

STATE CONTROLLER'S OFFICE  
PERSONNEL/PAYROLL SERVICES DIVISION  
P. O. BOX 942850  
Sacramento, CA 94250-5878

DATE: December 27, 2010

PAYROLL LETTER #10-021

TO: All Agencies/Campuses in the Uniform State Payroll System

FROM: Lisa Crowe, Chief  
Personnel/Payroll Services DivisionRE: **INTERNAL REVENUE SERVICE AUDIT****PLEASE SHARE WITH YOUR ALL ACCOUNTING AND PAYROLL OFFICERS**

The Internal Revenue Service (IRS) is conducting an audit of the State of California for tax years 2008 and 2009. As a part of this audit we are mandated to provide you with the attached appointment letters and publications. Please read and review these documents carefully. **Also, please complete the attached Acknowledgement Form and return it to our office no later than January 7, 2011. We require a signed Acknowledgement Form from either the agency chief or human resources/personnel officer.**

The IRS will be requesting the documentation required to complete their audit. Because some of the documentation is not available in the State Controller's Office, we will be issuing subsequent payroll letters notifying the agencies and campuses of the documentation that they must provide. In the next week, two payroll letters will be issued regarding settlements and employer provided vehicles.

**QUESTIONS**

If you have any questions regarding the Internal Revenue Service Audit, please contact Jennifer Rocco, Tax Support Manager (916) 322-8105 or [jrocco@sco.ca.gov](mailto:jrocco@sco.ca.gov).

Attachments: Acknowledgement by Agency or Campus  
Appointment Letters  
Revenue Procedure 98-25  
Publication 3498  
Publication 1  
Publication 5  
Notice 609  
Publication 1976

LC:JR:TSS

**ACKNOWLEDGEMENT BY AGENCY OR CAMPUS**

I certify that I have received and read Payroll Letter 10-021, Internal Revenue Service Audit, including all attachments.

\_\_\_\_\_  
Sign name

\_\_\_\_\_  
Print name

\_\_\_\_\_  
Title

\_\_\_\_\_  
Department

\_\_\_\_\_  
Telephone Number

\_\_\_\_\_  
E-mail Address

**Please complete the attached Acknowledgement Form and return it to our office no later than January 7, 2011. We require a signed Acknowledgement Form from either the agency chief or human resources/personnel officer.**

**Please fax your completed form to Jennifer Rocco, Tax Support Manager, State Controller's Office at (916) 322-0664. You can also scan your signed form and e-mail to [jrocco@sco.ca.gov](mailto:jrocco@sco.ca.gov).**



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

Internal Revenue Service  
55 S. Market Street, MS: 7600: LVB  
San Jose, Ca. 95113-2397

October 26, 2009

State Controller State of Calif  
P.O. Box 942850  
Sacramento, Ca. 94250

Person to Contact: Leslie Van Buren  
Telephone Number: 408-817-6356  
Refer Reply to: MS: 7600  
EIN: 94-6001347  
Tax Period(s) Ended: 03/31/2008 to  
12/31/2008  
Form(s): 941  
Appointment location:  
1515 S ST BLDG SUITE  
Sacramento, Ca. 95814

Dear Taxpayer:

This is to schedule an appointment for December 2, 2009, December 3, 2009, January 5, 2010, January 6, 2010 and January 7, 2010 at 10:00 a.m. to conduct an examination of your employment taxes for the periods shown above. This appointment will be held at your offices as identified above. Please refer to the attached Form 4564 for information that you are being asked to have available at the appointment.

You are also asked to complete and either send to me or have available at the meeting the completed "Authorization and Declaration" form which is enclosed. This form is used to notify the Government as to which employees of the State Controller State of Calif have been authorized by the State Controller State of Calif to receive or inspect confidential tax information, discuss tax issues, and execute binding agreements with the Government.

You may have someone represent the State Controller State of Calif during any part of this examination. If you want someone to represent the State Controller State of Calif, please provide a completed Form 2848, Power of Attorney and Declaration of Representative, either before or at the appointment.

We encourage you to read the Declaration of Taxpayer Rights found in the enclosed Publication 3498, The Examination Process. This publication also discusses general rules and procedures we follow in examinations. It explains what happens before, during, and after an examination, and appeal and payment procedures.

Please call or have your designee call me by November 9, 2009 to confirm this appointment and discuss arrangements for it. You are also requested to, at that time, provide the name and contact information of someone in your Information Technology Dept. who our computer specialist can work with to secure payroll, information return, and other detailed account information. Please make this person available for our initial meeting. Thank you for your cooperation during this examination.

Sincerely,

Leslie Van Buren  
Federal, State, Local Government Specialist  
Employee # 77-1944

Enclosures:  
Pubs 3498, 1976, 5, and 1 Notice 609  
Form 4564, Authorization and Declaration Form



TAX EXEMPT AND  
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DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

Internal Revenue Service  
55 S. Market Street, MS: 7600: LVB  
San Jose, Ca. 95113-2397

May 5, 2010

State Controller State of Calif  
P.O. Box 942850  
Sacramento, Ca. 94250

Person to Contact: Leslie Van Buren  
Telephone Number: 408-817-6356  
Refer Reply to: MS: 7600  
EIN: 94-6001347  
Tax Period(s) Ended: 03/31/2009 to  
12/31/2009  
Form(s): 941  
Appointment location:  
300 Capital Mall, 10<sup>th</sup> Floor  
Sacramento, Ca. 95814

Dear Taxpayer:

This is to schedule an appointment for June 1, 2010, June 2, 2010, and June 3, 2010 at 10:00 a.m. to conduct an examination of your employment taxes for the periods shown above. This appointment will be held at your offices as identified above. Please refer to the attached Form 4564 for information that you are being asked to have available at the appointment.

You are also asked to complete and either send to me or have available at the meeting the completed "Authorization and Declaration" form which is enclosed. This form is used to notify the Government as to which employees of the State Controller State of Calif have been authorized by the State Controller State of Calif to receive or inspect confidential tax information, discuss tax issues, and execute binding agreements with the Government.

You may have someone represent the State Controller State of Calif during any part of this examination. If you want someone to represent the State Controller State of Calif, please provide a completed Form 2848, Power of Attorney and Declaration of Representative, either before or at the appointment.

We encourage you to read the Declaration of Taxpayer Rights found in the enclosed Publication 3498, The Examination Process. This publication also discusses general rules and procedures we follow in examinations. It explains what happens before, during, and after an examination, and appeal and payment procedures.

Please call or have your designee call me by May 10, 2009 to confirm this appointment and discuss arrangements for it. You are also requested to, at that time, provide the name and contact information of someone in your Information Technology Dept. who our computer specialist can work with to secure payroll, information return, and other detailed account information. Please make this person available for our initial meeting. Thank you for your cooperation during this examination.

Sincerely,

Leslie Van Buren  
Federal, State, Local Government Specialist  
Employee # 77-1944

Enclosures:  
Pubs 3498, 1976, 5, and 1 Notice 609  
Form 4564, Authorization and Declaration Form

# Rev. Proc. 98-25, 1998-11 I.R.B. 7.

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## SECTION 1. PURPOSE

The purpose of this revenue procedure is to specify the basic requirements that the Internal Revenue Service considers to be essential in cases where a taxpayer's records are maintained within an Automated Data Processing system (ADP). This revenue procedure updates and supersedes Rev. Proc. 91-59, 1991-2 C.B. 841.

## SECTION 2. BACKGROUND

.01 Section 6001 provides that every person liable for any tax imposed by the Code, or for the collection thereof, must keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe. Whenever necessary, the Secretary may require any person, by notice served upon that person or by regulations, to make such returns, render such statements, or keep such records, as the Secretary deems sufficient to show whether or not that person is liable for tax.

.02 Section 1.6001-1(a) of the Income Tax Regulations generally provides that persons subject to income tax, or required to file a return of information with respect to income, must keep such books or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by that person in any return of such tax or information.

.03 Section 1.6001-1(e) provides that the books or records required by section 6001 must be kept available at all times for inspection by authorized internal revenue officers or employees, and must be retained so long as the contents thereof may become material in the administration of any internal revenue law.

.04 Rev. Rul. 71-20, 1971-1 C.B. 392, establishes that all machine-sensible data media used for recording, consolidating, and summarizing accounting transactions and records within a taxpayer's ADP



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system are records within the meaning of section 6001 and section 1.6001-1, and are required to be retained so long as the contents may become material in the administration of any internal revenue law.

### SECTION 3. SCOPE

#### .01 Records.

(1) The requirements of this revenue procedure pertain to all matters under the jurisdiction of the Commissioner of Internal Revenue including, but not limited to, income, excise, employment, and estate and gift taxes, as well as employee plans and exempt organizations.

(2) The requirements of this revenue procedure are applicable to any sections of the Code that have unique or specific recordkeeping requirements. For example, machine- sensible records maintained by the taxpayer to meet the requirements of section 274(d) relating to the amount, time, place, and business purpose of a business expense must meet the requirements of this revenue procedure.

(3) Except as otherwise provided in this revenue procedure, all requirements of section 6001 that apply to hardcopy books and records apply as well to machine-sensible books and records that are maintained within an ADP system.

#### .02 Taxpayers.

(1) A taxpayer with assets of \$10 million or more at the end of its taxable year must comply with the record retention requirements of Rev. Rul. 71-20 and the provisions of this revenue procedure. For purposes of this revenue procedure, a controlled group of corporations, as defined in section 1563, is considered to be one corporation and all assets of all members of the group are aggregated.

(2) A taxpayer with assets of less than \$10 million at the end of its taxable year must comply with the record retention requirements of Rev. Rul. 71-20 and the provisions of this revenue procedure if any of the following conditions exists:

(a) all or part of the information required by section 6001 is not in the taxpayer's hardcopy books and records, but is available in machine-sensible records;

(b) machine-sensible records were used for computations that cannot be reasonably verified or recomputed without using a computer (e.g., Last-In, First-Out (LIFO) inventories); or

(c) the taxpayer is notified by the District Director that machine-sensible records must be retained to meet the requirements of section 6001.

(3) A Controlled Foreign Corporation (CFC), a domestic corporation that is 25 percent foreign-owned, and a foreign corporation engaged in a trade or business within the United States at any time during a taxable year that maintains machine- sensible records within an ADP system must comply with the requirements of this revenue procedure to satisfy the recordkeeping requirements of sections 964(c), 982(d), 6038A(c)(4), and 6038C (and the regulations thereunder).

(4) An insurance company that maintains machine- sensible records within an ADP system to determine losses incurred under section 832(b)(5) must comply with the requirements of this revenue procedure and Rev. Proc. 75-56, 1975-2 C.B. 596. For this purpose, the machine-sensible records for a particular taxable year include the records for that year and the seven preceding years, all of which must be

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retained so long as they may become material to the examination of an insurance company's federal tax return.

(5) A taxpayer's use of a third party (such as a service bureau, time-sharing service, value-added network, or other third party service) to provide services (e.g., custodial or management services) in respect of machine-sensible records does not relieve the taxpayer of its recordkeeping obligations and responsibilities under section 6001 and this revenue procedure.

### SECTION 4. DEFINITIONS

.01 An "ADP system" consists of an accounting and/or financial system (and subsystems) that processes all or part of a taxpayer's transactions, records, or data by other than manual methods. An ADP system includes, but is not limited to, a mainframe computer system, stand-alone or networked microcomputer system, Data Base Management System (DBMS), and a system that uses or incorporates Electronic Data Interchange (EDI) technology or an electronic storage system.

.02 "Capable of being processed" means the ability to retrieve, manipulate, print on paper (hardcopy), and produce output on electronic media. This term does not encompass any requirement that the program or system that created the computer data be available to process the data unless that program or system is necessary to:

(1) a tax-related computation (e.g., LIFO inventories, insurance company loss reserve computations, and foreign tax credit computations); or

(2) the retrieval of data (e.g., some data base systems processes where the taxpayer chooses not to create a sequential extract (see section 5.02 of this revenue procedure)).

.03 A "DBMS" is a software system that creates, controls, relates, retrieves, and provides accessibility to data stored in a data base.

.04 "EDI technology" is the computer-to-computer exchange of business information.

.05 An "electronic storage system" is a system used to prepare, record, transfer, index, store, preserve, retrieve, and reproduce books and records by either: (1) electronically imaging hardcopy documents to an electronic storage media; or (2) transferring computerized books and records to an electronic storage media using a technique such as "COLD" (computer output to laser disk), which allows books and records to be viewed or reproduced without the use of the original program. See Rev. Proc. 97-22, 1997-13 I.R.B. 9, for electronic storage system requirements.

.06 A "machine-sensible record" is data in an electronic format that is intended for use by a computer. Machine-sensible records do not include paper records or paper records that have been converted to an electronic storage medium such as microfilm, microfiche, optical disk, or laser disk.

### SECTION 5. RETAINING MACHINE-SENSIBLE RECORDS

.01 General.

(1) The taxpayer must retain machine-sensible records so long as their contents may become material to the administration of the internal revenue laws under section 1.6001-1(e). At a minimum, this materiality continues until the expiration of the period of limitation for assessment, including extensions, for each tax

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year. In certain situations, records should be kept for a longer period of time. For example, records that pertain to fixed assets, losses incurred under section 832(b)(5), and LIFO inventories should be kept for longer periods of time.

(2) The taxpayer's machine-sensible records must provide sufficient information to support and verify entries made on the taxpayer's return and to determine the correct tax liability. The taxpayer's machine-sensible records will meet this requirement only if they reconcile with the taxpayer's books and the taxpayer's return. A taxpayer establishes this reconciliation by demonstrating the relationship (i.e., audit trail):

(a) between the total of the amounts in the taxpayer's machine-sensible records by account and the account totals in the taxpayer's books; and

(b) between the total of the amounts in the taxpayer's machine-sensible records by account and the taxpayer's return.

(3) The taxpayer must ensure that its machine-sensible records contain sufficient transaction-level detail so that the information and the source documents underlying the machine-sensible records can be identified.

(4) All machine-sensible records required to be retained by this revenue procedure must be made available to the Service upon request and must be capable of being processed.

(5) Except as otherwise required by sections 5.01(2) or (3) of this revenue procedure, a taxpayer is not required to create any machine-sensible record other than that created either in the ordinary course of its business or to establish return entries. For example, a taxpayer who does not create, in the ordinary course of its business, the electronic equivalent of a traditional paper document (such as an invoice) is not required by this revenue procedure to construct such a record, provided that the requirements of sections 5.01(2) and (3) are met. For requirements relating to hardcopy records, see section 11 of this revenue procedure.

(6) A taxpayer's disposition of a subsidiary company does not relieve the taxpayer of its responsibilities under this revenue procedure. The files and documentation retained for the Service by, or for, a disposed subsidiary must be retained as otherwise required by this revenue procedure.

### .02 DBMS.

(1) A taxpayer has the discretion to create files solely for the use of the Service. For example, a taxpayer that uses a DBMS may satisfy the provisions of this revenue procedure by creating and retaining a sequential file that contains the transaction-level detail from the DBMS and otherwise meets the requirements of this revenue procedure.

(2) A taxpayer that creates a file described in section 5.02(1) of this revenue procedure must document the process that created the sequential file in order to establish the relationship between the file created and the original DBMS records.

### .03 EDI.

(1) A taxpayer that uses EDI technology must retain machine-sensible records that alone, or in combination with any other records (e.g., underlying contracts, price lists, and price changes), contain all



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the information that section 6001 requires of hardcopy books and records. For example, a taxpayer that uses EDI technology receives electronic invoices from its suppliers. The taxpayer decides to retain the invoice data from completed and verified EDI transactions in its accounts payable system rather than retain the incoming EDI transactions. Neither the EDI transactions, nor the accounts payable system, contain product descriptions or vendor names. To satisfy the requirements of section 6001, the taxpayer must supplement its EDI records with product code description lists and a vendor master file.

(2) A taxpayer may capture the required detail for an EDI transaction at any level within its accounting system. However, the taxpayer must establish audit trails between the retained records and the taxpayer's books, and between the retained records and the tax return.

(3) Section 11.02 of this revenue procedure provides additional guidance concerning hardcopy requirements related to EDI transactions.

### SECTION 6. DOCUMENTATION

.01 The taxpayer must maintain and make available to the Service upon request documentation of the business processes that:

- (1) create the retained records;
- (2) modify and maintain its records;
- (3) satisfy the requirement of section 5.01(2) of this revenue procedure to support and verify entries made on the taxpayer's return and determine the correct tax liability; and
- (4) evidence the authenticity and integrity of the taxpayer's records.

.02 The documentation described in section 6.01 of this revenue procedure must be sufficiently detailed to identify:

- (1) the functions being performed as they relate to the flow of data through the system;
- (2) the internal controls used to ensure accurate and reliable processing;
- (3) the internal controls used to prevent the unauthorized addition, alteration, or deletion of retained records; and
- (4) the charts of accounts and detailed account descriptions.

.03 With respect to each file that is retained, the taxpayer must maintain, and make available to the Service upon request, documentation of:

- (1) record formats or layouts;
- (2) field definitions (including the meaning of all "codes" used to represent information);
- (3) file descriptions (e.g., data set name);

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(4) evidence that periodic checks (described in section 9.01(3) of this revenue procedure) of the retained records were performed to meet section 9.02(1) of this revenue procedure, if the taxpayer wants to take advantage of section 9.02 of this revenue procedure;

(5) evidence that the retained records reconcile to the taxpayer's books; and

(6) evidence that the retained records reconcile to the taxpayer's tax return.

.04 The system documentation must include any changes to the items specified in sections 6.01, 6.02, and 6.03 of this revenue procedure and the dates these changes are implemented.

### SECTION 7. RESOURCES

.01 The taxpayer must provide the Service at the time of an examination with the resources (e.g., appropriate hardware and software, terminal access, computer time, personnel, etc.) that the District Director determines is necessary to process the taxpayer's machine-sensible books and records. At the request of the taxpayer, the District Director may, at the District Director's discretion:

(1) identify the taxpayer's resources that are not necessary to process books and records;

(2) allow a taxpayer to convert machine-sensible records to a different medium (e.g., from mainframe files to microcomputer diskette(s));

(3) allow the taxpayer to satisfy the processing needs of the Service during off-peak hours; and

(4) allow the taxpayer to provide the Service with third-party equipment.

.02 An ADP system must not be subject, in whole or in part, to any agreement (such as a contract or license) that would limit or restrict the Service's access to and use of the ADP system on the taxpayer's premises (or any other place where the ADP system is maintained), including personnel, hardware, software, files, indexes, and software documentation.

### SECTION 8. NOTIFICATION

.01 Except as provided in section 9.02 of this revenue procedure, the taxpayer must promptly notify its District Director if any machine-sensible records are lost, stolen, destroyed, damaged, or otherwise no longer capable of being processed (as defined in section 4.02 of this revenue procedure), or are found to be incomplete or materially inaccurate (affected records).

.02 The taxpayer's notice must identify the affected records and include a plan that describes how, and in what timeframe, the taxpayer proposes to replace or restore the affected records in a way that assures that they will be capable of being processed. The plan must demonstrate that all of the requirements of this revenue procedure will continue to be met with respect to the affected records.

.03 The District Director will notify the taxpayer of any objection(s) to the taxpayer's plan.

.04 A District Director may consider, whenever warranted by the facts and circumstances, the possibility of requiring less than a total restoration of missing data.

.05 Examples.

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(1) Taxpayer A replaces its general ledger software system with a new general ledger software system with which the original system's records are incompatible. However, A's original records are retrievable and capable of being processed on A's hardware system. A is not required to notify its District Director of the change in its software system because A's records remain capable of being processed.

(2) Taxpayer B replaces its original ADP hardware system with a new system that cannot process the machine-sensible records created and maintained by B's original system. B must notify its District Director of this hardware system change and propose a plan for assuring that the machine-sensible records created and maintained by the original ADP hardware system are capable of being processed. To that end, B considers the following options: (1) having all records in the taxpayer's original system immediately reformatted so that the new system can retrieve and process those records; (2) having all records in its original system reformatted by a designated future date; or (3) having an arrangement with a third party to process all records in its original system on a compatible system. Any of these options may be acceptable provided the option selected enables the taxpayer to meet the requirements of this revenue procedure with respect to those records. The taxpayer must be able to demonstrate that any third party reformatting or processing is done with the quality controls in place that will ensure the continued integrity, accuracy, and reliability of the taxpayer's records.

### SECTION 9. MAINTENANCE

#### .01 Recommended Practices.

(1) The implementation of records management practices is a business decision that is solely within the discretion of the taxpayer. Recommended records management practices include the labeling of records, providing a secure storage environment, creating back-up copies, selecting an offsite storage location, and testing to confirm records integrity.

(2) The National Archives and Record Administration's (NARA) Standards for the Creation, Use, Preservation, and Disposition of Electronic Records, 36 C.F.R., Ch XII, Part 1234, Subpart C (1996), is one example of a records management resource that a taxpayer may choose to consult when formulating its records management practices.

(3) The NARA standard in 36 C.F.R. section 1234.30(g)(4) (1996) requires an annual reading of a statistical sampling of magnetic computer tape reels to identify any loss of data and to discover and correct the causes of data loss. In libraries with 1,800 or fewer storage units (e.g., magnetic tape reels), a 20 percent random sampling or a sample size of 50 units, whichever is larger, should be read. In libraries with more than 1,800 units, a sample of 384 units should be read. Although this NARA sampling standard is specifically for magnetic computer tape, the Service recommends that all retained machine-sensible records be sampled and tested as described in the NARA standard.

.02 Partial Loss of Data. A taxpayer that loses only a portion of the data from a particular storage unit will not be subject to the penalties described in section 12 of this revenue procedure if the taxpayer can demonstrate to the satisfaction of the District Director that the taxpayer's data maintenance practices conform with 36 C.F.R. section 1234.30(g)(4) (1996) (the NARA sampling standard). However, the taxpayer remains responsible for substantiating the information on its return as required by section 6001.

### SECTION 10. DISTRICT DIRECTOR AUTHORITY

#### .01 Record Retention Limitation Agreement.



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(1) A taxpayer who maintains machine-sensible records may request to enter into a Record Retention Limitation Agreement (RRLA) with its District Director. This agreement provides for the establishment and maintenance of records as agreed upon by the District Director and the taxpayer.

(2) The taxpayer's request must identify and describe those records the taxpayer proposes not to retain and explain why those records will not become material to the administration of any internal revenue law. The District Director will notify the taxpayer whether or not the District Director will enter into an RRLA.

(3) In an RRLA, the District Director may waive all or any of the specific requirements in this revenue procedure. A taxpayer remains subject to all the requirements in this revenue procedure that are not specifically modified or waived by an RRLA.

(4) Unless an RRLA otherwise specifies, an RRLA shall not apply to accounting and tax systems added subsequent to the completion of the record evaluation upon which the agreement is based. All machine-sensible records produced by a subsequently added accounting and tax system, the contents of which may be or may become material in the administration of the Code must be retained by the taxpayer signing the RRLA until a new evaluation is conducted by the District Director.

(5) Unless an RRLA specifies otherwise, it does not apply to a subsidiary acquired subsequent to the completion of the record evaluation upon which the RRLA is based. All machine-sensible records produced by the acquired subsidiary, the contents of which may be or may become material in the administration of the Code must be retained pursuant to this revenue procedure and any pre-acquisition RRLA ("former RRLA") that applies to the acquired subsidiary. The former RRLA applies to the acquired subsidiary until the District Director either revokes the former RRLA (in whole or in part) or enters into a new RRLA that applies to the acquired subsidiary.

(6) Upon the disposition of a subsidiary, the files being retained for the Service pursuant to an RRLA by, or for, the disposed subsidiary must be retained by the taxpayer until a new evaluation is conducted by the District Director.

(7) A District Director's decision to revoke an RRLA, or not to enter into an RRLA, does not relieve the taxpayer of its recordkeeping obligations under section 6001 or its responsibilities described in this revenue procedure.

### .02 Records Evaluation.

(1) The District Director may conduct a records evaluation at any time the District Director deems it appropriate to review the taxpayer's record retention practices, including the taxpayer's relevant data processing and accounting systems.

(2) The records evaluation described in section 10.02(1) of this revenue procedure is not an "examination", "investigation," or "inspection" of the books and records within the meaning of section 7605(b) of the Code, or a prior audit for purposes of section 530 of the Revenue Act of 1978, 1978-3 (Vol. 1) C.B. 119, as amended by section 1122 of the Small Business Job Protection Act of 1996, because this evaluation is not directly related to the determination of the tax liability of a taxpayer for a particular taxable period.

(3) The District Director will inform the taxpayer of the results of a records evaluation.



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### .03 Testing.

(1) The District Director may periodically initiate tests to establish the authenticity, readability, completeness, and integrity of a taxpayer's machine-sensible records retained in conformity with this revenue procedure.

(2) These tests may include a review of integrated systems such as EDI or an electronic storage system, and a review of the internal controls and security procedures associated with the creation and maintenance of the taxpayer's records.

(3) The tests described in section 10.03(1) of this revenue procedure are not an "examination", "investigation," or "inspection" of the books and records within the meaning of section 7605(b) of the Code, or a prior audit for purposes of section 530 of the Revenue Act of 1978, 1978-3 (Vol. 1) C.B. 119, as amended by section 1122 of the Small Business Job Protection Act of 1996, because these tests are not directly related to the determination of the tax liability of a taxpayer for a particular taxable period.

(4) The District Director will inform the taxpayer of the results of these tests.

### SECTION 11. HARDCOPY RECORDS

.01 The provisions of this revenue procedure do not relieve taxpayers of their responsibility to retain hardcopy records that are created or received in the ordinary course of business as required by existing law and regulations. Hardcopy records may be retained in microfiche or microfilm format in conformity with Rev. Proc. 81-46, 1981-2 C.B. 621. Hardcopy records may also be retained in an electronic storage system in conformity with Rev. Proc. 97-22. These records are not a substitute for the machine-sensible records required to be retained by this revenue procedure.

.02 A taxpayer need not create or retain hardcopy records if:

(1) the hardcopy records are merely computer printouts created only for validation, control, or other temporary purposes;

(2) the hardcopy records are not produced in the ordinary course of transacting business (as may be the case when utilizing EDI technology); or

(3) all the details relating to the transaction are subsequently received by the taxpayer in an EDI transaction and are retained as machine-sensible records by the taxpayer in conformity with this revenue procedure. For example, a taxpayer need not retain credit card receipts generated at the time of a transaction if all pertinent information on the receipts is subsequently received in an EDI transaction and retained as a machine-sensible record. See section 5.03 of this revenue procedure for requirements relating to EDI.

.03 A taxpayer need not create hardcopy printouts of its machine-sensible records unless requested to do so by the Service. The Service may request such hardcopy printouts either at the time of an examination or in conjunction with the tests described in section 10.03(1) of this revenue procedure.

### SECTION 12. PENALTIES

The District Director may issue a Notice of Inadequate Records pursuant to section 1.6001-1(d) if a taxpayer fails to comply with this revenue procedure (including a failure to satisfy the resource

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requirements of section 7 of this revenue procedure). Failure to comply with this revenue procedure may also result in the imposition of the applicable penalties under subtitle F of the Code, including the section 6662(a) accuracy-related civil penalty and the section 7203 willful failure criminal penalty.

### SECTION 13. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 91-59 is modified and superseded for machine- sensible records relating to taxable years beginning after December 31, 1997. However, a taxpayer that complies with this revenue procedure for taxable years beginning prior to that date is treated as having complied with Rev. Proc. 91-59 for those years.

### SECTION 14. EFFECTIVE DATE

This revenue procedure is effective for machine-sensible records relating to taxable years beginning after December 31, 1997.

### SECTION 15. INTERNAL REVENUE SERVICE OFFICE CONTACT

.01 Questions regarding this revenue procedure should be directed to the Office of the Assistant Commissioner (Examination). The telephone number for this office is (202) 622-5480 (not a toll- free number). Written questions should be addressed to:

Assistant Commissioner (Examination)  
Attention: CP:EX  
Internal Revenue Service  
1111 Constitution Ave., N.W.  
Washington, D.C. 20224

.02 Questions regarding the application of this revenue procedure to a specific factual situation should be directed to the appropriate District Director's office.

### SECTION 16. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1595.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The collections of information in this revenue procedure are in sections 8 and 10 of this revenue procedure. This information is required to ensure that machine-sensible records will constitute records within the meaning of section 6001. The collections of information are mandatory for a taxpayer whose machine- sensible records are kept within an ADP system. The likely respondents are individuals, state or local governments, farms, business or other for-profit institutions, federal agencies or employees, nonprofit institutions, and small businesses or organizations.

The estimated total annual recordkeeping burden is 120,000 hours.

## Rev. Proc. 98-25, 1998-11 I.R.B. 7.

The estimated annual burden per recordkeeper will vary from 20 hours to 60 hours, depending on individual circumstances, with an estimated average of 40 hours. The estimated number of recordkeepers is 3,000.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

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## **The IRS Mission**

*Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.*

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Department of the Treasury  
Internal Revenue Service

[www.irs.gov](http://www.irs.gov)

Publication 3498 (Rev. 11-2004)  
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## **The Examination Process**

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### **Introduction**

The Internal Revenue Service (IRS) accepts most federal returns as filed. Some returns, however, are examined, or audited, to determine if income, expenses, and credits are reported accurately.

This publication discusses general rules and procedures we follow in examinations. It explains what happens before, during, and after an examination. It also explains appeal and payment procedures.

As a taxpayer, you have the right to fair, professional, prompt, and courteous service from IRS employees, as outlined in the Declaration of Taxpayer Rights found on page 3.

We must follow the tax rules set forth by Congress in the Internal Revenue Code. We also follow Treasury Regulations, court decisions, and other rules and procedures written to administer the tax laws.

If the examination results in a change to your tax liability, you may ask us to reconsider your case. Some reasons why we may reconsider your case include:

- Your submitting additional information that could result in a change to the additional amount we have determined that you owe;
- Your filing an original delinquent return after we have determined that you owe an additional amount, or;
- Your identifying a mathematical or processing error we made.

You must request reconsideration in writing and submit it to your local IRS office.

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**? Do you have questions or need help right away? Call us. We're here to help you.**

**For General Information:**

For information about a specific examination please contact the person named on the appointment letter.



**For tax information and help:**

Call the number on the bill you received or call us toll free at:

- 1-800-829-1040 (for 1040 filers)
- 1-800-829-4933 (for business filers)
- 1-800-829-4059 /TDD



**For tax forms and publications:**

- 1-800-829-3676
- 1-800-829-4059 /TDD
- 1-703-368-9694-Forms by Fax



**Internet: [www.irs.gov](http://www.irs.gov)**

- FTP - [ftp.fedworld.gov/pub/](ftp://ftp.fedworld.gov/pub/)**
- TELENET-[iris.irs.gov](http://iris.irs.gov)**

You'll find answers to frequently asked tax questions, tax forms on-line, searchable publications, hot tax issues, news, and help through e-mail.



**If you prefer to write to us . .**

Enclose a copy of your tax bill. Print your name, social security number or taxpayer identification number, and the tax form and period shown on your bill. Write to us at the address shown on your tax bill.



**You may also visit your nearest IRS Office.**

You'll find the exact address in your local phone book under *U.S. Government*

## Declaration of Taxpayer Rights

### I. Protection of Your Rights

*IRS employees will explain and protect your rights as a taxpayer throughout your contact with us.*

### II. Privacy and Confidentiality

*The IRS will not disclose to anyone the information you give us, except as authorized by law. You have the right to know why we are asking you for information, how we will use it, and what happens if you do not provide requested information.*

### III. Professional and Courteous Service

*If you believe that an IRS employee has not treated you in a professional, fair, and courteous manner, you should tell that employee's supervisor. If the supervisor's response is not satisfactory, you should write to the IRS Director for your Area or the Center where you file your return.*

### IV. Representation

*You may either represent yourself or, with proper written authorization, have someone else represent you. Your representative must be a person allowed to practice before the IRS, such as an attorney, certified public accountant, or enrolled agent (a person enrolled to practice before the IRS). If you are in an interview and ask to consult such a person, then we must stop and reschedule the interview in most cases.*

*You can have someone accompany you at an interview. You may make sound recordings of any meetings with our examination, appeal, or collection personnel, provided you tell us in writing 10 days before the meeting.*

### V. Payment of Only the Correct Amount of Tax

*You are responsible for paying only the correct amount of tax due under the law—no more, no less. If you cannot pay all of your tax when it is due, you may be able to make monthly payments.*

### VI. Help with Unresolved Tax Problems

*The Taxpayer Advocate Service can help you if you have tried unsuccessfully to resolve a problem with the IRS. Your local Taxpayer Advocate can offer you special help if you have a significant hardship as a result of a tax problem. For more information, call toll-free, 1-877-777-4778 (1-800-829-4059 for TTY/TDD) or write to the Taxpayer Advocate at the IRS office that last contacted you.*

### VII. Appeals and Judicial Review

*If you disagree with us about the amount of your tax liability or certain collection actions, you have the right to ask the Appeals Office to review your case. You may also ask a court to review your case.*

### VIII. Relief from Certain Penalties and Interest

*The IRS will waive penalties when allowed by law if you can show you acted reasonably and in good faith or relied on the incorrect advice of an IRS employee. We will waive interest that is the result of certain errors or delays caused by an IRS employee.*

## Your Return Is Going To Be Examined.

### Before the Examination

We accept most taxpayers' returns as filed. If we inquire about your return or select it for examination, it does not suggest that you are dishonest. The inquiry or examination may or may not result in more tax. We may close your case without change or you may receive a refund.

The process of selecting a return for examination usually begins in one of two ways. One way is to use computer programs to identify returns that may have incorrect amounts. The programs may be based on information returns, such as Forms 1099 or W-2, on studies of past examinations, or on certain issues identified by other special projects. Another way is to use information from compliance projects that indicates a return may have incorrect amounts. These sources may include newspapers, public records, and individuals. If we determine the information is accurate and reliable, we may use it to select a return for examination.

Publication 556, *Examination of Returns, Appeal Rights, and Claims for Refund*, explains the rules and procedures that we follow in examinations. The following sections give an overview of how we conduct examinations.

### During the Examination

#### Examinations by Mail

Some examinations are conducted entirely by mail. If the examination is conducted by mail, you'll receive a letter from us asking for additional information about certain items shown on your return, such as income, expenses, and itemized deductions.

If the examination is conducted by mail, you can:

1. Act on your own behalf. (*In the case of a jointly filed return, either spouse can respond or both spouses can send a joint response.*)
2. Have someone represent you in correspondence with us. This person must be an attorney, accountant, enrolled agent, an enrolled actuary, or the person who prepared the return and signed it as the preparer. If you choose to have someone represent you, you must furnish us with written authorization. Make this authorization on Form 2848, *Power of Attorney and Declaration of Representative*.

*Note: You may obtain any of the forms and publications referenced in this publication by calling 1-800-829-3676.*

#### Examinations in Person

An examination conducted in person begins when we notify you that your return has been selected. We'll tell you what information you need to provide at that time. If you gather the information before the examination, we may be able to complete it more easily and in a shorter time.

If the examination is conducted in person, it can take place in your home, your place of business, an IRS office, or the office of your attorney, accountant, or enrolled agent (*a person enrolled to practice before the IRS*). If the time or place is not convenient for you, the examiner will try to work out something more suitable.

## Your Return Is Going To Be Examined. (cont.)

If the examination is conducted in person, you can:

1. Act on your own behalf. (In the case of a jointly filed return, either spouse or both can attend the interview.) If you are acting on your own behalf, you may leave to consult with your representative. We will suspend the interview and reschedule the examination. We cannot suspend the interview if we are conducting it as a result of your receiving an administrative summons.
2. Have someone accompany you, either to support your position or to witness to the proceedings.
3. Accompany someone who will represent you. This person must be an attorney, accountant, enrolled agent, an enrolled actuary, or the person who prepared the return and signed it as the preparer.
4. Have your representative act for you and not be present at the audit yourself. If you choose to have someone represent you in your absence, you must furnish us with written authorization. Make this authorization on Form 2848, *Power of Attorney and Declaration of Representative*.

### How to Stop Interest from Accumulating

During your examination, if you think you will owe additional tax at the end of the examination, you can stop interest from accumulating by paying all or part of the amount you think you will owe. Interest will stop accumulating on the part you pay when the IRS receives your money. Interest will only be charged on the tax, penalties, and interest that are unpaid on the date they are assessed.

### Consents to Extend the Statute of Limitations

We try to examine tax returns as soon as possible after they are filed, but occasionally we may request that you extend the statute of limitations of your tax return.

A return's statute of limitation generally limits the time we have to examine it and assess tax. Assessments of tax must be made within 3 years after a return is due or filed, whichever is later. We can't assess additional tax or make a refund or credit (unless you filed a timely claim) after the statute of limitations has expired. Also, if you disagree with the results of the examination, you can't appeal the items you disagree with unless sufficient time remains on the statute. Because of these restrictions, if there isn't much time remaining to examine your return, assess additional taxes, and/or exercise your appeal rights, you have the opportunity to extend the statute of limitations. This will allow you additional time to provide further documentation to support your position, request an appeal if you do not agree with our findings, or to claim a tax refund or credit. It also allows the Service time to complete the examination, make any additional assessment, if necessary, and provide sufficient time for processing.

A written agreement between you and the Service to extend the statutory period of a tax return is called a "consent." Consents can be used for all types of tax except estate tax.

There are two basic kinds of consent forms. One sets a specific expiration date for the extension, and the other for an indefinite period of time. Either type of consent may be limited by restrictive conditions. The use of a restricted consent is to allow the statute to expire with regard to all items on the return except those covered by the restrictive language.

If the statute of limitations for your tax return is approaching, you may be asked to sign a consent. You may:

1. Refuse to extend the statute of limitations;
2. Limit or restrict the consent to particular issues, or
3. Limit the extension to a particular period of time.

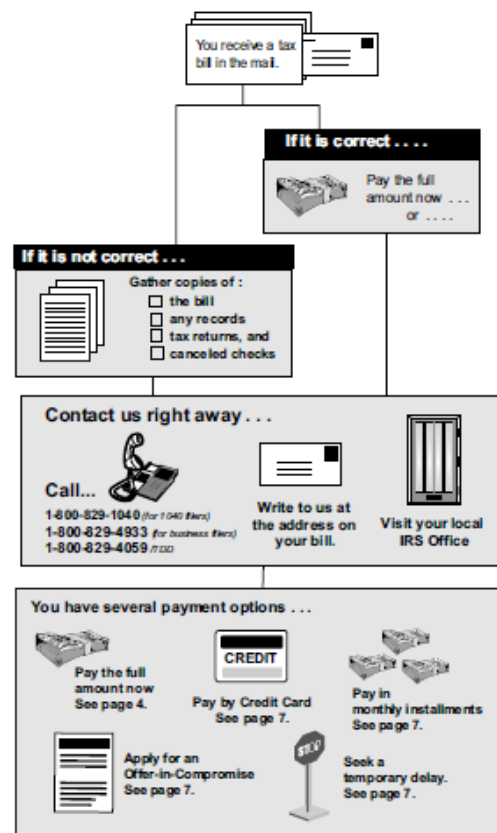
The consent will be sent or presented to you with a letter explaining this process and Publication 1035, *Extending the Tax Assessment Period*. For further information, refer to this publication.

### Results of the Examination

If we accept your return as filed, you will receive a letter stating that the examiner proposed no changes to your return. You should keep this letter with your tax records.

If we don't accept your return as filed, we will explain any proposed changes to you and your authorized representative. It is important that you understand the reasons for any proposed changes; don't hesitate to ask about anything that is unclear to you.

### What to Do When You Receive a Bill from the IRS





# What To Do If You Agree or Disagree with the Examination Results

## If You Agree

If you agree with a proposed *increase* to tax, you can sign an agreement form and pay any additional tax you may owe. You must pay interest and applicable penalties on any additional balance due. If you pay when you sign the agreement, interest is generally figured from the due date of your return to the date of your payment.

If you do not pay the additional tax and interest, you will receive a bill (See *What To do When You Receive a Bill from the IRS* on page 4.) If the amount due (including interest and applicable penalties) is less than \$100,000 and you pay it within 21 business days, we will not charge more interest or penalties. If the amount is \$100,000 or more, the period is reduced to 10 calendar days. If you can't pay the tax due at the end of the examination, you may pay whatever amount you can and request an installment agreement for the balance. (See *Setting up an Installment Agreement* on page 7.)

If you are entitled to a refund, you will receive it sooner if you sign the agreement form at the end of the examination. You will also be paid interest on the refund.

## If You Do Not Agree

If you do not agree with the proposed changes, the examiner will explain your appeal rights. If your examination takes place in an IRS office, you may request an immediate meeting with the examiner's supervisor to explain your situation. You may also enter into an *Agreement to Mediate* to help resolve disputes through Fast Track Mediation services. (See *next column*.) Mediation can take place at this meeting or afterwards. If an agreement is reached, your case will be closed.

If you cannot reach an agreement with the supervisor at this meeting, or if the examination took place outside an IRS office or was conducted through correspondence with an IRS Campus employee, the examiner will prepare a report explaining your position and ours. The examiner will forward your case to the Area office for processing.

You will receive:

- A letter (known as a 30-day letter) notifying you of your rights to appeal the proposed changes within 30 days,
- A copy of the examiner's report explaining the proposed changes, and
- An agreement or a waiver form.

You generally have 30 days from the date of the 30-day letter to tell us whether you will accept the proposed changes or appeal them. The letter will explain what steps you should take, depending on what action you choose. Be sure to follow the instructions carefully. Appeal rights are explained following this section.



## Caution

If you do not respond to the 30-day letter, or if you respond but do not reach an agreement with an appeals officer, we will send you a 90-day letter, also known as a *Notice of Deficiency*. This is a legal document that explains the proposed changes and the amount of the proposed tax increase. You will have 90 days (150 days if it is addressed to you outside the United States) from the date of this notice to file a petition with the Tax Court. If you do not petition the Tax Court you will receive a bill for the amount due.

## Fast Track Mediation Services

If you do not agree with any or all of the IRS findings, you may request Fast Track Mediation services to help you resolve disputes resulting from the examination (audits). Fast Track Mediation offers an expedited process with a trained mediator, who will help facilitate communication, in a neutral setting. The mediator will work with you and the IRS to understand the nature of the dispute. The purpose is to help the two of you reach a mutually satisfactory resolution that is consistent with the applicable law. The mediator has no authority to require either party to accept any resolution. You may withdraw from the mediation process anytime. If any issues remain unresolved you will retain all of your usual appeal rights.

Most cases qualify for Fast Track Mediation. To begin the process, you may request the examiner or IRS representative to arrange a mediation meeting. Both you and the IRS representative must sign a simple *Agreement to Mediate* form. A mediator will then be assigned. Generally, within a week, the mediator will contact you and the IRS representative to schedule a meeting. After a brief explanation of the process, the mediator will discuss with you when and where to hold the mediation session.

For additional information, refer to Publication 3605, *Fast Track Mediation-A Process for Prompt Resolution of Tax Issues*.



# How Do You Appeal a Decision?

## The Appeal System

Because people sometimes disagree on tax matters, the Service has an appeal system. Most differences can be settled within this system without going to court.

Your reasons for disagreeing must come within the scope of tax laws, however. For example, you cannot appeal your case based only on moral, religious, political, constitutional, conscientious, or similar grounds.

If you do not want to appeal your case within the IRS, you may take your case directly to tax court.

## Appeal Within the IRS

You may appeal our tax decision to a local appeals office, which is separate and independent of the IRS Office taking the action you disagree with. An appeals office is the only level of appeal within the IRS. Conferences with Appeals Office personnel may be conducted in person, through correspondence, or by telephone with you or your authorized representative.

If you want to have a conference with an appeals officer, follow the instructions in the letter you received. We will send your conference request letter to the appeals office to arrange for a conference at a convenient time and place. You or your qualified representative should be prepared to discuss all disputed issues at the conference. Most differences are settled at this level. Only attorneys, certified public accountants or enrolled agents are allowed to represent a taxpayer before Appeals. An unenrolled preparer may be a witness at the conference, but not a representative.

If you want to have a conference with an appeals officer, you may also need to file either a **small case request** or a **formal written protest** with the contact person named

in the letter you receive. Whether you file a small case request or a formal written protest depends on several factors.

## Making a Small Case Request

You may make a **small case request** if the total amount of tax, penalties, and interest for each tax period involved is \$25,000 or less, and you do not meet one of the exceptions below for which a formal protest is required. If more than one tax period is involved and any tax period exceeds the \$25,000 threshold, you must file a formal written protest for all periods involved. The total amount includes the proposed increase or decrease in tax and penalties or claimed refund. For an *Offer-in-Compromise*, include total unpaid tax, penalty, and interest due.

To make a small case request, follow the instructions in our letter to you by sending a brief written statement requesting an appeals conference. Indicate the changes you do not agree with and the reasons you do not agree with them.



### Caution

Be sure to send the protest within the time limit specified in the letter you received.

You must file a formal written protest

- If the total amount of tax, penalties, and interest for any tax period is more than \$25,000;
- In all partnership and S corporation cases, regardless of the dollar amount;
- In all employee plan and exempt organization cases, regardless of the dollar amount;
- In all other cases, unless you qualify for other special appeal procedures, such as requesting appeals consideration of liens, levies, seizures, or installment agreements.

*(See Publication 1660, Collection Appeal Rights, for more information on special collection appeals procedures.)*

## Filing a Formal Protest

When a formal protest is required, send it within the time limit specified in the letter you received. Include in your protest:

- Your name and address, and a daytime telephone number.
- A statement that you want to appeal the IRS findings to the Appeals Office.
- A copy of the letter showing the proposed changes and findings you do not agree with (*or the date and symbols from the letter.*)
- The tax periods or years involved.
- A list of the charges that you do not agree with, and why you do not agree.
- The facts supporting your position on any issue that you do not agree with.
- The law or authority, if any, on which you are relying.
- You must sign the written protest, stating that it is true, under the penalties of perjury as follows:

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

If your representative prepares and signs the protest for you, he or she must substitute a declaration stating:

- That he or she submitted the protest and accompanying documents and;
- Whether he or she knows personally that the facts stated in the protest and accompanying documents are true and correct.

We urge you to provide as much information as you can, as this will help us speed up your appeal. This will save you both time and money.

Additional information about the Appeals process may be found in **Publication 5, Your Appeals Rights and How to Prepare a Protest if you Don't Agree.**

# After the Examination

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## Payment Options

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### You can't pay all that you owe now

If you can't pay all your taxes now, pay as much as you can. By paying now, you reduce the amount of interest and penalty you owe. Then immediately call, write, or visit the nearest IRS office to explain your situation. After you explain your situation, we may ask you to fill out a Collection Information Statement. If you are contacting us by mail or by telephone, we will mail the statement to you to complete and return to us. This will help us compare your monthly income with your expenses so we can figure the amount you can pay. We can then help you work out a payment plan that fits your situation. This is known as an installment agreement.

### Payment by credit card

Individual taxpayers may make credit (and debit) card payments on tax liabilities (including installment agreement payments) by phone or Internet. Payments may be made to the United States Treasury through authorized credit card service providers.

The service providers charge a convenience fee based on the payment amount. You will be informed of the convenience fee amount before the credit card payment is authorized. This fee is in addition to any changes, such as interest, that may be assessed by the credit card issuer. Visit [www.irs.gov](http://www.irs.gov) to obtain a list of authorized service providers and to obtain updated information on credit card payment options.

*Note: You can use debit cards issued by VISA and MasterCard when making tax payments through the participating service providers. However, the service providers and card issuers treat debit cards and credit cards equally for the purpose of processing electronic tax payments. Therefore, debit card users are charged the same fee traditionally associated with credit card transactions*

### Payment by Electronic Federal Tax Payment System (EFTPS)

EFTPS is an Electronic Federal Tax Payment System developed by the Internal Revenue Service and Financial Management Service (FMS).

The system allows federal taxes to be paid electronically. The system allows the use of the Internet at [www.eftps.gov](http://www.eftps.gov) or telephone to initiate tax payments directly. EFTPS payments may also be made through your local financial institution. The service is convenient, secure and saves time.

You may enroll in EFTPS through the website at [www.eftps.gov](http://www.eftps.gov) or by completing a form available from EFTPS customer service at (800) 555-4477 or (800) 945-8400.

### Setting up an installment agreement

Installment agreements allow you to pay your full debt in smaller, more manageable amounts. Installment agreements generally require equal monthly payments. The amount and number of your installment payments will be based on the amount you owe and your ability to pay that amount within the time we can legally collect payment from you.

You should be aware, however, that an installment agreement is more costly than paying all the taxes you owe now. Like revolving credit arrangements, we charge interest on the unpaid portion of the debt. Penalties also continue to accumulate on installment agreements.

If you want to pay off your tax debt through an installment agreement, call the number shown on your bill. If you owe:

- \$25,000 or less in tax, we will tell you what you need to do to set up the agreement;
- More than \$25,000, we may still be able to set up an installment agreement for you, but we may also ask for financial information to help us determine your ability to pay.

Even if you set up an installment agreement, we may still file a Notice of Federal Tax Lien to secure the government's interest until you make your final payment.

*Note: We cannot take any collection actions affecting your property while we consider your request for an installment agreement, while your agreement is in effect, for 30 days after we reject your request for an agreement, or for any period while you appeal the rejection.*

If you arrange for an installment agreement, you may pay with:

- Personal or business checks, money orders, or certified funds (all made payable to the U.S. Treasury),
- Credit and debit cards,
- Payroll deductions your employer takes from your salary and regularly sends to IRS, or
- Electronic transfers from your bank account or other similar means.

### Apply for an Offer-in-Compromise

In some cases, we may accept an *Offer-in-Compromise* to settle an unpaid tax account, including any penalties and interest. With this kind of arrangement, we can accept less than the full amount you owe when it is doubtful we will be able to collect the entire amount due.

Offers in compromise are also possible if collection action would create an economic hardship. You may want to discuss these options with your examiner.

### Temporarily Delay the Collection Process

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If we determine that you can't pay any of your tax debt, we may temporarily delay collection until your financial condition improves. You should know that if we delay collecting from you, your debt will increase because penalties and interest are charged until you pay the full amount. During a temporary delay, we will again review your ability to pay. We may also file a *Notice of Federal Tax Lien*, to protect the government's interest in your assets. See Publication 594, *The IRS Collection Process*.



## After the Examination (cont.)

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### Innocent Spouse Relief

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If you filed a joint tax return, you are jointly and individually responsible for the tax and any interest or penalty due on the joint return, even if you later divorce. In some cases, a spouse may be relieved of the tax, interest, and penalties on a joint return.

You can ask for relief no matter how small the liability.

Three types of relief are available.

- Innocent spouse relief - may apply to all joint filers;
- Separation of liability - may apply to joint filers who are divorced, widowed, legally separated, or have not lived together for the past 12 months;
- Equitable relief - applies to all joint filers.

Innocent spouse relief and separation of liability apply only to items incorrectly reported on the return. If a spouse does not qualify for innocent spouse relief or separation of liability, the IRS may grant equitable relief.

Each type of relief is different and each has different requirements. You must file Form 8857, *Request for Innocent Spouse Relief*, to request any of these methods of relief. Publication 971, *Innocent Spouse Relief*, explains each type of relief, who may qualify, and how to request relief.

### You Must Contact Us

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It is important that you contact us regarding any correspondence you receive from us. If you do not pay your bill or work out a payment plan, we are required by law to take further collection actions.

### What If You Believe Your Bill is Wrong

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#### Caution

If you believe your bill is wrong, let us know as soon as possible. Call the number on your bill, write to the IRS office that sent you the bill, call 1-800-829-1040 (for 1040 filers), 1-800-829-4933 (for business filers), 1-800-829-4059 /TDD, or visit your local IRS office.

To help us correct the problem, gather a copy of the bill along with copies of any records, tax returns, and canceled checks, etc., that will help us understand why you believe your bill is wrong.

If you write to us, tell us why you believe your bill is wrong. With your letter, include copies of all the documents you gathered to explain your case. Please do not send original documents. If we find you are correct, we will adjust your account and, if necessary, send you a corrected bill.

## Privacy Act Statement

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*The Privacy Act of 1974 says that when we ask you for information, we must first tell you our legal right to ask for the information, why we are asking for it, and how it will be used. We must also tell you what could happen if you do not provide it and whether or not you must respond under the law.*

*This notice applies to tax returns and any papers filed with them. It also applies to any questions we need to ask you so we can complete, correct, or process your return; figure your tax; and collect tax, interest, or penalties.*

*Our legal right to ask for information is found in Internal Revenue Code sections 6001, 6011, and 6012(a), and their regulations. They say that you must file a return or statement with us for any tax you are liable for. Your response is mandatory under these sections.*

*Code section 6109 and its regulations say that you must show your social security number or individual taxpayer identification number on what you file. You must also fill in all parts of the tax form that apply to you. This is so we know who you are, and can process your return and papers. You do not have to check the boxes for the Presidential Election Campaign Fund.*

*We ask for tax return information to carry out the U.S. tax laws. We need it to figure and collect the right amount of tax.*

*We may give the information to the Department of Justice and to other Federal agencies, as provided by law. We may also give it to cities, states, the District of Columbia, and U.S. Commonwealths or possessions to carry out their tax laws. And we may give it to certain foreign governments under tax treaties they have with the United States.*

*We may also disclose this information to Federal, state, or local agencies that investigate or respond to acts or threats of terrorism or participate in intelligence or counterintelligence activities concerning terrorism.*

*If you do not file a return, do not give us the information we ask for, or provide fraudulent information, the law says that we may have to charge you penalties and, in certain cases, subject you to criminal prosecution. We may also have to disallow the exemptions, exclusions, credits, deductions, or adjustments shown on your tax return. This could make your tax higher or delay any refund. Interest may also be charged.*

*Please keep this notice with your records. You may want to refer to it if we ask you for other information. If you have questions about the rules for filing and giving information, please call or visit any Internal Revenue Service office.*



# Your Rights as a Taxpayer

*The first part of this publication explains some of your most important rights as a taxpayer. The second part explains the examination, appeal, collection, and refund processes. This publication is also available in Spanish.*

## THE IRS MISSION

PROVIDE AMERICA'S  
TAXPAYERS TOP QUALITY  
SERVICE BY HELPING THEM  
UNDERSTAND AND MEET  
THEIR TAX RESPONSIBILITIES  
AND BY APPLYING THE TAX  
LAW WITH INTEGRITY AND  
FAIRNESS TO ALL.

## Declaration of Taxpayer Rights

### I. Protection of Your Rights

IRS employees will explain and protect your rights as a taxpayer throughout your contact with us.

### II. Privacy and Confidentiality

The IRS will not disclose to anyone the information you give us, except as authorized by law. You have the right to know why we are asking you for information, how we will use it, and what happens if you do not provide requested information.

### III. Professional and Courteous Service

If you believe that an IRS employee has not treated you in a professional, fair, and courteous manner, you should tell that employee's supervisor. If the supervisor's response is not satisfactory, you should write to the IRS director for your area or the center where you file your return.

### IV. Representation

You may either represent yourself or, with proper written authorization, have someone else represent you in your place. Your representative must be a person allowed to practice before the IRS, such as an attorney, certified public accountant, or enrolled agent. If you are in an interview and ask to consult such a person, then we must stop and reschedule the interview in most cases.

You can have someone accompany you at an interview. You may make sound recordings of any meetings with our examination, appeal, or collection personnel, provided you tell us in writing 10 days before the meeting.

### V. Payment of Only the Correct Amount of Tax

You are responsible for paying only the correct amount of tax due under the law—no more, no less. If you cannot pay all of your tax when it is due, you may be able to make monthly installment payments.

### VI. Help With Unresolved Tax Problems

The Taxpayer Advocate Service can help you if you have tried unsuccessfully to resolve a problem with the IRS. Your local Taxpayer Advocate can offer you special help if you have a significant hardship as a result of a tax problem. For more information, call toll free 1-877-777-4778 (1-800-829-4059 for TTY/TDD) or write to the Taxpayer Advocate at the IRS office that last contacted you.

### VII. Appeals and Judicial Review

If you disagree with us about the amount of your tax liability or certain collection actions, you have the right to ask the Appeals Office to review your case. You may also ask a court to review your case.

### VIII. Relief From Certain Penalties and Interest

The IRS will waive penalties when allowed by law if you can show you acted reasonably and in good faith or relied on the incorrect advice of an IRS employee. We will waive interest that is the result of certain errors or delays caused by an IRS employee.

# Examinations, Appeals, Collections, and Refunds

## Examinations (Audits)

We accept most taxpayers' returns as filed. If we inquire about your return or select it for examination, it does not suggest that you are dishonest. The inquiry or examination may or may not result in more tax. We may close your case without change; or, you may receive a refund.

The process of selecting a return for examination usually begins in one of two ways. First, we use computer programs to identify returns that may have incorrect amounts. These programs may be based on information returns, such as Forms 1099 and W-2, on studies of past examinations, or on certain issues identified by compliance projects. Second, we use information from outside sources that indicates that a return may have incorrect amounts. These sources may include newspapers, public records, and individuals. If we determine that the information is accurate and reliable, we may use it to select a return for examination.

Publication 556, Examination of Returns, Appeal Rights, and Claims for Refund, explains the rules and procedures that we follow in examinations. The following sections give an overview of how we conduct examinations.

### By Mail

We handle many examinations and inquiries by mail. We will send you a letter with either a request for more information or a reason why we believe a change to your return may be needed. You can respond by mail or you can request a personal interview with an examiner. If you mail us the requested information or provide an explanation, we may or may not agree with you, and we will explain the reasons for any changes. Please do not hesitate to write to us about anything you do not understand.

### By Interview

If we notify you that we will conduct your examination through a personal interview, or you request such an interview, you have the right to ask that the examination take place at a reasonable time and place that is convenient for both you and the IRS. If our examiner proposes any changes to your return, he or she will explain the reasons for the changes. If you do not agree with these changes, you can meet with the examiner's supervisor.

### Repeat Examinations

If we examined your return for the same items in either of the 2 previous years and proposed no change to your tax liability, please contact us as soon as possible so

we can see if we should discontinue the examination.

## Appeals

If you do not agree with the examiner's proposed changes, you can appeal them to the Appeals Office of IRS. Most differences can be settled without expensive and time-consuming court trials. Your appeal rights are explained in detail in both Publication 5, Your Appeal Rights and How To Prepare a Protest If You Don't Agree, and Publication 556, Examination of Returns, Appeal Rights, and Claims for Refund.

If you do not wish to use the Appeals Office or disagree with its findings, you may be able to take your case to the U.S. Tax Court, U.S. Court of Federal Claims, or the U.S. District Court where you live. If you take your case to court, the IRS will have the burden of proving certain facts if you kept adequate records to show your tax liability, cooperated with the IRS, and meet certain other conditions. If the court agrees with you on most issues in your case and finds that our position was largely unjustified, you may be able to recover some of your administrative and litigation costs. You will not be eligible to recover these costs unless you tried to resolve your case administratively, including going through the appeals system, and you gave us the information necessary to resolve the case.

## Collections

Publication 594, The IRS Collection Process, explains your rights and responsibilities regarding payment of federal taxes. It describes:

- What to do when you owe taxes. It describes what to do if you get a tax bill and what to do if you think your bill is wrong. It also covers making installment payments, delaying collection action, and submitting an offer in compromise.
- IRS collection actions. It covers liens, releasing a lien, levies, releasing a levy, seizures and sales, and release of property.

Your collection appeal rights are explained in detail in Publication 1660, Collection Appeal Rights.

## Innocent Spouse Relief

Generally, both you and your spouse are each responsible for paying the full amount of tax, interest, and penalties due on your joint return. However, if you qualify for innocent spouse relief, you may be relieved of part or all of the joint liability. To request relief, you must file Form 8857, Request for Innocent Spouse Relief no later than 2 years after the date

on which the IRS first attempted to collect the tax from you. For example, the two-year period for filing your claim may start if the IRS applies your tax refund from one year to the taxes that you and your spouse owe for another year. For more information on innocent spouse relief, see Publication 971, Innocent Spouse Relief, and Form 8857.

## Potential Third Party Contacts

Generally, the IRS will deal directly with you or your duly authorized representative. However, we sometimes talk with other persons if we need information that you have been unable to provide, or to verify information we have received. If we do contact other persons, such as a neighbor, bank, employer, or employees, we will generally need to tell them limited information, such as your name. The law prohibits us from disclosing any more information than is necessary to obtain or verify the information we are seeking. Our need to contact other persons may continue as long as there is activity in your case. If we do contact other persons, you have a right to request a list of those contacted.

## Refunds

You may file a claim for refund if you think you paid too much tax. You must generally file the claim within 3 years from the date you filed your original return or 2 years from the date you paid the tax, whichever is later. The law generally provides for interest on your refund if it is not paid within 45 days of the date you filed your return or claim for refund. Publication 556, Examination of Returns, Appeal Rights, and Claims for Refund, has more information on refunds.

If you were due a refund but you did not file a return, you generally must file your return within 3 years from the date the return was due (including extensions) to get that refund.

## Tax Information

The IRS provides the following sources for forms, publications, and additional information.

- **Tax Questions:** 1-800-829-1040 (1-800-829-4059 for TTY/TDD)
- **Forms and Publications:** 1-800-829-3676 (1-800-829-4059 for TTY/TDD)
- **Internet:** [www.irs.gov](http://www.irs.gov)
- **Small Business Ombudsman:** A small business entity can participate in the regulatory process and comment on enforcement actions of IRS by calling 1-888-REG-FAIR.
- **Treasury Inspector General for Tax Administration:** You can confidentially report misconduct, waste, fraud, or abuse by an IRS employee by calling 1-800-366-4484 (1-800-877-8339 for TTY/TDD). You can remain anonymous.



# Your Appeal Rights and How To Prepare a Protest If You Don't Agree



Department of the Treasury  
Internal Revenue Service

[www.irs.ustreas.gov](http://www.irs.ustreas.gov)

Publication 5 (Rev. 01-1998)  
Catalog Number 460741

## Introduction

This Publication tells you how to appeal your tax case if you don't agree with the Internal Revenue Service (IRS) findings.

## If You Don't Agree

If you don't agree with any or all of the IRS findings given you, you may request a meeting or a telephone conference with the supervisor of the person who issued the findings. If you still don't agree, you may appeal your case to the Appeals Office of IRS.

If you decide to do nothing and your case involves an examination of your income, estate, gift, and certain excise taxes or penalties, you will receive a formal Notice of Deficiency. The Notice of Deficiency allows you to go to the Tax Court and tells you the procedure to follow. If you do not go to the Tax Court, we will send you a bill for the amount due.

If you decide to do nothing and your case involves a trust fund recovery penalty, or certain employment tax liabilities, the IRS will send you a bill for the penalty. If you do not appeal a denial of an offer in compromise or a denial of a penalty abatement, the IRS will continue collection action.

If you don't agree, we urge you to appeal your case to the Appeals Office of IRS. The Office of Appeals can settle most differences without expensive and time-consuming court trials. (Note: Appeals can not consider your reasons for not agreeing if they don't come within the scope of the tax laws (for example, if you disagree solely on moral, religious, political, constitutional, conscientious, or similar grounds).)

The following general rules tell you how to appeal your case.

## Appeals Within the IRS

Appeals is the administrative appeals office for the IRS. You may appeal most IRS decisions with your local Appeals Office. The Appeals Office is separate from - and independent of - the IRS Office taking the action you disagree with. The Appeals Office is the only level of administrative appeal within the IRS.

Conferences with Appeals Office personnel are held in an informal manner by correspondence, by telephone or at a personal conference. There is no need for you to have representation for an Appeals conference, but if you choose to have a representative, see the requirements under **Representation**.

If you want an Appeals conference, follow the instructions in our letter to you. Your request will be sent to the Appeals Office to arrange a conference at a convenient time and place. You or your representative should prepare to discuss all issues you don't agree with at the conference. Most differences are settled at this level.

**In most instances, you may be eligible to take your case to court if you don't reach an agreement at your Appeals conference, or if you don't want to appeal your case to the IRS Office of Appeals. See the later section Appeals To The Courts.**

## Protests

When you request an appeals conference, you may also need to file a formal written protest or a small case request with the office named in our letter to you. Also, see the special appeal request procedures in Publication 1660, Collection Appeal Rights. If you disagree with lien, levy, seizure, or denial or termination of an installment agreement.

## You need to file a written protest:

- In all employee plan and exempt organization cases without regard to the dollar amount at issue.
- In all partnership and S corporation cases without regard to the dollar amount at issue.
- In all other cases, unless you qualify for the small case request procedure, or other special appeal procedures such as requesting Appeals consideration of liens, levies, seizures, or installment agreements. See Publication 1660.

## How to prepare a protest:

When a protest is required, **send it within the time limit specified in the letter you received.** Include in your protest:

- 1) Your name and address, and a daytime telephone number,
- 2) A statement that you want to appeal the IRS findings to the Appeals Office,
- 3) A copy of the letter showing the proposed changes and findings you don't agree with (or the date and symbols from the letter),
- 4) The tax periods or years involved,
- 5) A list of the changes that you don't agree with, and why you don't agree.

- 6) The facts supporting your position on any issue that you don't agree with,
- 7) The law or authority, if any, on which you are relying.
- 8) You must sign the written protest, stating that it is true, under the penalties of perjury as follows:

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

**If your representative prepares and signs the protest for you, he or she must substitute a declaration stating:**

- 1) That he or she submitted the protest and accompanying documents and
- 2) Whether he or she knows personally that the facts stated in the protest and accompanying documents are true and correct.

We urge you to provide as much information as you can, as this will help us speed up your appeal. This will save you both time and money.

## Small Case Request:

If the total amount for any tax period is not more than \$25,000, you may make a small case request instead of filing a formal written protest. In computing the total amount, include a proposed increase or decrease in tax (including penalties), or claimed refund. For an offer in compromise, in calculating the total amount, include total unpaid tax, penalty and interest due. For a small case request, follow the instructions in our letter to you by: sending a letter requesting Appeals consideration, indicating the changes you don't agree with, and the reasons why you don't agree.

## Representation

You may represent yourself at your appeals conference, or you may have an attorney, certified public accountant, or an individual enrolled to practice before the IRS represent you. Your representative must be qualified to practice before the IRS. If you want your representative to appear without you, you must provide a properly completed power of attorney to the IRS before the representative can receive or inspect confidential information, Form 2848, Power of Attorney and Declaration of Representative, or any other properly written power of attorney or authorization may be used for this



purpose. You can get copies of Form 2848 from an IRS office, or by calling 1-800-TAX-FORM (1-800-829-3676).

You may also bring another person(s) with you to support your position.

## Appeals To The Courts

If you and Appeals don't agree on some or all of the issues after your Appeals conference, or if you skipped our appeals system, you may take your case to the United States Tax Court, the United States Court of Federal Claims, or your United States District Court, after satisfying certain procedural and jurisdictional requirements as described below under each court. (However, if you are a nonresident alien, you cannot take your case to a United States District Court.) These courts are independent judicial bodies and have no connection with the IRS.

### Tax Court

If your disagreement with the IRS is over whether you owe additional income tax, estate tax, gift tax, certain excise taxes or penalties related to these proposed liabilities, you can go to the United States Tax Court. (Other types of tax controversies, such as those involving some employment tax issues or manufacturers' excise taxes, cannot be heard by the Tax Court.) You can do this after the IRS issues a formal letter, stating the amounts that the IRS believes you owe. This letter is called a notice of deficiency. You have 90 days from the date this notice is mailed to you to file a petition with the Tax Court (or 150 days if the notice is addressed to you outside the United States). The last date to file your petition will be entered on the notice of deficiency issued to you by the IRS. If you don't file the petition within the 90-day period (or 150 days, as the case may be), we will assess the proposed liability and send you a bill. You may also have the right to take your case to the Tax Court in some other situations, for example, following collection action by the IRS in certain cases. See Publication 1660.

If you discuss your case with the IRS during the 90-day period (150-day period), the discussion will not extend the period in which you may file a petition with the Tax Court.

The court will schedule your case for trial at a location convenient to you. You may represent yourself before the Tax Court, or you may be represented by anyone permitted to practice before that court.

**Note:** If you don't choose to go to the IRS Appeals Office before going to court, normally you will have an opportunity to attempt settlement with Appeals before your trial date.

If you dispute not more than \$50,000 for any one tax year, there are simplified procedures. You can get information about these procedures and

other matters from the Clerk of the Tax Court, 400 Second St. NW, Washington, DC 20217.

### Frivolous Filing Penalty

**Caution:** If the Tax Court determines that your case is intended primarily to cause a delay, or that your position is frivolous or groundless, the Tax Court may award a penalty of up to \$25,000 to the United States in its decision.

## District Court and Court of Federal Claims

If your claim is for a refund of any type of tax, you may take your case to your United States District Court or to the United States Court of Federal Claims. Certain types of cases, such as those involving some employment tax issues or manufacturers' excise taxes, can be heard only by these courts.

Generally, your District Court and the Court of Federal Claims hear tax cases only after you have paid the tax and filed a claim for refund with the IRS. You can get information about procedures for filing suit in either court by contacting the Clerk of your District Court or the Clerk of the Court of Federal Claims.

If you file a formal refund claim with the IRS, and we haven't responded to you on your claim within 6 months from the date you filed it, you may file suit for a refund immediately in your District Court or the Court of Federal Claims. If we send you a letter that proposes disallowing or disallows your claim, you may request Appeals review of the disallowance. If you wish to file a refund suit, you must file your suit no later than 2 years from the date of our notice of claim disallowance letter.

**Note:** Appeals review of a disallowed claim doesn't extend the 2 year period for filing suit. However, it may be extended by mutual agreement.

## Recovering Administrative and Litigation Costs

You may be able to recover your reasonable litigation and administrative costs if you are the prevailing party, and if you meet the other requirements. You must exhaust your administrative remedies within the IRS to receive reasonable litigation costs. You must not unreasonably delay the administrative or court proceedings.

Administrative costs include costs incurred on or after the date you receive the Appeals decision letter, the date of the first letter of proposed deficiency, or the date of the notice of deficiency, whichever is earliest.

**Recoverable litigation or administrative costs may include:**

- Attorney fees that generally do not exceed \$125 per hour. This amount will be indexed for a cost of living adjustment.

- Reasonable amounts for court costs or any administrative fees or similar charges by the IRS.

- Reasonable expenses of expert witnesses.

- Reasonable costs of studies, analyses, tests, or engineering reports that are necessary to prepare your case.

**You are the prevailing party if you meet all the following requirements:**

- You substantially prevailed on the amount in controversy, or on the most significant tax issue or issues in question.
- You meet the net worth requirement. For individuals or estates, the net worth cannot exceed \$2,000,000 on the date from which costs are recoverable. Charities and certain cooperatives must not have more than 500 employees on the date from which costs are recoverable. And taxpayers other than the two categories listed above must not have net worth exceeding \$7,000,000 and cannot have more than 500 employees on the date from which costs are recoverable.

**You are not the prevailing party if:**

- The United States establishes that its position was substantially justified. If the IRS does not follow applicable published guidance, the United States is presumed to not be substantially justified. This presumption is rebuttable. Applicable published guidance means regulations, revenue rulings, revenue procedures, information releases, notices, announcements, and, if they are issued to you, private letter rulings, technical advice memoranda and determination letters. The court will also take into account whether the Government has won or lost in the courts of appeals for other circuits on substantially similar issues, in determining if the United States is substantially justified.

**You are also the prevailing party if:**

- The final judgment on your case is less than or equal to a "qualified offer" which the IRS rejected, and if you meet the net worth requirements referred to above.

A court will generally decide who is the prevailing party, but the IRS makes a final determination of liability at the administrative level. This means you may receive administrative costs from the IRS without going to court. You must file your claim for administrative costs no later than the 90th day after the final determination of tax, penalty or interest is mailed to you. The Appeals Office makes determinations for the IRS on administrative costs. A denial of administrative costs may be appealed to the Tax Court no later than the 90th day after the denial.



Department of the Treasury  
**Internal Revenue Service**

**Notice 609**

(Rev. December 2004)

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**Privacy Act Notice**

The Privacy Act of 1974 says that when we ask you for information, we must first tell you our legal right to ask for the information, why we are asking for it, and how it will be used. We must also tell you what could happen if you do not provide it and whether or not you must respond under the law.

This notice applies to tax returns and any papers filed with them. It also applies to any questions we need to ask you so we can complete, correct, or process your return; figure your tax; and collect tax, interest, or penalties.

Our legal right to ask for information is found in Internal Revenue Code sections 6001, 6011, and 6012(a) and their regulations. They say that you must file a return or statement with us for any tax you are liable for. Your response is mandatory under these sections.

Code section 6109 and its regulations say that you must show your social security number, employer identification number or individual taxpayer identification number on what you file. Section 6109 also requires return preparers to provide their identifying numbers on the return. You must also fill in all parts of the tax form that apply to you. This is so we know who you are and can process your return and papers. You do not have to check the boxes for the Presidential Election Campaign Fund.

We ask for tax return information to carry out the U.S. tax laws. We need it to figure and collect the right amount of tax.

We may give the information to the Department of Justice and to other federal agencies, as provided by law. We may also give it to cities, states, the District of Columbia, and U.S. commonwealths or possessions to carry out their tax laws. And we may give it to

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Notice **609** (12-2004)  
Cat. No. 45983A

certain foreign governments under tax treaties they have with the United States. We may also disclose this information to federal and state agencies to enforce federal nontax criminal laws, or to federal law enforcement and intelligence agencies to combat terrorism.

If you do not file a return, do not give us the information we ask for, or provide fraudulent information, the law says that we may have to charge you penalties and, in certain cases, subject you to criminal prosecution. We may also have to disallow the exemptions, exclusions, credits, deductions, or adjustments shown on your tax return. This could make your tax higher or delay any refund. Interest may also be charged.

Please keep this notice with your records. You may want to refer to it if we ask you for other information. If you have questions about the rules for filing and giving information, please call or visit any Internal Revenue Service office.



## INDEPENDENT CONTRACTOR OR EMPLOYEE?




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SECTION 530 PROVIDES  
BUSINESSES WITH  
RELIEF FROM FEDERAL  
EMPLOYMENT TAX  
OBLIGATIONS IF CERTAIN  
REQUIREMENTS ARE MET.

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## SECTION 530 RELIEF REQUIREMENTS

**Y**our business has been selected for an employment tax examination to determine whether you correctly treated certain workers as independent contractors. However, you will not owe employment taxes for these workers, if you meet the **relief requirements** described below. If you do not meet these **relief requirements**, the IRS will need to determine whether the workers are independent contractors or employees and whether you owe employment taxes for those workers.

**Section 530 Relief Requirements:**

To receive relief, you must meet all three of the following requirements:

**I. Reasonable Basis**

First, you had a reasonable basis for not treating the workers as employees. To establish that you had a reasonable basis for not treating the workers as employees, you can show that:

- You reasonably relied on a court case about Federal taxes or a ruling issued to you by the IRS; or
- Your business was audited by the IRS at a time when you treated similar workers as independent contractors and the IRS did not reclassify those workers as employees; or

- You treated the workers as independent contractors because you knew that was how a significant segment of your industry treated similar workers; or
- You relied on some other reasonable basis. For example, you relied on the advice of a business lawyer or accountant who knew the facts about your business.

If you did not have a reasonable basis for treating the workers as independent contractors, you do not meet the **relief requirements**.

**II. Substantive Consistency**

In addition, you (and any predecessor business) must have treated the workers, and any similar workers, as independent contractors. If you treated similar workers as employees, this relief provision is not available.

**III. Reporting Consistency**

Finally, you must have filed Form 1099-MISC for each worker, unless the worker earned less than \$600. Relief is not available for any year you did not file the required Forms 1099-MISC. If you filed the required Forms 1099-MISC for some workers, but not for others, relief is not available for the workers for whom you did not file Forms 1099-MISC.

*The IRS examiner will answer any questions you may have about your eligibility for this relief.*

