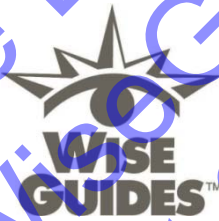


Internal Revenue Service
ENROLLED AGENT EXAM
Lesson Book

Part Three
Representation
Practice and Procedures



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FORWARD

CURRENT FEEDBACK IS THAT THE IRS ENROLLED AGENT EXAM IS DEFINITELY GETTING MORE DIFFICULT. Enrolled Agent Exam candidates have an ever-expanding amount of information to master. To make this more manageable, this course presents selected conceptual content to prepare candidates to pass the IRS Special Enrollment Examination (also known as the SEE, the EA Exam, and the IRS Enrolled Agent Exam).

MOST EXAM CANDIDATES NEED MORE THAN AN ABRIDGED VERSION OF INFORMATION TO PREPARE THEM TO PASS THE EA EXAM. Don't be fooled by "streamlined" or "fast" study methods, as such abbreviated efforts may not adequately prepare you for this increasingly difficult exam. Exam candidates have varying tax proficiency backgrounds and hence there is no appropriate one-size-fits-all study program.

WHICH TOPICS WILL BE ON YOUR EXAM? There are only one hundred questions on each part of the EA Exam. Since there are easily over a thousand possible questions per exam part, only a representative sampling of the subject matter is tested on each version of the exam. Which topics will be on your exam? No one knows. The actual questions are not released, and different versions of the exam are computer generated and randomly assigned. Also, it sounds like there is much overlap of topics appearing on the Part Three Exam! So, pay attention to "hints" throughout this Lesson Book about topics that may appear on your Part Three Exam even though the subtopic is identified by Prometric as a Part One or Part Two topic. Sorry, but that is the reality.

THE OBJECTIVE IS TO PASS THE EA EXAM ON THE FIRST TRY. Because of privacy regulations, candidate scores are not released, making it impossible for any provider of study materials to track and honestly report statistically valid "pass rates" of their customers. However, for over thirteen years, students have used our study materials to help them pass the EA Exam. If you use the WiseGuides™ **Internet eCourse Plus or Internet eCourse Premium**, and you follow our study plan (which includes reading the lessons and achieving targeted completion rates and Practice Exam scores per part), we **GUARANTEE you will pass.**

USE THE WISEGUIDES™ COMPREHENSIVE PROGRAM AND CHOOSE THE STUDY METHODS THAT WORK BEST FOR YOU. Exam topics are introduced in the Lesson Book or in the Internet eCourse or CD Courseware lessons. Next, topics are incrementally mastered using the Question & Answer Software with complete answer explanations that are aligned with the lesson's topics. To wrap-up the learning process, the WiseGuides™ eStudy Cards Software helps to truly master the material by challenging you to answer questions without the crutch of choosing between given answer options (also known as multiple choice guessing). Use of eStudy Cards enhances essential concept mapping skills critical to applying tax law.

READ THIS LESSON BOOK FROM START TO FINISH. The EA Exam continues to evolve with additional subtopics. Providing students with content and questions on every possible question would be a very unmanageable study tool. However, mastering the topics in the WiseGuides™ lessons and questions and answers will prepare you to pass the exam.

NON-SCORED EXAM QUESTIONS. When you take the IRS Special Enrollment Examination, your test will include some questions that are being field tested. Field testing is the source for future test questions. These questions do not count as part of your score, but you will not be told which questions they are. Keep this in mind as you take your timed exam, and use your time wisely. Our advice is to answer every question, not skipping any but marking those that stump you for review if time permits.

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Part Three

Representation, Practice and Procedures

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Section 3.01

Practice Before the IRS

Changes to Regulate Paid Return Preparers

CHANGES TO REGULATE PAID RETURN

PREPARERS. For years, there have been ongoing discussions about the need to regulate paid income tax return preparers. Discussions have now turned to actions and there are quite a number of proposed and impending changes in the income tax preparation industry. The following summarizes what led to and the current status of these changes as of April 1, 2011.

In June 2009, the Commissioner of Internal Revenue initiated a review of paid preparers to help IRS strengthen its partnerships with paid preparers and ensure that paid preparers adhere to applicable professional standards and follow tax laws. IRS recommended changes to the oversight of paid preparers in its December 2009 *Return Preparer Review* report.

Recommended changes include:

- Mandatory registration for paid preparers who are required to sign a federal tax return
- Competency testing
- Continuing education for paid preparers who are required to register with IRS and who are not attorneys, CPAs, or EAs
- Holding all paid preparers to *Circular 230* standards of practice, regardless of whether or not the preparers are required to sign a federal tax return.

The objectives of the above changes are to:

- Improve service to taxpayers
- Increase confidence in the tax system
- Increase taxpayer compliance.

REQUIRED PTIN INITIATED. IRS has already implemented a requirement that paid preparers obtain a PTIN if they prepare all or substantially all of a tax return filed after December 31, 2010.

- Paid preparers may register for a PTIN online or on paper via Form W-12, *IRS Paid Preparer Tax Identification Number (PTIN) Application*.
- Paid preparers who currently have a PTIN must register in the new PTIN registration system, but in most cases will retain their old PTIN as long as IRS can verify identifying information for the existing PTIN.
- Online registrants are supposed to receive a provisional PTIN immediately, while paper registrants are supposed to receive a provisional PTIN in 4-6 weeks.

SELF-DISCLOSURE SUBJECT TO

VERIFICATION. When applying for a PTIN, paid preparers are asked to self-disclose if they are compliant with their personal and business taxes, under penalty of perjury. Automated tax compliance checks will be performed on all paid preparers. Paid preparers are also asked if they have been convicted of a felony in the past 10 years, under penalty of perjury. The PTIN application includes space to write an explanation for both tax compliance and felony information.

Per the IRS, registrants who provide false information on their PTIN applications will have severely limited appeal rights if IRS proposes to deny them PTINs.

As of March 30, 2011, IRS had issued approximately 700,000 PTINs, approximately 60 percent of which were issued to paid preparers with existing PTINs and approximately 40 percent of which were issued to paid preparers without existing PTINs.

NEW CATEGORY OF PRACTITIONER.

IRS plans to hold paid preparers to *Circular 230* standards of practice and will establish a new category of practitioner—registered tax return preparer. These paid preparers will be limited in their practice before IRS to preparing tax returns, claims for refund, and other documents for submission to IRS, but will be required to adhere to professional ethical standards when doing so or face a penalty.

Additionally, paid preparers who are supervised by an attorney, CPA, Enrolled Agent, Enrolled Actuary, or Enrolled Retirement Plan Agent at a law firm, CPA firm, or other recognized firm and do not sign tax returns but obtain a PTIN, while not being granted rights to practice before IRS, will be required to meet the same standards. If paid preparers are denied a PTIN or have their PTIN revoked, paid preparers will have the right to appeal this denial or revocation in the same manner as other *Circular 230* sanctions.

- Competency tests will also be available at national and international locations.
- The test will allow individuals to consult forms and instructions during the test.
- A fee will be charged each time the candidate takes the test.

EDUCATION REQUIREMENTS AND COMPETENCY TESTING DELAYED.

The dates for implementing the competency testing and continuing education requirements are tentative because OMB is currently reviewing the proposed revisions to the *Circular 230* regulations. Because these proposed regulations are not final, IRS has not decided how it will implement some details of the competency testing and continuing education requirements.

SUITABILITY CHECKS. After completing the competency test, registered tax return preparers will be subject to suitability checks, which IRS plans to conduct to determine whether the individual has engaged in disreputable conduct. Section 10.51 of *Circular 230* (31 C.F.R. § 10.51) provides a list of conduct considered disreputable, including criminal convictions, and therefore punishable by sanction or disbarment.

Suitability checks for registered tax return preparers will be linked to the competency test so that when paid preparers take the competency test they will be fingerprinted, thereby submitting to a suitability check.

APPLYING PROPOSED CHANGES TO CIRCULAR 230.

A competency test will be required (with exceptions noted) to become an officially registered tax return preparer.

- Paid preparers who have a valid PTIN before competency testing is available will have until 2013 to pass a competency test.
- Paid preparers who register for a PTIN after testing is available must pass a competency test before obtaining a PTIN.
- IRS plans to develop and implement **one competency test for individuals who prepare returns from the individual tax return (Form 1040) series** and will assess whether IRS needs to add additional tests in the future. **Enrolled actuaries and enrolled retirement plan agents** will be exempt from the paid preparer competency testing requirement if they only prepare tax returns within their limited practice areas, and will be exempt from the continuing education requirement.

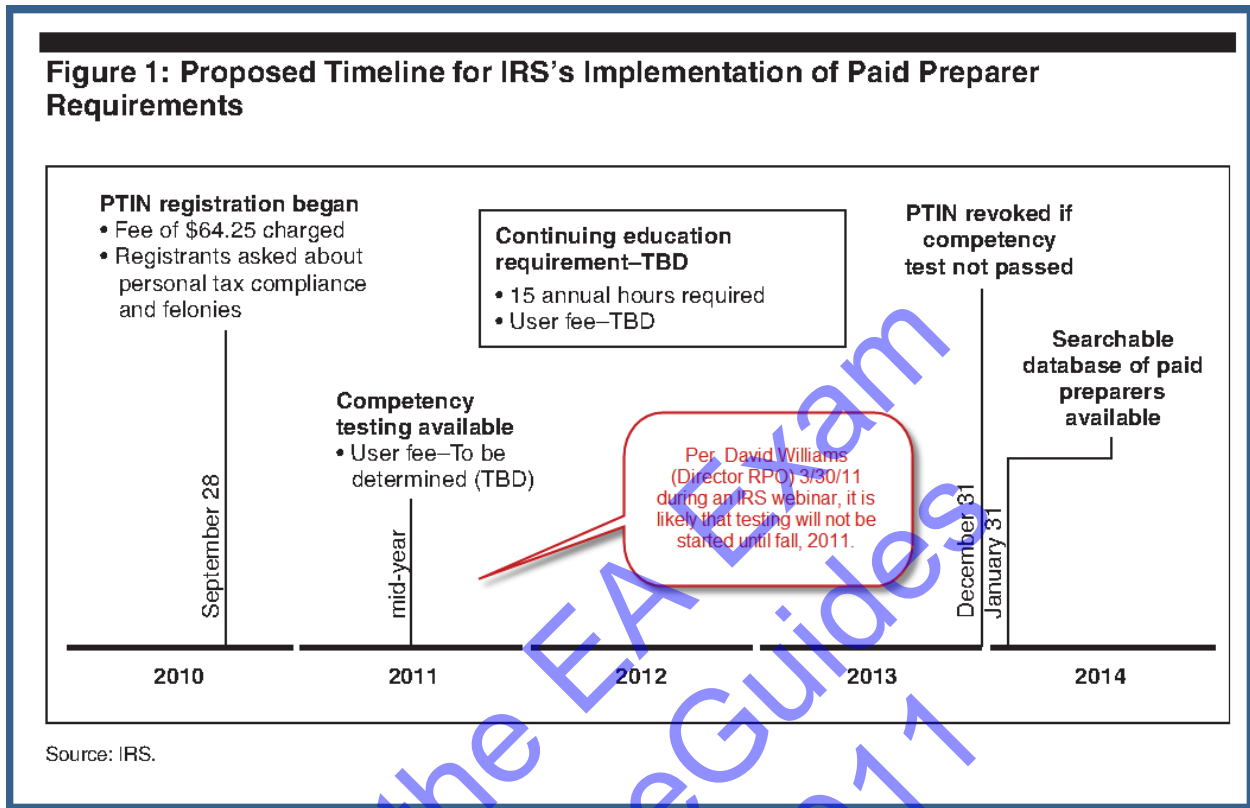
CONTINUING EDUCATION REQUIREMENT.

IRS plans to implement a continuing education requirement, whereby registered tax return preparers will be **required to take 15 hours of training annually:**

- 3 Hours of federal tax law updates
 - 2 Hours of ethics
 - 10 Hours of additional federal tax topics
- 15 TOTAL HOURS**

Plans are also underway to approve continuing education providers and audit a random sample of continuing education courses.

Proposed Timeline for Implementation of Paid Preparer Requirements



PENALTIES FOR PTIN NONCOMPLIANCE.

IRS has the authority to penalize paid preparers who are required to but fail to include a PTIN on a tax return.

DATABASE OF REGISTERED PREPARERS.

IRS plans to launch a publicly accessible database of all registered paid preparers **by January 31, 2014**, so that taxpayers can check whether a paid preparer has registered. The database will likely include preparers’ contact information, whether or not preparers have passed the competency test, professional credentials, and tax preparation legal problems, if applicable.

PROGRAM FUNDING. IRS is funding the administration of the paid preparer requirements through user fees for PTIN registration, competency testing, and continuing education.

IRS has only determined the user fee for PTIN registration so far, which is \$50 per PTIN. IRS contracted with a vendor to establish and maintain the PTIN registration system, and the vendor will charge a \$14.25 fee, bringing the **total fee for PTIN registration to \$64.25.**

Renewal Process

RENEWAL PROCESS. The renewal process uses a staggered renewal date which is noted on each enrollment card. Currently, the effective date of renewal is the first day of the fourth month following the close of the period for renewal described in Section 10.6.

Each individual enrolled to practice before the IRS is accorded active enrollment status subject to his renewal of enrollment as provided in Section 10.6 of the Treasury Department Circular 230.

The IRS has a staggered renewal process based on the last digit of the enrollee's Social Security number as follows:

- 0, 1, 2, or 3 – Renewal cycle is between November 1, 2009 and January 31, 2010.
- 4, 5, or 6 – Renewal cycle is between November 1, 2010 and January 31, 2011.* See **DELAY** noted below.
- 7, 8, or 9 – Renewal cycle was between November 1, 2008 and January 31, 2009.
- Other renewal date changes may be forthcoming due to the implementation of the new required PTIN system.

DELAY IN RENEWAL PERIOD FOR

CERTAIN ENROLLED AGENTS. Until further notice, the renewal period under Section 10.6(d) of the regulations governing practice before the IRS has been delayed for enrolled agents with Social Security numbers or tax identification numbers ending in 4, 5, or 6. (Renewal cycle is between November 1, 2010 and January 31, 2011.) When a date for the renewal period is determined, the IRS will publish a schedule for affected enrolled agents to renew their enrollment in the Internal Revenue Bulletin and on the IRS Office of Professional Responsibility (OPR) webpage at <http://www.irs.gov/taxpros/agents/index.html>.

This schedule will be published at least 30 days prior to the beginning of the revised period for enrollment. This delay will NOT impact an affected enrolled agent's current status as an enrolled agent in good standing. Also, the delay will not affect the number of hours of continuing professional education required for renewal or the time period within which these hours must be completed.

The IRS will generally send a reminder notice when the individual is due for renewal. However, if a reminder notice is not received, the individual must still file Form 8554, *Application for Renewal of Enrollment to Practice Before the Internal Revenue Service*, to renew his status.

Applications for renewal as an enrolled agent will be required between November 1 and January 31 of every subsequent third year as specified above according to the last number of the individual's Social Security number or tax identification number.

INITIAL ENROLLMENT PERIOD. Those individuals who receive initial enrollment as an enrolled agent after November 1 and before April 2 of the applicable renewal period will not be required to renew their enrollment before the first full renewal period following the receipt of their initial enrollment. Applications for renewal as an enrolled retirement plan agent will be required of all enrolled retirement plan agents between April 1 and June 30 of every third year period subsequent to their initial enrollment.

RENEWAL FEE. A nonrefundable fee is charged for each application for renewal. The renewal fee was \$125 prior to implementation of the new required PTIN system.

As of this writing, the annual renewal fee is under review by the Office of Professional Responsibility. Payment may be made using a check or money order or by paying electronically at www.pay.gov.

Other Duties

DUTY TO ADVISE. A practitioner who, having been retained by a client with respect to a matter administered by the IRS, knows that the client has not complied with the revenue laws of the U.S. or has made an error in or omission from any return, document, affidavit, or other paper which the client submitted or executed under the revenue laws of the U.S., must advise the client promptly of the fact of such noncompliance, error, or omission and of the related consequences as provided under the Code.

LIMITED PERFORMANCE AS A NOTARY. If the practitioner, who is a notary public, is employed as counsel, attorney, or agent in a matter before the IRS, or has a material interest in the matter, he **MUST NOT** engage in any notary activities relative to the matter.

LIMITED PRACTICE BY PARTNERS OF CURRENT AND FORMER GOVERNMENT EMPLOYEES. A partner of an officer or employee of the executive branch of the U.S. government, or of an independent agency of the U.S. or of the District of Columbia, may not represent anyone in a matter before the IRS in which the officer or employee has (or had) a personal or substantial interest as a government employee.

NEGOTIATION OF REFUND CHECKS. Practitioners who are income tax return preparers must not endorse or otherwise negotiate any refund check issued to a client—even if a valid power of attorney exists.

A tax return preparer will not be considered to have endorsed or otherwise negotiated a check solely as a result of having affixed the taxpayer's name to a refund check for the purpose of depositing the check into an account in the name of the taxpayer or in the joint names of the taxpayer and one or more other persons (excluding the tax return preparer) if authorized by the taxpayer or the taxpayer's recognized representative. (Section 6695(f))

DELAYS. Practitioner must not unreasonably delay prompt disposition of matters before the IRS.

Due Diligence

DUE DILIGENCE STANDARDS. A preparer should be informed on current tax laws, advise the client of the laws, ask questions of the client, have a routine in place that requires the client to provide documents, and follow that routine.

In general, a practitioner must exercise due diligence when performing ALL the following duties:

- In preparing or assisting in the preparation of, approving, and filing tax returns, documents, affidavits, and other papers relating to IRS matters
- In determining the correctness of oral or written representations made by the practitioner to the Department of the Treasury
- In determining the correctness of oral or written representations made by the practitioner to clients with reference to any matter administered by IRS

RELIANCE ON OTHERS. Except as provided in Sections 10.34, 10.35, and 10.37, a practitioner will be presumed to have exercised due diligence for purposes of Section 10.22 of the regulations if the practitioner relies on the work product of another person and the practitioner used reasonable care in engaging, supervising, training, and evaluating the person, taking proper account of the nature of the relationship between practitioner and the person.

Advising Clients on Potential Penalties

PENALTY AND DISCLOSURE ADVICE. A practitioner must inform a client of any penalties that are reasonably likely to apply to the client with respect to the following.

- A position taken on a tax return if the practitioner advised the client with respect to the position; or the practitioner prepared or signed the tax return
- Any document, affidavit, or other paper submitted to the IRS

The practitioner also must inform the client of any opportunity to avoid any such penalties by disclosure, if relevant, and of the requirements for adequate disclosure.

The advice to clients on potential penalties applies even if the practitioner is not subject to a penalty under the IRC with respect to the position or with respect to the document, affidavit, or other paper submitted.

RELYING ON INFORMATION FURNISHED BY CLIENTS. A practitioner advising a client to take a position on a tax return, document, affidavit, or other paper submitted to the IRS, or preparing or signing a tax return as a preparer, generally may rely in good faith WITHOUT verification upon information furnished by the client.

REASONABLE INQUIRIES. The practitioner may NOT, however, ignore the implications of information furnished to, or actually known by, the practitioner, and must make reasonable inquiries if the information as furnished appears to be incorrect, inconsistent with an important fact or another factual assumption, or incomplete.

Best Practices for Tax Advisors

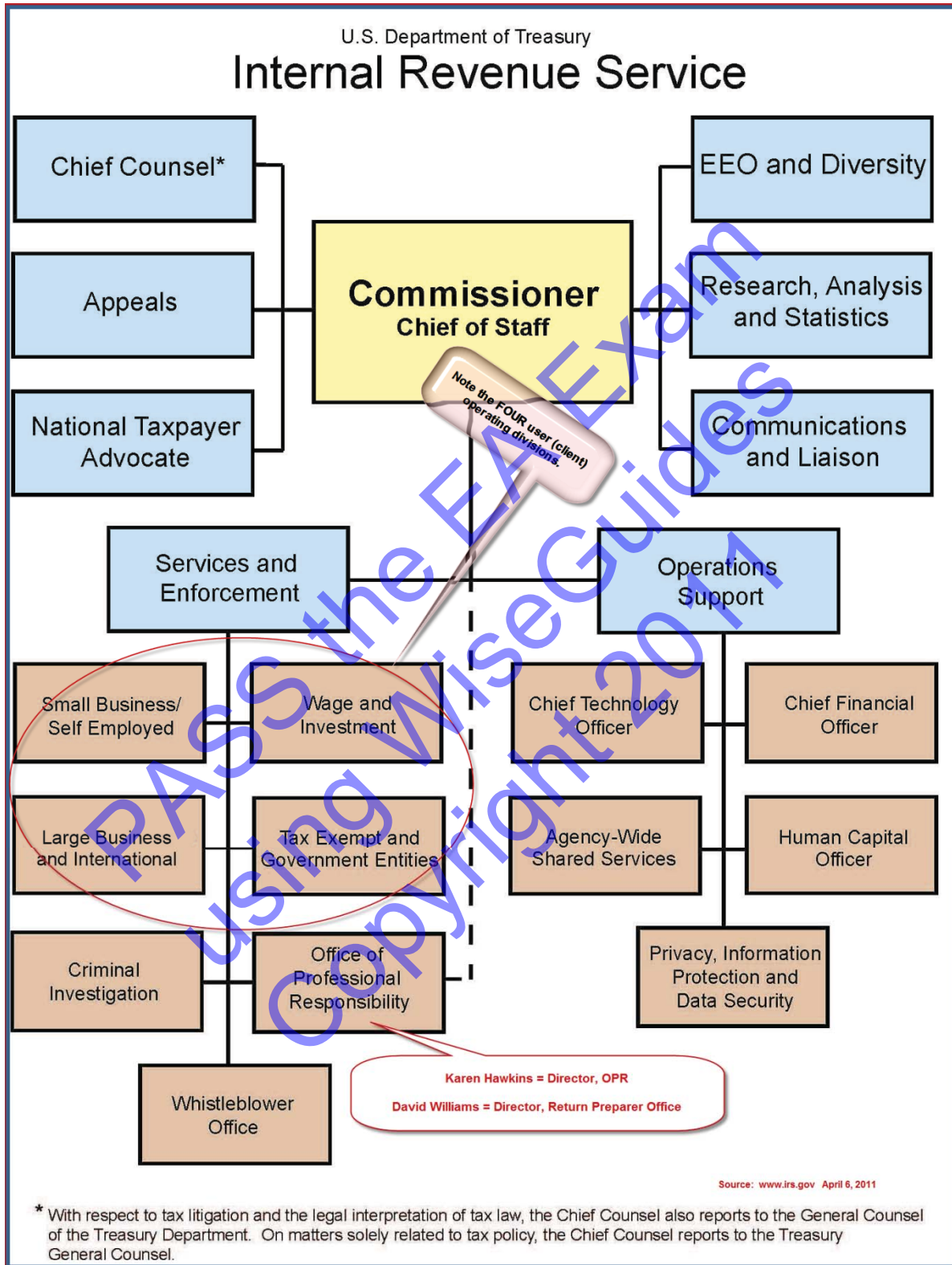
HIGHEST QUALITY REPRESENTATION STANDARDS. Tax advisors should provide clients with the highest quality representation concerning federal tax issues by adhering to best practices in providing advice and in preparing or assisting in the preparation of a submission to the IRS.

In addition to compliance with the standards of practice, best practices include the following:

- **Communicating clearly** with the client regarding the terms of the engagement. For example, the advisor should determine the client's expected purpose for and use of the advice and should have a clear understanding with the client regarding the form and scope of the advice or assistance to be rendered.
- **Establishing the facts**, determining which facts are relevant, evaluating the reasonableness of any assumptions or representations, relating the applicable law (including potentially applicable judicial doctrines) to the relevant facts, and arriving at a conclusion supported by the law and the facts
- **Advising the client regarding the importance of the conclusions** reached, including, for example, whether a taxpayer may avoid accuracy related penalties under the IRC if a taxpayer acts in reliance on the advice
- **Acting fairly and with integrity** in practice before the IRS

STAFF TRAINING. Tax advisors with responsibility for overseeing a firm's practice of providing advice concerning federal tax issues or of preparing or assisting in the preparation of submissions to the IRS should take reasonable steps to ensure that the firm's procedures for all members, associates, and employees are consistent with the above best practices.

Internal Revenue Service Organizational Chart as of 4/6/11



Basic Records

BASIC RECORDS. A preparer is not required to verify the client's books and records to verify information the client provided to the preparer; however, the preparer should advise clients to keep certain basic records. Basic records are documents that everybody should keep. These are records that prove income and expenses.

COMPUTER RECORDS STILL REQUIRE BACK-UP DOCUMENTATION OF TRANSACTIONS. Even if records are kept on a computer, the taxpayer must keep all the receipts, checks, and other documents.

Proof of Payment Records

PROOF OF PAYMENT RECORDS. Proof of payment alone is not proof that the item claimed on the return is allowable. Other documents that will help prove that the item is allowable should also be kept.

Generally, payment is proved with a cash receipt, financial account statement, credit card statement, canceled check, or substitute check. If payments are made in cash, taxpayer should get a dated and signed receipt showing the amount and the reason for the payment. If the payments are made by electronic funds transfer, proof of payment may be substantiated with an account statement.

RECORDS TO PROVE INCOME AND EXPENSE

Type of Item	Required Records
Income	<ul style="list-style-type: none"> ▪ Form W-2 ▪ Form 1099 ▪ Bank statements ▪ Brokerage statements ▪ Form K-1
Expenses	<ul style="list-style-type: none"> ▪ Sales documents ▪ Invoices ▪ Receipts ▪ Canceled checks or other proof of payment
Home / Real Estate	<ul style="list-style-type: none"> ▪ Closing statements ▪ Purchase and sales agreements ▪ Proof of payment ▪ Insurance records
Investments	<ul style="list-style-type: none"> ▪ Brokerage statements ▪ Mutual fund statements ▪ Form 1099 ▪ Form 2439

RECORDS TO PROVE PAYMENT

Payment Method	Required Information
Cash	<ul style="list-style-type: none"> ▪ Amount ▪ Payee's name ▪ Transaction date
Check	<ul style="list-style-type: none"> ▪ Check number ▪ Amount ▪ Payee's name ▪ Date the check amount was posted to the account by the financial institution
Debit or Credit Card	<ul style="list-style-type: none"> ▪ Amount charged ▪ Payee's name ▪ Transaction date
Electronic Funds Transfer	<ul style="list-style-type: none"> ▪ Amount transferred ▪ Payee's name ▪ Date the transfer was posted to the account by the financial institution
Payroll Deduction	<ul style="list-style-type: none"> ▪ Amount ▪ Payee code ▪ Transaction date

Avoiding Section 6694 Penalties

AVOIDING SECTION 6694 PENALTIES. For the \$1,000 (or 50% of fee, whichever is greater) per return penalty under IRC Section 6694(a) to apply, the preparer must have known (or should have known) that the position taken is questionable. If the preparer is relying in good faith on the advice of another preparer, or on the advice of a preparer who constituted the preparation of a substantial portion of the return or claim for refund, there is a reasonable cause and good faith exception to the \$1,000 penalty if the preparer had reason to believe the advising preparer was competent to render the advice.

Be aware that good faith reliance does not exist if the advice is not reasonable on its face; the preparer knew or should have known that the advising preparer was not aware of all relevant facts, or the preparer knew or should have known the advice was not reliable because of recent changes in the tax law.

ADEQUATE DISCLOSURE DEFENSE. A preparer is not subject to a civil penalty for an unrealistic position under IRC Section 6694(a) if the position is not frivolous and is adequately disclosed. Different disclosure rules apply to signing and non-signing preparers:

- **SIGNING PREPARERS.** The disclosure must be made on a properly completed and filed Form 8275, Disclosure Statement, or 8275-R, Regulation Disclosure Statement, as appropriate, or on the return per an annual revenue procedure.
- **NON-SIGNING PREPARERS.** The disclosure may be made in the manner prescribed above for signing preparers or by including in the advice to the taxpayer (or to another preparer) a statement that contains the information required by regulation.

RELYING ON INFORMATION FURNISHED BY TAXPAYER DEFENSE. A preparer is not required to audit or review the taxpayer's books and records to verify information the taxpayer provided to the preparer. However, if the regulations require the taxpayer to maintain certain records before claiming the deduction, the preparer must make inquiries to verify that the taxpayer is satisfying the requirements.

Response to Preparer Penalty Notification

RESPONSE TO PREPARER PENALTY NOTIFICATION. If a penalty is proposed against a preparer that the preparer does not agree with, the preparer can do one of the following:

- Request a conference with the agent and present additional information and explanations showing that the penalty is not warranted
- Wait for the penalty to be assessed and a notice and demand statement to be issued, then pay the penalty within 30 days and file a claim for refund
- Wait for the penalty to be assessed and a notice and demand statement to be issued, then pay at least 15% of the penalty within 30 days and file a claim for refund

PENALTY ABATEMENT. Section 6694(d) states that the penalty for understatements due to unrealistic positions or the penalty for willful or reckless conduct will be abated if a final administrative determination or a final judicial decision is made that there was no understatement of liability. If the return preparer has paid any part of the penalty, the payment will be refunded.

Preparer Standards Based on Return Position

PREPARER STANDARDS BASED ON RETURN POSITION. The following table illustrates the required preparer position (second row) needed to avoid a penalty based on the type of position taken (first row) on the return.

Required Preparer Standards Based on Return Position

Non- Disclosed Position (1)	Disclosed Position (2)	Tax Shelter Item	Reportable Transaction
Substantial Authority > 40%	Reasonable Basis > 20%	Substantial Authority > 40%	More Likely Than Not > 50%

(1) Does not pertain to Tax Shelter positions

(2) Does not pertain to Reportable Transactions

Small Business Owner New Estimated Tax Provision

SMALL BUSINESS OWNER NEW ESTIMATED TAX PROVISION. For 2009, qualified individuals with small businesses were eligible to make smaller estimated tax payments. If the taxpayer qualified, his required annual payment for 2009 was the smaller of 90% of the tax shown on his 2008 tax return or 90% of the tax shown on his 2009 tax return. Box F in Part II on Form 2210 or box C on Form 2210-F must be checked to certify that the taxpayer qualifies.

To qualify for the decreased estimated tax payments:

1. More than 50% of a taxpayer's gross income must have been from a business that had an average of fewer than 500 employees in 2008, and
2. The taxpayer's adjusted gross income in 2008 was less than \$500,000 (\$250,000 if filing as married filing separately for 2009).

➤ **NOTE.** This special provision was NOT available for tax year 2010 or 2011.

Back-up Withholding

BACK-UP WITHHOLDING. Persons (payers) making certain payments to payees must withhold and pay to the IRS a specified percentage of those payments, referred to as back-up withholding, under certain conditions.

Generally, under the back-up withholding rules, the business must withhold on a payment if:

1. The payee did not provide the payer with a taxpayer identification number in the required manner.
2. The IRS has notified the payer that the taxpayer identification number provided by the payee is incorrect.
3. The IRS has notified the payer to start withholding because the payee failed to report income on an income tax return in prior years.
4. The payee failed to certify that it was not subject to back-up withholding for underreporting of interest and dividends.

Payments that may be subject to back-up withholding include:

- Interest
- Dividends
- Rents
- Royalties
- Commissions
- Non-employee compensation
- Broker proceeds
- Barter exchange transactions
- Reportable gross proceeds paid to attorneys
- Certain gambling winnings
- Certain payments made by fishing boat operators

Payee TIN Penalties

PAYEE TIN PENALTIES. If a taxpayer fails to furnish a correct TIN to a requester, he is subject to a penalty of \$50 for each such failure unless the failure is due to reasonable cause and not to willful neglect.

If a taxpayer makes a false statement with no reasonable basis that results in no back-up withholding, the taxpayer is subject to a civil \$500 penalty.

Willfully falsifying certifications or affirmations may subject a taxpayer to criminal penalties including fines and/or imprisonment.

Centralized Authorization File (CAF)

CENTRALIZED AUTHORIZATION FILE (CAF).

The Power of Attorney (POA) is entered into the CAF. A power of attorney will be recognized after it is received, reviewed, and determined by the IRS to contain the required information.

However, until a power of attorney is entered into the centralized computer database called the CENTRALIZED AUTHORIZATION FILE (CAF), IRS personnel, other than the individual to whom the form is submitted, may be unaware of the authority of the person the taxpayer has named to represent him.

Therefore, during this interim, other IRS personnel who do not have access to a copy of the power of attorney may request that the taxpayer or his representative submit an additional copy.

The fact that the power of attorney or tax information authorization cannot be recorded onto the CAF system is NOT determinative of the current or future validity of the document.

When the IRS receives a complete and valid power of attorney, the IRS will then take action to recognize the representative. In most instances, this involves processing the document into the CAF system. Recording the data on the CAF enables the IRS to automatically direct copies of mailings to authorized representatives and to instantly recognize the scope of authority granted.

TAX MATTERS RECORDED ON CAF. Although a power of attorney or tax information authorization may be filed in all matters under the jurisdiction of the IRS, only those documents which meet EACH of the following criteria will be recorded onto the CAF system:

1. Specific tax period. Only documents which concern a matter(s) relating to a specific tax period (except for civil penalties) will be recorded onto the CAF system.
2. Future three-year limitation. Only documents which concern a tax period that ends no later than three years after the date a power of attorney is received by the IRS will be recorded onto the CAF system.

EXAMPLE. A power of attorney received by the IRS on August 1, 2000, which indicates that the authorization applies to Forms 941 for the quarters ended December 31, 2000, through December 31, 2010, will be recorded onto the CAF system for the applicable tax periods which end no later than July 31, 2003 (i.e., three years after the date of receipt by the IRS). However, the POA or tax information authorization which concerns tax periods that end more than three years from the date of receipt by the IRS is NOT considered INVALID for the period(s) not recorded onto the CAF system. Such POA or tax information authorization may be resubmitted at a later date.

3. Documents for prior tax periods. Documents which concern any tax period which has ended prior to the date on which a POA is received by the IRS will be recorded onto the CAF system provided that matters concerning these years are under consideration by the IRS.
4. Limitation on the number of representatives recorded. No more than three representatives appointed under a POA or three persons designated under a tax information authorization will be recorded onto the CAF system. If more than three representatives are appointed only the first three names will be recorded onto the CAF system.

Section 3.04

Electronic Filing

History of Electronic Filing

HISTORY OF ELECTRONIC FILING. The IRS e-file tax filing program for individual and business tax returns has come a long way since its debut as a pilot project in 1986 with the transmission of 25,000 refund-only individual income tax returns from five transmitters in three locations.

By 1994, approximately 98 percent of all individual tax returns could have been filed electronically. The IRS continues to work toward enabling 100 percent of all forms and schedules. As of October 2008, 90 million tax returns, almost 60 percent of all individual returns, were filed electronically of which 63 million returns came from tax professionals and more than 27 million were filed from home computers. While e-filing of individual returns reached the 69% rate during the 2010 filing season, the IRS has considerable challenges to meet in order to reach its 80% e-file goal for individual returns.

There are various reasons why e-filing has met with some resistance by both taxpayers and return preparers. One of the initiatives implemented to help reduce resistance by return preparers is to require some preparers to e-file individual returns.

Return Preparers Now Required to e-File

RETURN PREPARERS NOW REQUIRED TO E-FILE. Before November 6, 2009, U.S. law prohibited the IRS from requiring that individual income tax returns be e-filed. On that date, Congress passed and President Obama signed into law the *Worker, Homeownership, and Business Assistance Act of 2009*. One of the provisions in this 2009 Act mandated that individual income tax returns filed after December 31, 2010 by preparers who file more than 10 returns in a calendar year be e-filed.

Starting January 1, 2011, paid tax return preparers must comply with the new law that requires those who meet the definition of “specified tax return preparer” to electronically file federal income tax returns that they prepare and file for individuals, trusts and estates. The e-file requirement will be phased in over two years.

The new requirement does not apply to individuals who do not meet the definition of “tax return preparers” under the Internal Revenue Code and related regulations, such as an individual who provides tax assistance under a Volunteer Income Tax Assistance (VITA) program, a person who merely prepares a return of the employer (or of an officer or employee of the employer) by whom the person is regularly and continuously employed, or a person who prepares a return as a fiduciary for any person.

As a result of the new rules, preparers will be required to start using IRS e-file beginning:

- **January 1, 2011**— for preparers who anticipate filing **100 or more** Forms 1040, 1040A, 1040EZ and 1041 during the year; or
- **January 1, 2012**— for preparers who anticipate filing **11 or more** 1040, 1040A, 1040EZ and 1041 during the year.

The rules require members of firms to aggregate the number of returns that they reasonably expect to file as a firm. If that number is 100 or more in calendar year 2011 (11 or more in 2012 and thereafter), then all members of the firm must e-file the returns they prepare and file. This is true even if a member prepares and files fewer than the threshold on an individual basis.

EXAM REALITY NOTE. With the implementation of required e-Filing for tax season 2011, it is highly likely that the Part Three Exam will include more in-depth questions pertaining for e-Filing than had been asked in prior years.

Accordingly, this May 2011-February 2012 Edition of the Part Three Lesson Book provides expanded content pertaining to e-Filing. We recommend that you thoroughly review this section before taking your Part Three Exam.

Business e-File

BUSINESS E-FILE. There is an IRS e-file to meet the needs of all businesses, whether a business is big or small, or a self-employed business. IRS e-file is available for corporations, partnerships, employment taxes, and information returns, as well as returns for estates and trusts and exempt organizations.

Partnerships Required to e-File

PARTNERSHIPS REQUIRED TO E-FILE. Section 1224, of the Taxpayer Relief Act of 1997, requires partnerships (Form 1065 U.S. Partnership Return) with more than 100 partners (Schedules K-1) to file their return on magnetic media (electronically as prescribed by the IRS Commissioner). This law became effective for partnership returns with taxable years ending on or after December 31, 2000. Partnerships with 100 or less partners (Schedules K-1) may voluntarily file their return using the MeF Platform.

Corporations Required to e-File

CORPORATIONS REQUIRED TO E-FILE. Temporary Regulations issued January 11, 2005 and Final Regulations announced in TD 9363, which were implemented effective November 13, 2007, require certain corporations to electronically file. Those corporations with \$10 million or more in total assets and that file 250 or more returns a year are required to electronically file their Form 1120, 1120S, and 1120-F.

All returns filed by a corporation or members of a controlled group of corporations during the calendar year are counted regardless of type, including income tax returns, returns required under Section 6033, information returns, excise tax returns, and employment tax returns. Corrected returns, amended returns, or forms filed with the 1120, 1120S, or 1120-F tax return, such as Form 5471, are not counted. Returns filed by a related partnership are not included when determining if a corporation meets the 250-return threshold. For

Tax Years 2008 and forward, carryback claims (situations in which the change is due to a net operating loss carryback, a capital loss carryback, or a general business credit carryback) may be filed electronically.

Tax-Exempt Organizations e-Filing

TAX-EXEMPT ORGANIZATIONS E-FILING. With a few exceptions, most tax-exempt organizations that file Forms 990, 990-EZ, 990-PF, or 1120-POL can file electronically. Form 990-T, *Exempt Organization Business Income Tax Return*, is not yet available for electronic filing.

Exempt organizations can e-file:

- Form 990, *Return of Organization Exempt from Income Tax*;
- Form 990-EZ, *Short Form Return of Organization Exempt from Income Tax*;
- Form 990-PF, *Return of Private Foundation or Section 4947(a)(1) Trust Treated as a Private Foundation*;
- Form 1120-POL, *U.S. Income Tax Return for Certain Political Organizations*;
- Form 8868, *Application for Extension of Time to File an Exempt Organization Return*; and
- Form 7004, *Application for Automatic 6-Month Extension of Time To File Certain Business Income Tax, Information, and Other Returns* (the extension form associated with the 1120-POL).

SMALL TAX-EXEMPT ORGANIZATIONS. Many small tax-exempt organizations with annual gross receipts less than or equal to \$50,000 now must submit Form 990-N, *Electronic Notice (e-Postcard) for Tax-Exempt Organizations Not Required to File Form 990 or 990-EZ*, if they choose not to file Form 990 or 990-EZ.

LARGE TAX EXEMPT ORGANIZATIONS. E-filing of Forms 990 and 990-PF is required for some large tax-exempt organizations. For tax years ending on or after December 31, 2006, only organizations that file 250 returns during the calendar year and that have total assets of \$10 million or more are required to file Form 990 electronically.

PRIVATE FOUNDATIONS AND CHARITABLE TRUSTS. Private foundations and charitable trusts are required to file Forms 990-PF electronically regardless of their asset size, if they file at least 250 returns annually. The electronic filing requirement does not apply to the extension Form 8868, even if the filer is required to file its return (Form 990 or 9900-PF) electronically.

e-File Provider Eligibility

E-FILE PROVIDER ELIGIBILITY. The provider applicant identifies its Principals and at least one Responsible Official on its IRS e-file Application. The roles are not mutually exclusive; a Principal may also serve as the Responsible Official. A business is accepted and may continue to participate in IRS e-file if the business and its Principals and Responsible Official(s) meet and adhere to IRS e-file requirements.

Each individual who is a Principal or Responsible Official must meet the following criteria:

1. Be a United States citizen or an alien lawfully admitted for permanent residence (legal resident alien) as described in 8 U.S.C. §1101(a)(20) (1994);
2. Be 21 years of age as of the date of application
3. Meet applicable state and local licensing and/or bonding requirements for the preparation and collection of tax returns

Principal and Responsible Officials

PRINCIPAL AND RESPONSIBLE OFFICIALS. Generally, the Principal for a business or organization includes the following:

- **Sole Proprietorship:** The sole proprietor is the Principal for a sole proprietorship.
- **Partnership:** Each partner who has a 5 percent or more interest in the partnership is a Principal. If no partner has at least a 5 percent or more interest in the partnership, the Principal is an individual authorized to act for the partnership in legal and/or tax matters. At least one such individual must be on the application. See Note below.
- **Corporation:** The President, Vice-President, Secretary, and Treasurer are each a Principal of the corporation. See Note below.
- **Other:** The Principal for an entity that is not a sole proprietorship, partnership, or corporation is an individual authorized to act for the entity in legal and/or tax matters. At least one such individual must be on the application.

A large firm with multilayered management, that is not a sole proprietorship, includes only Principals and "Key Persons" who "participate substantially" with control over the firm's electronic filing operations" as Principals on the firm's IRS e-file Application. A large firm usually has subsidiaries or multiple operating divisions/branches.

"Key Persons" are individuals other than Principals (as defined above) who participate substantially with control over the large firm's electronic filing operation. "Participate substantially" means participation that is extensive and substantive, and not peripheral, clerical or ministerial.

RESPONSIBLE OFFICIALS. A Responsible Official is an individual with authority over the Provider's IRS e-file operation at a location, is the first point of contact with the IRS, and has authority to sign revised IRS e-file applications.

A Responsible Official ensures the Provider adheres to the provisions of the revenue procedure as well as all publications and notices governing IRS e-file. The Responsible Official may oversee IRS e-file operations at one or more offices, but must be able to fulfill identified responsibilities for each of the offices. If one individual cannot fulfill these responsibilities, add Responsible Officials to the e-file application. To add or change Responsible Officials, a Provider must revise its IRS e-file Application.

e-File Publications

E-FILE PUBLICATIONS. All Providers should become familiar with the various publications pertaining to the e-file program. A list of IRS e-file publications is in Publication 3112, *IRS e-file Application and Participation*.

Preparers should also thoroughly review Rev. Proc. 2007-40, *Requirements of Participants in IRS e-File Program*.

Publication 1345, *Handbook for Authorized IRS e-file Providers of Individual Income Tax Returns*, is intended to supplement the revenue procedure but does not supersede it (Rev. Proc. 2007-40).

However, Publication 1345 has the same legal force and effect as the revenue procedure. Violating a provision of Publication 1345 may subject the provider to sanctions.

Monitoring of Authorized e-file Providers

The **IRS monitors Authorized IRS e-file Providers for compliance** with the revenue procedure and IRS e-file rules and requirements through review of IRS records and during visits to Providers' offices and other locations where Providers perform IRS e-file activities.

During monitoring visits, the IRS may investigate complaints and ensure compliance with IRS e-file rules. Monitoring may include, but is not limited to the following:

- Reviewing the quality of IRS e-file submissions for rejects and other defects
- Checking adherence to signature requirements on returns
- Scrutinizing advertising material
- Examining records
- Observing office procedures

In addition, the IRS may monitor Authorized IRS e-file Providers for compliance with the tax return preparer regulations, including provisions of IRC Section 6695(g), which relates to the due diligence requirements for Earned Income Tax Credit claims on individual income tax returns.

When to Submit a New EFIN Application

WHEN TO SUBMIT A NEW EFIN APPLICATION. Applicants and authorized IRS e-file providers must submit a new application with fingerprint cards or other documentation for the appropriate individuals if any of the following applies:

1. Applicant has never participated in IRS e-file
2. Applicant has previously been denied participation in IRS e-file
3. Applicant has been suspended from IRS e-file
4. Applicant has not submitted any e-file returns for more than two years
5. Provider is participating in IRS e-file and wants to originate the electronic submission of returns from an additional location
6. Structure of the business has changed, requiring use of a new or different Taxpayer Identification Number (TIN).

IMPORTANT

Excerpts from Publication 1345, *Handbook for Authorized IRS e-file Providers of Individual Income Tax Returns*, are included at the end of this section.

Selected items include more information on monitoring of e-file Providers, sanctions, administrative reviews, revocation, and penalties.

Declaration Document and e-File Authorization Form 8879

DECLARATION DOCUMENT AND E-FILE AUTHORIZATION FORM 8879. Form 8879 is the declaration document and signature authorization for an e-filed return filed by an electronic return originator (ERO). Form 8879 is completed when the practitioner PIN method is used or when the taxpayer authorizes the ERO to enter or generate the taxpayer's personal identification number (PIN) on his e-filed individual income tax return.

EROs must retain Forms 8879 for three years from the later of the due date of return or the date received by the IRS.

Tax practitioners will no longer submit a paper signature for e-file returns using Form 8453, U.S. Individual Income Tax Declaration for an IRS e-file Return. Instead, the newly designed Form 8453, U.S. Individual Income Tax Transmittal for an IRS e-File Return, will be used to transmit supporting paper documents that are required to be submitted to the IRS with e-file returns.

Only the forms and supporting documents listed on the new Form 8453 can be submitted with the new form. If the return requires submission of any form or additional documentation that is not listed on Form 8453, then that return is NOT eligible for e-filing.

PROCESSING FORM 8879. The ERO must receive the completed and signed Form 8879 from the taxpayer before the electronic return is transmitted (or released for transmission). Form 8879 is not sent to the IRS unless requested to do so.

The ERO must provide the taxpayer with a copy of the signed Form 8879 (upon request) or corrected Form 8879.

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

Alternative Signature Methods for ERO

ALTERNATIVE SIGNATURE METHODS FOR ERO. EROs are allowed to sign the following forms by rubber stamp, mechanical device (such as signature pen), or computer software program:

- Form 8878, IRS e-file Signature Authorization for Form 4868 or Form 2350
- Form 8879, IRS e-file Signature Authorization.

The alternative methods of signing must include either a facsimile of the individual ERO's signature or of the ERO's printed name. EROs using one of these alternative means are personally responsible for affixing their signatures to returns or requests for extension. This rule does NOT alter the current requirement that Form 8878 and Form 8879 be signed by the taxpayer by handwritten signature.

Employer Federal Tax Returns

EMPLOYER FEDERAL TAX RETURNS. Employers who pay wages subject to income tax withholding (including withholding on sick pay and supplemental unemployment benefits) or Social Security and Medicare taxes must file payroll tax returns on a quarterly basis using Form 941, *Employer's Quarterly Federal Tax Return*, unless one of the following exceptions apply.

1. Seasonal employers are not required to file for quarters when they regularly have no tax liability because they have paid no wages.
2. Household employers report Social Security taxes, Medicare taxes, and withheld income tax on Schedule H (Form 1040) rather than on Form 941.
3. Employers for employees in American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, the U.S. Virgin Islands, and Puerto Rico use Form 941-SS or 941-PR rather than Form 941.
4. Agricultural employers reporting Social Security, Medicare and withheld income taxes use Form 943, rather than form 941.
5. Employers with an annual total liability for Social Security, Medicare, and withheld federal income taxes of \$1,000 or less may file an annual Form 944, *Employer's Annual Federal Tax Return*, rather than quarterly using Form 941.
6. Back-up withholding or income tax withholding on non-payroll payments such as pensions, annuities, and gambling winnings are reported on Form 945, *Annual Return of Withheld Federal Income Tax*, rather than Form 941. All income tax withholding reported on Forms 1099 or W-2G must be reported on Form 945. Form 945 is an annual tax return.

FORM 940. An annual return, Form 940, *Employer's Federal Unemployment (FUTA) Tax Return*, calculates the employer's federal unemployment tax liability. Form 940 must be filed by the beginning of February for the previous calendar year. Any unpaid FUTA must be paid when filing Form 940.

- **NOTE.** Separate deposits are required for payroll and nonpayroll (Form 945) withholding.

Payroll Tax Deposit Schedule Rules

PAYROLL TAX DEPOSIT SCHEDULE RULES. Employers must deposit federal income tax withheld, plus both the employer and employee portion of Social Security and Medicare taxes, plus or minus any prior period adjustments to tax liability.

The schedule that must be used is determined by the total tax liability that was reported on Form 941 during a four-quarter look back period. The look back period for the 2011 calendar year is July 1, 2009 through June 30, 2010.

PAYMENT WITH RETURN. Only very small employers—typically, those with a quarterly federal tax liability of less than \$2,500—can mail a check to the IRS with their quarterly or annual return. All others must pay using EFTPS.

If a business does not qualify to pay the tax when filing Form 941, it must deposit the taxes using one of the following schedules:

- Monthly depositor
- Semiweekly depositor

MONTHLY DEPOSITOR. If the business reported \$50,000 or LESS total tax liability for the look back period, the business is a monthly depositor and must deposit taxes on payroll during a month by the 15th day of the following month.

SEMI-WEEKLY DEPOSITOR. If the business reported MORE THAN \$50,000 total tax liability for the look back period, the business is a semiweekly depositor. Accumulated tax liability for payroll made on Wednesday, Thursday, and/or Friday is deposited by the following Wednesday. Accumulated tax liability for payroll made on Saturday, Sunday, Monday, and/or Tuesday is deposited by the following Friday.

NEXT-DAY DEPOSIT RULE. If a business accumulates a tax liability of \$100,000 or more on any day during a deposit period, the taxes must be deposited by the next banking day. It does not matter whether the business is a monthly or semiweekly schedule depositor.

Section 3.05

Examination, Appeal & Authority

Examination Selection Criteria

EXAMINATION SELECTION CRITERIA. The IRS examines (audits) tax returns to verify that the tax reported is correct. The IRS selects returns using a variety of methods, including:

- **Potential participants in abusive tax avoidance transactions** — Some returns are selected based on information obtained by the IRS through efforts to identify promoters and participants of abusive tax avoidance transactions. Examples include information received from “John Doe” summonses issued to credit card companies and businesses and participant lists from promoters ordered by the courts to be turned over to the IRS.
- **Computer Scoring** — Some returns are selected for examination on the basis of computer scoring. Computer programs give each return numeric “scores”. The Discriminant Function System (DIF) score rates the potential for change, based on past IRS experience with similar returns. The Unreported Income DIF (UIDIF) score rates the return for the potential of unreported income. IRS personnel screen the highest-scoring returns, selecting some for audit and identifying the items on these returns that are most likely to need review.
- **Large Corporations** — The IRS examines many large corporate returns annually.
- **Information Matching** — Some returns are examined because payer reports, such as Forms W-2 from employers or Form 1099 interest statements from banks, do not match the income reported on the tax return.
- **Automated Underreporter Program (AUR)** is a document matching initiative that results in CP-2000 notices that show proposed changes to a taxpayer's income tax return.

- **Related Examinations** — Returns may be selected for audit when they involve issues or transactions with other taxpayers, such as business partners or investors, whose returns were selected for examination.
- **Other** — Area offices may identify returns for examination in connection with local compliance projects. These projects require higher level management approval and deal with areas such as local compliance initiatives, return preparers or specific market segments.

This information can come from a number of sources, including newspapers, public records, and individuals. The information is evaluated for reliability and accuracy before it is used as the basis for an examination or investigation.

Potential Third Party Contacts

POTENTIAL THIRD PARTY CONTACTS.

Generally, the IRS will deal directly with the taxpayer or his duly authorized representative. However, sometimes the IRS will contact other persons if information is needed that the taxpayer has been unable to provide, or to verify information received.

If the IRS contacts other persons, such as a neighbor, bank, employer, or employees, the IRS will generally need to tell them limited information. The law prohibits the IRS from disclosing any more information than is necessary to obtain or verify the information they are seeking. The need to contact other persons may continue as long as there is activity in the taxpayer's case. If other persons are contacted, the taxpayer has a right to request a list of those contacted.

The IRS Restructuring and Reform Act of 1998, the Privacy Act of 1974, and the Paperwork Reduction Act of 1980 require that when the IRS asks a taxpayer for information that they must first tell the taxpayer:

- What their legal right is to ask for the information
- Why they are asking for it
- How it will be used
- What could happen if they do not receive it
- Whether the taxpayer's response is voluntary, required to obtain a benefit, or mandatory under the law

Revenue Rulings

REVENUE RULINGS. A revenue ruling is an official interpretation by the IRS of the Internal Revenue Code, related statutes, tax treaties, and regulations. It is the conclusion of the IRS on how the law is applied to a specific set of facts.

The purpose of these rulings is to promote a uniform application of the tax laws, and therefore IRS employees must follow the rulings. For example, a revenue ruling may hold that taxpayers can deduct certain automobile expenses.

Revenue rulings are published by the IRS in the Internal Revenue Bulletin (I.R.B.), which is issued weekly to the public, for the information of and guidance to taxpayers, IRS personnel, and tax professionals. Contents of the I.R.B. are consolidated at least semi-annually into a permanent, indexed Cumulative Bulletin (C.B.). All Supreme Court decisions on federal tax matters are published in the I.R.B. and the Cumulative Bulletin.

Revenue Procedures

REVENUE PROCEDURES. A revenue procedure is an official statement of a procedure that affects the rights or duties of taxpayers or other members of the public under the Internal Revenue Code, related statutes, tax treaties and regulations and that should be a matter of public knowledge. It is also published in the Internal Revenue Bulletin. While a revenue ruling generally states an IRS position, a revenue procedure provides return filing or other instructions concerning an IRS position.

For example, a revenue procedure might specify how those entitled to deduct certain automobile expenses should compute them by applying a certain mileage rate in lieu of calculating actual operating expenses.

Private Letter Rulings

PRIVATE LETTER RULINGS. A private letter ruling, or PLR, is a written statement issued to a taxpayer that interprets and applies tax laws to the taxpayer's specific set of facts. A PLR is issued to establish with certainty the federal tax consequences of a particular transaction before the transaction is consummated or before the taxpayer's return is filed. A PLR is issued in response to a written request submitted by a taxpayer and is binding on the IRS if the taxpayer fully and accurately described the proposed transaction in the request and carries out the transaction as described.

A PLR may not be relied on as precedent by other taxpayers or IRS personnel. PLRs are generally made public after all information has been removed that could identify the taxpayer to whom it was issued.

Technical Advice Memorandums

TECHNICAL ADVICE MEMORANDUMS. A technical advice memorandum (TAM) is guidance furnished by the Office of Chief Counsel upon the request of an IRS Director or an Area Director of Appeals, in response to technical or procedural questions that develop during a proceeding. A request for a TAM generally stems from an examination of a taxpayer's return, a consideration of a taxpayer's claim for a refund or credit, or any other matter involving a specific taxpayer under the jurisdiction of the Territory Manager or the Area Director of Appeals.

Technical Advice Memoranda are issued only on closed transactions and provide the interpretation of proper application of tax laws, tax treaties, regulations, revenue rulings, or other precedents. The advice rendered represents a final determination of the position of the IRS, but only with respect to the specific issue in the specific case in which the advice is issued. Technical Advice Memoranda are generally made public after all information has been removed that could identify the taxpayer whose circumstances triggered a specific memorandum.

Taxpayer OIC Qualifications

TAXPAYER OIC QUALIFICATIONS. Beginning July 17, 2006, in order to be considered for an OIC, a taxpayer must have met all of the following requirements:

1. The taxpayer is not a debtor in an open bankruptcy proceeding.
2. The \$150 application fee or a signed Form 656-A, "Income Certification for Offer in Compromise Application Fee and Payment," must be submitted.
3. The 20 percent payment with the lump sum offer or a signed Form 656-A, "Income Certification for Offer in Compromise Application Fee and Payment," must be submitted.
4. The first installment payment on a periodic payment offer or a signed Form 656-A, "Income Certification for Offer in Compromise Application Fee and Payment," must be submitted.

An offer that is received with a payment that is less than 20 percent payment on a lump sum offer will be deemed processable but the taxpayer will be asked to pay the remaining balance in order to avoid having the offer returned. Failure to submit the remaining balance will cause the IRS to return the offer and retain the \$150 application fee.

Taxpayers filing a periodic payment offer (e.g. short term periodic offer) are required to submit the full amount of their first installment payment in order to meet the processability criteria. If the full amount of the first installment is not provided, the IRS will deem the offer not processable and will return the \$150 application fee to the taxpayer.

If during the OIC investigation the initial offer amount is determined to be insufficient and not reflective of the taxpayer's ability to pay, the taxpayer may be contacted and asked to increase the offer and submit the corresponding 20 percent payment if the offer was filed as a lump sum cash offer, or the periodic payment if the offer is a short term or deferred payment offer. If the taxpayer fails to do so, the IRS may reject the offer and will credit the taxpayer's account with any payments submitted with the original offer.

The IRS will deem an OIC "accepted" that is not withdrawn, returned, or rejected within 24 months after IRS receipt.

APPLICATION FEE REQUIRED FOR OIC. All taxpayers who submit a Form 656 must pay a \$150 application fee EXCEPT in two instances:

1. The OIC is submitted based solely on "doubt as to liability," or
2. The taxpayer's total monthly income falls at or below 250% of the Department of Health and Human Services (DHSS) poverty income levels.

The IRS expects a taxpayer requesting an OIC to file all delinquent tax returns and pay any required estimated tax payments. The IRS will notify taxpayers and provide 30 days to file delinquent returns or make the required estimated tax payments. Failure to comply will cause the IRS to return the offer back to the taxpayer. The \$150 fee along with all payments previously paid will be retained by the IRS and applied to the taxpayer's liability.

Submitting an Offer in Compromise made where there is doubt as to the amount owed must be supported by evidence, and the amount acceptable will depend on the degree of doubt found in the particular case.

BUSINESS TAXPAYERS. Business taxpayers with employees must have made all required federal tax deposits for the current quarter. If all of the required payments have not been made, they must be made before the IRS begins to evaluate the offer. In addition, the taxpayer must remain current on filing and deposit requirements while the offer is being investigated.

TAX LIENS. If there is a Notice of Federal Tax Lien on record prior to filing Form 656, the lien is not released until the OIC terms are satisfied, or until liability is paid, whichever comes first. A Notice of Federal Tax Lien may be filed during the course of an OIC investigation regardless of the type of offer being considered.

- **NOTE.** Submission of an OIC does NOT AUTOMATICALLY stop collection action. If there is any indication that the taxpayer filed the offer simply to delay collection of the tax or that would interfere with collecting the tax, the IRS will IMMEDIATELY CONTINUE its collection efforts.

Releasing a Levy

RELEASING A LEVY. In general, the IRS MUST release a levy, if:

- The taxpayer pays the tax, penalty, and interest owed.
- The IRS discovers that the time period for collection ended before the levy was served.
- The IRS levied before they sent the taxpayer the TWO required pre-levy notices or before the taxpayer's time for responding to them has passed (10 days for the Notice and Demand for Payment, 30 days for the Notice of Intent to Levy and the Notice of Right to Hearing).
- The automatic stay during the taxpayer's bankruptcy is in effect.
- The levy is on property that the IRS is not allowed to levy.
- The IRS levied while the taxpayer has an accepted periodic payment offer in compromise or installment agreement in effect.
- The IRS levied while the IRS Office of Appeals is considering the taxpayer's appeal of the IRS termination of the taxpayer's installment agreement.
- The IRS levied while the IRS Office of Appeals is conducting the taxpayer's timely requested CDP hearing under IRC 6330 or during the U.S. Tax Court review of the CDP determination (unless the Court has issued an order permitting the levy).
- The IRS levied while it, or the IRS Office of Appeals, considers the taxpayer's timely request for innocent spouse relief or during the timely requested review by the Tax Court..

The IRS WILL release a levy if one of the following criteria is met:

- The IRS determines that the levy is creating an economic hardship for the taxpayer
- The IRS determines the FMV of the levied property exceeds the liability for which the levy was made, and release of the levy on part of the property can be made without hindering the collection of the liability
- The IRS determines the expense of selling the property would be greater than the government's interest in the property.

The IRS MAY also release a levy if the IRS determines that releasing the levy will help collect the tax. In general, releasing a levy will help the IRS collect the tax if ANY of the following occur:

- The taxpayer pays the amount of the government's interest in the property.
- The taxpayer enters into an escrow arrangement.
- The taxpayer furnishes an acceptable bond.
- The taxpayer enters into an installment agreement (unless the agreement says the levy does not have to be released), or the taxpayer makes some other acceptable agreement for paying the tax.
- The taxpayer agrees to extend the 10-year period the IRS has to collect the tax (but the taxpayer must agree before the time period ends).