered Debt , which applies to mortgages taken out on or before October 13, 1987,	Interest paid in that year is fully deductible.
It is Home Acquisition Debt , which applies to mortgages secured by a main or second home taken out after October 13, 1987 to buy, build, or improve the home, but only if throughout the year, these mortgages plus any Grandfathered Debt totaled \$1 million or less (\$500,000 or less if married filing separately).	Interest paid in that year is fully deductible.

If ...	Then ...
<p>It is Home Equity Debt, which applies to mortgages secured by a main or second home taken out after October 13, 1987, but only if throughout the year these mortgages totaled \$100,000 or less (\$50,000 or less if married filing separately), and totaled no more than the fair market value of the home reduced by outstanding Grandfathered Debt and Home Acquisition Debt. (See IRM 4.19.15.20.3.4.2, Evaluating Excess Mortgage Interest Taxpayer Responses, for a discussion of fair market value).</p> <p>Reminder:</p> <p>In appropriate circumstances, the \$100,000 limit for Home Equity Debt, can be utilized to increase the \$1 million limit for Home Acquisition Debt to \$1.1 million.</p>	<p>Interest paid in that year is fully deductible.</p>
<p>The mortgages do not fit into the above categories,</p>	<p>Interest paid in that year is limited. Refer to Pub 936, <i>Home Mortgage Interest Deduction</i> and IRM 4.19.15.20.3.4, <i>Excess Mortgage Interest Deduction – IRC 163</i> below.</p>

2. In order to compute the limit on the home mortgage interest deduction, where applicable, obtain information on the average outstanding mortgage balance(s) for the year under examination.

Note:

Use the highest mortgage balance if it is more beneficial for the taxpayer, but generally the average balance provides the most benefit. This information is only available from taxpayer documents. Refer to IRM 4.19.15.20.3.4, *Excessive Mortgage Interest Deduction – IRC 163*, for detailed procedures.

4.19.15.20.3.4 (03-14-2016)**Excess Mortgage Interest Deduction – IRC 163**

1. Home Mortgage Interest reported on Schedule A can be limited in some circumstances and therefore the taxpayer will not be able to deduct the full amount reported on Form 1098. Points count as interest and can also be limited. A tax examiner may receive this issue (home mortgage interest deducted in excess of the allowable limits) because of Discretionary Examination Business Rules (DEBR) Project Code 0417 or because of other Schedule A projects.
2. If the taxpayer deducted mortgage interest in excess of allowable limits, or if initiating Project Code 0417 cases, the examiner should request copies of the following information:
 - a detailed year-end interest statement showing the beginning and ending principal balances or interest rates for each loan on which interest was deducted,
 - Form HUD-1 *Settlement Statements*, and
 - worksheet(s) used by the taxpayer to compute the mortgage interest deduction limitation.
3. When initiating Project Code 0417 cases, send Letter 566-S with Form 886-H-INT, *Limited Home Mortgage Interest Deduction Supporting documents* and [Form 886-A-WORKSHEET](#), *Worksheet for Qualified Loan Limit and Deductible Home Mortgage Interest*.

4.19.15.20.3.4.1 (11-29-2011)**Computing the Limit on the Mortgage Interest Deduction**

1. Determine the **Average Mortgage Balance** of each loan for which the taxpayer is claiming a mortgage interest deduction using one of the following:
 - Average of first and last balance method
 - Interest paid divided by interest rate method
 - Provider statements

For part year loans, yearly average balance = (number of days loan held) x (average loan balance)/365.

2. **Simplified Method** - Determine the allowable mortgage interest deduction using the worksheet in Table 1 of Pub 936, *Home Mortgage Interest Deduction*. This worksheet uses a simplified method for computing the limit

by totaling the average balances of all the qualified mortgages and then determining the percentage of the total mortgage interest which is deductible.

3. **Exact Method** - The limit may be computed using an exact method which determines the limit on each qualified mortgage separately, starting with the oldest outstanding mortgage. The taxpayer may have used an exact method when computing the limit on the mortgage interest deduction. Verify the worksheet or formula provided by the taxpayer.
4. Apply the limit on deductible mortgage interest to deductible points as well.

4.19.15.20.3.4.2 (11-29-2011)

Evaluating Excess Mortgage Interest - Taxpayer Responses

1. The documentation provided by the taxpayer must verify that all of the requirements listed under *IRM 4.19.15.20.3.1, General Requirements* are met.
2. Process responses to the initial contact letter as follows:

If ...	And ...	Then ...
No Reply,	NA	Disallow the entire mortgage interest deduction.
Taxpayer replies with insufficient information to determine average balance of at least one of the mortgages,	NA	Disallow the entire mortgage interest deduction.
Taxpayer replies with sufficient information to determine average balance of mortgages,	Worksheet determines the mortgage interest deduction should have been limited,	Issue examination report disallowing the excess mortgage interest deduction.

If ...	And ...	Then ...
Taxpayer replies with sufficient information to determine average balance of mortgages,	The mortgage interest deduction is not limited or the tax reported on the taxpayer's return is substantially correct,	Close the examination using No Change procedures.
Taxpayer used an exact method to determine the allowable mortgage interest deduction,	You are able to verify the taxpayer's computation, or there is substantial agreement between the limit the taxpayer computed and the limit determined using the simplified method,	Close the examination using No Change procedures.

3. Observe the following guidelines when determining the extent of an excess mortgage interest deduction:
 - a. If you do not have an Average Balance for a loan, do not use the interest for that loan in the worksheet. There must be information for an average balance on at least one loan in order to complete the worksheet.
 - b. Accept the taxpayer's explanation for how the loan proceeds were used, unless the documentation shows otherwise.
 - c. If two unmarried taxpayers are deducting mortgage interest on a loan for property jointly owned by them, use the average balance of the entire loan for all parties and multiply the limitation by the amount of interest the taxpayer actually paid (i.e., do not compute the limitation using only one taxpayer's share of the loan). Accept the taxpayer's statement for the amount of interest the taxpayer actually paid, unless it is not consistent with the deduction the other owner is claiming.
 - d. If the acquisition debt exceeds \$1,000,000, the taxpayer may treat up to \$100,000 of the excess acquisition debt as Home Equity Debt, for an effective limit of \$1,100,000 on the mortgage debt on which interest may be deducted. However, the taxpayer may not treat actual Home Equity Debt in excess of \$100,000 as Home Acquisition Debt.

Example:

If the taxpayer has Home Equity Debt of \$200,000 and Home Acquisition Debt of \$800,000, only the interest on \$900,000 of mortgage debt is deductible – i.e., \$800,000 in Home Acquisition Debt + \$100,000 in Home Equity Debt – even though the total mortgage debt is less than \$1,100,000.

- e. The taxpayer may elect to deduct the limited mortgage interest as an investment interest expense. The amount that may be deducted is generally limited to the amount of the taxpayer’s net investment income. The taxpayer should use Form 4952, *Investment Interest Expense*, to figure the deduction for investment interest. Investment interest disallowed for the year under examination may be carried forward to future years. Refer to Pub 550, *Investment Income and Expenses*, for information on determining net investment income and limits on investment interest.

- f. The fair market value (FMV) of a home is the price at which the home would change hands between a seller and a buyer, neither having to sell or buy, and both having reasonable knowledge of all relevant facts. = = =
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4.19.15.21 (01-01-2016)

Charitable Contributions

- 1. Taxpayers may claim an itemized deduction for contributions or gifts made to or for the use of qualified charitable organizations and governments, other than foreign governments. Payments to qualified organizations are contributions if they are made without the taxpayer getting, or expecting to get, anything of equal value.

4.19.15.21.1 (01-01-2016)

Qualifying Payments

- 1. The following table provides some examples of qualifying and non qualifying payments.

Qualifying payments	Non-qualifying payments
Out of pocket expenses paid when serving as a volunteer for a qualified organization	Bingo, raffles, lottery tickets
Expenses paid for a student living with you, if the student was placed by a qualified organization	Membership dues or fees paid to country clubs or fraternal lodges

Qualifying payments	Non-qualifying payments
Gifts that are to or for the use of a qualified organization for its religious, charitable, educational, scientific or literary purposes	Tuition and registration fees, Temporary use of property
Gifts to or for the use of federal, state, and local governments	The value of your volunteer services
Certain automobile and travel expenses incurred when doing volunteer work	Personal living expenses incurred while performing services for a qualified organization
Cost and upkeep of uniforms required when doing volunteer work	Amounts paid for the benefit of an individual selected by the taxpayer

4.19.15.21.2 (12-01-2017)

Qualifying Organizations

1. Some qualified organizations are listed in Pub 78, *Cumulative List of Organizations*. If an organization is not listed in Publication 78 and is not a church or government, the taxpayer should be able to obtain a copy of the letter issued to the organization by the IRS granting it "qualifying organization" status.
2. If an organization provided by the taxpayer is questionable, verification may be obtained using an on-line search tool for exempt organizations called [Select Check](#). This sight identifies organizations eligible to receive tax-deductible charitable contributions.
3. Qualified and non-qualified organizations can include, but are not limited to:

Qualified Organizations	Non-qualified Organizations
Churches, synagogues and other religious organizations	Civic leagues, sports clubs, labor unions, chambers of commerce
Federal, state and local governments	Most foreign organizations

Qualified Organizations	Non-qualified Organizations
Organizations organized in the U.S. that are created and operated only for charitable or certain other purposes, public parks and recreation facilities	Lobbying groups
Salvation Army, Red Cross, Goodwill, Boy Scouts, Girl Scouts	Individuals, political groups or specific candidates for public office.
Volunteer fire departments	NA

4.19.15.21.3 (01-01-2016)**Cash and Non-cash Contributions**

- Contributions can be in the form of cash or non-cash. Examples of the types of contributions are:

Type of Contribution	Example
Cash	Cash, check, money order, credit card, payroll deductions such as for the Combined Federal Campaign (CFC), electronic funds transfers
Non-cash	Clothes, automobiles, household goods, artwork, stock, real estate, conservation easements

4.19.15.21.4 (08-04-2017)**Amount of Contribution Deduction**

- In general a taxpayer can deduct the full amount of a properly substantiated cash contribution, subject to percentage limitations.
- If the taxpayer paid the qualified organization more than the fair market value of an item he received in return, such as merchandise or tickets to sporting events, the deduction is limited to the amount in excess of the fair market value.
- For non-cash contributions, the deduction is usually equal to the fair market value of the non-cash contribution on the date of the donation.
- For contributions of clothing and household goods, the items must be in good used condition or better. If an item is not in good used condition or

better, then a deduction may be allowed if the amount claimed for the item is more than \$500, and the taxpayer includes with the return a qualified appraisal.

5. For contributions of motor vehicles, including an automobile, boat, and airplane, the claimed value of which exceeds \$500, the deduction is generally equal to the lesser of the gross proceeds from the sale of the vehicle, or the vehicle's fair market value on the date of the contribution. See the chart below for specific rules.

If ...	And ...	Then ...
The taxpayer donates a motor vehicle and deducts more than \$500	the qualified organization sells the vehicle without any significant intervening use or material improvement.	the deduction is the smaller of <ol style="list-style-type: none"> the fair market value on the date of the contribution, or the gross proceeds from the sale of the vehicle by the organization. Form 1098-C, <i>Contributions of Motor Vehicles, Boats, and Airplanes</i>, will show the gross proceeds and must be attached to the return.
The deduction for the motor vehicle is more than \$500	the vehicle is to be significantly used, or improved by the organization	in general, the taxpayer can deduct the fair market value of the vehicle on the date of the contribution. Form 1098-C will show if the vehicle is to be significantly used or improved by the organization and must be attached to the return.
The deduction for the motor vehicle is more than \$500	the vehicle is to be given to a needy individual by the organization, or sold to a needy individual by the organization for a price much lower than the vehicle's fair market value, in furtherance of the organization's charitable purpose.	in general the taxpayer may deduct the fair market value of the vehicle on the date of the contribution. Form 1098-C will show if the vehicle is to be transferred to a needy individual.

4.19.15.21.4.1 (03-11-2019)**Acceptable Documentation for Charitable Contributions**

1. The following table lists examples of acceptable documentation for charitable contributions.

Type of Contribution	Types of Documentation
All cash contributions	Cancelled checks, receipts, verification of electronic funds transfer, bank records, credit card statements or a statement from qualified charity. The documentation must show the name of the organization, the date, and the amount of the contribution. Refer to IRM 4.19.15.21.4.1, <i>Acceptable Documentation for Charitable Contributions</i> , paragraph (6) and (9) below for additional information about verifying contributions, if there is doubt regarding the authenticity of the statement provided.
Cash contribution of \$250 or more in a single payment	For each such donation -the taxpayer must obtain an acknowledgement/statement or receipt from the organization showing the date of the contribution, amount of the contribution, a description of any goods or services provided to the taxpayer by the organization, and an estimate of the value of the goods and services received, or if the goods and services provided are solely intangible religious benefits then a statement to that effect. The taxpayer must obtain the statement from the organization by the earlier of the filing of the return or the due date for the filing of the return (including extensions). Refer to IRM 4.19.15.21.4.1, <i>Acceptable Documentation for Charitable Contributions</i> , paragraph (6) and (9) below for additional information about verifying contributions, if there is doubt regarding the authenticity of the statement provided.
Expenses of less than \$250 incurred while volunteering for a charitable organization	Taxpayer's own records, showing the name of the donee, the date that services were performed, the amount of the expense, and the amount of reimbursement received, if any.

Type of Contribution	Types of Documentation
Expenses of \$250 or more incurred while volunteering for a charitable organization.	Taxpayer's own records, showing the name of the donee, the date that services were performed, the amount of the expense, and the amount of reimbursement received, if any, and a statement from the organization describing the services provided as well as providing a description of any goods or services provided by the organization in consideration and a good faith estimate of the value of those goods or services, or if the goods and services provided are solely intangible religious benefits then a statement to that effect.
Non-cash contribution less than \$250	A receipt from the charity showing the name of the organization, the date and location of the contribution and a reasonably detailed description of the non-cash contribution. If a receipt was impracticable to obtain (such as clothing left at an unattended Goodwill dropbox), the taxpayer must maintain a reliable written record that includes the fair market value of the property at the time of the contribution
Non-cash contributions of \$250 or more.	Taxpayer must obtain a written statement from the organization. Refer to <i>IRM 4.19.15.21.4.1, Acceptable Documentation for Charitable Contributions</i> paragraphs (6) through (8) below.
Non-cash contributions over \$500 but not more than \$5,000	Taxpayer must obtain a written statement from the organization showing all the information required for non-cash contributions of \$250 or more. In addition, Form 8283, <i>Noncash Charitable Contribution</i> , Section A, must be completed and attached to the return.
Non-cash contributions over \$5,000	Same documentation as above for non-cash gifts up to \$5,000 except, in lieu of Form 8283, Section A, Form 8283, Section B, must be completed and attached to the return. The taxpayer must also obtain a qualified appraisal unless the non-cash contribution meets the readily valued property exception for inventory, publicly traded securities, intellectual property and certain other property. (See Publication 561, <i>Determining the Value of Donated Property</i>).

Type of Contribution	Types of Documentation
Non-cash contribution of property over \$500,000	Taxpayer must attach a qualified appraisal to return unless contribution meets the readily valued property exception. Form 8283, section B, must also be completed and attached to the return. Everything required for property over \$5,000 is also required.
Contribution of motor vehicle, including automobiles, boats and airplanes of more than \$500	Taxpayer must attach Form 1098-C, <i>Contributions of Motor Vehicles, Boats, and Airplanes</i> , or other statement received from the charitable organization that reports the same information as the Form 1098-C. A qualified appraisal is also required if the taxpayer is entitled to deduct the fair market value, and the deduction is \$5,000 or more.
Clothing and furniture not in good used condition or better	The fair market value and amount claimed must be more than \$500 for a single item of clothing or household item, and the return must include a qualified appraisal.
Easements in Registered Historic Districts	A \$500 filing fee, a qualified appraisal, photographs of the entire exterior of the building, and a description of all restrictions on the building must be included with the return.

2. Form 14804, *Schedule A - Gifts to Charity*.
3. Taxpayers can provide information via mail, fax, e-mail or telephone.
4. Contributions are deductible only in the year they are made. Checks, receipts and other documentation provided by taxpayers should indicate a contribution made during the tax year in question.
5. Written statements from charitable organizations must be received by the taxpayer on or before the earlier of:
 - the date the return is filed for the year contribution was made, or
 - the due date of the return, including extensions.
6. For contribution of cash, acceptable charitable organization statements are bank records, credit card statements, or written receipts from charitable

organization and include:

- Name of the organization
 - Amount of the contribution
 - Date of the contribution
7. For all non-cash contributions of \$250 or more each. In addition to the above listed requirements:
- Amount of non-cash contribution
 - Whether goods or services were provided by the organization in return for the contribution
 - Description and good faith estimate of the value of goods or services, if any, that the organization provided in return for the contribution
 - Statement that goods or services, if any, that organization provided in return for the contribution consisted entirely of intangible religious benefits, if that was the case
8. Unless you question the authenticity of the acknowledgement/statement, when above items are present, do not request any additional information from the organization (official letterhead, signature, etc.). See IRM 4.19.15.21.4.1, *Acceptable Documentation For Charitable Contributions*, paragraph (10) below.
9. There may be instances when you question the authenticity of the statement submitted by the taxpayer. In those instances it is appropriate to request additional documentation to substantiate the contribution has been made. Some examples of circumstances in which to request additional information are when:
- the amount of the contribution is excessive in comparison to reported income;
 - documents appear altered;
 - unreadable receipts and/or statement, or
 - the statement or receipts does not include date, amount or the name of the organization.

Note:

Some religious organizations support the concept of tithing, or giving 10 percent of one's income. A taxpayer's deduction of 10 percent of income, alone, is not a basis to question documentation without considering other factors.

The workpapers **must be documented** to explain the reasons why additional documentation was requested and reasons that the statement appears questionable.

10. If you question the authenticity of the acknowledgement/statement, for:
 - Verification can be requested from the organization to ascertain it provided the acknowledgement/statement submitted by the taxpayer.
11. Many taxpayers make cash contributions for which they have no bank records, credit card statements or receipts. These contributions are not deductible. Taxpayers must maintain, as a record of a contribution, a bank record, a credit card statement, or a written communication from the donee showing the name of the donee organization, the date of the contribution, and the amount of the contribution.

4.19.15.21.4.2 (03-23-2016)

Limitations on Contributions

1. For individuals:
 - 50 percent limit: A taxpayer's total contribution deductions, for a taxable year, is limited to a maximum of 50 percent of the taxpayer's adjusted gross income (AGI) for the year in which the deduction is claimed. The 50 percent limit generally applies to contributions of cash to public charities.
 - 30 percent limit: Deductions are limited to 30 percent of AGI for contributions of cash to certain private foundations, contributions of capital gain property to public charities and certain foundations, and contributions "for the use of" charities.
 - 20 percent limit: Deductions are limited to 20 percent of AGI for contributions of capital gain property to certain private foundations.

Note:

Certain special limitations apply to contributions of conservation easements. These special limitations do not apply to contributions made in taxable years beginning after December 31, 2014, check IRC 170(b)(1)(E)(iv).

2. Excess contributions can be carried over:
 - If the taxpayer's deduction exceeds the amount allowed by these limitations, the taxpayer can carry the excess forward to the next five taxable years until it has been deducted in full.

- If the taxpayer carries a deduction forward to another taxable year, the carried forward amount must be considered in computing the taxpayer's deduction for that year.
- Any unused contribution that has not been deducted by the fifth succeeding year is lost.

Note:

If a taxpayer elects to claim the standard deduction (Does not file a Schedule A) in a tax year where the carryover may have been applied, the remaining carryover amount is reduced by any amount that may have been claimed during that year.

- If a deduction is disallowed for the current year, and the examiner determines that it has been carried forward, the carryforward year should be opened if the carryover is substantial and the approval of the manager is obtained.

Note:

Taxpayers should keep records (such as copies of tax returns and worksheets) to verify any carryover deductions.

3. Certain deductions are limited to basis. In addition to percentage limitations, a deduction for certain non-cash contributions is limited to the taxpayer's adjusted basis in the property. These include contributions such as:
 - Contributions of ordinary income property (such as inventory or short-term capital gain property)
 - Contributions of property to charities that are not public charities
 - Contributions of tangible personal property that is not used by the charity in its charitable function (such as property that is sold by the charity).

4.19.15.21.4.3 (10-01-2003)**Additional Research Material**

1. For additional information on allowable deductions you may refer to Publication 526, Charitable Contributions, for the tax year you are examining.

4.19.15.21.4.4 (04-26-2016)**Charitable Contribution Rules - Project Code 0391, Project Code 0392 and Project Code 0629**

1. Project Code 0391 is Charitable contributions carryover with no prior year Schedule A.
2. Project Code 0392 is Charitable contributions carryover with prior year contributions of less than 50 percent of AGI.
3. Project Code 0629 is Charitable contributions and identifies returns with a deduction for cash contributions. PC 0629 cases are automated for ACE processing.
4. The examination of these cases will begin with case selection from the Dependent Database (DDb). The selected returns will have broken one of the contribution business rules indicated above. DDb should also provide Schedule A, Line 18 amounts claimed on the taxpayer's prior three tax returns. Each case will be established on AIMS in Source Code 06 with the appropriate Project Code.

4.19.15.21.4.4.1 (04-26-2016)

Initial Contact

1. The following table shows the Initial Contact Letter to send to the taxpayer.

Project Code	Issue Letter	Amount to Disallow
PC 0391 PC 0392	Letter 566-S/Form 886-A with applicable explanation	Schedule A, Line 19 - All Gifts to Charity
PC 0629	Initial Contact Letter 566-S/Form 886-A Documents Request	

4.19.15.21.4.4.2 (03-14-2016)

No Response Cases

1. Take the following action if the taxpayer has not replied to the most recent letter by the normal purge date.

Latest Letter issued	Action
Letter 566-S	Issue Letter 525 with Form 4549/Form 4549-EZ.
Letter 525 or Letter 692 (SC/CG), and the Form 4549/Form 4549-EZ reflects a deficiency	Follow normal procedures to have Statutory notice issued based on the adjustments shown on Form 4549 /Form 4549-EZ.

4.19.15.21.4.4.3 (03-14-2016)

Processing Taxpayer Replies to Letter 566-S

- The following describes the processing of taxpayer replies to Letter 566-S for Project Codes 0391, 0392 and 0629 cases:

If	And	Then
The taxpayer responds to Letter 566-S	You are able to verify that the taxpayer is entitled to all of the amount as a contribution deduction.	Follow procedures in IRM 4.19.13.28, <i>Campus Closing Actions</i> .
The taxpayer responds to Letter 566-S	You are able to verify that the taxpayer is entitled to part of the amount as a contribution deduction.	Issue Letter 525 with a Form 4549/Form 4549-EZ and an appropriate explanation to the taxpayer. Follow normal procedure for mail out and suspense.
The taxpayer responds to Letter 566-S	You are unable to verify that the taxpayer is entitled to any part of the amount claimed as a contribution deduction.	Issue Letter 525 with the Form 4549/Form 4549-EZ and an appropriate explanation to the taxpayer. Follow normal Letter 525 procedures for mail out and suspense.
The taxpayer replies to Letter 566-S with information he is entitled to an additional deduction for contributions	You are able to verify that the taxpayer is entitled to an additional deduction.	Issue Letter 525 with a Form 4549/Form 4549-EZ and an appropriate explanation to the taxpayer. Follow normal Letter 525 procedures for mail out and suspense.

4.19.15.21.4.4.4 (04-17-2008)

Closing Actions

- Take the necessary action to close the case based on the chart below.

If the Taxpayer	Then
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If the Taxpayer	Then
Signs the Form 4549 /Form 4549-EZ, reflecting a deficiency or overpayment	Follow normal procedures for Closed Agreed cases.
Does not reply to Letter 525 or Letter 692 (SC/CG) and Form 4549/Form 4549-EZ reflects an overpayment	Follow normal procedure for Disposal Code 08 closings.
Does not reply to the 90 Day letter	Follow normal procedures for defaulting cases.
Verifies that the contribution is allowable as a carryover deduction	Follow normal procedures for No-Change cases.
Files a Form 1040X removing the contribution deduction and Accounts Management (AM) assesses the additional tax.	Close the case using Disposal Code 08. In Field 35 of Form 5344, Examination Closing Record , show the entire amount of the assessment.

4.19.15.22 (03-11-2019)

Casualty and Theft Losses

1. The examiner must keep in mind the following:
 - If the taxpayer’s property was covered by insurance and the taxpayer fails to file a timely claim for reimbursement, the taxpayer cannot take a deduction.
 - The taxpayer may deduct Nonbusiness casualty or theft losses only to the extent that:

Dollar Requirements for Deduction
The amount of each separate casualty or theft loss exceeds \$100 (\$500 for tax year 2009) and
The total amount of all losses during the year exceeds 10 percent of the adjusted gross income.

Note:

Simple disappearance of money or property (lost or mislaid) is not a theft.

Note:

See Form 14805, *Casualty and Theft Loss*, Pub 976, *Disaster Relief*, for the particular year under audit, to determine the special rules for claiming qualified disaster losses.

2. The 10 percent limit does not apply to losses of personal use property attributable to federally declared disasters declared in tax years beginning after 2007 and that occur before 2010. (The \$100 (\$500 for TY 2009) limit, however, does apply.)
3. The special rules that were in effect in 2008 and 2009 for losses of personal use property attributable to federally declared disasters do not apply to losses occurring in 2010 and later years. Instead, these losses are subject to the 10% of AGI limit and are deductible only if you itemize your deductions. These losses are subject to the \$100 per loss limit. The special rules do apply to a loss you are deducting in 2010 from a disaster that was declared a federal disaster in tax years beginning after 2007 and that occurred before 2010. For details see the Form 4684 instructions
4. In order to deduct a **casualty loss**, the taxpayer must be able to show all of the following:
 - a. The type of casualty (car accident, fire storm, etc.) and when it occurred.
 - b. That the loss was a direct result of the casualty.
 - c. That the taxpayer was the owner of the property, or if it was leased property that the taxpayer was contractually liable to the owner for the damage.
 - d. The amount of any insurance reimbursement.
5. In order to deduct a **theft loss**, the taxpayer must be able to show all of the following:
 - a. When the property was discovered missing.
 - b. The property was stolen.
 - c. The property belonged to the taxpayer.
 - d. Whether a claim for reimbursement exists for which there is a reasonable expectation of recovery.
6. The following situations can result in casualty losses:
 - Car accidents.
 - Earthquakes.
 - Floods.

- Fires.
- Government-ordered demolition or relocation of a home that is unsafe to use because of a disaster.
- Hurricanes.
- Mine cave-ins.
- Shipwrecks.
- Sonic booms.
- Storms.
- Tornadoes.
- Vandalism.
- Volcanic eruptions.

7. Considerations when taxpayer qualifies for a Disaster Area Loss:

- a. A Presidentially Declared Disaster is a disaster that occurred in an area designated by the President to be eligible for federal assistance under the Robert T. Stafford Disaster Relief and Emergency Assistance Act. This includes a major disaster or an emergency declaration under the Act. If the casualty loss is attributable to a federally declared disaster and is sustained in a federally declared disaster area, the taxpayer can elect to deduct the disaster loss for the preceding year. Ensure that the taxpayer is not claiming the same loss for both years.
- b. The taxpayer must reduce his casualty loss by funds received under any disaster provision and by any insurance reimbursement.

8. Kansas and Midwestern Disaster Areas:

- a. For taxpayers affected by Kansas storms and tornadoes that began on May 4, 2007, refer to Publication 4492-A. Refer to Publication 4492-B if the taxpayer was affected in Midwestern disaster area.
- b. The losses of personal use property that arose in these disaster areas are not subject to the \$100 or 10 percent of adjusted gross income limitation.
- c. The replacement period for property in these disaster areas that was damaged, destroyed or stolen has been extended from two to five years. For more information see Publication 547, *Casualties, Disasters, and Thefts*.

4.19.15.23 (03-11-2019)**Employee Business Expense (EBE) Cases**

1. These are cases with Form 2106, *Employee Business Expenses*, expenses included in Schedule A Miscellaneous Deductions, and where miscellaneous deductions do not appear consistent with the taxpayer's occupation or income. Because the Form 2106 and many lines on the 1040 Schedule A are not transcribed, you may see a combination of employee business expenses and miscellaneous expenses.
2. Returns may be requested for this issue.
 - a. Returns will be reviewed to determine if expenses appear in line with the occupation on the Form 2106.
 - b. Returns will be classified for other issues.
3. Initial Contact Letter 566-S (ICL), Form 13825, *Employee Business Expense Questionnaire*, and Form 886-I, *Employee Business Expenses* explains the substantiation required to support the employee business expense, and will be issued to the taxpayer.
4. Follow normal suspense time frames. If there is no response to the ICL, issue a report disallowing the entire employee business expense amount and other questioned miscellaneous expenses.

4.19.15.23.1 (09-25-2017)**Evaluating EBE Taxpayer Responses**

1. All responses need to be evaluated using judgment considering what is known about the occupation.
2. The reimbursement policy of the employer is the starting point for all EBE audits and MUST be secured.
3. Employees and self-employed individuals claiming un-reimbursed travel expenses may claim the government per diem rate for the meals and incidental expenses (M&IE) portion of travel expenses, provided they have supported the travel. However, employees and self-employed individuals claiming un-reimbursed lodging expenses must provide receipts for lodging expenses and may not use the government per diem rates for lodging expenses.
4. An expenditure for travel, meals, or entertainment, to the extent it is lavish or extravagant, shall not be allowable as a deduction.
5. Unless the taxpayer is eligible to use and does use the government per diem rates, documentary evidence is required for:

- a. Any expense for lodging while traveling away from home, and
 - b. Any other expenditure of \$75 or more.
6. IRC 274(d) provides that no deduction shall be allowed for entertainment, gifts, listed property or travel unless the taxpayer substantiates the following elements of the expenditures:
- a. Amount of each expenditure.
 - b. Time and place of the travel, entertainment, amusement, recreation, or use of the facility or property.
 - c. Date and description of the gift.
 - d. Business purpose for each expenditure.
 - e. Business relationship to the taxpayer of each person entertained, using an entertainment facility, or receiving a gift.
7. Many expenses not listed in (5) above can be summarized, or aggregated. See Publication 463 *Travel, Entertainment, Gift, and Car Expenses*, Section 5 *Record Keeping* for a table that shows the substantiation requirement for specific expenses.
8. The deduction for business-related meal and entertainment expenses are generally subject to a 50% limit or 80% if taxpayer is subject to the Department of Transportation's "hours of service" limits.
9. Travel expenses are deductible when taxpayers are temporarily away from their tax home. However, an indefinite assignment to another location is a change in tax home, thus travel expenses are not deductible.
10. Travel expenses for conventions, seminars, and similar meetings are deductible under IRC 162 if the taxpayer's attendance benefits or advances his trade or business. No deduction is allowable if a taxpayer is attending for social, political, or other purposes not related to his trade or business.
11. IRC 274(c)(1) states foreign travel must first be deductible under IRC 162 or IRC 212. The travel must be ordinary and necessary in the pursuit of a trade or business, or for the production of income. If the expense meets those requirements, then the business portion of the travel is deductible.
12. Travel outside of the United States generally must be allocated between business and personal. IRC 274(c)(2) provides two exceptions to the rule that travel expenses be allocated between business and personal. No allocation is made if foreign travel does not exceed one week, or if less than 25 percent of the trip is personal, then travel to and from the business destination is allowed in full.

13. Any issues beyond the expertise of the examiner assigned the case should be referred to the lead examiner to secure the appropriate technical guidance.
14. It is not necessary to fully allow or disallow any expenses. Expenses can be partially allowed when revising the report. Special care should be taken to explain these revisions to the taxpayer.
15. Additional Items to consider. Consider the following points when processing EBE cases.

Employee Business Expense Auditing Techniques
When examining employee business expenses, you must consider whether the employer has an expense allowance or reimbursement plan.
You must be able to determine if the plan is accountable or non-accountable. When examining expenses you believe are under a non-accountable plan, you may encounter nondeductible expenses that were reimbursed.
Always request a written statement explaining the requirements of the expense allowance or reimbursement plan from the employer. The written statement can be an excerpt from the employee handbook or a statement prepared for the purpose of the examination.
If the statement is prepared for the purpose of examination, be sure the author has sufficient knowledge of the expense allowance or reimbursement plan.
If the statement presented from the employer is vague, discuss with your manager or lead the possibility of making a third party contact.
Be logical in organizing the examination. It may be better to structure the examination of these expenses into categories i.e., travel, entertainment, listed property, gifts, than by time periods (all of May's expenses or July's expenses). Examining by topic will allow you to see inconsistencies in the taxpayer's records. It will also allow you to determine the credibility of the taxpayer's record keeping.
Look for recurring names for entertainment and meals, as well as recurring locations for travel. Recurring names may indicate a family member or a friend.
Be mindful of travel dates. Are the dates during holiday periods? If travel dates are during holiday seasons, this may indicate personal expenses.

Employee Business Expense Auditing Techniques

Does the taxpayer use a travel agent on some occasions and not at other times? If he uses a travel agent regularly, this may be a source of documentation. A travel agent may or may not be used by his company. Does he use more than one travel agent? Most companies use one travel agent; if there are two or more, there may be some personal expenses intermingled with valid business travel.

Hotel receipts will often show how many people stayed in a room. If friends or family were staying with the taxpayer while they were away from home, you must determine if there was a business purpose for their stay and what, if any, additional charges were incurred.

Airline tickets and travel agency statements will show departure dates and who actually traveled. Compare the dates of the business meetings with the actual length of the trip. You could discover that the taxpayer extended his/her stay for a personal vacation. Request a detailed itinerary.

For employees on "accountable" plans, evaluate any reimbursement records. In most cases, the expenses reimbursed by the employer should be accepted up to the amount of reimbursement on face value since it is assumed that they were incurred for a business purpose. However, look to see if any changes were made to the employee's compensation structure (i.e., where the employee's wages reduced by the amount of the "reimbursement") to determine if the purported reimbursements were merely re-characterized wages. Special attention should be paid when they exceed the reimbursement policy. This may also be used to establish the business portion of the use of an automobile where the employee is taking an actual expense deduction vs. a mileage deduction.

Be alert for altered documents. Look for erasures of dates, times, places or amounts. Look for possible consecutive numbered receipts, especially for high entertainment costs.

Taxpayer should provide documentary evidence along with account book, diary and log to support each element of an expense.

A cancelled check by itself doesn't prove a business expense without other evidence to show that it was for a business purpose.

To verify total miles for the year, the taxpayer should provide repair receipts, inspection slips or any other records showing total mileage at the beginning of the year as well as at the end of the year.

16. The employer's letter regarding the company's reimbursement policy helps to establish:
 - a. the business expenses were ordinary and necessary, and
 - b. the taxpayer is deducting a legitimate "out of pocket" expense.

If the taxpayer does not provide the employer's letter regarding the reimbursement policy, the expenses should be disallowed.

Note:

There may be instances when the taxpayer is unable to provide an employer's reimbursement policy letter because the employer is out of business, or in receivership. In these instances, if the taxpayer has provided enough corroborating information which shows the expenses are: a) ordinary and necessary, and b) the taxpayer is "out of pocket" for the expenses, then allow the verified expenses.

4.19.15.23.2 (01-01-2014)

Additional Information

1. Additional EBE information and materials should be referenced when processing EBE cases. These include:
 - Publication 463, *Travel, Entertainment, Gift, and Car Expenses*.
 - Training courses available: Training Doc 12266 *Basic Income Tax Law for Correspondence Examination – Module D, Standard and Itemized Deductions* (Lesson 7).
 - Publication 529, *Miscellaneous Deductions*.
 - Publication 17, *Your Federal Income Tax (For Individuals)*.
 - Treasury Regulation. § 1.274-5T(c)(6)(i)(B) (Aggregation of Expenditures)

4.19.15.24 (03-11-2019)

Miscellaneous Deductions - IRC 67

1. The examiner should have the taxpayer send in the following documentation:
 - Copies of cancelled checks and paid bills of the expenses claimed.
 - A complete explanation of the purpose of the expense.
 - , Form 14983 - *Schedule A - Other Miscellaneous Deductions*. , .

- Form 886-I, *Employees Business Expense Explanation of Items*.
- Form 13825, *Employee Business Expense Questionnaire*.

2. The table below lists deductions subject to the two-percent AGI limitation, deductions not subject to the two-percent AGI limitation, and nondeductible expenses.

Deductions Subject to the Two-percent of AGI Limitation	Deductions Not Subject to the Two-percent of AGI limitation	Nondeductible Expenses
<p>Unreimbursed employee expenses (Line 21 of Schedule A): Deductible unreimbursed employee expenses must be ordinary and necessary expenses paid or incurred during the tax year in carrying on a trade of business of being an employee.</p>	<p>Deductible expenses not subject to the two-percent of AGI limitation are:</p> <ul style="list-style-type: none"> • Casualty and theft losses from income-producing property. <p>See Pub 17, for an all-inclusive list of expenses.</p>	<p>Examples of nondeductible expenses are:</p> <ul style="list-style-type: none"> • Broker's commissions to buy investment property or to sell securities • Burial or funeral expenses • Campaign expenses • Capital expenses • Check writing fees • Club dues • Commuting expenses. If the taxpayer hauls tools, instruments, or other items in

Deductions Subject to the Two-percent of AGI Limitation	Deductions Not Subject to the Two-percent of AGI limitation	Nondeductible Expenses
		<p>an auto to and from work, the taxpayer can deduct only the additional cost of hauling the items (such as the rent for a trailer to carry the items).</p>
<p>Examples are:</p> <ul style="list-style-type: none"> • Business bad debt of an employee. • Expense of education that is work related if the education is not necessary to meet minimum requirements to qualify the taxpayer in the taxpayer’s trade or business, and does not qualify the taxpayer for a new trade or business, and 1) it maintains or improves skills required in the taxpayer’s present work, or 2) it is required by the employer or the law to keep the taxpayer’s current salary, status, or job, and the requirement serves a business purpose of the employer. • Legal fees related to your job. 	<ul style="list-style-type: none"> • Impairment-related work expenses of persons with disabilities. • Losses from other activities from Schedule K-1, box 2 • Repayments of more than \$3,000 under a claim of right. • Unrecovered investment in an annuity. 	<ul style="list-style-type: none"> • Fees and licenses such as car or marriage licenses and dog tags. • Fines or penalties. • Health Spa expenses. • Hobby losses • Home repairs, insurance, and rent. • Home security system. • Illegal bribes and kickbacks.

Deductions Subject to the Two-percent of AGI Limitation	Deductions Not Subject to the Two-percent of AGI limitation	Nondeductible Expenses
<ul style="list-style-type: none"> • Licenses and regulatory fees. • Malpractice insurance premiums. • Medical examinations required by employer. • Occupational taxes. • Passport for a business trip. • Work-related subscriptions to professional journals and trade magazines. • Work-related travel, transportation, and entertainment. • Business liability Insurance premiums. • Damages paid to a former employer for breach of an employment contract. • Depreciation on computers if for the convenience of employer and required as a condition of employment. • Dues to a chamber of commerce and professional societies. • Educator expenses over the limit on the amount that may 	<ul style="list-style-type: none"> • Losses from Ponzi-type investment schemes <p>Note: See Pub 17, for an all inclusive list of expenses.</p>	<ul style="list-style-type: none"> • Investment-related seminars. • Life insurance premiums. • Lobbying Expenses. • Losses from the sale of your personal home, personal furniture, or personal car. • Lost or mislaid items. • Lunches with coworkers • Meals while working late. • Personal disability insurance premiums. • Personal legal expenses. • Personal, living or family expenses.

Deductions Subject to the Two-percent of AGI Limitation	Deductions Not Subject to the Two-percent of AGI limitation	Nondeductible Expenses
<p>be taken as an adjustment to gross income.</p> <ul style="list-style-type: none"> • Job search expenses for a job in the taxpayer's present occupation. • Repayment of income aid payment under an employer's plan. • Research expenses of a college professor directly related to your teaching duties. • Tools used in the taxpayer's work. • Union dues and expenses. • Work clothes and uniforms if required and not suitable for everyday use. 		<ul style="list-style-type: none"> • Political contributions. • Professional accreditation fees. • Professional reputation. • Relief fund contributions. • Residential telephone service. • Stockholders meetings. • Tax-exempt income expenses. • Education expenses of a dependent (but see Education Tax Benefits). • The value of wages never received or lost vacation time. • Adoption expenses, but

Deductions Subject to the Two-percent of AGI Limitation	Deductions Not Subject to the Two-percent of AGI limitation	Nondeductible Expenses
		see Adoption Credit. <ul style="list-style-type: none"> • Personal accounts. • Travel expenses for another individual. • Voluntary unemployment benefit contributions. • Cost of a wristwatch.

Deductions Subject to the Two-percent of AGI Limitation	Deductions Not Subject to the Two-percent of AGI limitation	Nondeductible Expenses
Other expenses (Line 23 of Schedule A). A taxpayer can deduct certain other expenses as miscellaneous itemized deductions subject to the two-percent of AGI limitation. These other expenses are: <ul style="list-style-type: none"> a. expenses to produce or collect income that must be included in the taxpayer's gross income, 	<ul style="list-style-type: none"> • Impairment-related work expenses of persons with disabilities. • Losses from other activities from 	<ul style="list-style-type: none"> • Fees and licenses such as car or marriage licenses and dog tags. • Fines or penalties.

<p>Deductions Subject to the Two-percent of AGI Limitation</p>	<p>Deductions Not Subject to the Two-percent of AGI limitation</p>	<p>Nondeductible Expenses</p>
<p>b. expenses to manage, conserve or maintain property for producing gross income, and</p> <p>c. expenses to determine, contest, pay, or claim a refund of tax. The expenses in (1) and (2) must be reasonable and closely related to these purposes.</p> <p>Examples are:</p> <ul style="list-style-type: none"> • Appraisal fees for a casualty loss or charitable contribution. • Clerical help and office rent to manage investments. • Depreciation on home computer. • Excess deductions allowed a beneficiary on termination of an estate or trust. • Fees to collect interest and dividends. • Hobby expenses limited, in part, by hobby income. • Indirect deductions from pass-through entities. • Investment fees and expenses. • Legal expenses to produce or collect taxable income or to 	<p>Schedule K-1, box 2</p> <ul style="list-style-type: none"> • Repayments of more than \$3,000 under a claim of right. • Unrecovered investment in an annuity. • Losses from Ponzi-type investment schemes • Tax preparation Fees are placed on Line 22 of Schedule A. 	<ul style="list-style-type: none"> • Health Spa expenses. • Hobby losses. • Home repairs, insurance, and rent. • Home security system. • Illegal bribes and kickbacks. • Investment related seminars. • Life insurance premiums. • Lobbying Expenses. • Losses from the sale of your personal home, personal furniture, or personal car. • Lost or mislaid items. • Lunches with coworkers.

Deductions Subject to the Two-percent of AGI Limitation	Deductions Not Subject to the Two-percent of AGI limitation	Nondeductible Expenses
<p>obtain tax advice.</p> <ul style="list-style-type: none"> • Repayments of \$3,000 or less when the amount was included in income in the earlier year. • Repayments of social security benefits included in income in an earlier year. • Safe Deposit Box rent, but not for storing personal effects or tax-exempt securities. • Service charges on dividend reinvestment plans. • Trustee's administrative fees for IRA. 		<ul style="list-style-type: none"> • Meals while working late. • Personal disability insurance premiums. • Personal legal expenses. • Personal, living or family expenses. • Political contributions. • Professional accreditation fees. • Professional reputation. • Relief fund contributions. • Residential telephone service. • Stockholders meetings. • Tax-exempt income expenses.

Deductions Subject to the Two-percent of AGI Limitation	Deductions Not Subject to the Two-percent of AGI limitation	Nondeductible Expenses
		<ul style="list-style-type: none"> • Education expenses of a dependent (but see Education Tax Benefits). • Value of loss of wages. • Adoption expenses, but see Adoption Credit. • Personal accounts. • Travel expenses for another individual. • Voluntary unemployment benefit contributions. • Cost of a wristwatch.

4.19.15.25 (01-01-2015)

Return Preparer Referrals

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4.19.15.25.1 (03-11-2019)

Role of the Exam RPP Coordinator

1. The Exam RPP Coordinator at each site will be the liaison between Campus Exam and the HQ and elevate any issues for resolution.

2. RPP Coordinator's primary role is to provide technical assistance to Correspondence Exam in processing these cases.

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4.19.15.25.2 (01-01-2016)

Referral Process and AIMS Opening

- 1. Each Return Preparer Scheme has a unique SDC control number and is included in the record sent to the DDb.
- 2. Cases will be opened on AIMS by SB/SE HQ Return Selection and Delivery (RSD) team and controlled under Project Code 0133, Source Code 70. Any scheme that is related to EITC will be controlled under Project Code 0132.

The AIMS will reflect the respective PBC for each site and an Employee Group Code (EGC) of 5000.

3. AIMS Tracking Codes may be assigned to identify the scheme.

4. Returns will be electronically forwarded and established through RGS.

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4.19.15.25.3 (01-01-2016)

Controlling RPP Returns

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4.19.15.25.4 (03-11-2019)

Procedures for Examining RPP Cases

1. Normal Exam procedures will apply to processing these cases.
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4. Consult RPP Coordinator, Classification TCO (Tax Compliance Officer) or manager and notate workpapers about the additional issues included in the audit.
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7. Letter 566-B will be used to initiate the audit process for non-EITC cases. For EITC cases use Letter 566-S as the initial contact letter (ICL). The letter will be prepared by checking off the appropriate boxes for the issues being examined. Form 886-A with proper paragraphs and Form 4549/4549-EZ will be included, as well as the proper enclosures.
8. Follow normal deficiency processing from this point, allowing the normal time frames for purging and issuance of the Statutory Notice of Deficiency.
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- 11. The compliance employee or the manager should not obtain advice from CI for a specific case under examination. However, the campus can request clarification or additional information on a scheme, if necessary, via HQ.
- 12. Management must approve any short closing - DC 20, 32, or 33. If a determination is made to short close 25 or more cases from one scheme, then management must inform HQ timely the reason for survey.
- 13. Taxpayer/valid POA requests transfer of case(s) to Area Office Examination or Appeals Office, refer to IRM 4.19.13.15, *Transfers to Area Office Examination or Appeals Office*.
- 14. Examiners will ensure that procedures are followed for calculation of the interest suspension period as defined in IRC 6404(g). Please refer to IRM 4.19.13.6.1, *IRC 6404(g) Suspension of Interest and Certain Penalties* for additional information.

4.19.15.25.5 (01-01-2016)

Examining the Schedule A on Preparer Referrals

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3. The examiners are required to familiarize themselves with *Schedule A* See *IRM 4.19.15.20, Schedule A*. This IRM section will provide information related to the allowable and unallowable deductions on the Schedule A.

4. The examiner will consider asserting penalties such as negligence or substantial underpayment as applicable, as in the normal course of any examination if warranted on a case by case basis. Refer to IRM 20.1, *Penalty Handbook*, for additional procedures. If any indication of fraud is discovered

in either the substantiation submitted or in the return itself, this should be brought to the attention of the W&I RPP Coordinator/manager/W&I HQ analyst.

4.19.15.25.6 (01-01-2010)

Examining the Schedule C on Preparer Referrals

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4.19.15.26 (12-01-2017)

Correspondence Exam Tip Program

1. Cases worked in the Tip Program are initiated based on information received from Area Offices. Revenue Agents (RAs) and or Revenue Officer Examiners (ROEs) gather data from the employers of tipped employees and use this information to determine each employee’s correct tip income. If the employee did not report the correct amount of tips, Correspondence Exam will issue a report reflecting the increase in income tax and FICA taxes (which includes Social Security and Medicare) based on the unreported tip income. All other unreported income as identified on IRPTR should be addressed and included on the examination report per normal procedures.
2. The following conditions will apply:
 - The inventory will also include cases where the tipped employee has not filed a return.
 - In all cases normal non-ACE case processing procedures will be used.
 - Penalties will be asserted as required or deemed appropriate. Refer to IRM 20.1*Penalty Handbook* and IRM 4.19.13.6.2*Managerial Approval of Penalties/Bans*.
 - The terms "taxpayer" and "employee" are used interchangeably in this section.
 - All correspondence to the taxpayer should contain the name and telephone number of the examiner who prepared the report.
 - If a taxpayer has reached the wage base limit for Social Security wages, he or she is still subject to Medicare tax on all wages (including tips) received. There is no wage base limit for Medicare wages.
 - All forms that are specific to the Tip Program and are not currently available through Report Generation Software (RGS) will be loaded onto workstations and attached to the taxpayer’s file. These forms include Form 14980, *Employee Tip Examinations Worksheet*, Form 14980-C, *For Information Purpose Only*, and Form 14980-A, *Unreported Tip Income*. If

the examination is based on the percentage of gross sales method, Form 14980-B, *Computation of Tip Income Using McQuatter's Formula*, should be used to demonstrate how the unreported tip income was computed using the McQuatter's Formula. Form 14980-B, should be used for other Tipping Industries such as Food and Beverage cases, and Form 14980-A, *Explanation of Tip Income*, should be used for Gaming cases.

3. The program will consist of the following types of cases:
 - Non-participating filers who underreported their tip income
 - Non-participating non-filers
 - Participating non-filers

Gaming Industry cases will be assigned Project Code 0360 if they are from Casino's other than Indian Tribal Casinos. If they are from Indian Tribal Casinos they will be assigned Project Code 0916, Cosmetology Industry cases will be assigned Project Code 0672, and Food and Beverage Industry cases will be assigned Project Code 0364. Non-filer cases will be assigned the same Project Codes, however, Source Code 24 is used for these cases.

4. Original returns will not be ordered. RTVUE will be used unless it is necessary to review the original return during audit. If the taxpayer filed a Form 4137, *Social Security and Medicare Tax on Unreported Tip Income*, with his or her individual income tax return, follow the instructions in the table below to determine the under-reported tip income. On joint returns where both taxpayers are tip earners and have unreported tips, make a separate calculation for each taxpayer.

If	And	Then
The payer on the Employee Data Report matches a payer on IRPTR	That employer is the only one on IRPTR where the taxpayer would have received tip income	Consider the amount of tips reported on Form 4137 when determining the unreported tip income.

If	And	Then
The payer on the Employee Data Report matches a payer on IRPTR	There is more than one employer on IRPTR where the taxpayer would have received tip income	Consider the amount of tips reported on Form 4137 when determining the unreported tip income. Note: Instruct the taxpayer to provide a copy of Form 4137 and a breakdown on tips reported for each employer with the response to the letter if the Form 4137 was incomplete because it did not identify the employers and the tips reported for each employer.
It cannot be determined that the employer on Form 4137 is the same employer on the Employee Data Report	There is one or more than one employer on IRPTR where the taxpayer would have received tip income	When determining the unreported tip income for each employer, do a pro-rata allocation of the tip income reported on Form 4137 and apply the ratios to each employer.

5. The Tip Extension database will contain the following:
 - a. Participating Employees:

Conditions for Participating Employees
On joint returns where both are tipped employees and their participant status is different, an Employee Data Report will be generated for the employee who has under-reported their tip income regardless of participation status.
For taxpayers who worked for several employers and had different participation statuses with each employer, an Employee Data Report will only be generated for employers where the taxpayer under-reported tip income.
If the tipped employee is shown as participating but has reported tip income less than the amount on the agreement, the taxpayer will be treated as a non-participant.

- b. Primary and Secondary SSNs will be identified.
 - c. Amounts reported on Form 4137 will be identified.
6. The Forms 14439 prepared by the field agents for the Food and Beverage Industry are computed by establishing a tip rate based on both charged and cash sales and allocated to each employee based on position and hours worked. A stiff factor and a tip out rate may also be factored into the computation.
 7. Tip extension reports are no longer provided. These cases are delivered on Form 14439 , *Employee Data Report*. Forms 14439 will contain the percent of gross sales or an hourly rate, the venue, the position, hours worked, and shift. This information will be loaded onto the Form 14980, *Employee Tip Income Examinations Worksheet*, which will then be used as the allocation sheet.
 8. Form 4137, *Social Security and Medicare tax on Unreported Tip Income*, is used by an employee to compute the social security and Medicare tax owed on tips not reported to the employer. Unreported tip income, reported on Form 4137, is carried over to Form 8959, *Additional Medicare Tax*, which is used by an employee to compute Additional Medicare Tax owed on tips not reported to the employer.
 9. Additional Medicare Tax. A 0.9% Additional Medicare Tax (under IRC section 1401(b)(2)(B)) applies to Medicare wages, Railroad Retirement Tax Act (RRTA) compensation, and self-employment income that are more than:
 - \$125,000 if married filing separately,
 - \$250,000 if married filing jointly, or
 - \$200,000 for any other filing status .
 10. Tips are subject to Additional Medicare Tax, if, in combination with other wages and self-employment income, they exceed the individual’s applicable threshold. RRTA compensation and tips are separately compared to the threshold.

4.19.15.26.1 (01-01-2016)

Commonly Used Terms

1. The following table lists terms used in the Tip Income Program:

Term	Definition/Description
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Term	Definition/Description
(1) Tip Agreement	<p>Contract between an employer (of tipped employees) and the IRS.</p> <p>Note:</p> <p>There are various tip agreements between the IRS and the employer. Under a TRDA or GITCA, the employer must secure written statements from at least 75 percent of its employees stating they agree to participate in either the TRDA or GITCA. There are 4 types of tip compliance agreements:</p> <ul style="list-style-type: none"> • TRAC - Tip Reporting Alternative Commitment • TRDA - Tip Rate Determination Agreement • EmTRAC - Employer-designed TRAC • GITCA - Gaming Industry Tip Compliance Agreement
(2) Participating Employee	<p>A tipped employee who states in writing that they will report to their employer no less than the amount of tip income for his/her job classification, etc., as set forth in the Tip Agreement. This only applies to either a TRDA or GITCA.</p>
(3) Non-participating Employee	<p>A tipped employee who does not sign the declaration stating that they will report the actual tip income to their employer.</p>
(4) Venue	<p>Location where employee works, (i.g., Sunrise Cafe, Pool, Salon or Slots).</p>
(5) Job Classification/Position	<p>Employee's job title i.g., food, server, maitre d', bellman, bartender, colorist, nail technician etc.</p>

Term	Definition/Description
(6) Tip rate for all 1040 referrals	<p>Amount of tips per hour, shift, drink, car, etc., that is assigned to each employee, based on their job classification and venue.</p> <ul style="list-style-type: none"> • The examiner reviews the information provided by the employer and determines this amount. • These rates may be related to a general tip examination or for non-participants associated with a tip agreement. • The tip rate is multiplied by the number of hours, etc., the employee worked to determine the minimum amount of tips the employee should have reported as income to their employer.
(7) Tip rate/Food and Beverage	<p>The tip program has been expanded to other areas. For the Food and Beverage industries, the tip income is based on the employer's records.</p>
(8) Reported Tips	<p>The amount of tips an employee reports to their employer are included on his Form W-2.</p>
(9) Unreported Tips	<p>The difference between the employee's reported tips and the amount of tips determined to be earned based on the tip rate. Additional tip income information is shown on the Form W-2.</p>

Term	Definition/Description
(10) Allocated Tips	<p>Additional tip income on an employee's Form W-2. If the amount of tips the employee reported to the employer is less than 8 percent of the employee's tipped sales, an amount will be in box 8 of the Form W-2. The employee should include this amount on his tax return and on Form 4137.</p> <p>Note:</p> <p>Refer to Pub 531, <i>Reporting Tip Income</i>. If an employee's Form W-2 shows allocated tips, the employee is required to report the allocated tips on Form 4137, unless the employee has adequate records to show that the employee received less tips in the year than the allocated amount (see page 6 of Pub 531).</p> <p>Therefore, if an employee does not include the allocated tips on Form 4137 the allocated tips should not be considered in a tip exam. (If an employee insists they already included the allocated tips on the Form 1040, ask the employee to show where the tips were included on the Form 1040 for income tax and social security tax purposes.)</p>
(11) Form 4137	<p>Form 4137, <i>Social Security and Medicare Tax on Unreported Tip Income</i>, is used by the employee to report tip income (and the related FICA/Medicare taxes) not reported to their employer(s) during the year.</p> <p>Note:</p> <p>This includes any allocated tips shown in box 8 of their Form(s) W-2. Use Form 4137 to figure the social security and Medicare tax owed on those tips.</p>

Term	Definition/Description
(12) Employee Data Report	<p>Information from the Tip Data Report for each selected employee. Includes:</p> <ul style="list-style-type: none"> • Employer's name • Employee's position • Shift • Hours worked • Tips reported • Tip rate <p>This information is used to determine the amount of unreported tip income. The report also indicates if they are the Primary or Secondary taxpayer and whether they are a participating employee.</p>
(13) Form 2504	<p>Form 2504, <i>Agreement to Assessment and Collection of Additional Tax</i>, provides the adjustment to the employee's share of FICA and Medicare taxes and the related penalties. This form is generated in RGS.</p>
(14) Form 885-T	<p>Form 885-T, <i>Adjustment of Social Security on Tip Income Not Reported to Employer</i>, provides details of the computations for the taxes and penalties on Form 2504. This form is generated in RGS.</p>
(15) Form 14980 Tracking Sheet	<p>Note:</p> <p>The examiner/clerk will photocopy the Form 14980, <i>Employee tip Examination Worksheet</i>, from the closing file and indicate the disposal code on the form. This form will be mailed to the tip program coordinator/analyst.</p> <p>.</p>
Form 8959	<p>This form is used to compute and report Additional Medicare Tax on tips.</p>

4.19.15.26.2 (12-01-2017)**Contents of Case File**

1. Tip Income Information – The Area Offices will accumulate employer and employee data from the employers and determine which employees will be selected for an examination. For employee audits that are referred by the Area Offices, the data will be available on the Employee Data Report based on the Tip Agreement. The Employee Data Report and the list of selected employees will be provided to W&I headquarters/ Workload Development and Delivery team. The Food and Beverage and Cosmetology Industry tipped employee audits that are referred from Area Offices will contain a tip allocation worksheet or will be entered into an Excel spreadsheet.
2. The following information will be available for taxpayers who have been selected for examination:
 - Employee’s name and SSN.
 - Employee’s position, venue and shift.
 - Number of hours worked or sales (if applicable).
 - Form 14980, *Employee Tip Examinations Worksheet*.
 - Employer’s name.
 - Tip agreement date and RTVUE of tax return, if filed.
 - Tip rate for employee’s position, venue and shift per the Tip Agreement.
 - Fact of filing.
3. Other Case File Information - Case files may include the following information for all taxpayers:
 - AMDISA for the selected year(s).
 - IMFOLT for the selected tax year(s).
 - IRPTR information for the selected year(s).
 - McQuatter's allocation sheet for the Food and Beverage cases.
 - Employee Data Report.
 - Tracking sheet. Form 14980, *Employee Tip Examinations Worksheet*. (Two copies are required: one copy is to be used as a tracking sheet and another copy as part of the administrative file).

4.19.15.26.3 (12-01-2017)

Case Processing –General Information

1. The following information describes procedures that are specific to the Tip Income Program. Unless otherwise stated, normal case processing procedures should be followed.
2. Due to the specific procedures for assessing FICA taxes, all cases in the Tip Program should be filed separately from other cases or flagged for easy identification.
3. Adjustments to tip income involve both income tax and FICA taxes. Therefore, two sets of report forms are required:

Type of Tax	Report Form	Agreement Form
Income tax	Form 4549/Form 4549-EZ	Form 4549/Form 4549-EZ
Social Security	Calculated in RGS	Form 2504
Medicare	Calculated in RGS	Form 2504
Additional Medicare Tax	Form 885-T	Form 2504

4. As the chart shows, report forms must be prepared and sent to the taxpayer (tipped employee): along with Form 2504, **Agreement to Assessment and collection of Additional Tax and Acceptance of Over assessment**. Form 886-A, *Explanation of Items*, and Form 14980, *Employee Tip Examinations Worksheet*, must also be sent. If the examination was based on the percentage of gross sales, a Form 14980-B will need to be completed and sent to the taxpayer. Form 14980-A **Explanation of Tip Income**, shows how the tip income was computed using the McQuatter's Formula. This provides the taxpayer with a detailed computation of the unreported tip income. Make sure that your workpapers clearly explain how you arrived at your adjustments. This information will be extremely important if the taxpayer requests a transfer to an Area Office, requests an Appeals conference, or petitions the court.
5. Research AIMS to determine if another tax year is open for examination. If so, the cases should be worked by the same examiner.

4.19.15.26.3.1 (03-11-2019)

Filed Returns – Initial Contact

1. Compare the tip income reported on Form 1040, including amounts reported on Form 4137, **Social Security and Medicare Tax on Unreported tip Income**, to the tip income identified by the Area Office.

If	And	Then
The tip income identified by the Area Office exceeds the amount reported on the tax return, including Form 4137	NA	Include the unreported amount in the examination report.
The taxpayer worked for more than one employer where tips were received	The taxpayer participates in the tip agreement at one employer but does not participate at another	Only the tip income reported by the employer for which the employee underreported tip income should be included.
Both the taxpayer and the spouse on a joint return worked in a tipped occupation and a joint return was filed	There is tip income information for one taxpayer but not the other	Perform the necessary research to determine if there is unreported tip income for the other taxpayer and include all unreported tip income in the report.

2. Follow the instructions below when allocated tips are shown on the taxpayer's Form W-2:

If	And	Then
The payer is the same payer as shown on the tip Employee Data Report or other source document	The taxpayer included the allocated tip amount from Form W-2 as income on Form 1040	Give the taxpayer credit for the allocated tips reported on Form 1040 when determining the unreported tip amount.
The payer is the same payer as shown on the tip Employee Data Report or other source document	The taxpayer did not include the allocated tip amount from Form W-2 as income on Form 1040	Disregard the allocated tip amount. Use the information from the Employee Data Report to determine the unreported tip income.

If	And	Then
The payer is not the same payer as shown on the Employee Data Report or other source document	The taxpayer did not include the allocated tip amount from Form W-2 as income on Form 1040	Include the allocated tips as a separate issue when determining the unreported tip income.
The payer is not the same payer as shown on the Employee Data Report or other source document	The taxpayer included the allocated tip amount from Form W-2 as income on Form 1040	Assert the FICA penalty on the reported allocated tips.

3. Instructions for non-filers

- If the payer is the same payer as shown on the tip Employee Data Report or other source document, disregard the allocated tip amount. Use the information from the Employee Data Report or other source document to determine the unreported tip income.
- If the payer is not the same payer as shown on the Employee Data Report or other source document, include the allocated tips as a separate issue when identifying the unreported tip income.

4. Use the following table to determine other audit issues:

If	Then
The information on IRPTR shows allocated tips from a different type of property than the one that generated the unreported tip income.	That amount should be included in the unreported income, with the appropriate explanation(s) on Form 886-A. For example – if the unreported tips are from a casino venue and IRPTR shows allocated tips from a restaurant, include the allocated tips from the restaurant as unreported tip income on the exam report.
Any other items on the return require examination	Include them on the report with the appropriate explanation(s) on Form 886-A.

5. RGS categorization for unreported tip income is: AGI Adjustment/Taxable Earned or Personal Service Income/Unreported Tips from Form 4137.

Choose "Primary Taxpayer" or "Secondary Taxpayer" as appropriate and answer "Yes" to the "Assert FICA Penalty" question. This categorization will generate the preparation of Form 2504 and the proper transaction codes on Form 5344.

- Form 2504 will reflect a late filing penalty if it is applicable.
 - The taxpayer may be subject to a penalty equal to 50 percent of the FICA tax due on unreported tips reported on Form 4137 filed with the return. Write in and identify the applicable amount on the Form 2504 generated by RGS and recompute the total penalty amount shown on the Form 2504. Change the TC 310 amount on Form 5344 to reflect the correct amount.
 - Proper categorization of the tip income will generate Reference Codes 891, 892, 898 and 899 as necessary for the Primary or Secondary taxpayers on Form 5344 and on the Examination Closing Input Document (ECID). Do not delete the Reference Codes as they are required entries for the partial assessment and may need to be adjusted.
6. Use the following standard explanations for the tip income issues in your initial contact with the taxpayer and in subsequent contacts as necessary.

Explanation	Description
1101	Tips are includible in income
8107	IRC 6652(b) penalty – 50 percent of the FICA taxes on the unreported tip income
8201	IRC 3101 – employee’s share of the FICA taxes on the unreported tip income.
Custom Explanation	Explanation of tip income examination, examination reports and options available to the taxpayer. This is not currently an RGS paragraph. It is attached to the RGS file through MS Word.

7. Prepare the Form 14980, *Employee Tip Examinations Worksheet*. Enter the name(s) of the employer, taxpayer’s position, location worked, shift, hours, tip rate, amount of tips reported to the employer and amount of tips reported on Form 4137. The remaining calculations will be completed by the formulas built into the spreadsheet. The amount on the "Unreported Tips" line should be the same amount shown on Form 4549/Form 4549-EZ and Line 2 of Form 885-T, *Adjustment of Social Security Tax on Tip Income Not Reported to Employer*, as unreported tip income.

- Taxpayers contacted in this program have been advised of their reporting requirements by their employers and were given the opportunity to participate in the tip compliance agreement program. Choosing not to participate in a tip agreement is a tipped employee's choice. If the tipped employee does not accurately report his or her tip income, the failure to report income *may* constitute intentional disregard of rules or regulations, or otherwise be subject to a civil penalty.
8. Consider asserting the Accuracy Related Penalty for Negligence, IRC 6662(b) (1), on the amount of unreported tip income based on facts and circumstances surrounding the case. Assert IRC 6662(d) if requirements for the Substantial Underpayment Penalty are met.
 9. Consider any fraudulent/altered documents provided by the taxpayer for fraud penalty referral. Refer to IRM 25.1*Fraud Handbook* and IRM 4.19.10.4*Fraud Referrals* for a list of indicators of fraud and the referral process.
 10. Letter 525 is the initial contact letter for these cases. Prepare the mail-out package using normal procedures and include Form 14980-A, **Explanation of Tip Income** (Unreported Tip Income) and the custom explanation.
 - RGS auto-populates the deficiency, penalty and interest from Form 4549/Form 4549-EZ as the balance due on Letter 525. Correct this amount to include the Form 4549/Form 4549-EZ amount plus the taxes and penalty shown on Form 2504.
 11. Follow normal Letter 525 procedures for mail-out and suspense.
 12. Prepare a Form 886-A1, *Employee Tip Examinations Worksheet*, for each employee. This form can hold up to 5 venues. Complete the form with Employer name, and Employer Identification Number. Leave a copy of each Form 14980, *Employee Tip Examinations Worksheet*, that has been completed loose in the case file to be used as a tracking sheet. If multiple tracking sheets are prepared please staple them together so that they can be forwarded as one package.
 - On joint returns, enter the SSN of the taxpayer who received the tip income on the Form 14980*Employee Tip Examinations Worksheet*.
 - If the unreported tip income per the information provided by the Area Office was included on Form 4137 filed with the return, you must still complete a tracking sheet for the tips and FICA taxes shown on Form 4137 so the corresponding employer's share of FICA taxes can be assessed. Attach the Form 4137 filed with the return to the tracking sheet. No other documents or reports should be attached to the tracking sheet.

- When the case is ready to close, the tracking sheet Form 14980, *Employee Tip Examinations Worksheet*, should match the closing actions and determination on Form 5344. These tracking sheets will be sent to the originating Area Offices' Tip Coordinator on a monthly basis and quarterly basis to Indian Tribal Gaming (ITG) Tip Compliance Coordinator from TEGE. Tracking sheets are generally not needed for PC 0364 and 0672 since the employer received their Notice and Demand, unless instructed by HQ.
13. If the taxpayer does not sign agreed before the 90-day letter (Statutory Notice of Deficiency), is ready to be sent, the case will include two partial Forms 5344; one Form 5344 for the FICA taxes, penalty, and reference codes, and one for the income tax and related penalties and reference codes. If the taxpayer signs agreed before the Statutory Notice of Deficiency is ready to be sent, then only one Form 5344 is needed.

Disposal Code and Closure	Posting Delay Codes
DC 04 (agreed) before 90 day letter	All transactions can be entered on one Form 5344. No PDC needed.
DC 04 but IRC 6404(g) applies	Same as above but input PDC 1.
DC 08 (partial assessed)	FICA taxes and related actions will have to be processed on the partial Form 5344, and then the Statutory Notice of Deficiency can be issued.
DC 09 (agreed) after 90 day letter	Income tax and related actions will be processed on the closing Form 5344.
DC 09 (agreed) after 90 day letter and IRC 6404(g) applies	Same as above but input PDC 1.
DC 10 (Default) and DC 13 (Undeliverable)	Follow instructions for DC 09 above.

14. The FICA taxes and the related penalties cannot be included on the Statutory Notice of Deficiency. These assessments must be made prior to the issuance of the 90 day letter. Refer to IRM 25.6 Statute of Limitations for assessment statute of limitations on unreported tips income and IRM 4.23.7.4, *Form 4137 Requirements*. Ensure that the assessments are input timely and properly, prepare Form 5344 whenever you prepare a report and make the following notations (see table below) on the Examination Closing Input Document (ECID) or Form 3198. Attach the ECID to the inside of the

case folder. Attach Form 3198 to the outside of the case folder. The Examiner may include Form 14980-C, *FICA Tax and Penalty*, (For Information Only) with the 90 day package. This will inform the taxpayer that the income tax and the FICA taxes are both due.

If	Then	And Enter These Amounts
<p>You are issuing the report with Letter 525</p>	<p>Annotate the ECID or Form 3198</p> <ul style="list-style-type: none"> • Assess FICA taxes \$ XX.XX (TC 300) • Assess FICA Penalty \$XX.XX (TC 310) • Assess Delinquency Penalty \$XX.XX (TC 160) (if applicable) • Enter TC 470/ CC 90 • Enter Hold Code 4 <p>Change the TC 300 shown on Form 5344</p> <p>If applicable, change the TC 160 shown on the Form 5344</p>	<p>On</p> <ul style="list-style-type: none"> • Form 2504 - Total Amount of Tax • Form 2504 - IRC 6652(b) Penalty • Form 2504 - IRC 6651 Penalty <p>TC 300 entered by RGS less the total amount of tax on Form 2504. (Deficiency shown on Form 4549)</p> <p>TC 160 entered by RGS less the delinquency penalty shown on Form 2504</p>

4.19.15.26.3.2 (11-29-2011)

Non-Filers

1. Follow the procedures beginning at IRM 4.19.17.3, *Non-Filer Processing*.
2. The AIMS database should be created with the following information:

Item	Value
Status	06
Source Code	24
Project Code	The Gaming Industry cases generating from non-Indian Tribal Casinos will have Project Code 0360. Indian Tribal Gaming cases will have Project Code 0916. Food and Industry Non-Gaming cases will have Project Code 0364 and Cosmetology Industry will have Project Code 0672.
Org Code	5XXX
Push Code	036

3. After you have verified that the "dummy" TC 150 and TC 420 have posted to Master File, prepare Form 4549/Form 4549-EZ based on all available IRP information and the tip income information in the case file.
4. RGS categorization for unreported tip income is: AGI Adjustment/Taxable Earned or Personal Service Income/Unreported Tips from Form 4137. Choose "Primary Taxpayer." The Filing Status on these cases will be either "Single" or "MFS" . Answer "Yes" to the "Assert FICA Penalty" question. This categorization will generate the preparation of Form 2504 and the proper Transaction Codes on Form 5344.
5. Follow the instructions under Filed Returns for standard explanations, asserting penalties and the preparation of Examination Closing Input Document (ECID) or Form 3198, Form 14980-A, **Explanation of Tip Income**, (Unreported Tip Income) and the tracking sheet.
6. Send initial contact letter and follow normal procedures for preparation, mail-out and suspense.

4.19.15.26.4 (12-01-2017)

Case Processing – Revised Reports and Responses to 90 day Letters

1. If the taxpayer replies to the Letter 525 or Letter 1862 and a revised report is prepared, issue Letter 692 (SC/CG). Follow normal procedures for mail out and suspense of the letter.

If	Then	And Enter These Amounts
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If	Then	And Enter These Amounts
<p>You are issuing the report with Letter 692</p>	<p>Annotate the ECID or Form 3198:</p> <ul style="list-style-type: none"> • Assess FICA taxes \$ XX.XX (TC 300) • Assess FICA Penalty \$XX.XX (TC 310) • Assess Delinquency Penalty \$XX.XX (TC 160) (if applicable) • Enter Hold Code 4 <p>Change the TC 300 shown on Form 5344</p> <p>Annotate the ECID or Form 3198</p> <p>If the case falls under the provision of IRC 6404, input TC 971 AC 064 with dollar amount</p>	<p>On</p> <ul style="list-style-type: none"> • Form 2504 – Total Amount of Tax • Form 2504 – IRC 6652(b) Penalty • Form 2504 – IRC 6651 Penalty <p>TC 300 entered by RGS less the total amount of tax on Form 2504. (Deficiency shown on Form 4549)</p> <p>TC 160 entered by RGS less the Delinquency Penalty shown on Form 2504</p>

2. Ensure that the assessments for FICA tax and related penalties are made before the 90 day letter is issued. Refer to IRM 25.6, *Statute of Limitation*, on assessment statute of limitation on unreported tips income and IRM 4.23.7.4, *Form 4137 Requirements*. If you are evaluating a response to a 90 day letter and have reduced the amount of under-reported tip income, prepare the ECID or Form 3198, as shown in the table after the next paragraph to ensure that the taxpayer is not over-assessed for FICA taxes and the penalty.

Note:

If a taxpayer requests Appeals rights during the course of an examination, the FICA tax and penalty will be assessed prior to transferring to Fresno Appeals function. This is to ensure that the FICA tax and penalty statute are not barred. Any notices generated relating to FICA tax and penalty to the taxpayer should be suppressed. The Examiner/lead and the Clerical unit will

review case file to ensure that it is followed and that the case file includes workpapers and Form 14980 with tip unreported income calculations for the taxpayer. The Fresno appeals function will adjust/abate the FICA tax and penalty, if necessary, at the conclusion of their appeals process.

3. Send Letter 555 and follow the normal procedures for mail-out and suspense. Keep in mind the restrictions on increasing the assessment and requesting documentation after the statutory notice has been issued. See IRM 4.19.13.13, *Statutory Notices*.

Direction	Transaction/Reference Code	Amount
Abate FICA taxes	TC 301	Difference between the FICA taxes already assessed and the amount shown on the corrected Form 2504
Abate FICA Penalty	TC 311	Difference between the FICA penalty already assessed and the amount shown on the corrected Form 2504.
Abate Delinquency Penalty (if applicable)	TC 161	Difference between the delinquency penalty already assessed and the amount shown on the corrected Form 2504.
Input	Reference Codes 891 and 898 (for Primary taxpayer)	Difference between the Primary taxpayer's unreported tip income shown on Form 4549/Form 4549-EZ that accompanied the 90 day letter and the Primary taxpayer's unreported tip income shown on your revised report. (Show this amount in brackets.)

Direction	Transaction/Reference Code	Amount
Input	Reference Codes 892 and 899 (for Secondary taxpayer)	Difference between the Secondary taxpayer's unreported tip income shown on the Form 4549/Form 4549-EZ that accompanied the 90 day letter and the Secondary taxpayer's unreported tip income shown on your revised report. Show this amount in brackets.

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4.19.15.26.5 (03-11-2019)

Case Processing – Closing Actions and Other Information

1. There are special rules for assessing FICA taxes. FICA tax and the associated penalties may have to be assessed prior to issuing the 90 day letter. In order to ensure that assessments are input timely and properly, follow the instructions for the Examination Closing Input Document or Form 3198. Also refer to IRM 4.19.15.26.4 *Case Processing - Revised Reports and Responses to 90-Day Letters*, paragraph (2).
2. Unless otherwise instructed, follow normal closing procedures. Refer to the table to determine the action to take and to IRM 4.4, *AIMS Processing*.

If	Then
The taxpayer agrees to the 15/30 day letter	Input all transaction codes per the ECID, Form 3198, or Form 5344 as printed by RGS. Disregard handwritten notations, except for changes to the TC 310 amount.
The taxpayer does not respond to the 15/30 day letter	<p>Do a partial assessment if the case has a short statute. If not, input the partial assessments at the time of closing. Use AMCLSF and input the following:</p> <ul style="list-style-type: none"> • TC 300 per the examiner's instructions • TC 310 per the examiner's instructions. • TC 160 per the examiner's instructions. This will not occur on all cases. • Reference Codes 891, 892, 898 and 899 as shown on Form 5344. • If partial is input at closing use Posting Delay Code 1. • Hold Code 4 • TC 470 with Closing Code 90 on IDRS using Command Codes REQ77/FRM77 if partial is input prior to 90 day. <p>Prepare the 90 day letter for the income tax deficiency and penalties shown on Form 4549/Form 4549-EZ</p>

If	Then
The taxpayer agrees to the 90 day letter or the 90 day letter defaults.	Using AMCLSE input: <ul style="list-style-type: none"> • TC 300, TC 350/ Ref. 680, TC 160 per the Form 4549/Form 4549-EZ issued with the 90 day letter. • Input all other transactions and references per Form 5344, if they have not been previously input.
A revised report and Letter 555 adjusting the tip income were issued after the 90 day letter and the taxpayer agrees or the case defaults.	Do a partial abatement using AMCLSF and input the following: <ul style="list-style-type: none"> • TC 301 per the examiner's instructions. • TC 311 per the examiner's instructions • TC 161 per the examiner's instructions. This will not occur on all cases. • Reference Codes 891, 892, 898 and 899 per the examiner's instructions. Using AMCLSE input: <ul style="list-style-type: none"> • TC 300, TC350 / Ref. 680, TC 160 per the revised Form 4549/Form 4549-EZ issued with the Letter 555. • Input all other transactions and references per Form 5344, if they have not been previously input.

3. Requests for Transfers to an Area Office and Statute Extensions. A case should not be transferred if there are less than 13 months remaining on the statute of limitations. Refer to IRM 4.19.13.15.1, *Transfers to Area Office*.
- All Tip program cases that require transfer to Area Office should be routed to the clerical support unit. The support unit will update AIMS

and RGS and then route to the following address: Internal Revenue Service - Attn: PSP M/S 4031 - 600 17th Street - Denver, CO 80202

- HQ analyst should be informed of the transfer request to the Area Office.
- Refer to IRM 4.19.17, *Non-Filer Program*, for information on the statute of limitations for non-filers and the returns they file in response to the initial contact letter or subsequent letter.
- In cases where the time constraints do not allow for transferring the case, contact the taxpayer, explain the situation and ask the taxpayer to explain what his or her concerns are. Try to resolve the issues via correspondence. If the taxpayer insists on transferring his case and the Statutory Notice has not yet been issued and there are less than 13 months remaining on the statute of limitations, the statute of limitations must be extended.
- If the taxpayer filed Form 4137 with the tax return, prepare Form 872 *Consent to Extend the Time to Assess Tax*, and Form SS-10 *Consent to Extend the Time to Assess Employment Tax* to extend the statute of limitations on both the income and the FICA taxes. Follow normal procedures for mail out and suspense of the request to extend the statutes. Refer to IRM 25.6, *Statute of Limitations*.
- If Form 4137 was not filed with the return, prepare Form 872, **Consent to Extend the Time to Assess Tax**, for the income tax only.

4. Other Processing Guidelines

- If the taxpayer states that he or she disagrees with the report and you cannot clearly determine the basis of the disagreement, follow normal procedures for contacting the taxpayer to get clarification.
- If necessary, the unreported tip income as shown on the original report can be adjusted. However, do not change the taxpayer's hours, shift, position, or venue unless the taxpayer has provided information from the employer.
- Obtain as much information as possible from the taxpayer and document it in detail on your workpapers.
- Access any additional information that is available from the Tip Match database and other employer driven resources.
- If the taxpayer disagrees with an adjustment that is not related to the tip income use normal procedures to evaluate the information the taxpayer provides.

- Tip diaries must meet specific requirements in order to be accepted. For information on the specific requirements for a tip diary, see Pub 531, *Reporting Tip Income*, or section 31.6053-4(a)(2) of the Employment Tax Regulations. Also refer to the *SERP Job Aids*.
 - If the taxpayer states he or she agrees with the adjustment to the tip income, but provides information about employee business expenses the taxpayer may be entitled to, evaluate that information and make the necessary determination based on the information provided.
 - If the taxpayer responds to the Letter 1862 with a tax return, review the return for accuracy and process the return as instructed in IRM 4.19.17.3, *Non-Filer Processing*.
 - If the taxpayer's response results in a revision to Form 4549 /Form 4549-EZ and Form 2504 make sure you make the corresponding changes to the tracking sheet.
 - If the taxpayer wishes to have a representative conduct the examination on his or her behalf, Form 2848 must give the representative authority to handle the income tax and the FICA tax issues.
5. If a request is made for printed documentation to be sent to Tax Court or Appeals, follow the instructions below (for clerical only):
- a. Request the casefile from the CORR team,
 - b. Case will be sent to Clerical to have all the requested case documents printed,
 - c. Clerical will send casefile to Appeals or Tax Court with printed documentation enclosed.
 - d. A record should be kept by the Clerical manager.

4.19.15.27 (03-11-2019)

10 Percent Additional Tax on Early Distributions – IRC 72(t) & IRC 72(q)

1. The 10 percent additional tax is an income tax which is assessed on the Individual Master File and taken into account when the total corrected income tax is determined by the tax examiner. Returns included in this program apply to taxable early distributions from qualified retirement plans, Individual Retirement Arrangements (IRAs), or annuity contracts.
2. To encourage taxpayers to save for retirement, Congress enacted an early distributions tax that requires taxpayers to pay an amount equal to 10 percent (or 25 percent of certain SIMPLE IRA distributions, if applicable) of the taxable amount distributed from a retirement plan before they reached the age of 59¹/₁. The tax is 10 percent (or 25 percent if applicable) of the

amount of early distributions includible in gross income and required to be reported on Lines 15b or 16b of Form 1040.

Note:

For taxable year 2018, there are no lines 15b and 16b, this information will be reported on new line 4b of Form 1040.

The 25 percent additional tax applies to an early distribution from a SIMPLE IRA account that occurs within 2 years from the first contribution made by the employer. Distributions subject to the 25 percent additional tax are reported on Form 1099-R with a Distribution Code S in Box 7.

3. There are a number of exceptions to these additional taxes. Tax examiners will be required to determine if the taxpayer meets one of the exceptions or if the taxpayer simply failed to report the proper amount. See Table A and B for details regarding exceptions. Generally, the payer (individual or entity who is responsible for preparing Form 1099-R) will not know if a taxpayer is using the distribution for a first time home purchase, qualified medical expenses or qualified higher education expenses. Therefore, the payer will code the Form 1099-R Box 7 as 1 (early distribution, no known exception.)

4.19.15.27.1 (03-11-2019)

Procedural Instructions

1. Tax Examiners who work these cases should take the following Basic Income Tax Training lessons: IRA, Pensions, Annuities and IRA Deductions.
2. For more information consult Pub 590-B, *Distributions from Individual Retirement Arrangements (IRAs)*, Pub 575, *Pension and Annuity Income*, Instructions for Form 5329, *Additional Taxes on Qualified Plans (including IRAs) and Other Tax-Favored Accounts*, and Instructions for Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*
3. Tax examiners must conduct the following research before contacting the taxpayer to determine if the case should be surveyed and to ensure the audit report is correct.

IDRS Command Codes	If	Then
INOLES to determine taxpayer’s age. At time of distribution	59 1/1 or older	survey, close on AIMS using DC 31
	55 or older and meets exception per TABLES A and B	survey, close on AIMS using DC 31

IDRS Command Codes	If	Then
<p>TXMOD to verify if taxpayer amended Form 1040 and reported 10/25 percent additional tax</p>	<p>reported</p>	<p>survey case and close on AIMS using DC 31.</p>
<p>IRPTR</p> <p>a. to verify if payer filed amended Form 1099-R for the distribution(s) that is (are) subject to the 10 percent or 25 percent additional tax,</p> <p>b. to verify that all taxable pension, IRA distributions, or any other taxable income have been reported on the return. Include in income any unreported taxable income determined, and</p> <p>c. to determine if pension or IRA distributions are substantially equal to distributions received in the prior or subsequent tax years. These should be surveyed and closed DC 31 if criteria is met.</p>	<p>Form 1099-R Box 7 Code is:</p> <p>a. 2 (early distribution, exception applies (under 59 1/1))</p> <p>b. 3 (Disability), or</p> <p>c. 4 (Death)</p> <hr/> <p>Form 1099-R Box 7 Code is:</p> <p>a. G (Direct Rollover of a distribution to a qualified plan, a Section 403(b) plan, a governmental Section 457(b) plan, or an IRA. This does not include the direct rollover of a designated Roth account distribution.)</p> <p>b. H (Direct Rollover of a designated Roth account distribution to a Roth IRA.)</p> <p>Note:</p> <p>See the instructions to Form 1099-R for Codes G and H.</p>	<p>survey, close on AIMS using DC 31.</p> <hr/> <p>survey, close on AIMS using DC 31.</p> <p>Note:</p> <p>If the additional tax on early distribution does not apply, consider opening the examination if the amount of unreported income is material</p>

4. 10 percent additional tax cases are opened on AIMS in Project Code 0123, Source Code 06.

5. Cases selected using the UCP (Unattended Case Processing) Filter Create Discretionary tool will create in RGS Group B2, pending Status 10, with the Letter 566-S and accompanying Form 886-A. A 100 percent review of these cases is required to identify cases that should be surveyed prior to contacting the taxpayers. Based on the required research shown above, if it is determined the taxpayer meets one of the exceptions and is not liable for the 10 percent additional tax, the case should be surveyed and letter and forms not issued to the taxpayer. Also, the 10 percent additional tax issue should be reviewed to ensure the tax is only being assessed on applicable distributions and to include any unreported income. Cases which pass review, after any necessary corrections have been made, should be reintroduced to ACE (Automated Correspondence Exam) for subsequent automated processing.
6. The case will be suspended for 45 days.
7. The Letter 525, Form 886-A and Form 4549/Form 4549-EZ (audit report) will be prepared systemically during ACE Create 2 processing. Cases which fire one of the standard filters during Create 2 processing will reject to RGS Group B2. The audit reports must be randomly reviewed, per ACE procedures in IRM 4.19.20.2.9, *Reviews*. The standard explanation included in Form 886-A is determined by whether an amount is reported on Lines 15b and/or 16b on Form 1040, or 11b and/or 12b on Form 1040A.
 - a. Use the following standard explanations if an entry is on Line 16b (pensions and annuities taxable amount) but there is no entry on Line 15b (IRA distribution taxable amount) of the Form 1040.

Note:

For taxable year 2018, there are no lines 15b and 16b, this information will be reported on new line 4b of Form 1040.

Also, use if an entry is on Line 12b (pensions and annuities taxable amount) and there is no entry on Line 11b (IRA distribution taxable amount) of the Form 1040A:

Note:

For taxable year 2018, there is no Form 1040A.

Additional tax of 10 percent due to the early distribution made from your qualified retirement plan.

Additional tax of 10 percent due to the early distribution made from your qualified retirement plan.

We are proposing to adjust your tax by 10 percent of the taxable amount of the early distribution made from your qualified retirement plan because you received the distribution before you reached age 59¹/₁, and the payment did not qualify for one of the following allowable exceptions:

- Payments made from the Plan after you separate from service if you will be at least 55 during the year of payment
- Payments made on account of total and permanent disability
- Payments made in substantially equal amounts over your life or life expectancy (or the joint lives or life expectancies of you and your beneficiary)
- Payments after the death of the participant
- Payments of Employee Stock Ownership Plan (ESOP) dividends
- Payments paid directly to the government to satisfy a federal tax levy
- Payments made to an alternate payee under a Qualified Domestic Relations Order (QDRO)
- Payments not exceeding the amount of your deductible medical expenses (whether or not you itemized deductions)
- For distributions made before January 1, 2016 from a State or local governmental defined benefit pension plan to a qualified public safety employee who is at least age 50 at the time the public safety employee separates from service
- For distributions made after December 31, 2015, payments from a governmental plan to a qualified public safety employee who is at least age 50 at the time the public safety employee separates from service.
- Payments from CSRS and FERS made under a phased retirement annuity

Additional tax of 10 percent due to the early distribution made from your qualified retirement plan.

If you believe you qualify for one of the exceptions, please provide us with documentation that shows you meet one of the above exceptions.

Examples of acceptable documents include:

- corrected Form 1099-R from the issuing entity, or
- a statement from your plan administrator explaining why you meet the exception, or
- a statement from your medical practitioner explaining your disability, or
- copies of cancelled checks or receipts showing when and what qualified expenses were made, or
- a copy of the QDRO (generally part of your divorce decree).

Additional tax of 10 percent due to the early distribution made from your annuity contract.

Additional tax of 10 percent due to the early distribution made from your annuity contract.

We are proposing to adjust your tax by 10 percent of the taxable amount of the early distribution made from your annuity contract because you received a distribution before you reached age 59¹/₁, and the payment did not qualify for one of the following allowable exceptions:

- Payments after the death of the annuity owner
- Payment made on account of total and permanent disability
- Payments made in substantially equal amounts over your life or life expectancy (or the joint lives or life expectancies of you and your beneficiary)
- Payments allocable to an investment in the contract before August 14, 1982
- Payments made under a qualified personal injury settlement
- Payments made under an immediate annuity contract or
- Payments made under a deferred annuity contract purchased by your employer upon termination of a qualified plan that is held by your employer until you separate from service

If you believe you qualify for one of the exceptions, please provide us with documentation that shows you meet one of the above exceptions. Acceptable documents include:

- corrected Form 1099-R from the issuing entity, or
- a statement from your annuity holder explaining why you meet the exception, or
- a statement from your medical practitioner explaining your disability

- b. Use the following standard explanation if an entry is on Form 1040 Line 15b (IRA distribution taxable amount), but there is no entry on Line 16b (pensions and annuities taxable amount), or if an entry is on Line 11b (IRA distribution taxable amount), but there is no entry on Line 12b (pensions and annuities taxable amount) for Form 1040A.

Note:

For taxable year 2018, there is no line 15b or 16b. The information will be entered on new line 4b of the Form 1040. Also, for tax year 2018, there is no Form 1040A.

Additional tax of 10 percent due to the early distribution made from your Individual Retirement Account (IRA).

We are proposing to adjust your tax by 10 percent of the taxable amount of the early distribution made from your Individual Retirement Account (IRA) because you received the distribution before you reached age 59¹/₁, and the payment did not qualify for one of the following allowable exceptions:

- Payments made on account of the total and permanent disability
- Payments made in substantially equal amounts over your life or life expectancy (or joint lives or life expectancies of you and your beneficiary)
- Payments after the death of the IRA owner
- Payments for qualified higher education expenses
- Payments to buy, build, or rebuild a first home
- Payments paid directly to the government to satisfy a federal tax levy
- Payments not exceeding the amount of your deductible medical expenses (whether or not you itemized deductions)
- Payments to unemployed individuals for health insurance premiums
- Payments while you are on active duty if you were called to duty after September 11, 2001, for more than 179 days

Additional tax of 10 percent due to the early distribution made from your Individual Retirement Account (IRA).

If you believe you qualify for one of the exceptions, please provide us with documentation that shows you meet one of the above exceptions. Examples of acceptable documents include:

- corrected Form 1099-R from the issuing entity
- a statement from your plan administrator explaining why you meet the exception
- a statement from your medical practitioner explaining your disability, or
- copies of cancelled checks or receipts showing when and what qualifying expenses were made.

- c. Use all of the standard explanations (per 7a and 7b above) on Form 886-A if there is an entry on both Lines 15b (IRA distribution taxable amount) and 16b (pensions and annuities taxable amount) on Form 1040 [Lines 11b (IRA distribution taxable amount) and 12b (pensions and annuities taxable amount) on Form 1040A].
8. Suspend the case for 45 days waiting for taxpayer response to Letter 525. If no reply is received, follow the procedures in IRM 4.19.13.12, *No Response and Unagreed Cases*.
 9. Use the following table when reviewing the taxpayer’s reply.

If	Then
The taxpayer signs the report or, prior to the mailing of a Statutory Notice of Deficiency, pays the full amount,	Close the case using normal procedures.

If	Then
The taxpayer submits documentation and you need additional information,	a. If the taxpayer provides a phone number, attempt to call the taxpayer and notate the phone call in your case file. b. If the attempt to contact the taxpayer is unsuccessful, follow procedures in IRM 4.19.13.10.1, <i>Taxpayer Response – Additional Information Needed</i> .
The taxpayer appeals the determination,	Follow relevant procedures in IRM 4.19.13.12, <i>No Response and Unagreed Cases</i> and IRM 4.19.13.15, <i>Transfers to Area Office Examination or Appeals Office</i> .
The taxpayer submits sufficient documentation (refer to tables A and B below) to verify an exception was met,	Close no change using normal procedures.

Note:

The IRS has released new and updated publications and forms for individuals who received qualified disaster distributions from retirement plans in 2016 or 2017. The Disaster Tax Relief and Airport and Airway Extension Act of 2017 offered tax-related and other relief to victims of Hurricane or Tropical Storm Harvey, Hurricane Irma, Hurricane Maria, and the California wildfires, that occurred in 2017. In the Tax Cuts and Jobs Act, Congress extended distribution relief to 2016 disasters. New Publication 976, *Disaster Relief* summarizes various types of tax relief available for individuals and businesses affected by qualifying disasters in 2016 and 2017, including qualified disaster distributions.

10. Table A provides the category of payer (IRA, qualified retirement plan, or annuity) and in what tax year the exception is available. Verify that the correct plan applies to the correct exception. For example, a distribution from a 401(k) Plan is not available for the first time home buyer exception. The exception for distributions made after separation from service after age 55 is not available for an IRA distribution.

Table A

Exceptions to early distribution tax	IRA	Qualified Retirement Plan	Annuity	Tax Year
Payments made on or after the date the plan participant or account holder reached 59^{1/2} .	x	x	x	ALL
Payment made to a beneficiary upon death of the plan participant or contract holder.	x	x	x	ALL
Payment made based on total and permanent disability of the recipient.	x	x	x	ALL
Distribution made as a part of a series of substantially equal payments .	x	x	x	ALL
Distribution used for certain higher education expenses .	x	n/a	n/a	Starting 1998
Distributions used for first-time home purchase (Up to \$10,000).	x	n/a	n/a	Starting 1998
Distributions made after separation from service in or after the year the participant reached age 55 .	n/a	x	n/a	Starting 1998
Distributions made to the extent of deductible medical expenses that can be claimed on Line 4 of Schedule A Form 1040. (Does not apply to annuity contracts or modified endowment contracts.)	x	x	n/a	After 1996

Exceptions to early distribution tax	IRA	Qualified Retirement Plan	Annuity	Tax Year
Distributions made to unemployed (at least 12 weeks) individuals for health insurance premiums.	x	n/a	n/a	After 1996
Payments to an alternate payee under a qualified domestic relations order QDRO.	n/a	x	n/a	ALL
Payments made if, as of March 1, 1986 , the plan participant separated from service and began receiving benefits under a written election.	n/a	x	n/a	ALL
Payments made to correct excess deferrals, excess contributions , or excess aggregate contributions.	n/a	x	n/a	ALL
Payments allocable to investment in a deferred annuity contract before August 14, 1982.	n/a	n/a	x	ALL
Payments from an annuity contract under a qualified personal injury settlement.	n/a	n/a	x	ALL
Payments made under a deferred annuity contract purchased by the employer upon the termination of a qualified retirement plan or qualified annuity and that is held by the employer until the participant separates from service.	n/a	n/a	x	ALL

Exceptions to early distribution tax	IRA	Qualified Retirement Plan	Annuity	Tax Year
Payments made under an immediate annuity contract.	n/a	n/a	x	ALL
The distribution is due to an IRS levy under Section 6331 of the Internal Revenue Code.	x	x	n/a	Starting in 2000
Qualified hurricane distributions (up to \$100,000) as described in section 1400Q(a)(4) of the Internal Revenue Code.	x	x	n/a	On or after August 25, 2005 and before January 1, 2007
Distributions to qualified reservists called to active duty for more than 179 days or for an indefinite period.	x	x	n/a	After September 11, 2001
Payments from a federal retirement plan made under a phased retirement annuity program	n/a	n/a	n/a	After 2014
Payments made after August 17, 2006 and before January 1, 2016, from a State or local governmental defined benefit pension plan to a qualified public safety employee who is at least age 50 at the time the public safety employee separates from service.”	n/a	x	n/a	ALL

Exceptions to early distribution tax	IRA	Qualified Retirement Plan	Annuity	Tax Year
Payments made after December 31, 2015, from a governmental plan to a qualified public safety employee who is at least age 50 at the time the public safety employee separates from service.	n/a	x	n/a	ALL

11. The following bullets apply to Table A

- A five percent rate may apply to certain annuity distributions – see IRM 4.19.3.15.3, *10 Percent Tax on Early Distributions From Qualified Retirement Plans/25 Percent Tax on Early Distributions from SIMPLE IRAs*, for more information.
- IRAs include: Traditional, Roth, and SIMPLE IRAs.
- Qualified Retirement Plans include: 401(a) qualified pension, profit-sharing, and stock bonus plan, including 501(a) tax exempt trust plan, 403(a) qualified employee annuity plan, 403(b) employee annuity contract purchased by a public school or by a 501(c)(3) tax exempt organization, employee stock ownership plan (ESOP), 401(k) qualified cash or deferred arrangement plan, CSRS, FERS, the Federal Thrift Savings Plan, and any tax favored deferred compensation plan that is not an IRA, a SIMPLE IRA or an individual retirement annuity.

12. Table B details acceptable documentation for exceptions to the early distributions tax. The list is not all inclusive.

Note:

Always accept a corrected Form 1099-R. Do not accept Form 5329 submitted after filing as verification.

Table B

If the taxpayer claims one of the following exceptions:	Then acceptable verification is:
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If the taxpayer claims one of the following exceptions:	Then acceptable verification is:
Payments made on or after the date the plan participant or account holder reached age 59¹/₁ ,	Taxpayer's age verified using IDRS CC INOLES or birth certificate.
Payment made to a beneficiary upon death of an IRA holder or pension plan participant (not applicable to modified endowment contracts),	Date of death verified via IDRS CC INOLES or death certificate, plan beneficiary form or statement from plan administrator.
Payment made based on total and permanent disability ,	Letter from medical practitioner verifying the taxpayer's permanent and total disability.

If the taxpayer claims one of the following exceptions:	Then acceptable verification is:
<p>Distribution made as a part of a series of substantially equal payments,</p>	<ul style="list-style-type: none"> • Review prior and subsequent year IRP documents, tax returns or RTVUE for amounts distributed and/or reported. • Confirm math is correct by method described in Publication 590-B, <i>Distributions from Individual Retirement Arrangements (IRAs)</i>, or Publication 575, <i>Pension and Annuity Income</i>. • Rev. Rul. 2002-62 will affect some distributions made after 2001 if there has been a modification to the series of periodic payments.

If the taxpayer claims one of the following exceptions:	Then acceptable verification is:
<p>Distribution used for certain higher education expenses (tuition, fees, books, supplies and equipment required by the school for enrollment or attendance of a student). Eligible expenses should be reduced by scholarships and any other tax-free awards.</p> <p>Reminder:</p> <p>The distribution and payments must be within the same tax year.</p>	<p>Verified expenses from Form 1098-T using IDRS CC IRPTR, copies of cancelled checks/money orders and invoices, or statement from school showing dates and payment amounts of higher education expenses.</p> <p>Reminder:</p> <p>Do not accept direct payments from taxpayer to student.</p>

If the taxpayer claims one of the following exceptions:	Then acceptable verification is:
<p>Distributions used for a first-time home purchase, up to \$ 10,000 (this is a lifetime limit). The distribution must be used for this purpose within 120 days after the distribution. Must be principal residence</p> <ul style="list-style-type: none"> • Acceptable costs include expenses to acquire, construct or reconstruct a residence, reasonable settlement, financing, or other closing costs, • First time homebuyer defined as the taxpayer and, if married, the spouse, as well as any child, grandchild or ancestor of the taxpayer or spouse, who had no ownership interest in a principal residence in the two year period preceding the date of closing or preceding the date that construction/reconstruction commenced, • The 60-day rollover period (see below) for recontributing the distribution to an eligible retirement plan is extended to 120 days if the taxpayer does not close due to delay or cancellation of the purchase or construction of the residence. 	<p>To verify if first-time purchase, use IDRS and research prior years for mortgage interest or real estate tax payments for first time purchase:</p> <ul style="list-style-type: none"> • Copies of cancelled checks or money orders, contracts, or closing (settlement) statements showing how the money was used. • Letter from financial institution or seller explaining reason for delay or cancellation of closing if applicable.
<p>Distributions made after separation from service in or after the year the participant reached age 55.</p>	<ul style="list-style-type: none"> • Use IDRS CC INOLES to verify taxpayer's age • Check taxpayer's current and prior years Form W-2s to verify separation from service.

If the taxpayer claims one of the following exceptions:	Then acceptable verification is:
Distributions made to the extent of deductible medical expenses that can be claimed on Line 4 of Form 1040 Schedule A, regardless of whether the taxpayer itemized deductions. (Does not apply to annuity contracts or modified endowment contracts.)	<i>IRM 4.19.15.20</i> , Schedule A, for verification procedures.
Distributions made to individuals unemployed (for at least 12 weeks) for payment for health insurance premiums .	<ul style="list-style-type: none"> • Verify unemployment from Form 1099-G or employee records • Copies of cancelled checks, money orders for insurance payments or statement of account from insurance agent/company
Paid to an alternate payees under a qualified domestic relations order, QDRO .	Divorce decree or statement from plan administrator.
Payments from an employer plan made if, as of March 1, 1986 , the plan participant separated from service and began receiving benefits under a written election.	Statement from plan administrator.
Payments made from employer plans to correct excess wage deferrals, excess contributions, or excess aggregate contributions.	Statement from plan administrator. See Employee Compensation, Retirement Plan Contributions in Pub 575, <i>Pensions and Annuity Income</i> .

If the taxpayer claims one of the following exceptions:	Then acceptable verification is:
Payments from a deferred annuity contract to the extent allocable to investment in the deferred annuity contract before August 14, 1982 .	See Publication 575, <i>Pensions and Annuity Income</i> , for more information and accept statement from plan administrator.
Payments from an annuity contract under a qualified personal injury settlement .	See Publication 575, <i>Pensions and Annuity Income</i> , for more information and accept statement from plan administrator.
Payments made under an immediate annuity contract .	See Publication 575, <i>Pensions and Annuity Income</i> , for more information and accept statement from plan administrator.
Payments made under a deferred annuity contract , purchased by the employer upon the termination of a qualified retirement plan, or a qualified annuity that is held by the employer until the participant separates from service.	See Publication 575, <i>Pensions and Annuity Income</i> , for more information and accept statement from plan administrator.
The distribution is due to an IRS levy of a qualified plan or on an IRA under Section 6331 of the Internal Revenue Code	Copy of IRS levy showing account levied.

If the taxpayer claims one of the following exceptions:	Then acceptable verification is:
<p>Rollover – This is a tax-free distribution of assets from one eligible retirement plan that is reinvested in another eligible retirement plan or the same plan. The rollover must be completed within 60 days from the date of receipt of the distribution. The amount rolled over is not subject to either the 10 percent or 25 percent additional tax. See Publication 590-B, <i>Distributions From Individual Retirement Arrangements (IRAs)</i>, for the frozen deposit exception to this rule.</p>	<p>Statement from administrator of the new plan.</p>
<p>Transfer – If the taxpayer instructs the plan trustee to transfer funds directly to another plan, the transferred amount is not taxable or subject to the early distributions tax.</p>	<p>Statement from plan administrator.</p>
<p>Payments from CSRS and FERS made under a phased retirement annuity program.</p>	<p>Statement from plan administrator.</p>
<p>Permissible withdrawal made from an eligible automatic contribution arrangement (EACA)</p>	<p>Statement from plan administrator.</p>
<p>Payments made after August 17, 2006 and before January 1, 2016, from a State or local governmental defined benefit pension plan to a qualified public safety employee who is at least age 50 at the time the public safety employee separates from service.</p>	<ul style="list-style-type: none"> • Use IDRS CC INOLES to verify taxpayer’s age. • Statement from plan administrator verifying that taxpayer is a public safety employee.

If the taxpayer claims one of the following exceptions:	Then acceptable verification is:
<p>Payments made after December 31, 2015, from a governmental plan to a qualified public safety employee who is at least age 50 at the time the public safety employee separates from service.</p>	<ul style="list-style-type: none"> • Use IDRS CC INOLES to verify taxpayer's age. • Statement from plan administrator verifying that taxpayer is a public safety employee.

13. **The following bullets apply to Table B**

- The tax on early distributions does not apply to any part of the distribution that is tax free, such as amounts that represent a **return of the taxpayer's cost or amounts rolled over/transferred (see above)** to another retirement plan.
- To avoid the 25 percent additional tax on an early distribution from a SIMPLE IRA Plan, the distribution must be rolled over/transferred into another SIMPLE IRA Plan.
- Certain Roth IRA distributions are not subject to the 10 percent additional tax, see Instructions for Form 5329, *Additional Taxes on Qualified Plans (Including IRAS) and Other Tax Favored Accounts*, Page 2 and Publication 590-B, *Distributions from Individual Retirement Arrangements (IRAS)*, for more information. Rev. Rul., 2002-62 allows certain taxpayers who began receiving fixed payments from their IRA or retirement plan based on the value of their account at the time they started receiving payments to switch – without penalty – to a method of determining the amount of their periodic payments based on the value of their account as it changes from year to year. If the taxpayer elects to do this, it may result in a lower periodic payment. See Rev. Rul. 2002-62 for more details.
- Rev. Proc., 2003-16 provides guidance for applying to the IRS for a waiver of the 60-day rollover requirement. It also provides for an automatic waiver under certain circumstances. The Procedure is effective for distributions after December 31, 2001. See Rev. Proc., 2003-16 for more information.

- Rev. Proc. 2016-47 provides guidance for waiver of the 60-day rollover requirement from one retirement plan or individual retirement arrangement (IRA) into another plan or IRA by providing a "self-certification procedure" for taxpayers to use in claiming rollover treatment. This revenue procedure is effective on August 24, 2016.

4.19.15.28 (03-11-2019)

Gambling Issues (Income and Losses) - General

1. Taxpayers may deduct gambling losses as itemized deductions on Line 28 of Schedule A. The amount of gambling losses may not exceed the amount of the gambling income reported on Form 1040. Gambling losses cannot be netted against gambling income before the computation of the Adjusted Gross Income on the front of the Form 1040. Each item, income or loss, must be reported on the appropriate line or form.
2. Form W-2G is a reporting requirement for certain gambling winnings. Gambling winnings are not the same as gambling income. A taxpayer recognizes gambling income (or a gambling loss) at the end of the taxpayer's gambling session (for example, when tokens are redeemed).
3. The Initial Contact Letter 566-S will be used to inquire about the income and/or deductions. The Corporate Exam Toll Free telephone number will be used on these letters. Normal suspense periods will be applied to all letters issued.
4. The following table shows examples of documentation taxpayers may provide to support their deduction for gambling losses. This is not an all-inclusive table. For returns with unreported IRPTR gambling winnings, the taxpayer may provide information of gambling losses that offset winnings from gambling income. For example, a taxpayer may show that after receiving the winnings he subsequently continued to gamble and lose the winnings, and ended his gambling session with no gambling income. Use good judgment when evaluating any information the taxpayer provides, including the possible inclusion of additional income.

Note:

Refer to <http://www.irs.gov/pub/irs-utl/am2008011.pdf>, for additional information on the concept of a gambling session, for residents of the U.S. Courts have applied this concept to non-resident aliens as well. See *Park v. Commissioner* (722 F.3d 384, 406 U.S. App. D.C. 123).

Gambling documentation - Examples

Documentation or wagering activity	Information provided
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Documentation or wagering activity	Information provided
Diary of winnings and losses	<p>Date and type of wager or wagering activity</p> <ul style="list-style-type: none"> • Name and address or location of the gambling establishment. • Names of other persons present at the gambling establishment. • Amount(s) won or lost.
Canceled checks, credit records, bank withdrawals; copies of casino credit records, copies of casino check cashing records	Location of the gambling establishment; date of the wager.
Keno	Date the keno tickets were validated by the gambling establishment.
Slot machines	A record of the machine number and all winnings by date and time the machine was played.
Table games (twenty-one, blackjack, craps, poker, baccarat, roulette, wheel of fortune, etc.)	<ul style="list-style-type: none"> • The number of the table at which the taxpayer was playing. • Casino credit data indicating whether the credit was issued in the pit or at the cashier's cage.
Bingo	<ul style="list-style-type: none"> • A record of the number of games played, cost of tickets purchased, and amounts collected on winning tickets. • Supplemental records include any receipts from the casino, parlor, etc.

Documentation or wagering activity	Information provided
Racing (horse, harness, dog, etc.)	<ul style="list-style-type: none"> • A record of the races, amounts of wagers, amounts collected on winning tickets and amounts lost on losing tickets. • Supplemental records include unredeemed tickets and payment records from the racetrack.
Lotteries	<ul style="list-style-type: none"> • A record of ticket purchases, dates, winnings and losses. • Supplemental records include unredeemed tickets, payment slips, and winnings statements.

5. Taxpayers with whom telephone contact is made should be encouraged to respond in writing with all documentation related to their gambling activities.

4.19.15.28.1 (03-14-2016)

Initial Contact for Gambling Income

1. Issue Letter 566-S as the initial contact letter to the taxpayer. Check "Schedule A Itemized Deductions" . Identify the issue by typing "Gambling Losses" . Identify income as an issue if there is unreported income.

4.19.15.28.2 (12-12-2008)

Evaluating Gambling Issue Responses

1. Use the following guidelines when evaluating response to gambling issues.

4.19.15.28.2.1 (01-01-2015)

Gambling Losses – IRC 165(d)

1. Carefully examine all documentation of losses for the year of the loss to ensure the losses are for the year related to the win. Notate the workpapers with the amount of losses and income from the documentation.

2. Receipts provided to support losses may also include gambling income not included on the return. Carefully review all documentation for income as well as losses. Subsequent reports (except for cases where the statutory notice has been issued) must include the income as well as the losses.
3. Examine unredeemed (losing) tickets carefully to ensure that they are for the correct year and that they had not been previously discarded prior to being acquired by the taxpayer.
4. Use sound judgment when considering taxpayer replies. Consider all aspects of the case, including the credibility of the taxpayer, additional burden, and the amount of tax when deciding whether to pursue for more documentation.

4.19.15.28.2.2 (01-01-2015)

Gambling Income

1. Form 5754, *Statement by Person(s) Receiving Gambling Winnings*, is completed by the taxpayer and given to the payer of the gambling winnings to ensure that the Form W-2G issued is correctly prepared when the taxpayer receives gambling winnings on behalf of another person or as a member of a group of winners on the same winning ticket.
 - a. A signature is required on Form 5754 only if federal income tax was withheld from the winnings.
 - b. Form 5754 should not be accepted as proof the income was distributed to other taxpayers. If the amount of disputed winnings exceeds \$500, research the accounts of other taxpayers using Command Code IRPTR to determine if a Form W-2G was issued to that payee. If a Form W-2G was issued, then consider this an acceptable explanation.
 - c. If multiple Form W-2Gs were not issued, correspond with the taxpayer and explain that the gambling income is to be reported by the person to whom the Form W-2G is issued. Advise the taxpayer that a statement from the payer is required in order to accept the Form 5754.
2. Follow normal procedures for evaluating the information the taxpayer provides regarding the unreported gambling income. Make all necessary adjustments to gambling losses and income and issue a report, with the appropriate explanations and a cover letter. Refer to the table below for letter sequencing.

4.19.15.28.2.3 (03-14-2016)

Replies – General Processing

1. Use the following table when processing replies.

Processing Taxpayer Replies to Letter 566-S (CG) and Subsequent Letters

If	And	Then
The taxpayer replies to Letter 566-S, Letter 525, Letter 692 or the 90 day letter with information to support gambling losses	You are able to determine that he is entitled to the entire deduction	Close the case "no change."
The taxpayer replies to Letter 566-S or Letter 525 with information to support gambling losses	You are able to verify that the taxpayer is entitled to part of the amount claimed	Issue Letter 525 or Letter 692 with Form 4549, allowing the partial amount verified and an appropriate explanation.
The taxpayer replies to Letter 566-S or Letter 525 with information to support gambling losses	You are able to determine that the taxpayer is not entitled to any part of the deduction	Issue Letter 525 or Letter 692 with Form 4549 and an appropriate explanation.
The taxpayer replies to Letter 566-S, Letter 525 or Letter 692 with information to support gambling losses	You are able to determine that the Line 28 amount belongs on another line	Issue Letter 525 with Form 4549 and an appropriate explanation.
The taxpayer replies to the 90 day letter with information to support gambling losses	You are able to verify that the taxpayer is entitled to part of the amount claimed	Issue Letter 555 with a revised Form 4549 and an appropriate explanation to the taxpayer.
The taxpayer replies to the 90 day letter with verification of his deduction	You are able to determine that the taxpayer is not entitled to any part of the deduction	Issue Letter 555 with the latest Form 4549.

If	And	Then
The taxpayer replies to the 90 day letter with verification of his deduction	You are able to determine that the Line 28, Schedule A, amount belongs on another line	Issue Letter 555 with a revised Form 4549 and an appropriate explanation to the taxpayer. Do not increase the deficiency as shown on the 90 day letter.

4.19.15.28.2.4 (03-14-2016)**No Response Cases**

1. Take the following action if the taxpayer has not replied to the most recent letter by the normal purge date:

Latest Letter Issued	Action
Letter 566-S	Prepare Letter 525 and Form 4549 disallowing the gambling losses and adding the unreported gambling winnings. Use Standard Explanations #1407 and/or #9412.
Letter 525 or Letter 692 , and the Form 4549 reflects a deficiency	Follow normal procedures to have Statutory Notice issued based on the adjustments shown on Form 4549.
Letter 525 or Letter 692 , and the Form 4549 reflects an overpayment	Close the case DC 08.
90 day letter	Close the case DC 10.

4.19.15.28.3 (01-01-2015)**Special Gambling Closing Procedures**

1. When closing cases consideration must be given to the disposition of receipts to the taxpayers. Receipts will not be returned to the taxpayer as a matter of practice. All verification of losses must be retained with the case file. If the verification is not substantial, for example a statement from a casino, it can be retained in the closed case file. If the documentation would be difficult to file, retain the records in a retrievable method for a period of nine months.

2. Provided the IRS and the Taxpayer agree on the amount of the losses verified on the documentation, there is no reason to retain the receipts. If the taxpayer requests the return of the receipts, contact the taxpayer by telephone to confirm the taxpayer's request. Explain that there is no longer a tax requirement to retain the receipts. If the taxpayer insists, the tickets must be stamped before they are returned.

Note:

When making or receiving phone calls, an IRS employee must follow IRM 21.1.3.2.3, *Required Taxpayer Authentication*, to ensure that he or she is speaking to the appropriate taxpayer and to prevent the unauthorized disclosure of tax information.

3. If the taxpayer does not address the disposition of unredeemed tickets, retain them for a period of nine months after the case closes.

4.19.15.29 (03-11-2019)

Health Coverage Tax Credit – IRC 35

1. **Eligibility:** Health Coverage Tax Credit (HCTC) is a fully refundable credit available to two distinct groups of taxpayers:
 - a. Workers who have been adversely impacted by foreign trade and who are recipients of Trade Adjustment Assistance (TAA), Alternative Trade Adjustment Assistance (ATAA) or Reemployment Trade Adjustment Assistance (RTAA), and
 - b. Pension Benefit Guaranty Corporation (PBGC) pension payees who are at least age 55.
 - c. The term "eligible individual" in this text refers to a person meeting a) or b) above.
 - d. Beginning with May 2009, continued qualification of family members applies for 24 months following certain events; A spouse is **treated** as an eligible individual on finalization of divorce from an eligible individual. (A spouse receiving PBGC pension payments under a qualified domestic relations order (QDRO) **is** an eligible individual if age 55 or older and does not fall under this rule.); A spouse or any person who was a qualifying family member immediately preceding the death of an eligible individual is **treated** as an eligible individual as of the date of death. Refer to IRM 4.19.15.29, **Health Coverage Tax Credit - IRC 35**, paragraph (4), for the definition of **qualifying family members**. (Survivors receiving pension distributions from PBGC **are** eligible individuals if at least age 55; they do not fall under this rule.)
 - e. Tax accounts are coded with TC 971 AC 172 to indicate eligibility for one or more months during the tax year. The transaction displays the TIN of

the eligible individual (primary taxpayer versus secondary taxpayer). The Department of Labor (DOL) and PBGC transmit eligibility files to IRS for systemic coding.

- f. Submission Processing (SP) and Accounts Management (AM) correspond with taxpayers claiming HCTC when accounts do not have eligibility coding (under either TIN if a joint return) and taxpayers did not provide proof of eligibility with U.S. Form 1040, *Individual Income Tax Return*, Form 8453, *U.S. Individual Income Tax Transmittal for an IRS e-file Return*, or Form 1040X, *Amended U.S. Individual Income Tax Return*. Examiners input TC 971 AC 172 when taxpayers respond with eligibility letters from State workforce agencies (SWAs) or PBGC.
2. **Qualifying coverage:** Eligible individuals must be covered by qualifying health care insurance to benefit from HCTC, which includes:
- a. Consolidated Omnibus Budget Reconciliation Act (COBRA) continuation coverage,
 - b. Coverage under an employee benefit plan funded by a Voluntary Employees' Beneficiary Association (VEBA) established as a result of bankruptcy proceedings,
 - c. Group health plans available through the employment of the eligible individual's spouse,
 - d. State-qualified plans (SQPs), and
 - e. Individual health insurance which is defined as insurance for medical care offered to individuals other than in connection with a group health plan and does not include Federal or State-based coverage. For tax years prior to 2014, the eligible individual must have been covered under individual health insurance for the 30-day period ending on the date of separation from the employment which qualified the person for TAA/ATAA/RTAA or PBGC benefits. For tax years after 2015, coverage enrolled in through a Health Insurance Marketplace (Exchange) established under the Affordable Care Act (ACA) is not qualifying individual health insurance.
 - f. Qualifying coverage does **not** include; Flexible spending accounts (FSAs) or similar arrangements; Insurance if substantially all the coverage is for excepted benefits described in IRC section 9832(c), such as dental or vision plans, policies covering only a specified disease or illness, and hospitalization insurance. (The examples are not all-inclusive.)
 - g. Taxpayers are required to attach proof of payment for health care insurance to HCTC claims. SP and AM correspond for missing documentation.

3. **Other Specified Coverage:** Eligible individuals must not have other specified coverage, defined as:
 - a. Subsidized coverage; Coverage under a health plan maintained by a current or former employer of the taxpayer or taxpayer's spouse if the employer pays or incurs at least 50% of the cost of the coverage; For ATAA and RTAA recipients only, eligibility for coverage meeting IRM 4.19.15.29, paragraph (3)(a)(1) above, or enrollment in coverage under an employer-sponsored health plan if the employer pays any of the premiums; Coverage in lieu of a right to receive cash or other benefits under a cafeteria plan as described in IRC section 125(d)
 - b. Coverage under Medicare (entitlement under Part A, which generally occurs at age 65, or enrollment under Part B or Part C), Medicaid or the State Children's Health Insurance Program (SCHIP or CHIP), and
 - c. Coverage under the Federal Employees Health Benefits Program (FEHBP) or entitlement to coverage under the U.S. military's TRICARE program (formerly CHAMPUS).
4. **Qualifying Family Members:** If an eligible individual has qualifying coverage and does not have other specified coverage (refer to the exception in (c) below), the taxpayer may also claim HCTC for qualifying coverage of qualifying family members (QFMs).
 - a. A "qualifying family member" is a person who does not have other specified coverage and; Is the eligible individual's spouse **or**; Is claimed as a dependent on the tax return **unless** the taxpayer is the dependent's non-custodial parent **or**; Could be claimed as a dependent except the taxpayer is the custodial parent who released the right to claim the exemption to the non-custodial parent under the special support test for divorced or separated parents.
 - b. If spouses filing separate returns are both eligible individuals during the year, neither will be treated as a qualifying family member.
 - c. If HCTC would be allowed for qualifying coverage of the eligible individual but for Medicare coverage (entitlement under Part A or enrollment under Part B or Part C), the taxpayer may continue to claim HCTC for qualifying coverage of qualifying family members for the first 24 months after the recipient of PBGC or TAA/ATAA/RTAA benefits became covered by Medicare.
 - d. If a qualifying family member is treated as an eligible individual under the terms described in IRM 4.19.15.29, *Health Coverage Tax Credit – IRC 35*, paragraph (1)(d), then that person's qualifying family members are limited to those individuals who were qualifying family members immediately preceding the event that conferred provisional eligibility.

5. **Other Rules:** Additional considerations apply with respect to HCTC.
- a. HCTC is not allowed if the eligible individual; Was imprisoned under Federal, State or local authority **or**; Could be claimed as a dependent on another taxpayer's return.
 - b. Persons receiving COBRA premium assistance under the American Recovery and Reinvestment Act of 2009 are not treated as eligible individuals or qualifying family members.
 - c. Premiums claimed for HCTC may not be used in determining medical and dental expenses on Schedule A or a self-employed health insurance deduction (SEHID).
6. **HCTC Claims:** HCTC is determined on a month-by-month basis and is computed on Form 8885, *Health Coverage Tax Credit*
- a. As of March 2011, HCTC is equal to 72.5 percent of the premiums paid by an eligible individual for qualifying health insurance covering that person and qualifying family members **after** reduction by any distributions from an Archer Medical Savings Account (MSA) or Health Savings Account (HSA). (The credit was 65% from December 2002 through April 2009 and 80% from May 2009 through February 2011.)
 - b. December 2002 was the first month that HCTC became available with enactment of the Trade Adjustment Assistance Reform Act. Subsequent legislation modified and extended HCTC to December 2013. The Trade Preferences Extension Act of 2015 reinstated the credit, made it retroactive to tax years 2014 and 2015 and extended HCTC through 2019.
 - c. To claim HCTC for tax year 2014, taxpayers must file an amended return with Form 8885 due to the timing of legislation.
 - d. Beginning with tax year 2014, taxpayers must make an irrevocable election to claim HCTC. Generally, the election must be made by the due date (including extensions) for the return. Refer to tax year 2014 - 2016 claims <https://www.irs.gov/pub/irs-irbs/irb17-07.pdf>
 - e. Once HCTC is elected, the Premium Tax Credit (PTC) may not be claimed for the same coverage for that month or any subsequent months that the taxpayer is HCTC eligible for the TY.
 - 1- Taxpayers who previously claimed PTC or who received the benefit of advance PTC (APTC), must file Form 8962, *Premium Tax Credit (PTC)*. No PTC should be claimed for Marketplace coverage subject to the HCTC election. All APTC should still be reported on Form 8962, even for months subject to the HCTC election.
 - 2- The APTC repayment limitation on form 8962, line 28, may not apply when a taxpayer elects the HCTC for marketplace coverage..

7. **Advance (Monthly) HCTC - IRC 7527:** Advanced payments of HCTC became available for the first time in 2003.
- a. The HCTC Processing Center forwarded payment of 100 percent of the cost of health insurance coverage for a person enrolled in the advance monthly payment option directly to the insurance provider or third party administrator (TPA). The Center issued invoices to collect the taxpayer's portion. Refer to IRM 4.19.15.29, **Health Coverage Tax Credit - IRC 35**, paragraph (6)(a), for the percentage of premiums paid by Department of Treasury.
 - b. Advance HCTC was not available for tax years 2014 and 2015 due to the timing of extension legislation. It was reinstated on a limited basis in July of 2016 with the assistance of certain TPAs. Advance monthly HCTC has been available to all qualified applicants since January 1, 2017. Participants will not receive monthly invoices but will remit premium monthly payments with coupons available at www.irs.gov/hctc.
 - c. Advance monthly HCTC is posted to the tax account of the enrolled participant with TC 971 AC 171. The amount received from the taxpayer for the remaining portion of the premiums is recorded with TC 971 AC 170.
 - d. Advance monthly HCTC payments are reported to the taxpayer on Form 1099-H, *Health Coverage Tax Credit (HCTC) Advance Payments*.
8. **Resources:** For more information about HCTC, refer to Publication 502, *Medical and Dental Expenses (Including the Health Coverage Tax Credit)*, the instruction for Form 8885, Health , **Health Coverage Tax Credit**, Notices 2005-50 and 2016-02, and <http://www.irs.gov/hctc>.

4.19.15.29.1 (03-11-2019)

HCTC Case Selection & Classification

1. Procedures for HCTC audits are dependent on whether the credit has been posted to the taxpayer's account and the case selection method.
2. Returns are categorized as "**processed claims**" if HCTC is posted to the account. TXMOD of a processed claim should include TC 766 with CRN 250 in an amount equal to the HCTC claimed on Form 8885. (Processing errors can occur. Examples of improper HCTC adjustments include TC 291, TC 806 and TC 766 with CRN 336.) Processed claims are generally selected based on criteria established by W&I RICS Exam HQ.
3. For processing year 2016, processed claims for HCTC will be referred for examination using unallowable programming.

- a. SP will post Unallowable (UA) code 89 to a return when one or more of the following conditions exist; There is no TC 971 AC 172, and the taxpayer did not respond to an error notice with proof of eligibility; The taxpayer did not provide proof of payment for health insurance, **and/or** the taxpayer claimed HCTC and Premium Tax Credit (PTC) for the same month(s).
 - b. Refunds are frozen up to the amount of HCTC claimed with TC 576.
 - c. Cases are created systemically in source code (SC) 03 and project code (PC) 0505.
 - d. Manual classification prior to initial contact is required. Change the source code to 20 when additional audit issues are identified. Do not change the project code.
 - e. General UA procedures in IRM 4.19.15.15, *Unallowable Code (UA) Program*, apply except where contradictory with the above.
4. Beginning with filing season 2017, Dependent Database (DDb) filters will be used to identify processed claims for potential audit of HCTC. (Exception: Returns meeting the criteria in 4.19.15.29.1(3)(a)(3) will continue to be coded with UA 89).
- a. Returns selected via DDb filters will open in SC 06, PC 0505.
 - b. Taxpayers who receive advance monthly HCTC may erroneously claim the same coverage for the same months on Form 8885, **Health Coverage Tax Credit**, resulting in a duplicated or partially duplicated credit. = = =
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Tracking code 7560 is used for this compliance strategy.
 - c. Additional compliance strategies not involving advance monthly HCTC may include the use of tracking code 7559.
5. Returns are worked as " **unprocessed claims**" if HCTC is not posted to the account. Amended returns with increases to HCTC are CIS imaged and routed by AM to Exam classifiers if criteria per IRM 21.5.3-3, *Examination Criteria (CAT-A) - Credits*, is met. (For additional information refer to IRM 21.6.3.4.2.9.1, *Eligibility Requirements / Claim Processing*.)
- a. Open AIMS with SC 30 and PC 0505 when an amended return is referred and selected for HCTC.
 - b. General claims procedures in IRM 4.19.16, *Claims*, apply.

- 6. For processed and unprocessed claims not selected as described above, update AIMS and CEAS/RGS with tracking code 7561 when the scope of an audit is expanded to include HCTC.
- 7. When classifying HCTC claims, pay particular attention to related issues on the return or reflected on the tax account, including PTC/APTC, Schedule A medical and dental expenses, a SEHID, and deductions for an Archer MSA and HSA. For more information about related medical issues, refer to:
 - a. Pub 974, *Premium Tax Credit (PTC)*,
 - b. IRM 4.19.15.42, *Premium Tax Credit - IRC 36B*,
 - c. Pub 502, *Medical and Dental Expenses (Including the Health Coverage Tax Credit)*,
 - d. IRM 4.19.15.20, *Schedule A*,
 - e. Pub 535, *Business Expenses*,
 - f. IRM 4.19.15.30, *Self-Employed Health Insurance Deduction - IRC 162(l)*, and
 - g. Pub 969, *Health Savings Account and Other Tax-Favored Health Plans*.
- 8. Examiners must obtain managerial approval in the form of a non-action CEAS note prior to pursuing any large, unusual or questionable items (LUQs) not previously classified on a return.

4.19.15.29.2 (03-11-2019)

Research for HCTC Cases

- 1. Complete research is required when technical employees, other than examiners resolving ACE reject conditions, must take actions to prepare letters and/or review responses. Follow general procedures in IRM 4.19.13.4, *Researching Cases*, including documenting workpapers for research performed and pertinent information found.
- 2. =====
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- 3. Review MeF returns via EUP. Taxpayers may attach PDF files with supporting records. Note the entries on Form 8885, including the months checked.
- 4. Access CIS for documents received by AM. Consider a Form 8885 and any related records.
- 5. In IDRS, research the taxpayer’s TIN, including a spouse’s if applicable, for:

- a. HCTC adjustments (TC 766/767 CRN 250),
- b. HCTC eligibility indicator(s) (TC 971 AC 172),
- c. Coding for advance monthly HCTC (TC 971 AC 170/171),
- d. Age of the taxpayer(s) and qualifying family members,
- e. PBGC-based eligibility per Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*, " " ,
- f. Health insurance coverage and/or premium payment information per: Form 1095-A, *Health Insurance Marketplace Statement*; Form 1095-B, *Health Coverage*; Form 1095-C, *Employer-Provided Health Insurance Offer and Coverage*; Form 1099-H, *Health Coverage Tax Credit (HCTC) Advance Payments*; Form 1099-SA, *Distributions From an HSA, Archer MSA, or Medicare Advantage MSA*, **and/or** Form W-2, *Wage and Tax Statement*.

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4.19.15.29.3 (03-11-2019)

Initial Contact & No Response Procedures

1. Unprocessed Claims - Source Code 30

- a. Send Letter 566-D for initial taxpayer contact.
- b. Include Form 14749, *Health Coverage Tax Credit - Verification of Eligibility and Qualifying Insurance*, to request information the taxpayer could provide to verify HCTC claimed and any Forms 886 applicable for HCTC or other classified issues.
- c. Update to Status 10 and suspend the case for 45 days.
- d. Follow IRM 4.19.16.2.4.1, *Claims Contact Procedures*, if the taxpayer does not respond to Letter 566-D and IRM 4.19.16.2.4.2, *Claims Contact Responses*, if there is no reply to subsequent letters.

2. Processed Claims - Source Codes 03, 06 and 20

- a. Disallow HCTC on Form 4549, *Income Tax Examination Changes*, and send with Letter 525 for initial contact.
- b. If there are error codes for the Premium Tax Credit (PTC) on the return, include the appropriate adjustments to the PTC and the Advance PTC repayment on Form 4549. Refer to IRM 4.19.15.42.6, *Creating the PTC Issue(s)*, for error code specific instructions.
- c. Include any Forms 886 applicable for HCTC or other classified issues and; Form 14749, *Health Coverage Tax Credit - Verification of Eligibility and Qualifying Insurance*, if TC 971 AC 172 is not present **or**, Form 14749-A, *Health Coverage Tax Credit - Verification of Qualifying Insurance*, when an eligibility indicator is posted.

Note:

When reviewing accounts for eligibility indicators, ensure TC 971 AC 172 has not been reversed by TC 972 AC 172.

- d. For source codes 03 and 20, follow the additional procedure in IRM 4.19.15.15.5, *Processing Reply/NoReply Unallowable Cases*.
 - e. Update to Status 22 and suspend the case for 45 days.
 - f. Follow the instructions in IRM 4.19.13.12, *No Response and Unagreed Cases*, and IRM 4.19.10.1.5.2, *Standard Suspense Periods for Correspondence Examination*, if the taxpayer does not reply to the initial contact or subsequent letters.
3. **Closures:** Refer to IRM 4.19.15.29.5, *Case Closure*, when a closure is appropriate after no response from the taxpayer. It details specific actions needed for HCTC and provides references for general closing procedures.

4.19.15.29.4 (03-11-2019)

HCTC Responses

1. **General Guidelines:** Follow the steps in the table below to process replies (not all-inclusive).

If	Then
TC 971 AC 172 is not present and the taxpayer did not establish eligibility,	Do not allow HCTC. (Refer to IRM 4.19.15.29(1) for the definition of eligibility. Always ensure a TC 971 AC 172 is not reversed by TC 972 AC 172.)

If	Then
TC 971 AC 172 is not present and the taxpayer established eligibility for one or more months during the tax year,	Update TXMOD for the return with TC 971 AC 172. Include the TIN of the eligible individual. (For TAA/ATAA/RTAA, do not accept an application or enrollment form in lieu of an eligibility letter from an SWA dated after the eligible months for the year.)
The individual was a PBGC recipient under age 55 as of the first day of the month,	Do not allow premiums paid for anyone's coverage for that month in the HCTC computation. (Age 55 does not apply for a person treated as an eligible individual under the terms in IRM 4.19.15.29(1)(d).)
The eligible individual or spouse treated as an eligible individual due to divorce did not have qualifying coverage as of the first day of the month,	Do not allow premiums claimed for anyone's coverage for that month in the HCTC computation.
The eligible individual or spouse treated as an eligible individual due to divorce had other specified coverage as of the first day of the month,	Do not allow premiums claimed for anyone's coverage for that month in the HCTC computation. (Refer to the Medicare exception in IRM 4.19.15.29(4)(c), which conditionally allows HCTC for coverage of qualifying family members.)
An otherwise qualifying family member, including one treated as an eligible individual due to death, had other specified coverage as of the first day of the month,	Do not allow premiums claimed for coverage of the family member for that month in the computation of HCTC.

If	Then
A qualifying family member, including one treated as an eligible individual due to death, did not have qualifying coverage as of the first day of the month,	Do not allow premiums paid to cover the family member for that month in the HCTC computation.
The taxpayer is the non-custodial parent of a dependent on the return,	Do not allow premiums covering the child of divorced or separated parents in the computation of HCTC for any month.
Health insurance premiums were paid to cover a family member (other than a spouse on the return) who was not claimed as a dependent,	Do not allow premiums paid for the family member's coverage in the computation of HCTC <i>unless</i> the taxpayer is the custodial parent who unconditionally released the right to claim the exemption to the non-custodial parent with Form 8332, <i>Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent</i> , or a divorce decree executed before 2009.
A distribution from an HSA or Archer MSA reported on Form 1099-SA, <i>Distributions From an HSA, Archer MSA, or Medicare Advantage MSA</i> , was not included on Form 8885	Subtract the distribution from allowable premiums and recompute the HCTC.
The eligible individual or qualifying family member received COBRA premium assistance under ARRA 2009 as of the first day of the month,	Do not allow premiums paid for any health insurance covering that person for the same month in the HCTC computation. (A 65% subsidy was available to eligible workers who lost their jobs between Sept. 1, 2008, and May 31, 2010, for COBRA continuation premiums for themselves and their families for up to 15 months.)

If	Then
The taxpayer submits cancelled checks remitted to "U.S. Treasury - HCTC" and/or Form 1099-H to support premium payments on Form 8885,	Do not allow the payments for an end-of-year credit. Inform the taxpayer that the maximum monthly HCTC was allowed for the coverage associated with the advance payment program.
The taxpayer requests a case transfer or meeting with an Appeals Officer,	Follow relevant procedures in IRM 4.19.13.14, <i>Transfers to Area Office Examination or Appeals Office</i> .
The taxpayer states that supporting records for HCTC were attached to Form 1040 or 8453 or were provided in response to an error notice,	Inform the taxpayer that the information is not readily available and an attempt to obtain it would significantly delay resolution of the audit.
Verified payments for health insurance premiums are not allowable for HCTC but qualify as a Schedule A, Self-employed Health Insurance, HSA, or Archer MSA deduction,	Advise the taxpayer to file an amended return to claim the disallowed premiums as a deduction from income unless a double tax benefit was previously claimed.
HCTC is not allowable, but the taxpayer qualifies for PTC not currently on the tax account,	Allow PTC if the taxpayer previously claimed PTC/APTC and repaid it solely to claim HCTC. Otherwise, advise the taxpayer to file an amended return to claim PTC for the disallowed premiums.

If	Then
For TYs 2014 thru 2017, HCTC is allowable, but the taxpayer claimed PTC based on the same Marketplace coverage,	Disallow PTC claimed for any Marketplace coverage subject to the HCTC election starting with the first month for which the taxpayer elected to claim the HCTC: <ul style="list-style-type: none"> a. Determine the total amount of PTC for which the taxpayer is eligible and create an issue for Total PTC net credit adjustment to reduce the total PTC claimed on the return. b. Subtract the recomputed total PTC from the total Advance PTC received and create an Advance PTC repayment net tax adjustment if the result is a positive amount. Reduce the adjustment by any Advance PTC repayment already reported on the return.
HCTC and other classified issues are fully substantiated,	Allow all issues and close the case. (Math verify Form 8885.)

2. **Eligibility:** Taxpayers may check too many months on Form 8885 when eligibility was for less than the full tax year. Do not allow premiums claimed for any month if, as of the first day of the month, the eligibility requirement was not met.
 - a. Taxpayers whose returns were selected for audit because eligibility indicator TC 971 AC 172 was not present must verify eligibility for all months claimed. Generally, an eligibility letter from an SWA or PBGC is required. If HCTC is claimed based on the special rules in IRM 4.19.15.29(1)(d), the taxpayer may need to establish the date of the qualifying event and eligibility of the original recipient of TAA/ATAA/RTAA benefits or PBGC pension payments at that time.
 - b. The eligibility months may be determined through internal means when an eligibility indicator is present, such as = = = = = and eligibility letters available in EUP or CIS. If the eligibility months cannot be determined and it appears the taxpayer may otherwise qualify for HCTC, correspond for an eligibility letter.
 - c. Pensions are generally paid to retirees for life. If PBGC issued a Form 1099-R for the tax year prior to the one under audit and the payee taxpayer is the retired employee who was at least age 55 at the start of

the AIMS year, then the taxpayer was an eligible individual for the full year under audit or until the date of death, if applicable. (Retirees can be eligible individuals by virtue of PBGC pension payments and not receive distributions during the tax year. If the retiree elects a lump sum payment, PBGC should continue to transmit eligibility data until the person reaches age 65.)

d. Similar logic cannot determine TAA/ATAA/RTAA-based eligibility months. The maximum duration of assistance to affected workers varies between 104 and 156 weeks. Benefits may be terminated for lack of program participation, such as attendance for mandatory training, and then subsequently reinstated if the workers reapply. Participants may cease to qualify for assistance due to significant reemployment. (There is an additional grace month for HCTC eligibility after TAA/ATAA/RTAA benefits expire. SWAs include the grace month on HCTC eligibility letters.)

3. **Qualifying Coverage:** IRC § 35 identifies some types of coverage as non-qualifying for HCTC. However, any coverage not specified in IRC § 35 as qualifying is not qualifying. Refer to IRM 4.19.15.29, *Health Coverage Tax Credit – IRC § 35*, paragraph (2), for the complete list of qualifying coverage.

a. Group health plans available through the eligible individual’s current employer are not listed coverage and are generally not qualifying for HCTC. If the premiums claimed were for a group plan and the eligible individual was the primary insured, verify that the coverage was COBRA continuation, VEBA-funded due to bankruptcy or an SQP.

b. VEBAs may fund group coverage for retirees when the employer cannot meet COBRA continuation coverage requirements due to bankruptcy. When VEBAs fund individual health insurance, SQPs or work-related group plans with the spouse as the primary insured, bankruptcy is not a consideration because those coverage types are qualifying in their own right.

c. There are several types of coverage that a State may elect to designate as qualifying for HCTC, including some employee and retiree group plans. = = = = =
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d. FSAs and similar arrangements are listed as non-qualifying coverage. Employee contributions to FSAs are made via pretax payroll deductions.

e. The tax treatment of employee health benefits may be determined by comparing the deductions on the employee’s final leave and earnings statement for the year to the difference between the gross wages on the pay statement and taxable wages in box 1 of Form W-2.

- f. The Office of Chief Counsel has advised that pretax treatment for employee contributions for health care insurance is an arrangement similar to flexible spending (if not actually an FSA) and is therefore not qualifying for HCTC.
4. **Other Specified Coverage:** Review IRM 4.19.15.29, *Health Coverage Tax Credit – IRC 35*, paragraph (3), for details about other specified coverage and the consequence for HCTC.
 - a. Employers are more likely to pay at least 50% of the health insurance costs of a current employee than a former one. The percentage of the amount of premiums paid by the employer may be determined from Form W-2. Employer contributions are identified with code DD in Box 12. The employee's cost of coverage (including dental, vision, and FSC payments) should be itemized in box 14.
 - b. If IRC §125 is indicated, verify that the employee's payroll deductions were taxed. If not taxed, the plan meets the condition for other specified coverage. Refer to (3)(b)(1) above to determine the tax treatment.
5. **Qualifying Family Members:** Occasionally, examiners must determine the premiums paid for coverage of a nonqualifying family member or beneficiary when one policy covers multiple persons. Counsel provided guidance for the allocation in IRS Notice 2005-50. If the shared policy was enrolled in through a Marketplace, use the guidance in Notice 2016-02 instead.
6. **Workpapers:** Follow the general procedures in IRM 4.19.13.6, *Workpapers for All Cases*, when documenting taxpayer responses. Notate any information still needed and record details about supporting records received, such as:
 - a. The name of the eligible individual, the eligibility type, the eligibility months, and
 - b. The type of coverage, the primary insured and other covered individuals, the dates of coverage, the covered benefits, the employer and/or TPA associated with a group plan, the group name and number if applicable, the insurance provider, the policy number, the cost of premiums by month, and the payment method.
7. **Unprocessed Claims:** Consult IRM 4.19.16.2.4.1, *Claims Contact Procedures*, and IRM 4.19.16.2.4.2, *Claims Contact Responses*, for the letters and forms to send the taxpayer when considering responses for unprocessed claims.
8. **Processed Claims:** Refer to IRM 4.19.13.10.1, *Taxpayer Responses - Additional Information Needed*, for the actions to take when all audit issues of a processed claim are not resolved.

9. **Closures:** Refer to the next section, IRM 4.19.15.29.5, when a closure is appropriate after considering a response. It details specific actions needed for HCTC and provides references for general closing procedures, including those pertaining to agreed cases.

4.19.15.29.5 (01-01-2017)

Case Closure

1. **Unprocessed Claims:** Use the instructions in IRM 4.19.16.2.4, *Claims Processing in Examination Operation*, and IRM 4.19.16.2.4.2, *Claims Contact Responses*, when closing unprocessed claims if:

- a. Allowing HCTC, use Credit Reference Number (CRN) 250 with the allowable amount in Block 15 of Form 5344. Send Letter 570 to the taxpayer.
- b. Disallowing HCTC, and the taxpayer has not waived notification of claim disallowance, provide a detailed explanation on Letter 105C for a full disallowance or Letter 106C for a partial one.

Note:

When assessing additional tax to deny the HCTC, whether pre-refund or post-refund, deficiency procedures (including letter 3219) must be used.

2. **Processed Claims:** Follow procedures in IRM 4.19.13.28, *Campus Exam Closing Actions*, for processed claims. Also, follow the applicable steps below:

If	And	Then
Allowing any HCTC	TXMOD does not include an unreversed TC 971 AC 172,	<ul style="list-style-type: none"> • Input TC 971 AC 172 with the TIN of the eligible individual unless eligibility coding is AP or PN. • Input "1" in Block 43 of Form 5344 for a posting delay of one cycle to avoid an unpostable condition.

If	And	Then
Allowing all HCTC	Form 5344 does not include changes to tax, income, or other credits,	<ul style="list-style-type: none"> • Use DC 02 in Block 13 of Form 5344. • Input "no change" Issue Code 61065 in Block 41.
Disallowing some portion of HCTC	TC 766 for HCTC does not include a CRN,	Input CRN 767 with the disallowed amount and a minus sign (-) in Block 15 of Form 5344..
Disallowing some portion of HCTC	TC 766 includes CRN 250,	Input CRN 250 with the disallowed amount and a minus sign (-) in Block 15 of Form 5344.
Disallowing some portion of HCTC	HCTC is posted to the account in any other manner (see above),	<ul style="list-style-type: none"> • Consult the work leader for the appropriate reversal code. • Use Hold Code 3 in Block 7 of Form 5344 to prevent a notice.
Disallowing some portion of HCTC	A refund is frozen with TC 576 and the taxpayer did not agree to waive statutory notification of claim disallowance,	Issue Letter 105C. Refer to <i>IRM 4.19.15.15.5, Processing Reply/No Reply Unallowable Cases</i> , for more information.

4.19.15.30 (12-01-2017)

Self-Employed Health Insurance Deduction – IRC 162(l)

1. A taxpayer may be able to deduct part or all of the amount paid for health insurance, if the taxpayer is one of the following:
 - A self-employed individual and has a net profit for the tax year from a Schedule C, *Profit or Loss From Business (Sole Proprietorship)* Schedule C-EZ, *Net Profit From Business (Sole Proprietorship)* or Schedule F, *Profit or Loss From Farming*

- A shareholder owning more than two percent of the outstanding stock of an S Corporation (or is considered as owning more than two percent by reason of the attribution rules under IRC 318) with wages reported on Form W-2; or
- A partner with net earnings from self-employment reported on Line 14a of Form 1065, **U.S. Return of Partnership Income**).

Note:

A self-employed individual's deduction of health insurance for income tax purposes does not reduce his net earnings from self employment. (See Section 162(l)(4))

2. Taxpayer may be eligible for a section 162(l) deduction and the Premium Tax Credit (PTC) in the same taxable year. Under section 280C(g) of the Internal Revenue Code, a section 162(l) deduction is not allowed for premium paid by the PTC. However, a taxpayer must know the section 162(l) deduction to compute the PTC and the PTC to compute the sections 162(l) deduction. See Publication 974 and Rev. Proc. 2014-41 for more information on how taxpayers in this situation compute their section 162(l) deduction and PTC.
3. The section 318 attribution rules include four situations that result in a shareholder's stock in an S corporation being constructively owned by another person:
 - a. An individual will be considered to own the S corporation stock owned by their spouse (other than a spouse who is legally separated from the individual under a decree of divorce or separate maintenance), children (including legally adopted children), grandchildren and parents;
 - b. A beneficiary or owner of a trust (described in section 1361(c)(2)) will be considered to own the S corporation stock owned by the trust;
 - c. A beneficiary of an estate will be considered to own the S corporation stock owned by the estate; or
 - d. A person with an option to acquire S corporation stock will be considered to own the stock in which they hold the option.
4. A self-employed individual or employee-shareholder may claim 100 percent of the amount paid as an adjustment to income.
5. In calculating the deductible amount, taxpayers should use the Self-Employed Health Insurance Worksheet in the Instructions for Form 1040 which indicates the deduction is the lesser of
 - a. the amount paid for health insurance coverage, or

- b. net profit or earned income from the business under which the insurance plan is established, minus any deductions claimed on the Form 1040 for one-half of the Self-employment Tax and any contributions to Self-Employed SEP, SIMPLE, and Qualified Plans.
6. Taxpayers may receive a Form 1099-MISC, *Miscellaneous Income*, for self-employed income. Generally, the taxpayer prepares a Schedule C to report this income; however, it may also appear on the "Other Income" line. Ensure the taxpayer has reduced this income by any expenses applicable to the earning of this income to arrive at net income. Taxpayers who are in business as a self-employed writer, inventor, artist, etc., should report their income on Schedule C, and apply appropriate expenses to obtain net income.
7. Constructive ownership of stock under IRC 318 applies to taxpayer's spouse, his children, grandchildren and parents.
8. For purposes of the deduction, a two-percent-plus shareholder's wages from the S Corporation are treated as the shareholder's earned income. No deduction is allowed in excess of an individual's earned income derived from the trade or business with respect to which the plan providing the health insurance coverage is established.
9. For employee-shareholders, the health insurance premiums must be paid in the current year by the corporation and included in the wages (generally shown in Box 14 of the Form W-2) of the employee-shareholder. The amount may include payments for insurance covering the taxpayer, his/her spouse, and dependents. If the premiums were not included in the employee-shareholder's wages (in Box 1 of the Form W-2), the employee-shareholder may not deduct them.
10. The taxpayer may not claim the Health Coverage Tax Credit (for which additional qualifications apply) for the same expenses the taxpayer claimed for the Health Insurance Deduction.
11. A taxpayer may not take this deduction if the taxpayer participated, or is eligible to participate in any subsidized health plan maintained by his/her or spouse's employer.

4.19.15.30.1 (03-11-2019)

Self-Employed Health Insurance Deduction

1. Cases are worked to determine if taxpayers are:
 - a. Erroneously claiming health insurance payments in excess of earned income or net profits of the business,

- b. Erroneously claiming health insurance payments because they are unable to itemize, or
 - c. Claiming the deduction when they have no self-employment or earned income.
2. Procedures are as follows:
- a. The Initial Contact Letter 566-S will be used to inquire about the income and/or deductions.
 - b. The Corporate Exam Toll Free telephone number will be used on these letters.
 - c. Normal suspense periods will be applied to all letters issued.

4.19.15.30.2 (03-14-2016)

Initial Contact Letter

1. The following table shows the initial contact letter to be sent to the taxpayer:

Rule(s) Broken	Letter to Issue	Amount to Disallow
914: Taxpayer claiming self-employed health insurance deduction with no apparent self-employment income.	Letter 566-S with the appropriate box checked	None

4.19.15.30.3 (11-29-2011)

Evaluating Responses

1. Use the following guidelines when evaluating responses to Self-Employed Health Insurance Deduction:
- Carefully examine all documentation to determine if all or some of the amounts were paid for qualifying insurance. If the taxpayer was eligible to participate in the spouse's or the employer's subsidized health plan he **cannot** deduct premiums for any month in which he was eligible.
 - Determine if taxpayer had sufficient earned income for the claimed self-employed health insurance deduction. (Note: The deduction is limited to the profit from the business.) Review Form 1099-MISC or other documentation to ensure the taxpayer was self-employed. If the income is unreported, include additional income in the report and compute self-employment tax, if appropriate.

- If taxpayer indicates income is from an S Corporation, review Schedule K-1, **Partner's Share of Income, Deductions, Credits, etc.** and/or other documentation (i.e., Form W-2) to establish they received and reported wages from an S Corporation in which they were more than a two percent shareholder.
 - If IDRS information is used to link a taxpayer to a corporation, examiners may use judgment in accepting the taxpayer's statement as verification that he/she has more than two percent ownership. (The basis for the examiner's judgement must be fully documented on the workpapers.)
 - Ensure the taxpayer has reduced his earned income by any deduction he claimed for One-Half of Self-Employment Tax and a deduction he claimed for Self-Employed SEP, SIMPLE, and Qualified Plans (when applying lesser of earned income reduced by these deductions and amount paid).
 - If the taxpayer does not have a Form W-2 from a Subchapter S Corporation, a quick way to determine if the taxpayer is self-employed may be to review the taxpayer's Schedule SE, *Self-Employment Tax*. The amount of income on which he paid SE tax can be used as the amount of income from net self-employment income.
 - Responses involving the concept of material participation generally relate to the allowance of a loss rather than income and are unlikely to be applicable here.
 - Since our taxpayers are "cash basis" taxpayers, all deductible expenses must be incurred by them in the current year. Income must be distributed to them and/or reported by them when earned.
2. If the taxpayer filed a joint return, conduct research to determine if both spouses received earned income during the year in question. If both spouses received earned income, request a statement from the taxpayers' employers. The statement(s) must indicate:
- a. If the spouses were eligible to participate in the companies' subsidized health plan(s), and
 - b. The number of months (if any) that the spouses were eligible to participate in the plan.

4.19.15.30.4 (12-12-2008)

Potential Documentation

1. Request a copy of the health insurance policy indicating the payment was made for qualifying individuals, i.e., the taxpayer, spouse, or dependents.

2. If the insurance premiums were paid by the corporation, verify premiums were included in the taxpayer's wages from the corporation (most generally will appear on Form W-2).
3. If premiums were paid by the taxpayer, request cancelled checks, receipts, payroll deductions, etc., to support the deduction.
4. The Schedule K-1, **partner's Share of Income, Deductions, Credits, etc.** and/or BMFOL or BMFOLT for the S Corporation may be used to establish the taxpayer is linked to that corporation. Copies of the articles of incorporation, stock certificates or similar documentation may be used to establish whether the taxpayer is a more-than-two percent-shareholder. If the taxpayer indicates he qualifies by reason of attribution rules, ask the taxpayer about his relationship to the shareholder. Common sense may be applied in this area since small corporations often do not have all the formal trappings of a publicly held corporation. A taxpayer's statement may be sufficient to establish this fact if other issues have been satisfactorily resolved.
5. If the taxpayers are claiming payments for long-term care insurance, request birth certificates if the taxpayer's age can not be determined from IDRS. See Publication 535, *Business Expense*, to determine the aged-based limitations.
6. If the taxpayer paid the expenses to the insurance company, cancelled checks, documentation to show payroll deduction, etc., should be adequate to support the deduction.

4.19.15.30.5 (03-11-2019)

Resources To Assist In Technical Determination

1. Useful tools:
 - Publication 502, *Medical and Dental Expenses, Including the Health Coverage Tax Credit*.
 - Publication 535, *Business Expenses*.
 - IRC 162(l), IRC 1372, IRC 401, IRC 38B and IRC 318.
 - If payment is for long-term care insurance, see limitations in Chapter 7 of Publication 535.
 - Instructions for Form 1040, U.S. Individual Income Tax Return – includes a Self-employed Health Insurance Deduction Worksheet which the taxpayer should prepare to determine any limit to his deduction.

4.19.15.30.6 (03-14-2016)

Replies – General Processing

1. Use procedures in the following table when processing replies.

Processing Taxpayer Replies to Letter 566-S and Subsequent Letters

If	And	Then
The taxpayer replies to Letter 566-S, Letter 525, Letter 692 or the 90 day letter with information to support the deduction	You are able to determine that the taxpayer is entitled to the entire deduction	Close the case "no change" .
The taxpayer replies to Letter 566-S or Letter 525 with information to support the deduction	You are able to verify that the taxpayer is entitled to part of the deduction claimed	Issue Letter 525 or Letter 692 with Form 4549 and an appropriate explanation.
The taxpayer replies to Letter 566-S or Letter 525 with information to support the deduction	You are able to determine that the taxpayer is not entitled to any part of the deduction	Issue Letter 525 or Letter 692 with Form 4549 and an appropriate explanation.
The taxpayer replies to Letter 566-S, Letter 525 or Letter 692 with information to support deduction	You are able to determine that the amount belongs on another line	Issue Letter 525 with Form 4549 and an appropriate explanation.
The taxpayer replies to Letter 566-S, Letter 525 or Letter 692 with information	Time frame has expired and information indicates that taxpayer is not entitled or not eligible	Prepare Form 886-A addressing correspondence received and explain disallowance. Send Form 886-A with Form 4549 based on Local Procedures to have 90 day manual letter issued with the Form 886-A and Form 4549.

If	And	Then
The taxpayer replies to the 90 day letter with information to support deduction	You are able to verify that the taxpayer is entitled to part of the deduction claimed	Issue Letter 555 with a revised Form 4549 and an appropriate explanation to the taxpayer.
The taxpayer replies to the 90 day letter with verification of his deduction	You are able to determine that the taxpayer is not entitled to any part of the deduction	Issue Letter 555 with the latest Form 4549 and an appropriate explanation to the taxpayer.
The taxpayer replies to the 90 day letter with verification of his deduction	You are able to determine the deduction amount belongs on another line	Issue Letter 555 with a revised Form 4549 and an appropriate explanation to the taxpayer. Do not increase the deficiency as shown on the 90 day letter.

4.19.15.31 (03-11-2019)

Form 1040, Schedule C - Correspondence Examination

1. The Form 1040, Schedule C, *Profit or Loss From Business (Sole Proprietorship)*, is used to report the profit or loss for a business operating as a sole proprietorship. The nature of the business can be as a manufacturer of a product/goods, retail and wholesale sales, or provider of a service. A taxpayer can be involved in more than one business venture. A separate Schedule C is required for each type of business.
2. Each type of business has certain characteristics. For example, a manufacturing activity will have costs for materials and labor included in the costs of goods sold. On the other hand, a sales-oriented activity will normally only include the cost of items for resale in their cost of goods; the labor for sales would be included in the wages as an expense of sales. Finally, a service oriented activity will normally have no cost of goods, unless materials and supplies are sold or charged in the business.
3. An emerging area of activity in the past few years, the sharing economy, has changed how people commute, travel, rent vacation accommodations and perform many other activities. Also referred to as the on-demand, gig or

access economy, the sharing economy allows individuals and groups to utilize technology advancements to arrange transactions to generate revenue from assets they possess - (such as cars and homes) - or services they provide - (such as household chores or technology services). Although this is a developing area of the economy, there are tax implications for the companies that provide the services and the individuals who perform the services. Refer to **Sharing Economy Tax Center** on [irs.gov](https://www.irs.gov) for guidance on tax issues that may apply to those participating in the sharing economy.

4. Because the taxpayers are not accountable to anyone as sole proprietors there are opportunities for them to mix personal and business interests in the pursuit of their trade or business. It is incumbent on the examiner to recognize those instances where personal expenditures are being deducted as business expenses and to make the proper adjustments to the taxpayer's return.
5. If the verified expenses are determined to be personal expenses and are deductible on the Schedule A, the examiner should make the proper adjustments to the taxpayer's return.
6. To be deductible as a business expense, the expenditure must be reasonable, ordinary and necessary during the course of the business, and be related to the business. The objective of any correspondence examination related to a sole proprietorship is to verify the amount of the expenditures, determine if they qualify as business expenses, and that they were properly treated on the return. Correspondence examinations are limited in scope to certain line items to determine their deductibility as business expenses.
7. Business expenses are the costs of carrying on a trade or business, and they are usually deductible if the business is operated to make a profit. In determining whether a taxpayer is carrying on an activity for profit, nine factors are considered. No one factor alone is decisive. The issue of whether the taxpayer is carrying on an activity for profit isn't conducive to Correspondence Examination and should not be used to disallow the taxpayer's Schedule C expenses.
8. A Questionnaire (see *Exhibit 4.19.15-1.*) **Schedule C - General Questionnaire** should be used on all Schedule C examinations to determine the type of business involved, location, records available, ownership and how the business expenses are paid. In addition to the general questionnaire, there are issue specific Form 886-As and questionnaires designed to utilize the principles of Professional Decision Making (PDM) to assist in the evaluation of the taxpayer's documentation.
9. When the taxpayer is being examined for the income reported on Schedule C, Form 11652, *Questionnaire-- Form 1040 Schedule C (Profit or Loss From Business)*, will be sent as an enclosure with the Letter 566S, *Initial Contact*

Letter. See IRM 4.19.14.6.1, *EITC Schedule C Responses*, for guidelines that apply to Schedule C response, Project Code 0288.

4.19.15.31.1 (03-11-2019)

Schedule C - Car and Truck Expenses

1. The rules for a sole proprietor are the same as for an employee business expense (except that there is no accounting to another party). The expenses must be incurred in the conduct of the business. The taxpayer must show by diary, log or other means how many business and total miles were driven in a tax year. If the taxpayer is claiming actual expenses, records must be maintained to establish all the costs associated with the operation and maintenance of the vehicles as well as documentation to support the computation of the business use percentage. In addition, if the business use percentage is not greater than 50 percent there may be limitations imposed on certain expenses. Special rules apply for leased vehicles. Examiners must comment on personal usage of the vehicles in the workpapers.
2. Form 886-A Schedule C-5, *Car and Truck Expenses*, will be sent to request substantiation documentation for car and truck expenses claimed on Schedule C, and will include Schedule C-5, Car and Truck Expenses questionnaire.

4.19.15.31.2 (03-11-2019)

Schedule C - Travel Expenses

1. The rules for the travel expenses of a sole proprietorship are the same as for an employee business expense. The travel must be attributable to the pursuit of a trade or business. In addition there are specific record keeping requirements for travel, meals and entertainment (IRC 274(d)). For all travel expenses taxpayer must provide information to support the location, dates, business purpose, and who they met with along with the required receipts for the deductions claimed.
2. It is imperative that the examiner establish the taxpayer's "tax home" in order to accurately determine the eligibility of the amounts deducted as "away from home" expenses. The examiner must also determine whether the nature of the travel is temporary (generally last less than one year) or indefinite. If it is determined that a trip qualifies as business travel all the associated costs (airfare, rail fare, bus fare, lodging, meals, taxis, etc.) are also deductible. However, if the taxpayer is accompanied by a spouse, other family member or relative, the expenses for that person are considered nondeductible personal expenses unless he/she is performing bona fide business services.
3. Special allocations are required if a taxpayer is mixing personal and business activities on any given trip.

4. Form 886-A Schedule C-7, *Travel, Meals and Entertainment Expenses* will be sent to request substantiation documentation for travel, meals and entertainment expenses claimed on Schedule C, and will include Schedule C-7, Travel, Meals and Entertainment.

4.19.15.31.3 (03-11-2019)

Schedule C - Mortgage Interest

1. Mortgage interest deducted on a Schedule C should be directly related to a business asset. If the taxpayer is using a structure for both business and personal activities an allocation must be computed to properly reflect the amount attributable to the business. If an adjustment is made to remove a portion of the mortgage interest because it is deemed to be a personal expense the examiner must consider whether it may still be deductible as an itemized deduction on the Schedule A.
2. Form 886-A Schedule C-3, *Interest*, will be sent to request substantiation documentation for interest expenses claimed on Schedule C.

4.19.15.31.4 (03-11-2019)

Schedule C - Legal and Professional Fees

1. Amounts paid to attorneys, accountants, appraisers, engineers, etc., for services related to the operation of a business are deductible as business expenses. Amounts paid for wills, estates, divorce and tax preparation fees (except for business returns such as Forms 941 and 940) are personal expenses and should not be deducted as a business expense (however if they qualify as a deductible personal expense the proper adjustment must be considered). The costs of defending an action in criminal court are not deductible as a business expense. Expenses incurred before the business commences are considered start-up or getting ready expenses and are not currently deductible (these expenses may be capitalized and amortized if the taxpayer makes a proper election). Illegal payments (bribes, kickbacks, etc.) are not deductible as business expenses. Expenses related to the acquisition of real estate or a capital asset should be added to the basis of that asset and depreciated. Legal or professional fees incurred in the process of acquiring, creating, or enhancing intangible property should be capitalized and amortized. Fees incurred in defending or perfecting title to real property, tangible personal property, and intangible property, such as a patent should be capitalized and depreciated or amortized. The examiner should seek technical assistance if the issue of capitalization and depreciation is being considered.
2. Form 886-A Schedule C-2, *Legal and Professional Fees*, will be sent to request substantiation documentation for legal and professional fees claimed on Schedule C.

4.19.15.31.5 (03-11-2019)**Schedule C - Repairs and Maintenance**

1. Expenses incurred to repair or maintain equipment and property used in carrying on a trade or business are generally deductible as business expenses. However, if the taxpayer pays or incurs amounts for the improvement of tangible real or personal property, these costs are generally treated as capital expenditures and depreciated over the appropriate recovery period. Amounts are treated as improvements if they are for betterments to tangible property, for replacements of tangible property, or for adapting tangible property to a new or different use. If the taxpayer determines the expenditures are for an improvement, then the taxpayer may still be entitled to a deduction if these expenditures are for the recurring activities that the taxpayer expects to perform to keep the property in an ordinarily efficient operating condition. For example, deductible repairs may include repainting exteriors and interiors of business buildings, repairing broken window panes, replacing worn-out minor parts, sealing cracks and leaks, and changing oil or other fluids to maintain business equipment.
2. See Treas. Reg. § 1.263(a)-3, for additional information on the definition of improvement and exceptions to the improvement rules. Examiners should review receipts and invoices to identify the property that was repaired or improved and to determine the nature of the work done on the property. Examiners should further consider whether these expenditures were for improvements or other capital expenditures. Examiners should seek technical assistance if they are considering an adjustment to capitalize and depreciate any given repair or maintenance expense.
3. See , Form 886-A - Schedule C - , *Repairs and Maintenance*.
4. See *Exhibit 4.19.15-4, Schedule C – Repairs and Maintenance Questionnaire*.

4.19.15.32 (03-11-2019)**Schedule F Expenses**

1. The Form 1040, [Schedule F, Profit or Loss From Farming](#), is used to report farm income and expenses. A farm includes grain, livestock, dairy, poultry, fish, fruit, and truck farms. It also includes plantations, ranches, ranges, orchards and groves. See Pub 225 for more information.
2. A taxpayer is a farm-related taxpayer if any of the following tests apply:
 - a. Main home is on a farm.
 - b. Principal business is farming.
 - c. A member of the family meets tests (1) or (2).

Note:

For this purpose, family includes taxpayer’s brothers and sisters, half-brothers and half-sisters, spouse, parents, grandparents, children, grandchildren, aunts, uncles and their children.

- 3. =====
- =====
- a. =====
- b. =====
- c. =====
- d. =====
- e. =====
- =====

Note:

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- 4. Schedule F cases will be started in Program Code 0199 and worked only in the Brookhaven Service Center Campus.
- 5. When inspecting returns always look for costs being deducted that appear to be excessive for the income reported. To be deductible, a business expense must be both ordinary and necessary. An ordinary expense is one that is common and accepted in the trade or business. A necessary expense is one that is helpful and appropriate for the trade or business.
- 6. It is important to separate deductible expenses from the following expenses:
 - **Capital Expenses**, (payment or debt incurred for the acquisition, improvement, Production or improvement of property subject to certain exceptions.) See Publication 225, *Capital Expenses*, for certain expenses that must be capitalized, including safe harbors and exceptions.
 - **Personal Expenses**, including gasoline, oil, fuel, repairs, maintenance or mortgage interest. It is not always easy to determine the business and non-business parts of an expense. Any reasonable allocation is acceptable. What is reasonable depends on the circumstances in each case.

7. IRC § 162 and Treas. Reg. § 1.162-12 provides for the deduction of ordinary and necessary expenses, paid or incurred in connection with the operation and maintenance of a farm. Most farmers use the cash method of accounting to record their expenses. When using the accrual method of accounting, farm business expenses are not deductible until economic performance occurs. Economic performance generally occurs as the property or services are furnished to the farmer and the liability is incurred. See **Farmers ATG - Expenses** at <https://www.irs.gov/businesses/small-businesses-self-employed/farmers-atg>, for detailed information.
8. Farmers often write a substantial number of checks during the last few days of the tax year to pay expenses. Large disbursements should always be part of your examination. You must then determine if the disbursement is a payment or a deposit. Whether an expenditure is a payment or a deposit depends on the facts and circumstances of each case.
9. A deposit to be applied against a future expense is not deductible; unless the expense is for **future supplies** (Addressed in Supplies below). Although a check is written, no deduction is allowable until the expense is actually incurred. The following factors, although not all inclusive, are indicative of a deposit rather than a payment:
 - a. The absence of specific quantity terms.
 - b. The right to a refund of any unapplied payment credit of the contract.
 - c. The treatment of the expenditure as a deposit by the seller.
 - d. The right to substitute other goods or products as specified in the contract.

These Factors apply to all farm expenses for which a payment is made prior to delivery.

4.19.15.32.1 (12-01-2017)

Custom Hire

1. Farmers hire individuals or businesses who own equipment (for example, no till planters and combines) the farmer does not own to perform specific activities on their farms. These amounts are fully deductible as an expense on line 13 of Schedule F.

Note:

Do not include amounts paid for rental or lease of equipment operated by the taxpayer; these should be listed on line 24A, *Rent or lease*.

Note:

Do not include amounts paid to employees as wages. If a pilot case is claiming wages under Custom Hire on line 13 of their Schedule F, send a secured e-mail containing the SSN and details pertaining to the issue to: jacquelyn.c.washington@irs.gov.

2. Acceptable documentation may include receipts or contracts from the provider and canceled checks or bank statements showing payment for services.

4.19.15.32.2 (12-01-2017)

Gasoline, Fuel and Oil

1. Fuel expenses **on the farm** may include gas, diesel, or oil. All fuel expenses must be for conducting business on the farm. The following questions must be asked:
 - a. Do you have a storage tank on the farm?
 - b. How do you account for personal use from the storage tanks?
 - c. If fuel was purchased from a gas station, request an explanation why, to ensure it was not for personal use.
2. Acceptable documentation may include receipts for purchase and canceled checks or bank statements showing payment for the purchase. Reasonable documentation explaining business versus personal use of fuel.

4.19.15.32.3 (12-01-2017)

Mortgage Interest

1. Mortgage Interest on real property used in the taxpayer's farming business (other than their main home), will be claimed on line 21a, if paid to a bank or other financial institution for which the taxpayer received a Form 1098 (or similar statement).

Note:

If purchased from a bank the loan may include taxpayer's personal residence. You will need to separate personal use and farm use of the loan and any interest claimed.

2. Farms generally have one of two types of purchase agreements for farms, purchased from a family member or purchased from a bank.
3. If purchased from a family member the taxpayer may have an amortization schedule with a purchase agreement. A Form 1098 will not be issued. This interest amount will be claimed on Line 21b and will not be included in the audit.

4. If the mortgage loan combines farm and personal assets, the taxpayer must provide a breakdown showing the amount of interest applied to farm and personal.

4.19.15.32.4 (03-11-2019)

Repairs & Maintenance

1. Amounts paid for repairs and maintenance of farm buildings, machinery, and equipment may be deducted as ordinary and necessary business expense provided the amounts are not paid for improvements to such property (**i.e.**, betterments, restorations, or adaptations of such property to a new or different use).

Note:

Do not allow deductions for repairs or maintenance on personal residence.

4.19.15.32.5 (03-11-2019)

Supplies

1. Farmers can prepay for supplies used in the upcoming year. IRC § 464 limits the allowable deduction for prepaid supplies if they exceed 50% of the total deductible farm expenses for the taxable year. If the prepaid farm supplies have actually been used or consumed, the amount is fully deductible.
2. For example:
 - a. The expense must be a payment for the purchase of supplies, not a deposit. The amount is considered a payment if it was made under a binding commitment to accept delivery of a specific quantity at a fixed price, and the farmer is not entitled to a refund or repurchase.
 - b. The prepayment is not merely for tax avoidance, but has a specific business purpose. Examples of business benefits are; Fixing maximum prices; Securing an assured feed supply, and; Securing preferential treatment in anticipation of shortages.
 - c. The deduction does not result in a material distortion of income. Some factors to consider in determining whether there is a material distortion of income are; The farmer's customary business practices in conducting the farming operation; The materiality of the expenditure in relation to the taxpayer's income for the year; The time of the year the purchase is made, and; The amount of the expenditure in relation to past purchases.
3. Acceptable documentation may include receipts or contracts and copies of checks or bank statements showing payment. The taxpayer must include a reasonable explanation for prepaying the supplies.

4.19.15.33 (03-11-2019)

Return Preparer Analysis Tool (RPAT) Program

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b. =====
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2. AIMS Openings:

- Project Code (SPC) 0258, Source Code 49 will be used when opening the inventory. The inventory will be opened by SB/SE team.
- AIMS Tracking Code, when applicable.

3. Procedures for processing the inventory. Correspondence Exam will:

- Classify the returns based on the pre identified issues.
- If overview or audit issues are identified in the inventories, limit the scope of the audit to those issues. However, if other issues/credits or Schedules appear egregious and the issue requires examination, scope can be expanded with concurrence from manager/lead/Classification TCO.
- Inform HQ analyst of any trends, patterns of false documents. Do not submit fraud referrals unless coordinated with HQ analysts.

Note:

Do not routinely disallow the entire Schedule A in its entirety, unless a pattern of abuse is noted. See *IRM 4.19.15.25.5.Examining the Schedule A on Preparer Referrals* for further discussion.

- Issue Initial Contact Letter 566-S, 30 day and 90 day letters per normal procedures.
- Document the workpapers, with any statements provided/made by the taxpayer.
- Follow examination and closing procedures as provided under PC 0133 Program. See *IRM 4.19.15.25, Return Preparer Referrals, IRM 4.19.15.20, Schedule A, IRM 20.1, Penalty Handbook, IRM 4.19.13.26Campus Exam Identity Theft, IRM 4.19.15.3, Education Tax Credits, General Requirements and Exam Programs, ,,* and other sections as applicable.

4. SB/SE HQ analyst may forward the audit results on the egregious preparers to CI HQ quarterly on Form 13649, *Multi-Case Inventory Referral (formerly Referral for SB/SE Campus Correspondence Examination)*, for preparer penalty considerations or to LDC on a secured E-mail.

5. Programming has been established through DDb to identify each scheme and related taxpayers so that the examination results can be queried at the HQ level by the Scheme Identification Numbers and Project Codes.

4.19.15.34 (12-01-2017)

CI Education Credit Program

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3. AIMS Openings:

- Project Code (PC) 0385, Source Code 70 will be used when opening the inventory and the inventory will be opened by the WDD team.
- AIMS Tracking Code, if applicable.
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4. Procedures for processing the inventory:

- Issue audit letters as specified under PC 0133 Program. See *IRM 4.19.15.25, Return Preparer Referrals*.
- Document the workpapers, with any statements provided/made by the taxpayer.
- Follow examination and closing procedures as provided under PC 0133 Program. See *IRM 4.19.15.25, Return Preparer Referrals*.
- *IRM 4.19.15.20, Schedule A . IRM 4.19.15.3, Education Tax Credits - General Requirements and Exam Programs, IRM 20.1, Penalty Handbook, IRM 4.19.13.26Campus Exam Identity Theft, and other IRM sections as applicable.*

5. Effective for tax years after 2015, if the taxpayer’s claim for AOTC is due to reckless or intentional disregard of rules and regulations, a 2-year ban may apply. If the claim is fraudulent, a 10-year ban may apply. The 2 and 10-year bans do not apply to the Lifetime Learning Credit or the tuition and fees deduction. See IRC section 25A(i)(7), and IRM 4.19.14.7.1, *2/10 Year Ban - Correspondence Guidelines for Examination Technicians*.

**4.19.15.35 (03-11-2019)
Individual Taxpayer Identification Number (ITIN)**

1. A TIN must be furnished on all tax returns, statements, and other tax-related documents. The Department of the Treasury created the individual taxpayer identification number (ITIN) so that a foreign individual not eligible for a SSN could use an identification number for federal tax reporting. See Treasury Regulation § 301.6109-1. An ITIN
 - a. Does not authorize an individual to work in the United States.
 - b. Does not qualify an individual for the EITC.
 - c. Is not valid for identification purposes outside the tax system.
 - d. Does not entitle the holder to Social Security benefits.
 - e. Does not establish or affect immigration status.
2. Any individual who has a valid filing requirement but does not qualify for an SSN is eligible to receive an ITIN.

4.19.15.35.1 (03-11-2019)

ITIN Issuance and Expiration

1. An ITIN is a nine-digit tax processing number issued by the Internal Revenue Service in the same format as an SSN, except that:
 - a. The first digit is (9).
 - b. The fourth and fifth digits range from (50-65), (70-88), (90-92), or (94-99).
2. Under section 203 of the PATH Act of 2015, ITINs that haven't been included on a federal tax return at least once in the last three consecutive tax years will expire. In addition, ITINs that were assigned before 2013 will expire according to an annual schedule based on the middle digits of the ITIN. Taxpayers with an expired ITIN who file an income tax return will need to submit Form W-7 with supporting identity documentation in order to receive a refund.
 - a. If an ITIN wasn't included on a federal tax return at least once for tax years 2013, 2014, or 2015, the ITIN expired on December 31, 2016, unless renewed.
 - b. If an ITIN's middle digits are 78, or 79, the ITIN expired on December 31, 2016, unless it was renewed.

If ITIN Issued:	Then ITIN Expires:
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If ITIN Issued:	Then ITIN Expires:
Before 2013	<p>Earlier of:</p> <ul style="list-style-type: none"> • Applicable date below or • If 3 consecutive tax years of non-use, earlier of: <ul style="list-style-type: none"> ◦ last day of 3rd consecutive tax year of non-use or ◦ last day of tax year that includes December 18, 2015. <p>Applicable Dates:</p> <ul style="list-style-type: none"> • Issued before 2008 - Expires Jan. 1, 2017 • Issued in 2008 - Expires Jan. 1, 2018 • Issued in 2009 or 2010 - Expires Jan. 1, 2019 • Issued in 2011 or 2012 - Expires Jan. 1, 2020
After 2012	Last day of 3rd consecutive tax year of non-use

3. If an ITIN's middle digits are 70, 71, 72 or 80, the ITIN expired on December 31, 2017, unless renewed.

4.19.15.35.2 (01-01-2017)

Resident Alien (RA)

1. An individual who is a lawful permanent resident of the United States (green card holder) may claim the same deductions as a U.S. citizen. A green card holder is eligible to receive an SSN, must use an SSN when filing a U.S. tax return, and is not eligible for an ITIN.
2. A foreign individual who is not a green card holder but who meets the substantial presence test for a calendar year is considered a U.S. resident alien (RA) for tax purposes. If such individual is not eligible to obtain an SSN, the individual is eligible to receive an ITIN, and as an RA, may claim the same deductions as a U.S. citizen. Refer to Pub 1915, *Understanding Your IRS Individual Taxpayer Identification Number (ITIN)*, and Pub 519, *U.S. Tax Guide for Aliens*, for more information.

3. In general, a foreign individual satisfies the substantial presence test for a calendar year if the individual is physically present in the U.S. for:
 - a. At least 31 days in the current year, and
 - b. A total of 183 days during the three-year period that includes the current year, and the two years immediately before that. Total days are calculated as total days in the current year, plus one-third of the days for the immediate prior year, and one-sixth of the days for the second prior year.
4. A taxpayer's claimed dependent who is a foreigner may receive an ITIN if the dependent is not eligible to receive an SSN.

4.19.15.35.3 (03-11-2019)

Child Tax Credit (CTC) and Additional Child Tax Credit (ACTC)

1. In addition to other requirements, generally the CTC and ACTC are only allowed for children who are:
 - a. U.S. citizens or nationals, or
 - b. U.S. resident aliens. A child who is a U.S. lawful permanent resident (green card holder) is eligible for an SSN. If a taxpayer claims CTC or ACTC for a child with an ITIN, the taxpayer must establish during an examination that the child met the substantial presence test (was physically present in the United States for the required number of days) see IRM 4.19.15.35.1, *ITIN Issuance and Expiration*, paragraph (3) above, or met the requirements for the first-year election. Refer to Pub 519, *U.S. Tax Guide for Aliens*, for more information about a first-year election.
2. For returns and amended returns filed after December 18, 2015, the taxpayer and the taxpayer's spouse, if filing jointly, must have an SSN or an ITIN by the due date of the tax return (including extensions) in order to claim the child tax credit.
3. For returns and amended returns filed after December 18, 2015, the child tax credit is not allowed with respect to a child who didn't have an SSN, an ITIN, or an ATIN by the due date of the tax return (including extensions).
4. Effective for tax years after 2015, if the taxpayer's claim for the CTC/ACTC is due to reckless or intentional disregard of rules and regulations, a 2-year ban may apply. If the claim is fraudulent, a 10-year ban may apply. See IRC 24(g), for more information.

4.19.15.35.4 (01-01-2017)

Initiation

1. After completing research to determine the issues for examination, for PC 0900 initiate the case with Letter 566-S, *Initial Contact Letter*, and for PC 1175 initiate the case with Letter 566-B, *Service Center ICL/30 Day Combo Letter*. Use the check boxes to identify the issues in question. Include Form 886-H-ITIN, *Examination of Items* requesting documentation for the selected issues. If other issues not shown on Form 886-H-ITIN are selected for examination, additional Forms 886-H may be used to request needed documentation.
2. Follow the procedures in the IRM 4.19.13, *General Case Development and Resolution*.

4.19.15.35.5 (03-11-2019)

Earned Income Tax Credit

1. An EITC claimed by a taxpayer with an ITIN should be disallowed in processing with Math Error 702. An EITC claimed by a taxpayer for a child with an ITIN should be disallowed in processing with Math Error 745. Research is necessary to verify whether the EITC was disallowed in processing. Integrated Data Retrieval System (IDRS) command codes TXMOD or IMFOLT will verify if the taxpayer has received the EITC. If the taxpayer received the EITC, this will be selected as an issue for examination.
2. If the taxpayer is a U.S. citizen or resident alien married to a nonresident alien (NRA) spouse, the taxpayer is not eligible for EITC. The only way that a U.S. citizen or resident alien married to an NRA spouse can be eligible for EITC is if the taxpayer and the NRA spouse elect, by the filing of a joint return with a statement noting the election, for the NRA spouse to be treated as a resident alien. A taxpayer who is married to an NRA spouse may qualify for head of household filing status. However, even if the taxpayer is considered unmarried for filing status purposes, because the taxpayer is married to an NRA spouse, the taxpayer is not eligible for EITC. See Chapter 1 - Rules for Everyone, in Pub 596, *Earned Income Credit (EIC)*, and Pub 519, *U.S. Tax Guide for Aliens*.
3. If the taxpayer has an SSN valid for employment (and if married, the spouse also has an SSN valid for employment) and a qualifying child for whom EITC is claimed has an SSN valid for employment, the taxpayer may qualify to receive EITC based on the child who has the SSN valid for employment.

4.19.15.35.6 (03-11-2019)

Acceptable Documentation

1. For additional information regarding acceptable documentation, refer to IRM 4.19.14.6.5, *Personal Exemptions and Dependents*, t. The table below states, in general, what documentation may verify a requirement.

Issue	Documents
Filing Status	<p>Head of household (HOH) is the only filing status we will pursue. Qualifying rules for HOH status can be found in Publication 501, <i>Exemptions, Standard Deduction, and Filing Information</i>.</p> <p>Note:</p> <p>A resident alien (RA) taxpayer married to a nonresident alien (NRA) spouse may be considered unmarried for the purposes of HOH filing status if the NRA spouse does not elect, by filing jointly with the taxpayer, to be treated as an RA. See section 5 of Publication 519, <i>U.S. Tax Guide for Aliens</i>, for filing status rules for married RAs. (For the purposes of the EITC, if a RA who chooses HOH filing status is married to a NRA, both spouses must have SSNs valid for employment).</p>

Issue	Documents
Federal Income Tax Withheld	<p>a. ===== =====</p> <p>b. ===== =====</p> <ul style="list-style-type: none">• =====• =====• =====• ===== <p>Note:</p> <p>=====</p> <p>=====</p> <p>=====</p> <p>=====</p> <p>=====</p> <p>=====</p> <p>=====</p> <p>=====</p> <p>=====</p>

Issue	Documents
Income	<p>=====</p> <p>=====</p> <p>=====</p> <p>=====</p> <p>=====</p> <p>=====</p> <p>=====</p> <p>=====</p> <p>=====</p> <p>=====</p> <p>• =====</p> <p>• =====</p> <p>• =====</p>
Support	<p>Use judgment when it comes to how many records you will require to determine over 50 percent of the support. Common items that are received are bills for utilities, money orders for the support of dependents in Mexico/Canada, Form 1098, rental receipts, lease agreements, medical receipts including verification of medical insurance.</p>
Qualifying Person	<p>To determine if a person is a qualifying person for HOH purposes, there are various records that can be accepted. The relationship of the person to the taxpayer can be verified through birth certificates, and/or court records. Multiple birth certificates may be required to verify the relationship if the person is a niece/nephew or grandchild.</p>
Residence	<p>The most common types of records that are acceptable include school, medical, or social service records listing the person's name and address, and dates. You may use your judgment and, if questionable, consult your manager.</p>
Dependent	<p>Follow all of the established rules for determining whether the dependency exemption is allowable. Refer to Publication 501, <i>Exemptions, Standard Deductions, and Filing Information</i>, for current rules.</p>

Issue	Documents
Child and Dependent Care Credit	<p>The same records that verify relationship for the dependency exemption can verify relationship for this issue. In addition, you can accept marriage licenses and court orders to establish the relationship between the taxpayer and the child or other dependent. Earned income can be verified via IDRS research such as RTVUE and IRPTR. A letter from the provider, bank statements or canceled checks can verify payments to the provider. For more information, refer to Publication 503, <i>Child and Dependent Care Expenses</i>.</p>
Education Credits	<p>All verification rules to determine allowable expenses and eligible educational institutions apply. To see if the school is eligible, check the U.S. Department of Education's list of accredited schools. Some educational institutions located outside the U.S. also participate in the U.S. Department of Education's Federal Student Aid programs but are not on the list. If the school is not on the list, the taxpayer must prove the foreign school is an eligible educational institution. An eligible educational institution is an accredited school that offers higher education beyond high school and that is eligible to participate in the student aid program run by the U.S. Department of Education. For more information see <i>IRM 4.19.15.3, Education Tax Benefits - General Requirements and Exam Programs</i>, and Pub 970, <i>Tax Benefits for Education</i>.</p> <p>Note:</p> <p>If a RA taxpayer is married to a NRA spouse, no credit is allowed unless an election to file jointly is made.</p>
Child Tax Credit and Additional Child Tax Credit	<p>The qualifying child must be a U.S. citizen, U.S. national, or U.S. resident alien (See <i>IRM 4.19.15.35.2, Resident Alien</i>). American Samoans and Northern Mariana Islanders are U.S. nationals. For more information, refer to Publication 972, <i>Child Tax Credit</i>.</p>

Note:

Use caution in allowing the income or withholding credits if the taxpayer was identified in QRP since the Service has already contacted the employer and determined the wages and/or withholding to be false or inflated. Refer to *IRM 4.19.14.9.4, QRP Replies and Closing Process*.

4.19.15.35.7 (03-11-2019)**Employment-Related Identity Theft**

1. IRM 25.23.1.4.1, *Identity Theft in Tax Administration*, describes employment-related or income-related identity theft. Follow guidance in IRM 25.23.2.4.4(1), *Initial Allegation or Suspicion of Tax-Related Identity Theft - IMF Identity Theft Indicators*, paragraph (6), and IRM 25.23.2.8.5, *Employment-related Identity Theft - TC 971 AC 525*, when information from the ITIN taxpayer examination indicates that another individual's SSN has been used for employment purposes.

4.19.15.36 (01-01-2014)**Conversion of Invalid Form 1120S Cases - Background**

1. Subchapter S Corporations (1120S Corporation) who have failed to file elections (Form 2553, *Election by a Small Business Corporation*), or have filed invalid elections, are converted to a Form 1120, *Subchapter C Corporation*.
 - a. An 1120S corporation is generally a non-taxable entity whose income flows through via Schedule K-1, **Partner's Share of Income, Deductions, Credits, etc.** to the shareholder to be taxed on the shareholder's return. One tax advantage to an 1120s Shareholder is when the corporation has a loss (subject to loss limitation rules), the shareholder can report that loss on their own return (e.g., Form 1040), reducing the taxable income and tax. When an 1120S corporation is converted to an 1120 corporation, the shareholder can no longer report these flow-through items. For example, if the 1120S corporation had reported a loss, the 1040 shareholder is no longer able to claim that loss on Schedule E, **Supplemental Income and Loss**. The 1120 corporation is not impacted in this example because it has a loss and is unlikely to owe tax.
2. If the 1120S return is converted to an 1120 return subsequent to the shareholders filing their own returns, compliance action may be required to make the appropriate changes.

4.19.15.36.1 (01-01-2014)**Identifying the Form 1120S Return to be Examined**

1. Workload Selection and Delivery (WSD) will identify 1120S converted returns with characteristics meeting the Correspondence Examination criteria.
2. The identified returns will be further filtered to ensure there has been no subsequent activity which changes the need to examine the return.
3. Returns will be placed on AIMS with Project Code 0157 and assigned to a campus.

- 4. A spreadsheet showing the associated shareholder's returns will also be provided.

4.19.15.36.2 (01-01-2016)

Examining the Converted Form 1120S Return and Adjusting the Shareholders Returns

1. **Loss returns** - =====
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- a. The campus will be sent a spreadsheet identifying the shareholders and the amount of the flow through loss that is no longer includable on the return due to the conversion of the 1120S corporation.
- b. The campus will issue an initial contact letter (combo) with a report disallowing the flow through loss shown on the spreadsheet.
- c. If the taxpayer/shareholder does not respond, default procedures will be followed.
- d. If the taxpayer/shareholder does respond, it will generally be similar to the following: "This business entity has always been treated as an 1120S corporation and every year the shareholders have reported their income from the entity on their individual returns" . In their response, the corporation/shareholder might cite certain Revenue Procedures which allow the corporation/shareholder relief in this situation. The corporation/shareholder might cite Rev. Proc. 2003-43, Rev. Proc. 2004-48, Rev. Proc. 2007-62, Rev. Proc. 2013-30, or Rev. Proc. 97-48. If any of these Revenue Procedures are cited, please refer the request to the Entity section of your campus for action. Please ensure that Entity contacts you as soon as a decision is made. Most of the time the corporation/shareholder will contact the IRS before compliance action is taken. If Entity grants relief under any of these Revenue Procedures, the corporate return will be converted back to an 1120S corporation and the shareholder returns will be no-changed.
- e. If Entity does not grant relief, follow normal closure practices.

2. **Gain Returns** - Only the corporation will be examined. The shareholders will be sent a letter advising them to submit an amended return to adjust the gain reported on their individual returns.

- a. The campus will be sent a spreadsheet identifying the corporation and the amount of gain that is now taxable due to the conversion of the 1120S.
- b. The campus will issue an initial contact letter with a report to the corporation that includes the income previously passed through to the

shareholders.

- c. If the corporation does not respond, default procedures will be followed.
- d. If the corporation does respond, it will generally be similar to the following, "This business entity has always been treated as an 1120S corporation and every year the shareholders have reported their income from the entity on their individual returns." In their response, the corporation/shareholder might cite certain Revenue Procedures which allow the corporation/shareholder relief in this situation. The corporation/shareholder might cite Rev. Proc. 97-48, Rev. Proc. 2003-43, Rev. Proc. 2004-48, or Rev. Proc. 2007-62, Rev. Proc. 2013-30 . If any of these Revenue Procedures are cited, please refer the request to the Entity section of your campus for action. Please ensure that Entity contacts you as soon as a decision is made. Most of the time the corporation/shareholder will contact the IRS before compliance action is taken. If Entity grants relief under any of these Revenue Procedures, the corporate return will be converted back to an 1120S corporation and the shareholder returns will be no-changed.
- e. If Entity does not grant relief, follow normal closure practices.
- f. When the corporate case is ready to close, issue the shareholders a letter notifying them that due to the conversion of the 1120S, the flow through income is no longer includable on their individual returns. Include an amended return (Form 1040-X).

4.19.15.37 (12-01-2017)

Moving Expenses – IRC 217

1. Exam cases involving moving expenses are worked under Project Code 0380 and Project Code 0419.

4.19.15.37.1 (03-14-2016)

Initial Contact Letter

1. Issue Letter 566-S with the appropriate box checked. See Form 14978- *Moving Expenses Deduction Supporting Documents*, for documents request that may be used for this issue.

4.19.15.37.2 (12-12-2008)

Evaluating Responses

1. Use the following guidelines when evaluating response to Moving Expense deductions.
 - Determine if the move is job related. The move must be related both in time and in place, to the start of work at the **new job location**.

If	And	Then
The taxpayer provided information to show the move was related to the start of work at a new location	NA	The move was job related. Continue evaluating taxpayer response.
The taxpayer did not provide employer information and RTVUE shows the taxpayer was not employed in the prior year, and had no Schedule C, partnership, or 1120-S income	The taxpayer has no employment in the year being examined	Disallow the moving expense because the move was not related to the start of work. Issue Letter 525 with a report.

4.19.15.37.2.1 (11-29-2011)

Distance Test

1. Determine if the taxpayer meets the **distance test**. The **new job location** must be at least 50 miles farther from the taxpayers old home than the old job location was from the taxpayer’s old home.
 - a. Determine the number of miles from the taxpayer’s old home to his new work place.
 - b. Determine the number of miles from the taxpayer’s old home to his old workplace.
 - c. Subtract Step 2 from Step 1. The difference indicates the miles.

If	Then
The number of miles in Step 3 above is less than 50,	Disallow the moving expenses because the distance test was not met. Issue Letter 525 and report.
The number of miles in Step 3 above is 50 or more,	The distance test was met. Continue evaluating the taxpayer’s response.

4.19.15.37.2.2 (03-11-2019)

Time Test

1. Determine if the taxpayer meets the **time test**. If the taxpayer is an employee, he/she must work full time for at least 39 weeks during the first 12 months after arriving in the general area of the new job location.

- a. The taxpayer may count only full-time work as an employee, not any work as a self-employed person.
- b. The taxpayer does not have to work for the same employer for all 39 weeks.
- c. The taxpayer does not have to work 39 weeks in a row.
- d. The taxpayer must work full time within the same general commuting area for all 39 weeks.

If the taxpayer is an employee or self-employed, he/she must work full time for at least 39 weeks during the first 12 months and for a total of at least 78 weeks during the first 24 months after arriving in the general area of the new job location.

- a. The taxpayer may count any full-time work done either as an employee or as a self-employed person.
 - b. The taxpayer does not have to work for the same employer for all 78 weeks.
 - c. The taxpayer does not have to work 78 weeks in a row.
 - d. The taxpayer must work full time within the same general commuting area for all 78 weeks.
2. If the taxpayer does not meet the time test, disallow the expenses and issue Letter 525 with a report. If the taxpayer meets the time test, continue evaluating the taxpayer's receipts, cancelled checks, etc., to determine allowable expenses.

Note:

There are exceptions for the time test for members of the Armed Forces, and for retirees or survivors who moved to the United States, and in certain other situations. See Publication 521, *Moving Expenses*.

4.19.15.37.3 (12-12-2008)

Additional Information

1. Additional information should be referenced when working moving expense cases. These include:
 - Form 3903 *Moving Expenses*
 - Publication 521 *Moving Expenses*
 - Publication 17 *Your Federal Income Tax (For Individuals)*

4.19.15.38 (01-01-2015)**First-Time Homebuyer Credit – IRC 36**

1. The First-time Homebuyer Credit (FTHBC) is a fully refundable, limited time, credit available for first-time home buyers for 2008, 2009 and 2010. Originally introduced in 2008, it was later expanded by the American Recovery and Reinvestment Act (ARRA) of 2009 and the Worker, Homeownership and Business Assistance Act (WHBAA) of 2009. The credit is computed on Form 5405 – **Repayment of the first-Time Homebuyer Credit**, and entered on Line 69 of the TY (Tax Year) 2008 Form 1040 and Line 67 of the TY 2009 Form 1040, and Line 67 of the TY 2010 Form 1040.
2. The FTHBC is allowed as a credit against tax in an amount not to exceed the lesser of 10 percent of the purchase price of the residence and:
 - a. \$7,500 (\$3,750 for married filing separate returns) for purchases made after April 8, 2008 and before January 1, 2009.
 - b. \$8,000 (\$4,000 for married filing separate returns) for purchases made after December 31, 2008 and before May 1, 2010.

Exception:

If the taxpayer enters into a written binding contract before May 1, 2010 to purchase a principal residence and the contract provides for closing on the purchase before July 1, 2010, then the home must be purchased before October 1, 2010.

3. For homes purchased in the 2008 qualifying period, the credit is taken on the 2008 tax return. FTHBC taken for a 2008 purchase must be paid back (recaptured) over a fifteen year period. Annual repayments are 6.67 percent of the amount of the credit allowed (divided into fifteen payments). The repayment begins in the second tax year following the year for which the credit was taken (i.e., FTHBC taken in TY 2008 will begin repayment in TY 2010). The repayment will be reported on Line 59b of the TY 2012 Form 1040 and Line 59b of the TY 2011 Form 1040 and Line 59 of TY 2010 Form 1040 checking box c.
4. For homes purchased in the 2009 and 2010 qualifying periods, taxpayers have the option of taking the credit on the tax return for the year of purchase or the previous year. Taxpayers who wish to claim the credit on the previous year and who, at the time the home was purchased, had already filed a return for the previous year may file an amended return to claim the credit.
5. Taxpayers claiming the credit on their 2009 tax return or later tax return must file a paper return and attach a copy of their properly executed settlement statement used to complete the purchase.

6. FTHBC taken for 2009 and 2010 purchases does not have to be repaid as long as the home remains the taxpayer's primary residence for the next 36 months after the purchase date.
7. The credit will post to Master File as a Transaction Code (TC) 766 with a Credit Reference Number (CRN) 258. Since both the 2008 and 2009 credits are defined with the same CRN, the 2009 credit will be identified on IDRS (Integrated Data Retrieval System) with a Special Processing Code (SPC) "H" on Command Code (CC) RTVUE and TRDBV.
8. For further details regarding the credit and repayment provisions, see: Publication 530, *Tax Information for Homeowners*, Publication 17, *Your Federal Income Tax (for Individuals)*. There is also a First-Time Homebuyer Credit Information Center on irs.gov.
9. FTHBC in Discretionary Exam is worked under Project Code (PC)1015 for pre-refund cases and PC1037 for post-refund cases. In FY 2010 cases with EITC and FTHBC will open in PC0099 and if a Schedule C filter breaks, PC0585 (SB/SE). Long-Time Residency Credit (LTRC) and EITC will open in PC1024 and PC0608 (SB/SE) if Schedule C filter breaks.
10. Tax year 2009 returns will be systemically requested when AIMS is opened because the settlement statement is attached to the return and is needed for case evaluation.
11. For cases established under Project Codes other than those established for FTHBC/LTR (1015, 1037, 1043, 1044, 0099, 0585, 1024 and 0608) that are later expanded to include the FTHBC issue, input AIMS Tracking Code 9216 and keep the case in its original Project Code. Do not add this Tracking Code on cases where the FTHBC is part of the original examination scope; i.e., (Questionable Refund Program) QRP.

4.19.15.38.1 (01-01-2015)

Conditions to Qualify for the Credit

1. The following qualifications apply to homes purchased in 2008, 2009, and 2010 qualifying periods.
 - a. The home must be purchased on or after April 9, 2008, and prior to May 1, 2010.

Exception:

If the taxpayer enters into a written binding contract before May 1, 2010 to purchase a principal residence, and the contract provides for closing on the purchase before July 1, 2010, then the home must be purchased before October 1, 2010.

- b. Home must be located in the United States and must meet the definition of a home: A house, condo, co-op, mobile home, house trailer, boat or similar property that has sleeping, cooking and toilet facilities.
- c. Homes constructed by the taxpayer will be treated as "purchased" by the taxpayer on the date the taxpayer first occupies the residence. This also applies to manufactured homes.
- d. The home must be the taxpayer's principal residence.
- e. The property cannot be purchased from a family member or acquired by gift or inheritance. For the purpose of FTHBC, family members include spouse, parent, grandparent, child or grandchild. Purchases from brothers, sisters, cousins, aunts or uncles can qualify for the FTHBC. For purchases made before November 7, 2009, purchases from in-laws (relatives of a spouse) can qualify for FTHBC. Effective with purchases made after November 6, 2009 the home cannot be purchased from lineal relatives of a spouse (either ancestors or descendants of spouse).
- f. The taxpayer must be a first-time homebuyer. The definition of a first-time homebuyer is any individual (and if married, the individual's spouse) that has not owned a principal residence during the three year period ending on the date of the purchase for which the FTHBC is being claimed.
- g. Effective for purchases made after November 6, 2009, a taxpayer who could be claimed as a dependent by another taxpayer is not eligible for FTHBC.
- h. Income limits, phase-out rules, and price limitations:

PURCHASE DATE	PURCHASE PRICE	MARITAL STATUS	MODIFIED ADJUSTED GROSS INCOME (MAGI)	FTHBC ELIGIBILITY
April 9, 2008 through November 6, 2009	Any	Single	Up to \$75,000	Full credit
April 9, 2008 through November 6, 2009	Any	Married	Up to \$150,000	Full credit

PURCHASE DATE	PURCHASE PRICE	MARITAL STATUS	MODIFIED ADJUSTED GROSS INCOME (MAGI)	FTHBC ELIGIBILITY
April 9, 2008 through November 6, 2009	Any	Single	Between \$75,000 and \$95,000	Subject to phase-out rules (See Form 5405)
April 9, 2008 through November 6, 2009	Any	Married	Between \$150,000 and \$170,000	Subject to phase-out rules (See Form 5405)
April 9, 2008 through November 6, 2009	Any	Single	\$95,000 or more	FTHBC is not allowed
April 9, 2008 through November 6, 2009	Any	Married	\$170,000 or more	FTHBC is not allowed
After November 6, 2009	\$800,000 or less	Single	Up to \$125,000	Full credit
After November 6, 2009	\$800,000 or less	Married	Up to \$225,000	Full Credit
After November 6, 2009	\$800,000 or less	Single	Between \$125,000 and \$145,000	Subject to phase-out rules (See Form 5405)
After November 6, 2009	\$800,000 or less	Married	Between \$225,000 and \$245,000	Subject to phase-out rules (See Form 5405)

PURCHASE DATE	PURCHASE PRICE	MARITAL STATUS	MODIFIED ADJUSTED GROSS INCOME (MAGI)	FTHBC ELIGIBILITY
After November 6, 2009	\$800,000 or less	Single	\$145,000 or more	FTHBC is not allowed
After November 6, 2009	\$800,000 or less	Married	\$245,000 or more	FTHBC is not allowed
After November 6, 2009	More than \$800,000	Any	Any	FTHBC is not allowed

2. It is possible for unmarried persons who buy a house together to share the credit. All persons must separately meet all qualifications and follow MAGI phase-out rules. The sum of credits taken by all individuals for one home cannot exceed the total credit available for the home purchased.
3. A taxpayer (X) who never owned a home but whose former spouse (Y) was a homeowner during the 3 prior years, may qualify for the credit if the taxpayer (X) was divorced from spouse (Y) when the qualifying home was purchased, and all other qualifications are met.
4. A taxpayer (X) who owned a home jointly with a former spouse (Y) and relinquished ownership by quitclaiming the property to spouse (Y) may qualify for the credit. To qualify, the purchase of the new home must be made more than three years after the taxpayer (X) relinquished their ownership interest and the taxpayer (X) must be divorced from spouse (Y) when the qualifying home is purchased. All other qualifications must also be met.
5. Taxpayers cannot claim the credit if they claimed the District of Columbia First-time Homebuyer Credit.

4.19.15.38.2 (01-01-2015)

Special Rule for Long Time Residents

1. The Worker, Homeownership and Business Assistance Act (WHBAA) of 2009 extended the FTHBC to certain long-time homeowners buying a subsequent principal residence.

2. The credit provides a special rule for Long Time Residents (LTR) and is allowed as a refundable credit against tax in an amount not to exceed the lesser of 10 percent of the purchase price of the residence or \$6,500 (\$3,250 for married filing a separate return).
3. The credit will post to Master File as a TC 766 with a CRN 258. The Long-Time Resident Credit will be identified on IDRS with a SPC "Y" on CC RTVUE and TRDBV.
4. LTR in Discretionary Exam is worked under PC 1043 for pre-refund cases and PC 1044 for post-refund cases. In FY 2010, cases with EITC and LTR will open in PC 1024 and PC 0608 (SB/SE) if a Schedule C filter breaks.
5. The following qualifications must be met under this provision:
 - a. The taxpayer must have owned and lived in the same principal residence for at least five consecutive years during the eight-year period that ends on the date of purchase of the new principal residence.
 - b. The taxpayer must purchase a new principal residence after November 6, 2009 and before May 1, 2010. Homes constructed by the taxpayer will be treated as "purchased" by the taxpayer on the date the taxpayer first occupies the residence. This standard also applies to manufactured homes.

Exception:

If the taxpayer enters into a binding contract before May 1, 2010 to purchase a principal residence that provides for closing on the purchase before July 1, 2010, then the home must be purchased before October 1, 2010.

- c. The home must be located in the United States and must meet the definition of a home: A house, condo, co-op, mobile home, house trailer, boat or similar property that has sleeping, cooking and toilet facilities.
- d. The home purchased must be the taxpayer's principal residence.
- e. The property cannot be purchased from a family member nor be acquired by gift or inheritance. For the purpose of FTHBC, family members include spouse, parent, grandparent, child or grandchild. Purchases from brothers, sisters, cousins, aunts or uncles can qualify for the FTHBC. The home cannot be purchased from lineal relatives of a spouse (i.e., neither ancestors nor descendants of spouse).
- f. The taxpayer claiming the credit cannot be claimed as a dependent by another taxpayer.
- g. Income limitations and phase-out rules:

MARITAL STATUS	MODIFIED ADJUSTED GROSS INCOME	FTHBC ELIGIBILITY
Single	Up to \$125,000	Full credit
Married	Up to \$225,000	Full credit
Single	Between \$125,000 and \$145,000	Subject to phase-out rules (See Form 5405).
Married	Between \$225,000 and \$245,000	Subject to phase-out rules (See Form 5405).
Single	\$145,000 or more	FTHBC is not allowed.
Married	\$245,000 or more	FTHBC is not allowed.

- h. The purchase price cannot exceed \$800,000.
- i. It is possible for unmarried persons who buy a home together to share the credit. All persons must separately meet all qualifications for the credit. The sum of credits taken for one home, by all individuals meeting the Long Time Resident requirements cannot exceed the total credit available for the home purchased.

4.19.15.38.3 (03-14-2016)

Research and Initial Contact

1. Conduct IDRS research on the three prior years to look for deductions or credits claimed or reported by third parties that indicate that the taxpayer(s) may have owned a home during that period. Some examples are: mortgage interest and/or real estate taxes paid – either reported to the IRS on Form 1098, *Mortgage Interest Statement*, and/or claimed on a prior Schedule A, **Itemized Deductions**. Ordinarily, taxpayers whose returns have indications of prior home ownership receive math error notices disallowing the credit. Math error procedures are addressed in *IRM 4.19.15.10, Math/Clerical Error*.
2. Research of approved third party databases, such as Accurint, can be used to verify some aspects of a home purchase such as buyer's and seller's name(s), address, purchase date and price. While this is useful, especially in classifying 1040X claims, Accurint data – or lack of it – can never be the sole reason for denying FTHBC.
3. IDRS research should include, but is not limited to Command Codes: IRPTRL, RTVUE, ENMOD, INOLE, FTBOL, and DFAST.
4. IDRS Command Code (CC) FTBOL was developed to assist in identifying the reason the return was selected for examination. When the primary SSN is

input, FTBOL will literally identify the Rules "fired" for both the primary and secondary TIN, with an "X" . The Rules "fired" are also highlighted for better visualization.

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6. Check one of the blank issue boxes on Letter 566-S and fill in: **First Time Homebuyer Credit**, or **Special Rule for Long Time Resident**. Request documentation on Form 886 to validate the qualifying conditions for the credit. (Use Form 886-H-FTHBC/WHBAA, *First-Time Homebuyer Credit Worker, Homeownership and Business Assistance Act of 2009 Supporting Documents*, for 2009 returns when requesting documentation for the First Time Homebuyer Credit and a settlement statement is attached to the return. Use Form 886-H-FTHBC, *First-Time Homebuyer Credit Supporting Documents*, and LTR when requesting documentation for the First Time Homebuyer Credit and the settlement statement is questionable or not attached to the return.) This is not an all-inclusive list and multiple documents can be used in conjunction to make your determination. Additional documentation may be requested based on the circumstances of

each individual case – including taxpayer written responses and/or telephone calls.

7. Use Form 886-H-FTHBC-LTR, *First-Time Homebuyer Credit or Special Rule for Long-Time Resident Supporting Documents*, when requesting documentation for the Special Rule for Long Time Resident and a settlement statement is attached to the return. The following documents are requested to verify that the taxpayer is a long time resident who lived in the same principal residence for 5 consecutive years:

- Copy of the closing contract (for example, the HUD-1 Settlement Statement) bearing the name(s) of the buyer(s), and date of transaction for the prior residence.
- Copies of real estate taxes paid for the property for at least five consecutive years; the information should show the dwelling/improvements located on the land
- Yearly mortgage interest statements for five consecutive years
- Any other information that indicates ownership of the prior principal residence, and that the home was used as a principal residence for five consecutive years. This may include copies of homeowner insurance policies, statements from utility companies, or school records which show the name(s) and address.

Note:

The taxpayer may send any of the above for any year so long as the information is for five consecutive years.

Example:

The taxpayer sends mortgage interest statements for three consecutive years, insurance for one year, and real estate taxes for two years for the same residence. Each item is for a different year, and altogether represents five consecutive years.

8. To verify the new property as a principal residence, at least two of the following documents are requested on Form 886-H-FTHBC-LTR:
- A copy of the taxpayer's current driver's license or other state-issued identification showing the home address
 - A copy of a recent pay statement (within the last two months) showing the taxpayer's name and home address
 - A copy of a recent bank statement (within the last two months) showing the name and address

- A copy of a current automobile registration showing the name and home address
 - Confirmation of change of address from the U.S. Post Office showing former and current addresses
 - Contract from moving company for the taxpayer's receipt of transported household items showing points of origination and destination
9. Use Form 886-H-FTHBC or Form 886-H-FTHBC-LTR for returns when requesting documentation for either the First Time Homebuyer Credit or the Special Rule for Long Time Resident and the settlement statement is questionable, or not attached to the return. Form 886-H-FTHBC or Form 886-H-FTHBC-LTR, in addition to information requested in Paragraphs (7) and (8) shown above, requests the taxpayer to verify the details of the purchase of a new principal residence and asks for the following verification:
- A copy of the settlement statement which includes the property address, the buyer(s) and seller(s) names, purchase price, and date of transaction. If the settlement statement is unsigned, also provide a copy of the final purchase/sale contract which includes all signatures.
 - If a mobile home was purchased, a copy of the executed retail sales contract which includes the property address, the seller(s) and buyer(s) names, purchase price and date of purchase.
 - A copy of the recent monthly/quarterly mortgage statement.

Note:

If the purchase was financed through a private mortgage and statements are not available, the taxpayer must provide a copy of the front and back of a cancelled check from a payment made within the last three months. If the purchase was a cash sale, proof is needed that the property was paid for – a copy of the cancelled check(s) (front and back) or other payment instrument.

- If the new principal residence is constructed by taxpayer or reconstructed by the taxpayer, the taxpayer should attach a copy of the certificate of occupancy. If a taxpayer is in a county that does not require a certificate of occupancy, the taxpayer must provide the following: (1) a statement that a certificate of occupancy is not available, (2) documentation to substantiate the new home construction, such as sales tickets for buildings materials, and (3) proof that the taxpayer occupies the home, such as utility bill.

4.19.15.38.4 (01-01-2017)

Evaluating Responses

1. Evaluate responses to ensure FTHBC/LTR qualifications are met and that documents submitted contain all of the required signatures as stated on the Form 886-H-FTHBC/Form 886-H-FTHBC-LTR . Review all documentation to ensure that information such as names, addresses, dates, and purchase price, in and among the documents received, stand in correlation.
2. CC FTBOL, if present, will identify the rules "fired" for case selection. If this and/or other IDRS research conducted (*IRM 4.19.15.38.3., Research and Initial Contact*) reveal conditions that may indicate prior home ownership, evaluate documentation as follows:

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3. Perform IDRS research on any co-buyers listed on the Settlement Statement (or otherwise provided by the taxpayer) to determine if they also took the FTHBC.

If	And	Then
A co-buyer (Taxpayer B) has also claimed the maximum amount of FTHBC allowed for the property.	There is no open examination on Taxpayer B, and Taxpayer B was allowed a FTHBC refund (the refund was not frozen).	Disallow the FTHBC for Taxpayer A, and inform Taxpayer A that the maximum FTHBC has already been taken by the co-buyer of the property.

If	And	Then
A co-buyer (Taxpayer B) has also claimed the maximum amount of FTHBC allowed for the property.	There is an open examination on Taxpayer B and/or Taxpayer B's FTHBC refund was frozen.	<ul style="list-style-type: none"> • Associate the cases and work together. If Taxpayer B does not currently have an open audit for FTHBC, open the audit. • Inform both taxpayers that a co-buyer have claimed the maximum amount of FTHBC allowed on the property. Taxpayers A and B must coordinate the allocation of the credit, as to not to exceed the maximum credit allowed for the property.
A co-buyer (Taxpayer B) has already been allowed a FTHBC that, when added to the amount Taxpayer A is claiming, exceeds the maximum amount of FTHBC allowed for the property.	There is no open examination on the Taxpayer B and Taxpayer B was allowed a FTHBC refund (the refund was not frozen).	Reduce the FTHBC for Taxpayer A so that the sum of all FTHBC claimed does not exceed the maximum amount allowed for the property. Inform the taxpayer that the FTHBC is being reduced because of the amount previously allowed to the co-buyer.

If	And	Then
A co-buyer (Taxpayer B) has already been allowed a FTHBC that, when added to the amount Taxpayer A is claiming, exceeds the maximum amount of FTHBC allowed for the property.	There is an open examination on Taxpayer B and/or Taxpayer B's FTHBC refund was frozen.	<ul style="list-style-type: none"> • Associate the cases and work together. If Taxpayer B does not currently have an open audit for FTHBC, open the audit. • Inform both taxpayers that co-buyers have claimed the maximum amount of FTHBC allowed on the property. The taxpayers A and B must coordinate the allocation of the credit, as to not exceed the maximum credit allowed for the property.
No other co-buyer claimed the FTHBC.	Taxpayer A meets all FTHBC qualifications.	Allow FTHBC.

4. There may be instances where some documents requested by Examination are not available to the taxpayer. In evaluating correspondence or speaking to the taxpayer on the phone, it is proper to suggest alternative sources to assist taxpayers in meeting our documentation requirements. Some examples:

- a. A letter from a government agency (city, town, county or state) on official letterhead, bearing the official raised seal and original signature(s).
- b. Statements from the mortgage company which shows the name of the owners, address of the property, and date of ownership.
- c. A certified copy of the purchase contracts/documents can be obtained from the real estate broker or closing attorney.
- d. To assist in proving residency, the following documents, only if they show the taxpayer's address, may be considered with other documents submitted by the taxpayer:

Additional Documents that may be Considered

Additional Documents that may be Considered

- a. Valid insurance policy – auto, home or life
- b. School records that contain satisfactory information on the identity and relationship of the parent/guardian to the child in school
- c. Installment loan contract from a bank or other financial institution
- d. Major credit card bill issued within the last sixty days
- e. Utility bill issued within the last sixty days
- f. Public assistance check stub or food stamp card issued by a government agency
- g. Confirmation of change of address from U.S. Post Office
- h. Contract from moving company for the taxpayer's receipt of transported household items, showing points of origination and destination.

5. Any such document can be used alone if it shows all of the information needed to substantiate the credit (including primary residency information), or in conjunction with other acceptable documents received.

4.19.15.38.5 (11-29-2011)**Problem Correction Report**

1. The Problem Correction Report identifies pre-refund cases where the refunds held with a TC 810 may have been processed incorrectly. Refer to IRM 4.19.13.29, **Problem Correction Reports**, for procedures for working this report.

4.19.15.38.6 (12-01-2017)**Establishing Taxpayer Residency Status**

1. Taxpayers claiming the First Time Homebuyer Credit must be residents of the United States (U.S.). Consequently, taxpayers claiming the FTHBC should certify that they have not claimed treaty benefits as a resident of a treaty country pursuant to the tiebreaker rule in an income tax treaty. Ordinarily, alien taxpayers who have Alien Registration Cards (Green Cards) are considered residents of the U.S. under IRC 7701(b) and are issued an SSN.

2. An ITIN is issued by the Service to an alien individual who does not qualify for an SSN, but who has a filing requirement for tax purposes. Since individuals with ITIN's may or may not be residents of the U.S., an individual who files a return using an ITIN is not automatically barred from claiming the FTHBC. Alien individuals who do not have green cards are considered U.S. residents if they meet the Substantial Presence Test under IRC 7701(b).
3. To meet the Substantial Presence Test for calendar year (January 1 to December 31), taxpayers must be physically present in the U.S. for at least 31 days during the current year, and at least 183 days during the three year period that includes the current year and the two immediately preceding years.
4. For computing the 183 days count:
 - a. All days present (qualifying days) in the U.S. in the current year,
 - b. 1/3 of the qualifying days in the immediate preceding year,
 - c. 1/6 of the qualifying days in the second preceding year

Example:

A taxpayer submits information for his 2009 return and is able to show that he was present in the U.S for 60 days in 2007, 100 days in 2008, and 120 days in 2009.

Computation

Step	Action
Step 1	60 days $\times \frac{1}{1} = 10$ days present in the US. in 2007 100 days $\times \frac{1}{3} = 33$ days present in the U.S. in 2008
Step 2	10 days + 33 days + 120 days = 163 days

In this example, the taxpayer did not establish U.S. residency in 2009 by meeting the Substantial Presence Test, and the FTHBC would not be allowable.

5. The following language may be used on a separate Form 886-A (do not add it to the standardized Forms 886-H that are used for the credit):
 - **A person must be a resident of the United States (U.S.) to qualify for the First Time Homebuyer Credit. Because you are filing your tax return using an Individual Tax Identifying Number (ITIN), we need to verify that you were a resident of the U.S. within the meaning of Internal Revenue Code (IRC) 7701(b).**

- You are a resident of the U.S. for tax purposes under IRC 7701(b) if you are either a lawful permanent resident of the U.S. (known as the green card test) or meet the substantial presence test for the calendar year (January 1 to December 31). You qualify as a resident of the U.S. for 20XX under the Substantial Presence Test if you were physically present in the United States; or at least 31 days during 20XX, **and**, The total number of days in the U.S. for 20XX plus the two preceding calendar years equals or exceeds 183 days. (To determine the number of days present, count all the days present in the U.S. for 20XX, 1/3 the days present in 20XX, and 1/6 the days present in 20XX.)
 - You are a resident of the U.S. for tax purposes under IRC 7701(b) if you are either a lawful permanent resident of the U.S. (known as the green card test) or meet the substantial presence test for the calendar year (January 1 to December 31).
 - If you were lawfully admitted for permanent residence, please provide a copy of your alien registration card or **Green Card**
 - If you are a resident qualifying under the Substantial Presence Test for 20XX, we need you to provide copies of at least two of the following for 20XX and each of the two preceding years; Employee check statements for wages paid, (the information should show your name, address, and the date); Copy of your lease agreement and cancelled checks paid for rent; Certified letter from your employer(s) showing the length of your employment, and; Any other information which shows your residence and includes your name, address, and a date. It should contain a letterhead and/or telephone number of a person to contact.
 - We also need you to certify that you have not claimed treaty benefits as a resident of a treaty country pursuant to the tiebreaker rule in an income tax treaty for calendar year 20XX.
 - Please return the requested information with a copy of the letter in the envelope provided.
6. In evaluating the taxpayer's response, ensure that the taxpayer's name in the submitted documents match the name reported on the tax return. If the names do not match, U.S. residency has not been established unless the taxpayer is able to establish a legal basis for the different names.
7. Filing a tax return in prior years establishes that at some point in time, the taxpayer was present in the U.S., however it does not establish the number of days present in the U.S. The number of days present is needed to establish residency in computing the Substantial Presence Test.

4.19.15.38.7 (12-01-2017)

Accelerated Recapture of the First-Time Homebuyer Credit

1. Taxpayers are required to repay the First Time Homebuyer Credit if the home is disposed of or ceases to be the taxpayer's main home before the end of the recapture period.
2. For homes purchased in 2008, taxpayers generally must repay all remaining annual installments in the year the disposition occurred if the taxpayers disposed on the home during the 15-year recapture period.
3. For homes purchased in 2009 and 2010, taxpayers must generally repay the credit in the year of the disposition if the disposition occurred within 36 months of the purchase date.
4. If the home is sold to an unrelated person, repayment in the year of the sale is limited to the amount of the gain on the sale. For taxpayers that meet this standard, the taxpayer will reduce the adjusted basis of the home by the amount of the credit.

Note:

A gift of a home to a relative or non-relative, including a part sale/part gift triggers full repayment of the credit. The gain limitation does not apply to the taxpayer's repayment liability.

5. The following dispositions require accelerated repayment:
 - The home was sold
 - The entire home was converted to business or rental property
 - The home was abandoned, other than in the face of foreclosure
 - The lender foreclosed on the mortgage
 - The home is no longer the taxpayer's main home
6. Exceptions to the acceleration rule:
 - Death of a taxpayer
 - Involuntary conversion
 - Transfers between spouses / divorce
 - Qualified official extended duty for members of the Armed Services, members of the Foreign Service of the United States, or members of the Intelligence community (dispositions of cessations after Dec. 31, 2008 only)
7. Taxpayers must file Form 5405, *First-Time Homebuyer Credit and Repayment of the Credit*, with the appropriate box checked in Part III, with their Form 1040, *U.S. Individual Income Tax Return*.

8. When manually adjusting the FTHBC recapture amount, specific reference numbers must be used with each adjustment. For more information about manually adjusting the First-Time Homebuyer Credit, see IRM 21.6.4.4.18.4 *Manually Adjusting the Recapture Amount*.

Caution:

When manually transferring the repayment amount to the liable taxpayer (when both taxpayers are no longer liable due to a divorce, for example.) be sure the repayment amount shows on CC IMFOLF under the correct liable primary or secondary taxpayer’s SSN.

4.19.15.38.8 (11-29-2011)

Procedures for TY 2008 FTHBC Returns

1. Taxpayers claiming the First-Time Homebuyer Credit on their 2008 returns must repay the credit in installments of up to \$500.00 beginning on their 2010 tax return.
2. Taxpayers who fail to include the repayment on their return will have the repayment added to the 2010 return as a math error.
3. The repayment will be reflected on line 59 of CC RTVUE or with Math Error Code 648 (if the repayment was added as a math error).
4. If the taxpayer responds, the employee must perform IDRS research to determine if the taxpayer reported the repayment on the 2010 return. The following table provides procedures for addressing the FTHBC installment payment.

IF	AND	THEN
The FTHBC was disallowed	The taxpayer signed the agreement.	Prepare a Letter 89C, selecting paragraphs F and R. In paragraph F, include the following statement: "We have closed your case based on your signed agreement dated mm/dd/yyyy. Our records indicate that a repayment installment of the First-Time Homebuyer Credit was included on your 2010 return. In order to recover this repayment, you must file a Form 1040X." Select additional paragraphs (as needed) based on the facts of the case. Close the case agreed per IRM 4.19.13.10, <i>Taxpayer Replies</i>

IF	AND	THEN
The taxpayer submits a full payment before the issuance of the Notice of Deficiency.	N/A	Prepare a Letter 89C, selecting paragraphs F and R. In paragraph F, include the following statement: "We have closed your case based on payment dated mm/dd/yyyy. Our records indicate that a repayment installment of the First-Time Homebuyer Credit was included on your 2010 return. In order to recover this repayment, you must file a Form 1040X." Select additional paragraphs (as needed) based on the facts of the case. Close the case agreed per IRM 4.19.13.12, <i>No Response and Unagreed Cases</i> . Prepare a Letter 555 and Form 886A. On the Form 886A, inform the taxpayer that he must file a Form 1040X to recover the repayment installment reported on the 2010 return. Close the case default per IRM 4.19.13.10.1, <i>Taxpayer Responses – Additional Information Needed</i> .
The taxpayer submitted documentation after the issuance of the Notice of Deficiency	The case is being closed default	Prepare a 555 letter and Form 886A. On the Form 886A, inform the taxpayer that he must file a Form 1040X to recover the repayment installment reported on the 2010 return. Close the case default per IRM 4.19.13.9.1, <i>Taxpayer Responses - Additional Information Needed</i> .
During the examination, you determine that the taxpayer is not eligible for the First-Time Homebuyer Credit	N/A	Use the appropriate letter based on the status. On the Form 886A, specify the reasons that the taxpayer does not qualify for the credit. (Example: We disallowed the credit because you did not live at the residence at the end of the tax year.) Inform the taxpayer that he must file a Form 1040X to recover the repayment installment reported on the 2010 return.

5. Whenever possible, examiners should include a Form 1040X with their response.

4.19.15.39 (12-01-2017)**Multiple Filers**

1. A multiple filer situation occurs when a TIN is used for a primary taxpayer on one return and a secondary taxpayer on another return.
2. When this filing situation occurs, Masterfile will post the second return as outlined in IRM 21.6.7.4.5, *Multiple Uses of Taxpayer Identification Numbers – CP 36F (DUPTIN Filing Condition) (Worked in Brookhaven (IMF), paragraph (2), and Philadelphia Accounts Management Only (International))*.
3. AM (Accounts Management) has contacted the common taxpayer for additional information to resolve the situation. Cases not resolved by AM will be routed to Examination Classification.
4. If selected for Correspondence Exam, one return will be a joint return and the other return a non-joint return (Single, Head of Household or Married Filing Separate). The case file should contain the taxpayer's response to AM to assist with processing these cases.
 - If not selected, the filing status should be corrected to MFS with no change to the tax. Remove the secondary TIN with no change to the tax.
5. Selected returns will be opened in Source Code 04, PC 0982. Cases should be worked together because responses may impact either case; however, if both taxpayers were contacted and there is sufficient documentation to close one of the cases, it should be closed. This program could involve the following return scenarios:
 - Joint return followed by a separate return before the due date of the return.
 - Separate return followed by a joint return before the due date of the return.
 - Joint return followed by a separate return after the due date and the filer of the separate return indicates he/she did not file the joint return
6. The inventory will be centralized in Ogden and Brookhaven.

4.19.15.39.1 (03-11-2019)**Initial Contact**

1. If a joint return is filed and a subsequent separate return is received before the due date of the return, the subsequent separate return supersedes the joint return for the filer of the separate return only. The correct information for the filer that did not file a superseding return will be determined by

examination. For returns filed on paper, conduct IDRS research to determine which return was filed first.

- If none of the income on the joint return belongs to the taxpayer filing the non joint return, the case should be handled as follows:

If	And	Then
Non-joint taxpayer states he/she is not married	Provides a copy of a divorce decree	On the joint return, change the Filing Status (FS) to single and change the standard deduction amount. Disallow the spousal exemption. Review Form 6754, <i>Examination Classification Checksheet</i> , for additional items such as duplicate dependency exemptions. All issues should be identified on the ICL. The non-joint return filer need not be contacted if the non-joint return was filed correctly.
Taxpayers are married but the filer of the separate return did not sign the joint return.	NA	Change the filing status on the joint return to MFS and change the standard deduction amount. Consider any statutory adjustments or other tax benefits such as EITC. Disallow the spousal exemption. Review Form 6754, <i>Examination Classification Checksheet</i> , for additional items such as duplicate dependents. If the separate return is other than MFS, the non-joint taxpayer should be contacted about filing status as well as any duplicate dependency issues. All issues should be identified on the ICL.
No information is available to determine correct FS for both returns	NA	Change FS to MFS on both returns; include any statutory adjustments as well as any items identified on Form 6754, Examination Classification checksheet . All issues should be identified on the ICL.

- If income reported on the joint return belongs to the non-joint return, remove the income and adjust the tax/credits accordingly.
- Issue Letter 566-S, checking the appropriate boxes for items classified.

- If the non-joint return is not contacted, retain the two cases together and upon closing, survey using DC (Disposal Code) 32.

Note:

When changing FS to MFS, if one itemizes, both must itemize. If unable to determine entitlement for duplicate dependency exemptions, disallow on both returns until verification of entitlement is received.

2. If a separate return is filed before the due date of the return, followed by a joint return election; determine if the request for a married filing joint election is valid. Refer to IRM 25.6.1.9.4.4 , *Joint Return After Separate Return*. For paper and electronically filed returns, conduct IDRS research **before** issuing 566-S. Research should include CC IRPTR, INOLES, NAMES and ACCURINT. If no reply from the common taxpayer, follow the procedures in the table below:

If	And	Then
No reply from the common taxpayer	Return was timely filed	<ol style="list-style-type: none"> a. Compare the data on the FS 1/3/4 return to the joint return to verify income/withholding is reported. b. If any of the income on the FS 1/3/4 return was not reported on the FS 2/6 return, send Letter 566S, Initial Contact Letter, <i>checking the appropriate for items classified</i>, to the common taxpayer. Do not back out the FS 1/3/4 return. c. If no response to Letter 566S after 30 days (hold for 45 days), process the amended return for the taxpayer who has not filed as an original return using FS 3.

Note:

Care must be taken when processing statute year claims to prevent erroneous abatements. The filing of a married filing joint return subsequent to separate return(s) may affect the Assessment Statute Expiration Date (ASED). The Service will have at least one year from the actual filing of a married filing joint return to make an assessment, IRC Section 6013(b)(4).

Caution:

Each situation is different and all scenarios cannot be addressed in the IRM. All accounts should be adjusted using the facts and knowledge of the case. All decisions, facts, or findings must be documented in the workpapers.

3. If a separate return is filed after the due date of the return, when the joint return was not signed by the non-joint taxpayer, follow the procedures below. For paper filed returns, conduct IDRS research to determine if return was properly signed. See IRM 4.19.11.2.17, *Unlawful Returns - Joint Filed Returns*, if it is determined that the return was not signed.
 - If the income reported on the joint return belongs to the non-joint return, remove the income and adjust the tax/credits accordingly.
 - Issue Letter 566-S, checking the appropriate boxes for items classified.
 - The non-joint return filer is not contacted, retain the two cases together and upon closing, survey using DC 32.

4. If a separate return is received after the due date of the return and it is not accepted, the joint return is the return of record. For paper returns, conduct IDRS research to determine which return was filed first.
 - If the income reported on the separate return is not included on the joint return, add the income to the joint return.
 - Issue Letter 566-S, checking the appropriate boxes for items classified.

Note:

Submission Processing is required to correspond for missing signatures on joint returns. If no response is received, the CCC (Computer Condition Code) is set to a "3" and a TC 570 is input to freeze the account. (See IRM 3.11.3.5.3.2, *No Reply/Incomplete Reply/Undeliverable Correspondence* and IRM 3.12.37.26.2, *Signature Requirements*). IMFOLR will display the CCC on an account.

5. Disclosure of returns is subject to the disclosure rules under section 6103. If a joint return is filed, both spouses to whom the return relates are entitled to access the return. In the case of a return of an individual, however, only that individual can generally obtain a copy of the return. See IRC 6103(e)(1) and/or IRM 11.3.2.4 , *Persons Who May Have Access to Returns and Return Information Pursuant to IRC §6103(e)*.

6. If there is an Innocent Spouse control or the taxpayer requests relief from the liability, contact your Innocent Spouse Coordinator.

4.19.15.39.2 (03-11-2019)

Responses

1. Responses should be handled as follows:

If	And	Then

If	And	Then
Taxpayer submits a joint return with only primary taxpayer's income	Signature of spouse is on the return along with proof of signature (statement from spouse along with copy of driver's license or similar proof of signature) or you can determine signature is valid	Issue Letter 539 and Form 4549 to include all income on the joint account. Prepare Form 4549 on the non-joint account to back out account and follow separate to joint procedures. If dependents were classified due to duplication, taxpayer would not be required to substantiate dependency exemptions. Close agreed based upon Form 1040-X if figures match, otherwise request signature.
Taxpayer submits joint return with all income	Signature of spouse is on the return along with proof of signature (statement from spouse along with copy of driver's license or similar proof of signature) or you can determine signature is valid	Close agreed based upon Form 1040-X if figures match; otherwise request signature.
Taxpayer states that return was signed by spouse	No proof of signature (letter from spouse with no proof of signature) or signatures do not match	Issue Letter 545, prepare Form 4549 and disallow all classified issues. Ask for proof by requesting a picture ID with signature, such as a driver's license.
Taxpayer states returns do not belong to taxpayer	Appears to be different taxpayers	Follow IRM 4.19.13.27, <i>Mixed Entity Procedures</i> .

If	And	Then
Taxpayer states taxpayer has never been married	IDRS research indicates only joint return was filed	Issue Letter 525, Form 4549, and change FS to Single. Disallow spousal exemption.
Taxpayer states taxpayer is married, but the spouse did not live with the taxpayer during the last six months of the tax year	Taxpayer verifies that the spouses did not live together during the last six months; taxpayer provides proof such as lease agreements and utility bills	Follow IRM 4.19.14.6.7, <i>Problem Correction Reports</i> .

Note:

Care should be taken to ensure that any warranted adjustments on the secondary or separate return are not overlooked. Due to the possible adverse impact on these returns, both returns should be closed at the same time. Self-assign both cases and work them at the same time. See IRM 4.19.19.6.1, *Self-Assign General*, paragraphs (5) and (6). Each taxpayer should be advised of the final outcome.

4.19.15.39.3 (12-01-2017)**Additional Closing Actions**

1. When closing cases, check the return filed second for TC 570. If there is a TC 570, release the freeze upon closing.
2. If an AM09 transcript is received from Accounts Management, the transcript must be worked to release any monies frozen on the account.

4.19.15.40 (12-01-2017)**Alternative Motor Vehicle Credit, Qualified Electric Vehicle Credit, or Qualified Plug-In Electric Drive Motor Vehicle Credit**

1. The Emergency Economic Stabilization Act of 2008 (ESSA) and the American Recovery and Reinvestment Act of 2009 (ARRA) created tax credits for various types of electric vehicles.
2. The Qualified Plug-in Electric Drive Motor Vehicle Credit, Qualified Electric Vehicle Credit, and the Alternative Motor Vehicle Credit are claimed by filing Form 8936, *Qualified Plug-in Electric Drive Motor Vehicle Credit*, Form 8834, *Qualified Electric Vehicle Credit*, Form 8910, *Alternative Motor Vehicle Credit*, respectively with Form 1040.
3. Vehicles must meet certain requirements. Generally, you can rely on the manufacturer's (or in the case of a foreign manufacturer, its domestic distributor's) certification that a specific make, model, and model year vehicle qualifies for the credit if that manufacturer or importer chooses to certify to the IRS that its vehicle meets the statutory test. Qualified Electric Motor Vehicle Credit examinations will open in Source Code 06, Project Code 1045 with the following tracking codes:

Tracking Code	Project Code 1045
6392	Form 8936, <i>Qualified Plug-In Electric Drive Motor Vehicle Credit</i> for Four-Wheeled Vehicles (this form also includes the credit for 2-wheeled plug in electric vehicles acquired in 2015 and 2016 and the 2- and 3-wheeled plug-in electric vehicles acquired in 2012 and 2013)
6393	Form 8834, <i>Qualified Plug-In Electric and Electric Vehicle Credit</i> for 4-Wheeled Low-Speed, 2 or 3-Wheeled Vehicle acquired before 2012
6394	Form 8910, <i>Alternative Motor Vehicle Credit</i>

4. Letter 566B (CG) is issued as the ICL/30 Day Combo letter with Form 4549, updated to Status 22.
5. Enter the vehicle credit form number (8910, 8834, or 8936) filed with Form 1040 in the fill-in box on Letter 566B (CG).
6. Include Form 886-A, *Explanation of Items*, for the appropriate forms as shown in IRM 4.19.15.40.5, *Taxpayer Explanations For Form 886-A*.

4.19.15.40.1 (12-01-2017)

IRC 30D - Qualified Plug-In Electric Drive Motor Vehicle Credit

1. Form 8936 is used to claim the Qualified Plug-In Electric Drive Motor Vehicle Credit. Line 23, reflecting the smaller of line 19 or line 22 is entered on line

54 of Form 1040 or line 51 of Form 1040 NR.

2. The credit applies to qualified plug-in electric drive motor vehicles acquired after Dec. 31, 2009. The minimum amount of the credit for qualified plug-in electric drive vehicles is \$2,500 and the credit tops out at \$7,500 depending on the battery capacity.
3. To qualify, the vehicle must:
 - a. Be a new vehicle with four or more wheels,
 - b. Have a gross vehicle weight rating of less than 14,000 pounds,
 - c. Draw propulsion using a battery with at least four-kilowatt hours that can be recharged from an external source of electricity, and
 - d. Be manufactured primarily for use on public streets, roads, and highways.
4. The following requirements must also be met:
 - a. Original use of the vehicle began with the taxpayer,
 - b. The vehicle was acquired for personal use or to lease to others, not for resale,
 - c. The vehicle must be owned and not leased,
 - d. The vehicle was placed in service during the tax year, and
 - e. The vehicle is used primarily in the United States.
5. The credit is subject to a phase-out (reduction) once the vehicle manufacturer (or, for a foreign manufacturer, its domestic distributor) sells 200,000 vehicles after 2009. The reduction begins in the second calendar quarter after the quarter in which the 200,000th vehicle was sold. Then the reduction allows 50% of the full credit for 2 quarters, 25% of the full credit for 2 additional quarters, and no credit thereafter.
6. Tentative credit amounts acknowledged by the IRS are available at www.irs.gov. To view these amounts or check for updates search for "Qualified Plug-in Electric Drive Motor Vehicles (IRC 30D)"
7. Any unused portion of the personal credit is lost and cannot be carried forward or back.
8. For more information see Questions and Answers, Notice 2009-54 (2009-26 I.R.B. 1124) and Notice 2009-89 (2009-48 I.R.B. 714). For more information you may also see Notice 2012-54, Notice 2013-67 and Notice 2016-51.

9. For Form 886-A, **Explanation** and Form 8936 *Qualified Plug-In Electric Drive Motor Vehicle Credit* please refer to IRM 4.19.15.40.5, *Taxpayer Explanations for Form 886-A*, paragraph (4).

4.19.15.40.2 (03-11-2019)

IRC 30 – Qualified Plug-In Electric and Electric Vehicle Credit

1. Form 8834 is used to claim a credit for certain two or three wheeled vehicles or low speed vehicles with four wheels acquired after February 17, 2009 and before January 1, 2012. For 2- or 3-wheeled vehicles (but not low speed vehicles) described in section 30 acquired after December 31, 2011 and before January 1, 2014, the same credit is now set forth in new section 30D(g) and is claimed on Form 8936. (The 2-wheeled vehicle credit also available in 2015 and 2016 under section 30D(g) and claimed on Form 8936.)

Note:

Section 30 was repealed effective December 19, 2014

2. The amount of the credit is 10 percent of the cost of the vehicle, up to a maximum credit of \$2,500.
3. Form 8334 (2014 version), line 7, which reflects the smaller of line 1 or line 6 is reported on line 54 of Form 1040 or line 51 of Form 1040 NR.
4. To qualify, the vehicle must:
 - a. Be manufactured primarily for use on public streets, roads, and highways,
 - b. Have a gross vehicle weight rating of less than 14,000 pounds,
 - c. Be a low speed vehicle if it has 4 wheels, and
 - d. Be propelled, to a significant extent, by electric motor that draws electricity from a battery that has a capacity not less than 4 kilowatt hours (2.5 kilowatt hours for 2 or 3 wheeled vehicles) that can be recharged from an external source of electricity.
5. The requirements listed under *IRM 4.19.15.40.1*, *IRC 30D – Qualified Plug-In Electric Drive Motor Vehicle Credit*, paragraph (4), must be met.
6. Any unused portion of the personal credit is lost and cannot be carried back or forward.
7. For more information see: Fact sheet 2009-10 and Notice 2009-58.
8. For Form 886-A, *Qualified Plug-In Electric and Electric Vehicle Credit – Form 8834 explanation* See *IRM 4.19.15.40.5, Taxpayer Explanations for Form 886-A*, paragraph (3).

Note:

If a qualified plug-in electric vehicle acquired before 2010 also qualifies for the plug-in electric drive motor vehicle credit on Form 8936, no credit is allowed for that vehicle on Form 8834.

4.19.15.40.3 (03-11-2019)

IRC 30B - Alternative Motor Vehicle Credit

1. Form 8910 is used to claim the Alternative Motor Vehicle Credit or credit for plug-in electric vehicle conversions. Line 15, reflecting the smaller of line 11 or line 14 of Form 8910 is reported on line 54 of the Form 1040 or line 51 of Form 1040 NR.
2. Section 30B also provides a tax credit for plug-in electric drive conversion kits.
3. The credit is equal to 10% of the cost of converting a vehicle to qualified plug-in electric drive motor vehicle and the conversion must be made before Jan. 1, 2012. The maximum amount of the credit is \$4,000.
4. A taxpayer may claim this credit even if the taxpayer claimed a credit under Section 30B for the same vehicle in an earlier year.
5. An alternative motor vehicle is a vehicle with at least four wheels that qualifies as one of the following types of vehicles:

Type of Vehicle	Requirements
Advanced lean burn technology vehicle. Vehicle must have been purchased prior to 1/1/2011.	New vehicles with an internal combustion engine that incorporated direct injection, designed to operate primarily using more air than is necessary for complete combustion of the fuel, and meets certain additional requirements.
Qualified Hybrid vehicle. Heavy Hybrid Vehicles must have been purchased prior to 1/1/2010. Hybrid passenger automobiles and light trucks must be purchased before 1/1/2011.	New vehicles that draw propulsion energy from onboard sources of stored energy, that are both an internal combustion or heat engine using consumable fuel and rechargeable energy storage system, and meets certain additional requirements.

Type of Vehicle	Requirements
Qualified Alternative fuel vehicle. Vehicle must have been purchased prior to 1/1/2011.	New or converted vehicles fueled solely by compressed natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, any liquid that is at least 85% methanol, or a mixture of one of these fuels and a petroleum-based fuel, and that meets certain additional requirements.
Qualified fuel cell vehicles. Vehicle must have been purchased prior to 1/1/2018.	New vehicles propelled by power derived from one or more cells that convert chemical energy directly into electricity by combining oxygen with hydrogen fuel and that meets certain additional requirements.
Qualified plug-in electric motor vehicle. The conversion must be done prior to January 1, 2012, in order to qualify for the credit.	Vehicles converted (and then placed in service after February 17, 2009) to be propelled to a significant extent by an electric motor that draws electricity from certain batteries capable of being recharged from an external source of electricity and meets certain additional requirements.

6. The requirements listed under *IRM 4.19.15.40.1* , *IRC 30D – Qualified Plug-In Electric Drive Motor Vehicle Credit*, paragraph (4), must be met.
7. A taxpayer is not eligible for this credit if they are entitled to the Qualified Plug-in Electric Drive Motor Vehicle Credit on Form 8936 or the Qualified Electric Vehicle Credit Form 8834.
8. Any unused portion of the personal credit is lost. It cannot be carried forward or back.
9. For additional questions see www.irs.gov and search for "Alternative Motor Vehicle Credit" .
10. Form 886-A, Alternative Motor Vehicle Credit - Form 8910 Explanation, please refer to *IRM 4.19.15.40.5, Taxpayer Explanations For Form 886-A*, paragraph (2).

4.19.15.40.4 (12-01-2017)

Special Situations and Replies

1. Taxpayers may claim the correct amount of credit on the wrong form. Before a credit can be disallowed, the examiner should review all vehicle listings

prior to making a determination.

Note:

Cadillac, Hummer and Hummer H3 trademark is used by the American Custom Golf Carts. These vehicles use a Trojan battery. It is important to note that Model Year 2009 Cadillac Escalade 2WD Hybrid is qualified for credit of \$2,200 and Cadillac Escalade AWD Hybrid is qualified for a credit of \$1,800 on Form 8910. Model Year 2010 Cadillac Escalade 2WD Hybrid and Cadillac Escalade 4WD Hybrid are qualified for a credit of \$2,200 on Form 8910.

2. A credit claimed on an incorrect form should be processed as follows:

If	And	Then
The taxpayer claims a vehicle on Form 8834 that should have been claimed on Form 8936 or Form 8910	The amount claimed is the allowable amount from either Form 8936 or Form 8910	Allow the credit
The taxpayer claims a vehicle on Form 8834 that should have been claimed on Form 8936 or Form 8910	The amount claimed exceeds the allowable amount	Disallow the portion of the credit that exceeds the allowable amount
The taxpayer claims a vehicle on Form 8936 that should have been claimed on Form 8834 or Form 8910	The amount claimed is the allowable amount from either Form 8834 or Form 8910	Allow the credit
The taxpayer claims a vehicle on Form 8936 that should have been claimed on Form 8834 or Form 8910	The amount claimed exceeds the allowable amount	Disallow the portion of the credit that exceeds the allowable amount
The taxpayer claims a vehicle on Form 8910 that should have been claimed on Form 8834 or Form 8936	The amount claimed is the allowable amount from either Form 8834 or Form 8936	Allow the credit
The taxpayer claims a vehicle on Form 8910 that should have been claimed on Form 8834 or Form 8936	The amount claimed exceeds the allowable amount	Disallow the portion of the credit that exceeds the allowable amount

3. Processing Taxpayer Replies

If	And	Then
The requested documentation is sent in	It meets the criteria of the credit claimed	No change the case.
The bill of sale is sent in without the certification	The certification can be validated through the index to Manufacturers at https://www.irs.gov/businesses/small-businesses-self-employed/a-z-index-for-business	No change the case
The bill of sale is sent in without the certification	The certification <i>cannot</i> be validated through the Index to Manufacturers at https://www.irs.gov/businesses/small-businesses-self-employed/a-z-index-for-business	Refer to IRM 4.19.13.10.1, <i>Taxpayer Response - Additional Information Needed</i>

Note:

If the amount of credit claimed is incorrect: Revise the report to reflect the correct amount of allowable credit. On Form 886A state: **The amount of credit claimed on your original return was over the allowable limit for the credit. We have revised our report to reflect the amount of credit you are entitled to.** Refer to IRM 4.19.13.10.1, *Taxpayer Response - Additional Information Needed*.

4.19.15.40.5 (12-01-2017)**Taxpayer Explanations for Form 886-A**

1. The following explanations can be used for Form 886-A
2. **Alternative Motor Vehicle Credit - Form 8910 Explanation:** To be allowed the Alternative Motor Vehicle Credit you must provide documentation that qualifies you for this credit. Please provide a copy of the valid sales contract and the manufacturer's certification, or the domestic distributor's certification if a foreign manufacturer, for each vehicle claimed on the Form 8910. In addition to certification, the following requirements must be met to qualify for the credit:
 - a. You are the owner of the vehicle. If the vehicle is leased, only the lessor and not the lessee, is entitled to the credit.

- b. You placed the vehicle in service during your tax year.
- c. The original use of the vehicle began with you.
- d. You acquired the vehicle for use or to lease to others, and not for resale, and e.
- e. You used the vehicle primarily in the United States.

Note:

If you claimed the credit for converting a motor vehicle to a qualified electric plug-in electric drive motor vehicle, please provide copies of receipts substantiating the costs of the conversion. The law requires that plug-in vehicle conversions have in-service dates after February 17, 2009 and that the conversions be made before January 1, 2012.

3. **Qualified Electric Vehicle Credit –Form 8834 Explanation:** To be allowed the Qualified Plug-in Electric and Electric Vehicle Credit you must provide documentation that qualifies you for this credit. Please provide a copy of the valid sales contract and the manufacturer’s certification, or the domestic distributor’s certification if a foreign manufacturer, for each vehicle claimed on the Form 8834. In addition to certification, the following requirements must be met to qualify for the credit:
- a. You acquired (a vehicle is not “acquired” before the date on which title to that vehicle passes under state law) the vehicle after February 17, 2009, and before January 1, 2012.
 - b. You are the owner of the vehicle. If the vehicle is leased, only the lessor and not the lessee, is entitled to the credit.
 - c. You placed the vehicle in service during your tax year.
 - d. The original use of the vehicle began with you.
 - e. You acquired the vehicle for use or to lease to others, and not for resale, and
 - f. The vehicle is manufactured primarily for use on public streets, roads, and highways, and not for off-road use, such as on a golf course.
 - g. You used the vehicle primarily in the United States.
4. **Qualified Plug-In Electric Drive Motor Vehicle Credit - Form 8936 Explanation:** To be allowed the Qualified Plug-In Electric Drive Motor Vehicle Credit you must provide documentation that qualifies you for this credit. Please provide a copy of the valid sales contract and the manufacturer’s certification, or the domestic distributor’s certification if a foreign manufacturer, for each vehicle claimed on the Form 8936. In

addition to certification, the following requirements must be met to qualify for the credit:

- a. You are the owner of the vehicle. If the vehicle is leased, only the lessor and not the lessee, is entitled to the credit.
- b. You placed the vehicle in service during your tax year.
- c. The original use of the vehicle began with you.
- d. You acquired the vehicle for use or to lease to others, and not for resale, and
- e. You used the vehicle primarily in the United States.

4.19.15.41 (03-11-2019)

Residential Energy Credits

1. The American Recovery and Reinvestment Act (ARRA) of 2009 revised and extended provisions of the Energy Policy Act of 2005. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 extended the Nonbusiness Energy Property Credit through 2011 and made other changes to this credit. The Nonbusiness Energy Property Credit expired on December 31, 2011, but the American Taxpayer relief Act of 2012 retroactively extended the Nonbusiness Energy Property Credit through 2013. The Tax Increase Prevention Act of 2014 extended the Nonbusiness Energy Property credit through 2014, and the Protecting Americans from Tax Hikes Act of 2015 extended the Nonbusiness Energy Property Credit through 2016. Also, the Residential Energy Efficient Property Credit is available through 2016. The Bipartisan Budget Act of 2018 amended the Residential Energy Efficient Property Credit to extend the credit for fuel cell property, small wind energy property, and geothermal heat pump property through 2021 at specified applicable percentages as described in Section 25D.

Note:

The Bipartisan Budget Act (BBA) of 2018 extended the Nonbusiness Energy Property Credit through December 31, 2017. The BBA also extended the Residential Energy Efficient Property Credit through December 31, 2021.

2. These cases will open in Project Code 1046.
3. Tracking Code 6203 will be used for credits claimed when there is no indication of home ownership (It must be noted that home ownership is not required for the Residential Energy Efficient Property Credit). No tracking code will be used for other cases.
4. Residential Energy Credits are non-refundable.
5. The following apply to all residential energy credits:

- Taxpayers can rely on manufacturer’s certification in writing that a product is a qualifying product for the credit.
 - For credit purposes, costs are treated as being paid when the original installation of the item is completed, or in the case of costs connected with the construction or reconstruction of the taxpayer’s home, when the taxpayer’s original use of the constructed or reconstructed home begins. Taxpayers cannot claim the Nonbusiness Energy Property Credit for property installed on a newly constructed home.
 - If a subsidy was provided by any public utility for the purchase or installation of an energy conservation product, the cost must be reduced by the amount of the subsidy before computing the credit. This rule also applies if a third party such as a contractor receives the subsidy on the taxpayer’s behalf.
6. For specific information on each credit, refer to:
- IRM 4.19.15.41.1, *Nonbusiness Energy Property Credit*,
 - IRM 4.19.15.41.2, *Residential Energy Efficient Property Credit*,
 - IRM 4.19.15.41.3, *Initial Contact Letter*,
 - IRM 4.19.15.41.4, *Taxpayer Replies*,
 - Form 5695, *Residential Energy Credits*,
 - Technical Communication Document (TCD) 0172 in the numeric index at <http://techcomm.web.irs.gov>, and
 - Interactive Tax Law Assistant (ITLA) link from TCD 0172.

4.19.15.41.1 (03-11-2019)

Nonbusiness Energy Property Credit

1. The Non-business Energy Property Credit is claimed in Part I of Form 5695, *Residential Energy Credits* in 2011 and prior but is claimed in Part II of Form 5695 in 2012 and forward.
2. The two types of Non-business Energy Property Credit are:

Qualified Energy Efficiency Improvements	Residential Energy Property Costs
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Qualified Energy Efficiency Improvements	Residential Energy Property Costs
<ul style="list-style-type: none"> • A qualified building envelope component (for example the following four bullets). • Qualified insulation material or system that is specifically and primarily designed to reduce heat loss or gain of a home when installed in or on such a home. • Certain exterior windows and skylights. • Certain exterior doors. • Qualified roof products. • Qualified metal roof with appropriate pigmented coatings or asphalt roof with appropriate cooling granules that are specifically and primarily designed to reduce the heat gain of the home, and the roof meets or exceeds the Energy Star program requirements in effect at the time of purchase or installation. • Does not include the cost of on site preparation, assembly, or original installation of the building envelope component. • Additionally, to qualify for a credit, the original use of a building envelope component must begin with the taxpayer and the building envelope component is expected to remain in use for at least 5 years. 	<ul style="list-style-type: none"> • Certain electric heat pump water heaters; electric heat pumps; central air conditioners; natural gas, propane, or oil water heaters; and stoves that use biomass fuel. • Qualified natural gas, propane, or oil furnaces and qualified natural gas, propane, or oil hot water boilers. • Certain advanced main air circulating fans used in natural gas, propane, or oil furnaces. • Includes any labor costs properly allocable to the on site preparation, assembly, or original installation of the energy property. • Residential energy property expenditures must originally be placed in service by the taxpayer.

Note:

As noted earlier, the Non-business Energy Property credit is also available in 2011 (The American Taxpayer Relief Act of 2012 extended the credit through 2013). Some of the efficiency standards were amended for 2011 and remain the same for 2012, 2013, 2014 and 2015. For example: Exterior windows, skylights, and exterior doors must meet the Energy Star program requirements. The Tax Increase Prevention Act of 2014 extended the Nonbusiness Energy Property Credit through 2014, and the Protecting Americans from Tax Hikes Act of 2015 extended the Nonbusiness Energy Property Credit through 2016 (and also updated the standards for exterior windows, skylights, or exterior doors placed in service after December 21, 2015, to be the version 6.0 Energy Star requirements). The Bipartisan Budget Act of 2018 extended the Nonbusiness Energy Property Credit through December 31, 2017.

3. ARRA increased the credit rate to 30 percent of the cost of all qualifying improvements made in tax years 2009 and 2010, and raised the maximum credit limit to \$1,500 claimed for 2009 and 2010 combined.

Note:

The Non-business Energy Property credit was extended to 2011 by the Tax Relief Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (The American Taxpayer Relief Act of 2012 extended the credit through 2013). The Tax Increase Prevention Act of 2014 extended the Nonbusiness Energy Property Credit through 2014, and the Protecting Americans from Tax Hikes Act of 2015 extended the Nonbusiness Energy Property Credit through 2016. Also, this law amended the credit in other ways. Starting in 2011, the credit is 10 percent of the amount paid or incurred for qualified energy efficiency improvements and the amount of residential energy property expenditures. The lifetime limitation is \$500 for all Non-business Energy Property with no more than \$200 of this amount being attributable to windows. Additionally, there are other limitations such as \$50 for any advanced main air circulating fan, \$150 for any qualified natural gas, propane, or oil furnace or hot water boiler, and \$300 for any item of energy-efficient building property. The Bipartisan Budget Act of 2018 extended the Nonbusiness Energy Property Credit through December 31, 2017.

4. To qualify for the credit, the qualified energy efficiency improvements or residential energy property must be installed on or in the taxpayer's main home located in the United States (must be an existing home or an addition or renovation to an existing home). Main home is generally the home where the taxpayer lives most of the time. A temporary absence due to special circumstances, such as illness, education, business, military service, or vacation, will not change their main home.
5. Taxpayers cannot claim the Non-business Energy Property Credit for property installed on a newly constructed home.

4.19.15.41.2 (03-11-2019)

Residential Energy Efficient Property Credit

1. The Residential Energy Efficient Property Credit is claimed on Part II of Form 5695, *Residential Energy Credits* for 2011 and prior, and Part I in 2012 and forward.
2. For tax years 2009 through 2021, qualified residential energy efficient property is any of the following:
 - Qualified solar electric property,
 - Qualified solar water heating property,
 - Qualified small wind energy property,
 - Qualified geothermal heat pump property, and
 - Qualified fuel cell property.
3. A taxpayer can take a credit up to 30 percent of the costs of a qualified energy property, including labor costs properly allocable to the onsite preparation, assembly, and the original installation of the property and for piping or wiring to interconnect such property to the home.
4. There is no maximum annual credit limit for solar electric, solar water heating, small wind energy, and geothermal heat pump property. However, the credit for qualified fuel cell property is limited to a maximum of \$500 for each one-half kilowatt of capacity of the property.
5. To qualify for the credit, the residential energy property must be installed on or in connection with the taxpayer's home located in the United States (both existing homes and new construction qualify). The taxpayer must use the home as a residence, but the taxpayer does not necessarily have to own the home.
6. Except for fuel cell property, the home does not have to be the taxpayer's main home. For a definition of "main home" refer to IRM 4.19.15.41.1, *Nonbusiness Energy Property Credit*.
7. Costs allocable to a swimming pool, hot tub, or any other energy storage medium which has a function other than the function of such storage do not qualify for the credit.
8. If the taxpayer cannot use all of the credit because of the tax liability limit, they can carry any unused portion of the credit forward to the next tax year.

4.19.15.41.3 (03-11-2019)

Initial Contact Letter

1. For the initial contact, Letter 566-S along with Form 886A is issued to the taxpayers and the cases are updated to Status 10 on AIMS.
2. The issue to create in RGS is energy credit.
3. The credit is calculated on Form 5695.
4. For information on the order in which non refundable credits are applied, refer to Form 5695.
5. To figure the credit when there is joint ownership of the energy property, joint occupancy of the home, or for married taxpayers with more than one home, refer to the instructions for Form 5695.
6. The following paragraphs can be used on Form 886A for the Nonbusiness Energy Property Credit:
 - *To qualify for the credit you must have installed one or more of the following in your main home:*
 - *A qualified insulation material or system that is specifically and primarily designed to reduce heat loss or gain of a home when installed in or on such a home.*
 - *Certain exterior windows and skylights.*
 - *Certain exterior doors.*
 - *A qualified metal roof with appropriate pigmented coatings or asphalt roof with appropriate cooling granules that are specifically and primarily designed to reduce the heat gain of your home, and the roof meets or exceeds the Energy Star program requirements in effect at the time of purchase or installation.*
 - *Certain electric heat pump water heaters; electric heat pumps; central air conditioners; natural gas, propane, or oil water heaters; and stoves that use biomass fuel.*
 - *Qualified natural gas, propane, or oil furnaces and qualified natural gas, propane, or oil hot water boilers.*
 - *Certain advanced main air circulating fans used in natural gas, propane, or oil furnaces.*
 - *Additionally, to qualify for a credit, the original use of a building envelope component must begin with you, and the residential energy property expenditures must originally be placed in service by you.*

- *A building envelope component is expected to remain in use for at least 5 years.*
 - *You must verify that you owned the home and that it was your main home by providing your mortgage and/or property tax statement and a copy of a utility statement or similar document issued during the tax year.*
 - *You must provide documentation proving that the product you purchased qualifies for the credit. For example, you may provide a copy of the manufacturer's certification statement certifying that the product qualifies for the credit.*
 - *In addition, please submit documentation to verify the amount paid for your qualified energy efficiency improvement or residential energy property. This can include a cancelled check or a credit card transaction and receipt of the improvement, which shows the date of the transaction and the amount of payment.*
 - *Remember that installation costs are not allowed on energy efficiency improvements. Only include the purchase price of the improvement property.*
 - *The maximum allowable credit is \$1500 over tax years 2009 and 2010 combined (The American Taxpayer Relief Act of 2012 extended the credit through 2013).*
7. The following paragraphs can be used on Form 886A for the Residential Energy Efficient Property Credit:
- *To qualify for the Residential Energy Efficient Property Credit, you must have installed one or more of the following items in or on your home; Qualified solar electric property; Qualified solar water heating property; Qualified small wind energy property; Qualified geothermal heat pump property; Qualified fuel cell property.*
 - *You must provide documentation to verify that you used the home as a residence. If you owned the home, for example, you may provide a mortgage or property tax statement. If you rent the home, you may provide documents such as a lease agreement and utility bills. In addition you must provide; A copy of the manufacturer's documentation proving that the product you purchased qualifies for the credit; For qualified solar water, you must provide evidence that your property is certified for performance by the non-profit Solar Rating Certification Corporation or a comparable entity endorsed by the government of the state in which such property is installed; For qualified fuel cell property, you must establish that your home was your main home during the tax year, by providing a*

utility statement or similar document showing your address during the tax year.

- *Please submit documentation to verify the amount paid on your Residential Energy Efficient Property. Include a valid signed contract showing what was installed and the date of installation. Proof of payment may be in the form of a cancelled check, credit card transaction or a loan document and a receipt for the improvement.*

4.19.15.41.4 (01-01-2014)

Taxpayer Replies

1. Evaluating taxpayer replies

If	And	Conclusion
Taxpayer submits proof of purchase; proof of payment; documentation such as a manufacturer's certification proving that the product taxpayer purchased qualifies for the credit; proof of home ownership, if applicable; and proof that the home was their main home, if applicable	the amounts claimed on the original return are correct	No change the case.
Taxpayer submits proof of purchase; proof of payment; documentation such as a manufacturer's certification proving that the product taxpayer purchased qualifies for the credit; proof of home ownership, if applicable; and proof that the home was their main home, if applicable	the amounts claimed on the original return are higher than the maximum amount of credit	Revise the report to reflect the correct amount of allowable credit. On Form 886A state: "The amount of credit claimed on your original return was over the allowable limit for the credit. We have revised our report to reflect the amount of credit you are entitled to." Refer to IRM 4.19.13.10.1, <i>Taxpayer Responses – Additional Information Needed.</i>

If	And	Conclusion
Taxpayer submits only one required piece of information, without the other requested information	you were able to contact the taxpayer by phone	If the taxpayer faxes in the missing information and substantiates entitlement of the credit; no change the case. If the taxpayer is unable to fax in the requested documentation, see below for information on proceeding to the next stage of the examination. Refer to IRM 4.19.13.10.1, <i>Taxpayer Responses – Additional Information Needed.</i>
Taxpayer submits only one required piece of information, without the other requested information	you were unable to contact the taxpayer by phone	Proceed to the next stage of the examination. On Form 886-A make sure to thank the taxpayer for their correspondence and request the missing information. Make sure to state exactly what information is needed to allow the credit. Refer to IRM 4.19.13.9.1, <i>Taxpayer Responses – Additional Information Needed.</i>

4.19.15.42 (03-11-2019)

Premium Tax Credit - IRC 36B

1. The premium tax credit (PTC) is a refundable tax credit designed to help eligible individuals and families with low or moderate income afford health insurance purchased through the Health Insurance Marketplace, also known as the Exchange, beginning in 2014. Taxpayers can choose to have an estimate of their PTC paid in advance (called advance payments of the PTC, Advance credit payments, APTC) to their insurance companies to lower what they pay for their monthly premiums, or they can forgo advance credit payments and get all of the benefit of the PTC when they file their tax return for the year. If a taxpayer chooses advance payments of the PTC the taxpayer must reconcile the amount paid in advance with the actual PTC computed when filing their tax return.
2. The Health Insurance Marketplace is where taxpayers will find information about private health insurance options, purchase health insurance, and obtain help with premiums and out-of-pocket costs if eligible. The Department of Health and Human Services (HHS) administers the

requirements for the Marketplace and the health plans offered. More information about the Marketplace may be found at HealthCare.gov.

3. There are 4 categories or “metal levels” of coverage in the Marketplace. Plans in each category pay different amounts of the total costs of an average person’s care. The categories have nothing to do with the quality or amount of care provided. The plans are:

Plan Type	The Health Plan Pays (on average)	The Taxpayers Pays
Bronze	60%	40%
Silver	70%	30%
Gold	80%	20%
Platinum	90%	10%

Note:

Individuals may also enroll in catastrophic coverage plans, which pay less than 60% of the total average cost of care on average. They’re available only to people who are under 30 years old or have a hardship exemption. PTC is not allowed for coverage under a catastrophic plan.

4. The Marketplace will estimate the amount of the premium tax credit that a taxpayer may be able to claim for the tax year, using information provided about family size, projected household income, whether the members of the family enrolled in coverage are eligible for employer coverage or government-sponsored coverage, and other information. This estimated credit is the maximum amount of advance credit payments for which the taxpayer is eligible. Based upon that estimate, the taxpayer may decide to have all, some, or none of the estimated credit paid directly to the insurance company to be applied to the monthly premiums. If a taxpayer receives the benefit of advance payments of the premium tax credit, the taxpayer must reconcile the amount of the advance credit payments with the allowable amount of the premium tax credit for the year.
5. Form 8962, *Premium Tax Credit*(PTC), is used to claim the credit and to reconcile advance credit payments with allowable amount of PTC for the year. Taxpayers who had excess advance credit payments must treat the excess amount as an additional tax, subject to limitations based on the taxpayer’s household income. If the allowable amount of PTC for the year is great than the advance credit payments, the net PTC reduces tax liability or results in a refund.
6. Taxpayers who purchased health insurance through the Marketplace for themselves, a spouse or a dependent will receive a Form 1095-A, *Health*

Insurance Marketplace Statement, to assist in completing Form 8962. The Form 1095-A includes the monthly premium for the plan enrolled in, the monthly premium for the taxpayer's applicable benchmark plan and the advance credit payments made for the taxpayer.

7. For further details about the Premium Tax Credit, see Pub 17, *Your Federal Income Tax*, Pub 974, *Premium Tax Credit*, and the instructions for Form 8962. Additional information may also be found on the Affordable Care Act Resource page located on SERP, and at www.irs.gov/uac/Affordable-Care-Act-Tax-Provisions-for-Individuals-and-Families.

4.19.15.42.1 (03-11-2019)

Premium Tax Credit Eligibility

1. A taxpayer is eligible for a premium tax credit for a taxable year if he or she meets all of the following:
 - a. The taxpayer, the taxpayer's spouse if a joint return is filed, or a dependent of the taxpayer must have been enrolled in a qualified health plan offered through the Marketplace for one or more months in which he or she was not eligible for other health insurance such as employer or government-sponsored coverage, that has minimal essential coverage,
 - b. The taxpayer must have paid his or her share of the plan premiums for one or more of the months by the taxpayer's tax return due date (not including extensions),
 - c. The taxpayer must be an applicable taxpayer. An applicable taxpayer is a taxpayer with household income of at least 100 percent* but not more than 400 percent of the federal poverty line for the taxpayer's family size, who uses a filing status other than married filing separately**, and cannot be claimed as a dependent by another person.

Note:

*There are two exceptions for taxpayers below 100% of the FPL (see instructions for Form 8962). **An abused or abandoned spouse who cannot file jointly because of the abandonment or abuse may still be an applicable taxpayer.

- d. The taxpayer, spouse, or dependent must be a U.S. citizen, or lawfully present in the U.S.
 - e. The taxpayer, spouse, or dependent must not be incarcerated
2. Filing Status
 - a. Taxpayers who file a married filing separate tax return, will not be eligible for the premium tax credit, unless they meet the criteria in

section 1.36B-2(b)(2)(ii) of the Income Tax Regulations, which allows certain victims of domestic abuse and spousal abandonment to claim the credit, using the married filing separate filing status. This relief from the joint filing requirement may be used for no more than three consecutive years.

4.19.15.42.2 (03-11-2019)

Common Terms

1. Household Income is the sum of the modified adjusted gross income (MAGI) of the taxpayer, the MAGI of the taxpayer's spouse, if married, and either filing a joint return or filing a separate return and claiming a personal exemption for the spouse, and the MAGI of all the dependents of the taxpayer required to file a tax return because their income is above the filing threshold.
2. Modified Adjusted Gross Income (MAGI) is the adjusted gross income shown on the return plus:
 - a. Excluded foreign earned income
 - b. Foreign earned income housing cost exclusion
 - c. Tax-exempt interest,
 - d. Non-taxable social security benefits
 - e. Non-taxable railroad retirement benefits

Note:

Modified adjusted gross income does not include Supplemental Security Income (SSI).

3. To be eligible for a PTC, a taxpayer must have household income of at least 100 percent and not more than 400 percent of the Federal Poverty Line (FPL) for the taxpayer's family size (although there are 2 exceptions for taxpayers below 100 percent of the FPL). For 2013, for residents of one of the 48 contiguous states or Washington, D.C., a few examples of the federal poverty levels are:
 - a. \$11,490 (100%) up to \$45,960 (400%) for one individual
 - b. \$15,510 (100%) up to \$62,040 (400%) for a family of two
 - c. \$23,550 (100%) up to \$94,200 (400%) for a family of four
4. The federal poverty line or FPL is an income amount considered poverty level for the year, for the size of the family. The Department of Health and Human Services (HHS) determines the federal poverty line amounts

annually. HHS provides three federal poverty lines: one for residents of the 48 contiguous states and D.C., one for Alaska residents and one for Hawaii residents. For purposes of the premium tax credit, eligibility for a certain year is based on the most recently published set of federal poverty guidelines at the time of the first day of the annual enrollment period for coverage during that year. As a result, the premium tax credit for 2014 is based on the 2013 FPL. The premium tax credit for 2015 is based on the 2014 FPL. Current FPLs and updated information can be found on the HHS website and in the instructions for Form 8962, *Premium Tax Credit*(PTC), at www.irs.gov. under line 4.

4.19.15.42.3 (03-11-2019)

PTC Project Codes

- The following table provides an overview of the Non-EITC single-issue Premium Tax Credit (PTC) programs worked in Exam:

PTC Program worked in Exam

Project Code	Project Code Title	Project Code Description	Initial Contact Letter
1300	Premium Tax Credit Pre-Refund	Non-EITC examination questions taxpayer eligibility for PTC for the year. Refund is held on taxpayer's account.	CP 06 or LTR 566-S with Form 14950
1310	Premium Tax Credit Post Refund	Non-EITC examination questions taxpayer eligibility for PTC for the year. Refund is not held on taxpayer's account.	CP 06A or LTR 566-S with Form 14950
1322	Premium Tax Credit (Non-EITC)	This examination includes the PTC, questionable W-2s (income) and credits. Note: There are different types of QRP cases identified by various source codes. See IRM 4.19.14.9.2, <i>QRP Source Code and Project Codes</i>	LTR 566-S or 566B with Form 4549, <i>Income Tax Examination Changes</i> with Form 14950

Project Code	Project Code Title	Project Code Description	Initial Contact Letter
1321	Premium Tax Credit SLCSP	This examination includes the Second Lowest Cost Silver Plan (SLCSP) for the Premium Tax Credit	LTR 566-S with form 14950

- Tracking Code 8071 will be used to identify Discretionary cases that also have PTC issues. The Discretionary cases that are in other project codes with this tracking code will reject from ACE automation. The examiner will need to manually add the PTC issue and reintroduce the cases into the ACE automation process.

4.19.15.42.4 (02-26-2015)

Case Selection

- When a Premium Tax Credit (PTC) return is filed, Submission Processing (SP) will compare the return information against the information from the Federal and State Health Exchanges. If the information on the return does not match the information from the exchanges, SP will correspond with the taxpayer to obtain the information needed to process the return.
- If the taxpayer does not respond, SP will input error codes on the return. Nine error codes will be worked in Exam. (Four error codes apply to single-issue examinations.) Please refer to IRM 4.19.14.8.4, *Premium Tax Credit (PTC)*, for a description of the error code conditions.
- After SP inputs the error codes, the returns will be available in Dependent Database (DDb) for case selections.
- DDb will generate flags which will be used to strengthen the selection criteria in conjunction with the error codes. There are 11 flags that will be used. Refer to IRM 4.19.14.8.4, *Premium Tax Credit (PTC)*, for a description of the flags.
- The overall priorities for selecting pre-refund cases are as follows:
 - Returns with an error code and a flag
 - Returns with an error code
 - No error code, which includes special processing code (SPC) 4, aging reason code (ARC) 7 or 8 and computed zero values

6. Cases will *not* be selected for returns only meeting the flags criteria unless there is an indication the data matching was not completed.

4.19.15.42.5 (03-11-2019)

Research and Initial Report Writing

1. **Fully automated cases.** The following types of cases will be fully automated by ACE:

- Combination EITC/PTC cases with PTC EC 190, 191 or 195.
- Single issue non-EITC PTC cases with PTC EC 190, 191 or 195.

For these cases, the PTC is disallowed in full or the advance payments of PTC are being treated as repayment, and the cases will be fully automated. The PTC issue will be created by ACE processing, the Examination Report Form 4549 will be generated at the ACE Create II stage and Letter 525 with the Examination Report will be issued by the Consolidated Print Strategy (CPS) sites.

2. **Partially automated cases.** The following types of cases will be partially automated:

- Any currently automated (EITC or non-EITC) project codes with a PTC EC 193, 194, 196, 197, 198 or 199.
- Any currently automated (EITC or non-EITC) project codes with multiple PTC error codes.
- Any currently automated non-EITC project codes with tracking code 8071.

Cases will be routed to RGS Group B2. ACE will create the case and all issues with the exception of the PTC and/or APTC repayment issue. Examiners will perform the relevant research, create the PTC and/or APTC Repayment issue, and generate the Examination Report Form 4549. The RAR report (Form 4549 and accompanying forms) will be printed and mailed by the campus at the appropriate time. The cases can then be reintroduced to ACE Group B0 for Aging and Closing.

3. **Manual Cases-** Manually created cases will set up in ACE Group B1. Examiners will perform the relevant research, create the PTC and/or APTC Repayment issue, along with other relevant issues and generate the Examination Report Form 4549. The Letter 566-S, 566B, Form 4549 and accompanying forms will be printed and mailed by the campus. The cases can then be reintroduced to ACE Group B0 for Aging and Closing.
4. PTC allowed on the original return posts as a Transaction Code (TC) 766 with credit reference number (CRN) 262. Excess APTC Repayment is included in

the total tax. Posted PTC associated data can be viewed in the posted return section of CC TXMOD or CC IMFOLR. The data elements are:

PTC Data Elements

Data Element	Term
Total Premium Tax Credit	TOTAL PTC
Advance Premium Tax Credit	TOTAL APTC
Excess Advance Payment Above Limitation	LIMIT AMT
Excess APTC Repayment	APTC TX LIAB

Note:

Note: The PTC which posts as TC 766 CRN 262 is the Reconciled Premium Tax Credit which is the Total PTC minus the Advance PTC. For additional credit reference numbers that relate to the adjustment of PTC data, refer to IRM 21.6.3.4.2.12.7, *Adjusting Accounts*.

5. **Federal Poverty Line** - The Department of Health and Human Services (HHS) determines the federal poverty line amounts annually. A taxpayer who receives excess advance payments must treat the excess amount as additional tax, subject to limitations based on the household percentage of FPL; limitations do not apply in all circumstances).
6. The repayment limitation for advance payments are:
 - \$300 for single (\$600 for all other filing status) with household income under 200% of the FPL
 - \$750 for single (\$1,500 for all other filing statuses) with household income at least 200% but less than 300% of FPL
 - \$1,275 for single (\$2,550 for all other filing statuses) with household income at least 300% but less than 400% of the FPL
 - There is no limitation if the taxpayer's household income is 400% or more of the FPL

The taxpayer's liability is the smaller of the excess advance payment or repayment limitation.

Note:

FPL tables change from year to year. The appropriate table to use is the table in effect at open enrollment, so for tax year 2015, the 2014 FPL table will be used.

7. FPL Percentages Not Eligible for PTC -

- **Household Income Below 100% of the FPL;** If the household income is less than 100% of the Federal poverty line and the taxpayer does not meet the requirements under **Estimated household income at least 100% of the Federal poverty line or Alien lawfully present in the United States**, the taxpayer is not eligible to take the PTC. Please refer to <http://core.publish.no.irs.gov/instrs/pdf/i8962--2017-00-00.pdf>, Form 8962 Instructions, page 8, for additional information regarding the exceptions.
- **Household Income Above 400% of the FPL;** If the household income is greater than 400% of the FPL, the taxpayer cannot take the PTC. The taxpayer must repay all APTC paid for individuals in the tax family.

4.19.15.42.6 (03-11-2019)

Creating the PTC Issue(s)

1. For cases assigned to ACE Group B2 or B1, examiners will have to create the PTC issue based on the assigned Error Code(s) and/or Flags.
2. Prior to creating the PTC issue, insure that all other issues that might affect the PTC have been addressed:
 - Research IDRS CC IRPTRL to insure that all income has been properly reported on return. Create issues to address any unreported or misreported income in the General Income section under Special Applications in RGS. Be sure to include income from both spouses on jointly filed returns. Refer to IRM 4.19.11.2.1, *Procedures for Screening Individual Returns*, paragraph (10), for guidance on the types of underreported income that should be addressed.
 - If the case has multiple EITC/PTC issues, insure that all of the issues that pertain to Filing Status and Dependent Exemptions are properly created.
3. Research IDRS CC DLITE to determine the Error Code (EC)(s) and/or Flags that apply to the case. Refer to IRM 4.19.14.8.4, *Premium Tax Credit (PTC)*, for a description of the Error Code of Flag conditions.

Note:

When Error Codes are present they may also be viewed on: 1) IDRS CC RTVUE Definer 1, 2) IDRS CC TRDBV CODES screen, 3) RGS in the Pre-audit comments of the Batch History Issue

Issue Determination

IF	AND	THEN
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IF	AND	THEN
Error Codes and Flags exist on DLITE	NA	Follow the steps in paragraphs 4 -9 and 11 -12 to create the appropriate PTC issues in RGS based on the Error Codes
Only Flags exist on DLITE	There is an indication that data matching was not completed: SPC 4 (CC RTVUE) Definer R1 or ARC 7 or 8 (CC AMDIS)	Follow the steps in paragraphs 10 -12 to create the PTC issue in RGS based on the Flags only

4. When ACA Verification System (AVS) data is available at the time the taxpayer's return is processed, the data from that system is displayed on IDRS CC RTVUE screens B1 and B2. This data will be used to determine the Per Exam amounts on the PTC issues in RGS.

RTVUE fields used in creation of PTC Issues

RTVUE Definer	Field Name	Description
B1	AVS EXPOSURE AMT	Discrepancy in the PTC calculated by AVS. This will include any increase to the repayment of Advance PTC
B1	AVS RECONCILED PTC	This number will generally be the same as the amount of PTC that is posted to the tax module. (TC 766 CRN 262)
B2	PREM CMPTR AMT	The policy premium amounts per AVS. Note: There will be a yearly amount (row Y) and amounts for each month. These amounts are compared to the corresponding entries on F 8962 Part 2 to identify discrepancies.
B2	SLCP CMPTR AMT	The SLCP premium amounts per AVS (see Note above)

RTVUE Definer	Field Name	Description
B2	MAX APTC CMP	Advance PTC paid per AVS (see Note above)
B2	CNTRB CMPTR AMT	Taxpayer's monthly contribution.

5. There are two IMF Codes in RGS for creating PTC issues:

- IMF Code 62002 - Premium Tax Credit (PTC)
- IMF Code 62003 – Excess Advance PTC (APTC) Repayment

Use IMF Code 62003 when creating the issue associated with PTC Error Code 190 (as described below.) For all other PTC Error Codes and Flags use IMF Code 62002. As always, when creating multiple issues in RGS with the same IMF Code you must give each issue a unique name. Give each issue a name that is descriptive of the associated issue categorization.

6. The following ECs will result in a full disallowance of the PTC and full repayment of any Advance PTC. These issues will normally be created systemically by ACE on the initial 30-day report:

Error Codes resulting in full disallowance of PTC

Error Code	RGS Issue Categorization	Per Return Amount	Per Exam Amount	Standard Paragraph Number
190	APTC repayment-net tax adj	Form 1040 Line 46 or Form 1040A Line 29	Per Return Amount + AVS EXPOSURE AMT (from IDRS CC RTVUE Definer B1)	8703
191	Net PTC-net credit adj	AVS RECONCILED PTC (from	0	8704
195	Net PTC-net credit adj	IDRS CC RTVUE Definer B1)	0	8707

Caution:

The APTC repayment net adjustment cannot be used to create the issue for EC 190 if the taxpayer has provided a response (i.e. Form 8962). EC 190 will require adjustments to specific lines of Form 8962.

7. These instructions provide guidelines for adjusting specific lines on Form 8962. The taxpayer's Form 8962 entries may be viewed on the following:
 - IDRS CC RTVUE Definer PT and P2
 - IDRS CC TRDBV 8962 screen
 - RGS Return Setup Form 8962 tab
 - RTF F8962 section (viewable in RGS)
8. Follow the steps below to create the RGS PTC issue. Multiple error conditions may result for some of the Error Codes listed below.

Error codes that potentially affect multiple entries on Form 8962

Error Code	RGS Issue Categorization	Per Return Amount	Per Exam Amount	Standard Paragraph Number
190 with response (i.e. Form 8962)	Create issues for each entry on F-8962 Columns A, B, & F, lines 12-23 that do not match the corresponding entries on IDRS CC RTVUE B2	See Table in paragraph 9	See Table in paragraph 9	Provide appropriate explanation based results of Form 8962
193 with no other error	Net PTC-net credit adj	AVS Reconciled PTC (from IDRS CC RTVUE Definer B1)	0	8705

Error Code	RGS Issue Categorization	Per Return Amount	Per Exam Amount	Standard Paragraph Number
193 with any of the following ECs: 197, 198, 199	Do NOT create an issue for Net PTC - net credit adj. Create the issues for the additional ECs as described in para 8	See table in para 9	See Table in para 9	8705 (Include this paragraph on each associated issue.)
194 (may be accompanied by ECs 197, 198, and/or 199)	Create issues for each entry on F8962 Columns A,B & F, lines 12-23 that do not match the corresponding entries on IDRS CC RTVUE B2	See Table in para 9	See Table in para 9	8706
196 (This EC indicates that the TP incorrectly used the annual calculation – Form 8962, Line 11 – instead of the monthly calculation – Form 8962, Lines 12-23)	Create issues for each month that has a non-zero entry in the first, second or fifth column on IDRS CC RTVUE B2	PTC-calculation method-Monthly = 0: (Important: Enter zero as the Per Return Amount for each issue. Do NOT try to divide the TP’s entries on Line 11 between the various months.)	PTC-calculation method-Monthly = 1: See Table in para 9 for appropriate fields to use from IDRS CC RTVUE Definer B2	8706

9. The following Error Codes indicate that the taxpayer's entries on specific lines on Part 2 of Form 8962 do not match the values provided by the AVS. The radio buttons on the RGS Return Setup F8962 tab will indicate whether the taxpayer is using the annual or monthly method to calculate the PTC. If the taxpayer is using the monthly method, you will need to create an issue for each month where the taxpayer's entry does not match the corresponding AVS. You do not need to create an issue for any month in which the taxpayer's Form 8962 entry matches the AVS value.

Note:

If you are creating monthly issues in association with Error Code 196 (see above) you will have to create an entry for each month for which there is a non-zero AVS value.

Error codes pertaining to entries on Part 2 of Form 8962

Error Code	RGS Issue Categorization	Per Return Amount	Per Exam Amount (research IDRS CC RTVUE Definer B2)	Standard Paragraph
197 (TP used annual calculation)	PTC-annual premium amount	Form 8962 Column A Line 11	PREM COMPTR AMT line Y	8708
197 (TP used monthly calculation)	PTC-monthly premium amount- (month) Note: Create an issue for each month for which the amount from F8962 does not match the corresponding amount from IDRS CC RTVUE B2.	Form 8962 Column A Lines 12 – 23 (or 0 if creating this issue in association with EC 196)	PREM COMPTR AMT lines J - D	8708 (Input paragraph on each monthly issue created*)

Error Code	RGS Issue Categorization	Per Return Amount	Per Exam Amount (research IDRS CC RTVUE Definer B2)	Standard Paragraph
198 (TP used annual calculation)	PTC-annual premium SLCSF amount	Form 8962 Column B Line 11	SLCP CMPTR AMT line Y	8708
198 (TP used monthly calculation)	PTC-monthly prem SLCSF-(month) See Note above.	Form 8962 Column B Lines 12 – 23 (or 0 if creating this issue in association with EC 196)	SLCP CMPTR AMT lines J - D	8708 (Input paragraph on each monthly issue created*)
199 (TP used annual calculation)	PTC-annual advance	Form 8962 Column F Line 11	MAX APTC CMP line Y	8708
199 (TP used monthly calculation)	PTC-monthly advance-(month) See Note above	Form 8962 Column F Lines 12 – 23 (or 0 if creating this issue in association with EC 196)	MAX APTC CMP lines J - D	8708 (Input paragraph on each monthly issue created*)

* Standard paragraph 8708 must be input on at least one monthly adjustment. For the remaining monthly adjustments, you may use a custom paragraph. The custom paragraph may consist of a single character such as a period (.). This will allow the paragraph to appear only once on the form instead of multiple times which may cause confusion. A generic paragraph such as 9426 can also be used.

- Use the following table to create the PTC issue based on the PTC Flags. (**IMPORTANT:** This table should only be used if AVS data is unavailable and it is not possible to determine whether there are any PTC error conditions associated with the return).

PTC Flag	RGS Issue Categorization	Per Return Amount	Per Exam Amount	Standard Paragraph Number
PTC - SLCSP Flag	Net PTC-net credit adj	AVS RECONCILED PTC (from IDRS CC RTVUE Definer B1) (TC 766 CRN 262 amount on IDRS CC IMFOLT if no RTVUE Definer B1)	0	8715
PTC Flag # 1 - 11	Net PTC - net credit adj	AVS RECONCILED PTC (from IDRS CC RTVUE Definer B1) (TC 766 CRN 262 amount on IDRS CC IMFOLT if no RTVUE Definer B1)	0	8716

- Run a tax computation in RGS. RGS will generate statutory issues for the change to the Net PTC (Form 8962, Line 26) and the Excess Advance PTC as needed.
- Generate the Form 4549 Examination report including the tax computation report for Form 8962 and save to Case File Documents. If this is the initial report, print and mail the report per local procedures and move the case file to ACE Group B0 for Aging and Closing. Include Form 14950 Premium Tax Credit Verification, with the mail packet.

4.19.15.42.7 (03-11-2019)

Evaluating Responses

- Taxpayers must provide verification to show they are eligible to claim the Premium Tax Credit (PTC). The taxpayer must have purchased health insurance through a Health Insurance Marketplace. If the health insurance was not purchased through a Marketplace, then the taxpayer is not eligible for PTC and does not need to send us any documentation.

IF	THEN acceptable documentation is:
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IF	THEN acceptable documentation is:
Taxpayer needs to verify names of the individuals they are claiming for PTC	Insurance enrollment forms, invoices, statements from the insurance provider, or Form 1095-A
Taxpayer Form 8962 is incorrect or is missing (not attached to tax return)	<p>Completed or corrected Form 8962</p> <p>Note:</p> <p>You will need to calculate the PTC using AMS PTC calculator or create issues in RGS corresponding to the Form 1095-A.</p> <p>Refer to IRM 4.19.15.42.6, <i>Creating the PTC Issue(s)</i>.</p>
Information is needed to support the allocation of the PTC in Part 4 of the Form 8962	<p>Statement from the insurance provider which shows:</p> <ul style="list-style-type: none"> • Policy number • Social security number • Start and stop months • Percentage of allocation <p>Note:</p> <p>You will need to calculate the PTC using AMS PTC calculator or create issues in RGS corresponding to the taxpayer's entries on Form 8962. Refer to IRM 4.19.15.42.6, <i>Creating the PTC Issue(s)</i>.</p>
Information is needed to support the alternative calculation for marriage in Part 5 of the Form 8962	Taxpayer's date of marriage. (marriage certificate)

IF	THEN acceptable documentation is:
Proof of payment for the health premium is needed	<ul style="list-style-type: none"> • Cancelled checks (both sides) • Paid receipts • Certificate or insurance coverage • Credit card statements • Bank statements
<p>Taxpayers may send in Form 1095-A or Form 1095-B which can be used to verify items on the Form 8962.</p>	

Caution:

A Form 1095-A marked as Void means the form is no longer valid. The taxpayer is not liable for any APTC originally reported on the Form, nor are they eligible for any credit for data originally reported. A Form 8962 does not have to be submitted to update the account.

Reminder:

In 2015, Oregon state-run Marketplace transitioned to Federal. Oregon state-run Marketplace systems did not allow for the electronic transmission of corrected Forms 1095-A for Tax Year 2014 return data when updated information was received from the health care providers. If working a PTC-related return from a taxpayer that participated in the Oregon State Marketplace coverage, and the information the taxpayer provides cannot be verified on BOE or CC IRPOL, advise the taxpayer that they will need to request an official statement from Oregon along with the corrected Form 1095-A that verifies the information reported on his or her return. Refer taxpayers with questions to the Oregon Marketplace at: **1-855-268-3767 (TTY 711)** or e-mail address: **Info.Marketplace@oregon.gov**.

2. Judgment must be used based on the facts and circumstances in each case to make a substantially correct determination. Workpapers must contain determinations, facts, and circumstances pertaining to the cases.

Note:

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3. A taxpayer (TP1) must allocate policy amounts (enrollment premiums, applicable SLCSP premiums and/or APTC) with another taxpayer (TP2), for example, TP1 and TP2 are former spouses, if (1) the same policy covers one or more individuals claimed on TP1’s return and one or more individuals claimed on TP2’s return, and (2) the Form 1095-A for the policy lists one or more individuals in TP1’s family and one or more individuals in TP2’s family. The taxpayers generally may agree on any allocation percentage from zero through one hundred percent (for example, they may agree to allocate 40% of the policy amounts to TP1 and 60% to TP2), but that same percentage must be used for all of the policy amounts being allocated (that is, if they choose 40/60, then 40/60 must be used for all policy amounts being allocated). Also, if the taxpayers do not agree on an allocation percentage, the default allocation percentage for a particular taxpayer is generally equal to the number of individuals enrolled in the policy and claimed as a personal exemption deduction on the taxpayer’s return, divided by the total number of individuals enrolled in the same policy (Allocation Situation 4 in the Form 8962 instructions). Finally, if policy amounts are being allocated because the taxpayers are still married to each other but using either the married filing separately or the head-of-household filing status (Allocation Situation 2 in the Form 8962 instructions), the enrollment premiums and the APTC must be divided equally between the taxpayers (50/50 allocation), and the applicable SLCSP premiums are not allocated (each taxpayer computes his or her own applicable SLCSP premiums if allowed a PTC for the year).

Example:

Bob and Carol have 5 children and divorced in 2014. For 2016, Carol and the five children enroll in the same Marketplace policy and Bob enrolls in his employer’s coverage. A Form 1095-A for the policy is sent to Carol. However, Bob claims two of the children on his 2016 return and Carol claims the other three on her 2016 return. Bob and Carol must allocate the policy amounts for the policy on which Carol and the five children enrolled. They can agree on the percentage to be allocated to Bob and the percentage to be allocated to Carol. If they do not agree, the enrollment premiums, the SLCSP premiums, and APTC would be allocated as follows:

1. Bob checks the yes box on line 9 of Part II of his F-8962. In Part IV, he enters the appropriate information, including Carol’s SSN in column b and inputs **0.33** in columns (e), (f) and (g) (Bob is claiming 2 individuals on the policy and a total of 6 are enrolled).

2. Carol checks the yes box on line 9 of Part II of her F-8962. In Part IV, she enters the appropriate information, including Bob’s SSN in column b and inputs **0.67** in columns (e), (f) and (g) (Carol is claiming 4 individuals on the policy and a total of 6 are enrolled).

Any other allocation percentage is acceptable as long as both taxpayers agree.

If the taxpayers must allocate but have not agreed on the percentage or have not reported an allocation, use the default allocation when preparing the Exam report.

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Reminder:

Only exemptions claimed for individuals enrolled in the Marketplace are used in the calculation. For instance, if Bob also claimed an exemption for his mother who is Medicare eligible, this would not affect the calculation. Similarly, the calculation would not be affected if Bob was enrolled in a separate Marketplace policy.

Note:

In the case of married taxpayers with a shared policy electing to file separately, the amounts must be allocated as follows:

If	Then
Both taxpayers are filing Married Filing Separate (FS 3)	50% of any APTC received must be allocated to each return, regardless of the number of exemptions claimed on either return
One taxpayer meets the requirements for filing Head of Household (FS 4)	50% of the APTC is allocated to each return. 50% of the enrollment premiums are allocated to the taxpayer filing FS 4. The SLCSPP premiums are not allocated. The taxpayer filing FS 4 calculates the SLCSPP premiums that are appropriate based on his/her tax family and reports this in Part II of Form 8962 and reports 0.5 in columns (e) and (g) of Part IV.
Both taxpayers meet the requirements for filing Head of Household (FS 4)	50% of the APTC and enrollment premiums are allocated to each return. The SLCSPP premiums are not allocated. The taxpayers calculate the SLCSPP premiums that are appropriate based on their tax family and report this in Part II of Form 8962. They report 0.5 in columns (e) and (g) of Part IV.

Reminder:

Identify the shared policy in the workpapers. When communicating the basis for the adjustment to the taxpayer(s) adhere to the disclosure guidelines discussed below.

4. Third party data of another taxpayer (for example, Form 1095-A data found on the Coverage Data Repository(CDR)) may sometimes be needed to calculate the taxpayer's PTC. If requested by the taxpayer, you may provide the following information as long as the information is directly related to or directly affects the resolution of the taxpayers' filing\reporting requirements:

- Recipient's name
- Premium amount
- SLCSP amount
- APTC amount

Only information about who received health insurance and amounts should be disclosed if the taxpayer specifically requests assistance. Never provide recipients' SSN or address.

Note:

If there is a discrepancy between the information the taxpayer provides and the data on CC RTVUE or CDR, use the Form 1095-A to verify SLCSP, APTC and Premiums. The Form 1095-A data is accessible via CC IRPOL or through Business Objects. Refer to IRM 2.3.86, *Command Code IRPOL*, for guidance using CC IRPOL.

4.19.15.42.8 (01-01-2017)**Closing Procedures**

1. See IRM 4.19.13.28 , *Campus Exam Closing Actions*, paragraph (1), for closing procedures.

4.19.15.43 (07-29-2015)**Campus Employment Tax Non-Filer Program**

1. Campus Employment Tax Non-Filer program is worked by Cincinnati campus PBC 296, Project Code 0453.

Note:

Cincinnati campus does not work PBC 212.

2. Small Business and Self Employed (SB/SE) Employment Tax Headquarters has primary responsibility for workload selection and delivery. Campus

Employment Tax Non Filer (ETNF) program is set up to ensure that all employers are in compliance with filing their employment tax returns. The program is also used to educate the taxpayer and help the taxpayer understand their legal obligations and rights. Tax Examiners will carry out their responsibilities during an examination by resolving any employment tax issue.

3. The Internal Revenue Service has the authority to prepare tax returns for any person or business that fails to submit a tax return required by Internal Revenue law or regulation at the time prescribed, or makes (willfully or otherwise), a false, or fraudulent tax return.
4. Types of Employment Tax:
 - IRC § 3101 through § 3128 Federal Insurance Contributions Act (FICA)
 - IRC § 3201 through § 3241 Railroad Retirement Tax Act (RRTA)
 - IRC § 3301 through § 3311 Federal Unemployment Tax Act (FUTA)
 - IRC § 3321 through § 3322 Railroad Unemployment Repayment Tax (RURT)
 - IRC § 3401 through § 3406 Federal Income Tax Withholding (FITW)

Note:

The ETNF program does not pursue the tax pertaining to the Railroad Retirement Tax Act (RRTA) or Railroad Unemployment Repayment Tax (RURT).

5. Federal Insurance Contributions Act (FICA) - FICA imposes a tax on both employers and employees. The amount of the tax is based on the amount of wages paid with respect to employment. For more information on what wages are subject to FICA tax, see the chart, Special Rules for Various Types of services and Payments, in section 15 of Pub 15, *(Circular E), Employer's Tax Guide*, FICA tax is composed of:
 - a. Old Age, Survivors, and Disability Insurance (OASDI), commonly referred to as social security tax.
 - b. Hospital insurance (Medicare)tax.
 - c. Additional Medicare Tax.
6. Federal Unemployment Tax Act (FUTA) - Title IX of the Social Security Act established the unemployment insurance system. The Federal Unemployment Tax Act (FUTA) was designed to encourage the states to enact unemployment insurance plans. This would enable the states to

provide benefits to workers during periods of temporary unemployment. To involve the states, Congress took the following actions:

- a. Established the federal unemployment tax rate
 - b. Allowed a limited credit against the federal tax to an employer if the state law meets certain federal requirements and the state certifies that the credit is allowable.
7. The federal portion of the tax is used to administer both the federal and state programs. Taxes collected by the states are usually paid as unemployment benefits. Generally, no part of the state unemployment tax is withheld from employee wages.
8. Employment Tax Forms:
- Form 941- *Employer's QUARTERLY Federal Tax Return*
 - Form 943- *Employer's Annual Tax Return for Agricultural Employees*
 - Form 944- *Employer's ANNUAL Federal Tax Return*
 - Form 945- *Annual Return of Withheld Federal Income Tax*
 - Form 940- *Employer's Annual Federal Unemployment (FUTA) Tax Return*
 - Form 1040, Schedule H - *Household Employment Taxes*
9. Employment tax returns do not follow statutory notice of deficiency procedures.

4.19.15.43.1 (07-29-2015)

Employment Tax Non-Filer Initial Contact Letter

1. Issue Letter 4107, *Initial Contact Letter-No Employment Tax Returns Filed*, with 17 day suspense period and attach appropriate Forms 940, 941, 943, 944, or 945. Do not send Form 4759, *Postal Tracer*.
2. Attach Form 886-A, *Explanation of Items*,
3. Complete case history with appropriate examiner's time and action taken.
4. POA must be on file for all periods under examination in order to receive a copy of the initial contact letter. See IRM 4.19.13.8, *Power of Attorney and Other Third Party Authorizations*.

4.19.15.43.2 (03-11-2019)

Employment Tax Non-Filer Responses

1. Responses from a taxpayer related to the Letter 4107, *Initial Contact Letter-No Employment Tax Returns Filed*, or the Letter 4108, *30 Day Letter to Taxpayer-No Employment Tax Returns Have been Filed*, are handled in the same manner, provided no assessment is on the account.
2. All responses from a taxpayer must be examined; however, requesting additional information in response to Letter 4108 should be limited to two attempts when no response is received from the taxpayer.
3. Use the If and then chart below as a guide to complete taxpayer pre assessment responses.

If	And	Then
The taxpayer replies to Letter 4107 or Letter 4108 and states return(s) was filed	No tax return(s) or supporting documents are included	Research account for filed returns, if unable to locate, send a quick note. Note: If a letter from a taxpayer was received after the initial contact (Letter 4107), then a copy of the quick note should be sent with the second contact (See IRM 4.19.15.43.3, <i>Second Contacts</i>).
The taxpayer replies to Letter 4107 or Letter 4108 and states returns were filed under another Employer Identification Number (EIN)	Research of IDRS command codes verifies this information is correct	Close the case "No Change" and issue Letter 4109 to the taxpayer.

If	And	Then
The taxpayer replies to Letter 4107 or Letter 4108 and states returns were filed under another Employer Identification Number (EIN)	Research of IDRS command codes verifies this information in incorrect	Send a quick note to the taxpayer with copies of IRPTR prints. Note: If a letter from a taxpayer was received after the initial contact (Letter 4107), then a copy of the quick note should be sent with the second contact (Letter 4108).
The taxpayer replies to Letter 4107 or Letter 4108 with copy(s) of return(s)	Research of IDRS command codes indicates a TC 976 and TC 290	Close the case "No Change with Adjustment" and issue Letter 4110, <i>No Change Letter When Taxpayer Provides Missing Employment Tax Returns</i> , to the taxpayer.
The taxpayer replies to Letter 4107 or Letter 4108 with copy(s) of return(s)	Return is missing a signature	Attempt a phone call for the missing signature. If unable to reach the taxpayer by phone, send a quick note requesting signature.

If	And	Then
The taxpayer replies to Letter 4107 or Letter 4108 with the signed return(s) under examination	The return(s) match the information on file or research of the IDRS command codes show return(s) were filed and match the information on file Note: BRTVUE prints can be used as copies of return(s) to close an examination as long as the wages match or are higher than reported.	Close the case "Agreed" and issue Letter 4110 to the taxpayer. Note: If a TC 976 is on TXMOD without a TC 290, an -A freeze will post on TXMOD. If the case is being closed, the -A freeze needs to be addressed by placing a "1" in line 9 on form 5344.
The taxpayer replies to Letter 4108 with signed returns under examination	The returns only verify a portion of the information we have on file	Accept filed returns and issue a quick note with a revised report.
The taxpayer replies to Letter 4108 with a signed copy of Form 2504, <i>Agreement to Assessment and Collection of Additional Tax and Acceptance of Overassessment.</i>	NA	Close the case "Agreed" and issue a quick note to the taxpayer.
The taxpayer replies that the business has been sold	NA	Send a quick note requesting the bill of sale or other documents to verify the sale of the business.
The taxpayer replies with Schedule H	NA	Close the case "No Change" and send Schedule H to Receipt and Control for processing.

If	And	Then
The taxpayer replies to Letter 4107 or Letter 4108 stating they are a church	There is no indication of the church being exempt	Send a quick note to the taxpayer. Note: If the church has only one employee who is the minister and he/she filed self-employment tax on the personal tax return, then the church does not have to file a return.
The taxpayer replies with Form 940	And is taking the state credit, but no Form 940-B was submitted	Send a quick note and Form 940-B to the taxpayer.

4.19.15.43.3 (07-29-2015)**Second Contacts**

1. If no response to Letter 4107, issue Letter 4108 with proposed examination report (Form 2504, Form 4666, Form 4667 and/or Form 4668). Include an Explanation of Items and:
2. Input Social Security and Medicare wages/TIPS from IRPTR document.
3. Input Federal Income Tax Withholding from IRPTR document.
4. Input timely deposits.
5. Forms 941 - Filed returns not under exam must be input. Do not include quick assessment or over reported federal income tax withholding.
6. Remove FUTA wages when not being pursued.
7. Document the actions taken in case history (Form 9984).
8. POA must be on file for all periods under examination to receive notices. See IRM 4.19.13.8, *Power of Attorney and Other Third Party Authorizations*.

Note:

The maximum wage base limitation for Social Security wages may change each year. See Instruction for Forms 941/944 for tax year in question.

4.19.15.43.4 (07-29-2015)**Complete Form 13496 Certification**

1. Substitute for Return (SFR) program was developed to contact taxpayers who have not filed tax returns voluntarily and for whom income information is available to substantiate a significant tax liability. IRC § 6020(b) grants the IRS the authority to create a tax return for the taxpayer if the taxpayer fails to file the return by the time prescribed or files a false or fraudulent return.
2. IRC § 6020(b) provides that a tax return is good and sufficient for all legal purposes. However, the § 6020(b) return is not treated as a tax return filed by the taxpayer. Form 13496 is associated with a substitute for return case file to establish that IRC § 6020(b) criteria are met in order that the failure-to-pay penalty under IRC § 6651(a)(2) will be sustained in court. For example, be aware of the following:
 - IRC § 6020(b) tax return does not start the statute of limitations on an assessment.
 - IRC § 6020(b) tax return does not stop the Failure to Pay (FTP) penalty.

Note:

Form 13496 is an "internal use only" form and should not be sent to the taxpayer.

3. Whenever the examiner revises a report of proposed adjustments that increases the total tax liability of the taxpayer (without regard to whether or not the revised report is reissued to the taxpayer), a recertification is required on another Form 13496 dated on or after the date of the revised report.
4. If the report of proposed adjustments involves more than one tax period, a separate Form 13496 for each tax period is created, and attached to a copy of the report.
5. Refer to IRM 20.1.2.2.10.2, *Processing When Deficiency Procedures Do Not Apply*.

4.19.15.43.5 (07-29-2015)**Undeliverable Mail**

1. Research IDRS for a current address.
2. If 2nd contact has not been sent, send undeliverable Letter 4107 to new address. Allow 10 days for response.
3. If 2nd contact has been sent:

- Letter 4107 received - send undeliverable letter 4107 and copy of letter 4108 and attachments to new address. Allow 30 days for response.
 - Letter 4108 received – send undeliverable letter 4108 and attachments and copy of letter 4107 to new address. Allow 30 days for response.
 - Letter 4107 & Letter 4108 received - send undeliverable Letter 4107 & Letter 4108 and attachments to new address. Allow 30 days for response.
4. If no new address is found, follow normal closing procedures.

4.19.15.43.6 (07-29-2015)

Closures

1. If taxpayers do not respond to our exam, close case default after Day 46. Anything other than default, refer to ETNF Responses IRM 4.19.15.43.2, *Employment Tax Non Filer Responses*.
 - DC 01 - No Change with Adjustment
 - DC 02 - No Change
 - DC 03 - Agreed before Letter 4108
 - DC 04 - Agreed after Letter 4108
 - DC 08 - Default
2. On secondary tax periods priority code 9 is not required on BMF cases. See IRM 4.4.12.5.19., *FTP for SFRs*, paragraph (2).
3. Refer to IRM 4.4.12, *Examined Closings, Surveyed Claims and Partial Assessments*, for further closing guidance.

4.19.15.43.7 (07-29-2015)

Penalties

1. A SFR IRC § 6020(b) report must be prepared before penalties can be considered. Penalties to be considered:
 - Failure to Deposit penalty (FTD) IRC § 6656 – Refer to IRM 20.1.4.1, *Overview and General*
 - Failure to File Penalty (FTF) IRC § 6651(a)(1) - Refer to IRM 20.1.2, *Failure to File/Failure to Pay Penalties*
2. Failure to Pay penalty (FTF) IRC § 6651(a)(2) and interest is generated after the closing of examination. If tax is full paid FTD penalty, FTF penalty, FTP

penalty or interest will not generate. Refer to IRM 20.1, *Penalty Handbook*.

4.19.15.43.8 (07-29-2015)

Request for Penalty Relief

1. The initial request for relief may occur either during or after an examination.
2. Refer to IRM 20.1.1.3, *Criteria for Relief from Penalties*, as a resource guide for the non-assertion penalties due to Reasonable Cause (RC).
3. If the taxpayer is entitled to penalty relief, complete RC penalty lead sheet and document workpapers that RC was considered, and how RC was established.
4. If the taxpayer is not entitled to penalty relief, Complete RC penalty lead sheet and document workpapers that RC was considered and why RC does not apply.

4.19.15.43.9 (07-29-2015)

FUTA Certification

1. The Federal Unemployment Tax Act (FUTA) provides for cooperation between the federal and state governments in the establishment and administration of unemployment insurance programs. Under this dual system, the employer is subject to a payroll tax levied by the federal and state governments. The taxpayer may be allowed a maximum credit of 5.4% against the FUTA tax of 6.0% for payments made to the state. Employers whose payments are received by the state after the due date of the federal return plus extensions are allowed 90% of the credit that would have been allowed had the payments been made on time. In addition, an employer's credit will be reduced if the employer paid wages that are subject to the unemployment tax laws of a credit reduction state. There are currently 53 participating agencies which encompass the 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands.
2. If taxpayer files Form 940 taking state credit, send quick note requesting verification to taxpayer and send Form 940-B to state where business operated.
3. If Form 940 is received, check the return to see if the taxpayer took the state credit on the return. If they did, make one attempt to contact the taxpayer to see if they can secure the state certification. If no phone number, you will need to send a letter to the taxpayer requesting verification from the state where the business operated. You will suspend the case for 45 days. If no response, treat as a no consideration.
4. If the taxpayer responds with questions or concerns regarding the assessments made, address the issues with the taxpayer by sending the

appropriate letter.

Note:

Be sure to update the ASED if applicable.

4.19.15.43.10 (07-29-2015)

Return Posted as TC 976/977

1. An "A" freeze should be present on account with TC 976/977 and must be resolved before the case can be closed off of AIMS.
2. Returns should be updated to reply status.
3. Attempt should be made to secure the TC 976/977
 - Secure CIS image, if not available
 - Secure TRDBV, if not available
 - Secure BRTVUE

4.19.15.43.11 (07-29-2015)

Missing Signature

1. Return information on TRDB is considered a signed return.
2. An unsigned return is not a valid return. A faxed signature is acceptable.
3. Attempt to call taxpayer for a signed return. If unable to contact taxpayer, send quick note requesting signature.

4.19.15.43.12 (07-29-2015)

Identity Theft - BMF Accounts

1. IRM 25.23.9.5, *BMF Identity Theft Procedures*, provides service wide guidance on BMF identity theft issues, including documentation and actions required for general processing of BMF IDT claims.
2. See IRM 25.23.9.2, *Definition of Business Identity Theft*, for a definition of BMF identity theft.
3. BMF accounts include the following entity types: corporations, partnerships, estate, trust, exempt organization, or government entity.
4. Follow IRM 25.23.10, *Compliance Identity Theft*, for functional guidance regarding controls, work paper documentation, acknowledgement, etc., unless noted otherwise below.

Note:

Use Letter 5316C, *BMF IDT Acknowledgement*, and Letter 5317C, *BMF ID Theft Interim Closure*, in lieu of the Letter 5064C, *Compliance - Identity Theft*, to acknowledge receipt of the documentation and closing letter.

5. BMF IDT indicators are not applied until the IDT has been confirmed. Refer to IRM 25.23.9.4, *Preliminary BMF Research* and IRM 25.23.9.5, *Allegation or Suspicion of BMF Identity Theft - TC 971 AC 522 IDTCLM*.
6. Follow normal controls until the IDT allegation has been verified. Once verified, open TXMOD controls using TPPI as the category code.
7. Account corrections will be performed within the Frivolous Return Program (FRP) team unless there is a lost refund. Cases meeting the lost refund criteria will be referred to DITA in accordance with IRM 4.19.13.6, *Campus Exam Identity Theft*.
8. If the identity theft is substantiated, include an apology as part of the Letter 5317C, *BMF ID Theft Interim Closure*, if a CP72 or Letter 3176 was issued.
9. Abate any penalties assessed based upon the identity theft return and remove all information on the taxpayer from the FRP Master Database.

Note:

Managerial approval is not required to abate a frivolous penalty when a penalty was asserted based upon a return filed that has been deemed identity theft. Penalty abatement is required on all cross reference accounts, if applicable.

10. If the taxpayer does not prove identity theft, a determination cannot be made using internal research tools (IRS identified) or provides information appearing to be fraudulent indicated by the same signature on the identity theft form and the tax return submitted, issue letter Letter 105C disallowing the claim and reverse the IDT indicator in accordance with IRM 25.23.9.5, *BMF Identity Theft Procedures*, continue processing the frivolous filing following normal procedures.

Note:

Reverse any identity theft indicators when no identity theft occurred. Refer to IRM 25.23.9.6.3, *Manually Reversing TC 971 AC 522 IDTCLM, IDTDOC or CIDT*.

11. Once all actions have been taken, remember to close the identity theft issue. Refer to IRM 25.23.9.6.3, *Closing BMF Identity Theft Issues - TC 971 AC 522 CLSIDT*.

4.19.15.43.13 (07-29-2015)

General Information

1. Campus Employment Tax Non-Filer program (PBC 296 and Project Code 0453) is worked by Cincinnati Campus Reporting Compliance Field Support Operation.

4.19.15.43.13.1 (07-29-2015)

Taxpayer Advocate Service (TAS) Cases

1. For information on TAS cases, refer to IRM 4.19.13.24, *Taxpayer Advocate Services (TAS) Procedures*.

4.19.15.43.13.1.1 (07-29-2015)

Form 3870 Request for Adjustment

1. When a case is being worked by the field, the revenue officer (RO) will submit a Form 3870, *Request for Adjustment*. These cases will be treated as priority cases.
2. These cases will be controlled to you only on IDRS

If	Then
The Form 3870 includes information that will allow you to accept the return and adjust the account accordingly	Input a TC29X. Adjust the penalties according to IRM 20.1.
The Form 3870 does not include sufficient information to resolve the discrepancy	Contact the preparer of the Form 3870 to request the additional information needed to resolve the discrepancy and suspend the case for 30 business days.
The information is received	Process your case using the procedures above.
The information is not received	Reject the case back to the revenue officer and input "rejudoc" in the activity field on IDRS.

4.19.15.43.13.2 (07-29-2015)

Controlling the Case

1. Per Policy Statement P-21-3, if the taxpayer submits an original return in response to a substitute for return we prepared, this does not meet the definition of correspondence. However, if the taxpayer submits correspondence with the return, then it meets Action 61 Guidelines. See IRM

21.3.3.2, *What is the Definition of Correspondence? - Policy Statement P-21-3 (Formerly P-6-12) Exclusion List.*

2. Stamp the return with date received in the FSO area.
3. Control the earliest module on IDRS.
4. If Policy Statement P-21-3 applies, then an interim letter must be sent and subsequent follow-up interim letters must be sent.

4.19.15.43.13.3 (07-29-2015)

Examiner Procedures

1. The following subsections explain the procedures to be utilized by tax examiners.

4.19.15.43.13.3.1 (07-29-2015)

Unsigned Return

1. If the return is unsigned and a phone number is available, make one attempt to contact the taxpayer to secure the signature. However, before you do this, also verify the income and withholding reported on the Forms W-2 and the returns. You can use Command Code IRPTRI to do so. If there is a discrepancy, you will want to address this at the same time you are securing the signature. If no phone number is available, send Letter 21-C, *Employment Tax Return Incomplete for Processing*: Form 941, 943, 944, 945, CT-1, Letter requesting the signature for each return unsigned. Suspend for 45 days. If no response to the 21C Letter, treat as a no consider and issue appropriate closing letter. If signature requirement is secured, go to IRM 4.19.15.43.13.3.2, *Signed Return*.

4.19.15.43.13.3.2 (07-29-2015)

Signed Return

1. If you receive a signed return or a signature is received in regards to the 21C Letter that was sent, you will verify the wages and withholding reported on the return(s) matches the Forms W-2 on file. You will use Command Code IRPTRI to verify this information.
2. If the Forms W-2 on file are less than what is reported on the returns, you will accept the returns as filed and make the additional assessment and send the taxpayer the appropriate closing letter addressing the issue that the returns reported more income than what was on the Forms W-2.
3. If the Forms W-2 on file are more than what is reported on the returns and a phone number is available, make one attempt to contact the taxpayer to

discuss what was reported on the Forms W-2 and what is being reported on the returns.

4. If no phone number is available, send appropriate closing letter.

Note:

If one of the returns is reporting more income and withholding than what is assessed, you will make the additional assessment for that module and address this with the taxpayer. A signed return reporting more income for that particular module is a valid return and the correct tax for that module must be assessed. **Be sure to update the ASED is applicable.**

4.19.15.43.13.4 (07-29-2015)

Closing Procedures

1. If the return(s) are accepted and are signed, input TC29X to adjust the account using the appropriate Item Reference Number/Credit Reference Number. Close the IDRS control base (if applicable). Adjust any penalties that were or should be assessed per IRM 20.1, Penalty Handbook
2. If the return(s) are not accepted due to a missing signature one phone contact should be attempted and documented in the workpapers. If a signature is not obtained, input TC290 for zero. Send a Letter 105C if zero balance due and a Letter 916C if there is a balance due. Explain the issue to the taxpayer.
3. If the return(s) are not accepted due to wages and/or withholding not matching the Forms W-2 on file (less than) and we made one phone call attempt per IRM 4.19.15.43.13.5, *Telephone Contact*, input TC 290 for zero. Send Letter 105C for a zero balance due and Letter 916C for a balance due. Explain the issue to the taxpayer.
4. If the return(s) are not accepted due to wages and/or withholding not matching the Forms W-2 on file (more than) and we made one phone call attempt per IRM 4.19.15.43.13.5, *Telephone Contact*, you will assess the additional tax on the modules that are more than and then input a TC290 for zero on the other modules that were reporting less than what we assessed. You will then send the taxpayer a 916C Letter explaining the issue to them.

Note:

Be sure to update the ASED if applicable.

4.19.15.43.13.5 (07-29-2015)

Telephone Contact

1. If the taxpayer provides a phone number, at least one phone call must be made in an effort to secure missing information or clarify an unresolved issue relative to the reconsideration request before disallowing in full or in

part due to lack of information. Before calling the taxpayer review the case file and advise the taxpayer what documentation is needed. Workpapers must be documented with the taxpayer's phone number, date and time of contact. See IRM 4.13.3.9, *Telephone Contact*.

4.19.15.43.13.6 (07-29-2015)

Replies to Disallowance Letters (105C, 106C and 916C)

1. If the taxpayer submits additional information that would result in us accepting the returns as filed, review the returns to ensure they are signed and all wages and withholding are reported. If you can adjust the account per the returns, follow procedures in IRM 4.19.15.43.3, *Second Contacts*, and IRM 4.19.15.43.4, *Complete Form 13496 Certification*.
2. If the taxpayer submits the same information or still does not send what is required, send a 916C letter. Input TC 290 for zero.

4.19.15.43.13.7 (01-01-2016)

Statute of Limitations

1. The Internal Revenue Code provides that the IRS will assess tax, make refunds or credits, and collect taxes within specific time limits. These limits are known as the Statutes of Limitations. Examiners must be aware of these limitations and the necessary steps required to be taken when these limitations are encountered.
 - a. Since, in most instances, the reconsideration request is for a tax decrease the examiner may be making adjustments that may result in an overpayment and will have to determine if the taxpayer is entitled to receive a refund of that overpayment. The statute of limitations that applies to overpayments is known as the Refund Statute Expiration Date (RSED). Generally a claim for refund must be filed within three years from the date the original return was filed or two years from the date the tax was paid, whichever is later. There may be multiple RSED's that apply to a taxpayer's particular situation. In computing the period of limitations, IRC Section 6513(c) provides that employment tax returns reporting FICA tax or FITW for any period ending with or within a calendar year filed before April 15 of the succeeding calendar year are deemed filed on April 15 of such succeeding calendar year. Likewise, IRC Section 6513(c) provides that FICA tax or FITW paid during any period ending with or within a calendar year before April 15 of the succeeding calendar year is deemed paid on April 15 of the succeeding calendar year.
 - b. If no return was filed, the claim may be allowed if filed within 2 years from the date of payment(s). See IRM 25.6.1.10.2.7, *Claims for Credit or Refund – General Time Period for Submitting a Claim*, for guidance.

- c. A claim or amended return is timely if received or postmarked within 3 years of the received date of the original return or within two years of the date the tax is paid. See IRM 25.6.1.10.2.7, *Claims for Credit or Refund – General Time Period for Submitting a Claim* and IRM 25.6.1.5, *Basic Guide for Processing Cases with Statute of Limitations Issues*, for guidance.
2. If an adjustment is made to a taxpayer's account and the result is an overpayment that cannot be refunded due to the RSED, the examiner is required to take the following actions:
 - a. Notify the taxpayer that an adjustment was made to the account however due to the Refund Statute Expiration Date (RSED) the overpayment that is being requested will not be refunded. Use Letter 105C or Letter 106C with the appropriate explanation. See IRM 25.6.1.10.1.1, *Abatement Authority*.

4.19.15.43.13.8 (03-11-2019)

RSED on Original Return

1. Original returns claiming a refund filed by a taxpayer are valid claims. The taxpayer's two-year period of limitations under IRC 6532(a)(1) , for filing a refund suit does not begin to run until a notice of claim disallowance is sent by registered or certified mail.
2. The period of limitations under IRC 6532(a)(1) applies when the taxpayer submits a valid claim. If a claim is defective (i.e., IRS cannot reach the merits of the claim), and the taxpayer fails to respond to a request to provide the information needed to make the claim valid, the submission does not provide the basis for filing a refund suit. When a claim is valid, but additional information is needed to substantiate it, and the taxpayer fails to provide it, a notice of claim disallowance should be issued to start the IRC 6532(a)(1) period. It does not apply if any of the items as stated on the original return, are amended. Supplemental information provided after the RSED can be considered if final action has not been taken on the claim. However, information provided after the RSED cannot vary the facts or legal basis of a claim so as to constitute, in effect, a new claim. IRS may waive the requirement in its regulations as to the form and contents of a claim, but it cannot waive the requirement under IRC 6511 that a claim be submitted timely.
3. If a taxpayer submits a reconsideration request for reversal of an audit assessment or reversal of credits disallowed on the **original** return and we have not sent a formal disallowance letter, then the RSED is still open. See IRM 25.6.1.10.2.5.4, *Reconsideration after the RSED, where Notice of Claim Disallowance not Sent*, for additional information and instruction on how to input the adjustment when the RSED is expired.

4.19.15.43.13.9 (03-27-2018)**Case Assembly**

1. All documents must be saved electronically in RGS as a Case File Document or as an Office Document. For ETNF cases, there will always be primary tax period documents and, if more than one period is being examined, there will be secondary tax period documents.
2. When the case comes to the Tax Examiner from Case Selection, there will be paper W-2 prints and a paper Employment Classification Worksheet. The first contact letter may or may not be in the file. Scan the Classification sheet to create a PDF file and then save it, titled "Classification Worksheet" , into the primary tax period Case File Documents in RGS. Generate another copy of the Letter 4107 just for the RGS file. This letter copy will also be saved in the Case File Documents, titled "Letter 4107 _ICL" , in RGS for the primary tax period.

Note:

To get the ETNF database to print PDF documents, you need to change your default printer setting on your computer to "Adobe PDF" . These PDF documents can then be saved into the RGS cases (that are merged in) or saved into the secure SBU folder and then copied into the RGS cases at a later time. Alternatively documents may be scanned to PDF.

3. All documents, returns, or other information sent by the taxpayer must be scanned and then saved into RGS, to the appropriate tax period, including:
 - Any original returns. If an original return is received in Exam, it will be marked as "Delinquent Return Secured by Exam" before it is scanned. If an image of the return is on AMS, then save that image into RGS.
 - All other documents and information sent by the taxpayer. Save these documents with the file name "CRDMMDDYYNAME" where the MMDDYY is the received date of the documents and NAME is the control name of the taxpayer.

The following documents must be saved in RGS as part of the appropriate primary tax period case:

- Form 5344, *Examination Closing Record*
- Dummy Form 94X in lieu of Form 13496, *IRS Section 6020(b) Certification* (if the taxpayer filed a return, the dummy 94X is not required)
- Form 2504, *Agreement to Assessment and Collection of Additional Tax and Acceptance of Overassessment*, all copies (if issued)
- Form 4666, Form 4667, and/or Form 4668 (if Issued)

- Letter 4108, *30 Day Letter to Taxpayer - No Employment Tax Returns Have Been Filed* (if issued)
- Form 886-A, *Explanation of Items* (if issued)
- Form 13683 (if issued)
- Letter 4107, *Initial Contact Letter - No Employment Tax Returns Filed*
- History Sheet
- Letter 4018, Form 13683, Form 886-A, Form 2504, Form 4666, Form 4667 and Form 4668, should be saved as one file named L4108_SCR

Note:

Any form or letter that has a pen and ink change must be scanned and saved in RGS.

4. The following documents must be saved in RGS to the appropriate secondary tax period:
 - Form 5344, *Examination Closing Record*
 - Dummy Form 94X in lieu of Form 13496, *IRC Section 6020(b) Certification* (if the taxpayer filed a return, the dummy 94X is not required)
 - Form 2504, *Agreement to Assessment and Collection of Additional Tax and Acceptance of Overassessment*, (if issued)
 - Form 4666, Form 4667, and/or Form 4668 (if issued)
 - History Sheet
5. Closing Packets: The closing packet that will be sent to Files will include a printed copy of Form 5344, *Examination Closing Record*, for **every** tax period. All original returns should be attached to the appropriate Form 5344. Since all documents are saved on RGS, nothing else is required to be sent to Files.

Exhibit 4.19.15-1

Schedule C - General Questionnaire

[Please click here for the text description of the image.](#)

Exhibit 4.19.15-2

Schedule C - Car and Truck Questionnaire

[Please click here for the text description of the image.](#)

Exhibit 4.19.15-3

Schedule C - Travel, Meals and Entertainment Expense Questionnaire

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Exhibit 4.19.15-4

Schedule C - Repairs and Maintenance Questionnaire

[Please click here for the text description of the image.](#)

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