



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

SMALL BUSINESS/SELF-EMPLOYED DIVISION

November 24, 2008

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MEMORANDUM FOR EXAMINATION AREA DIRECTORS

FROM: Monica L. Baker /s/ *Monica Baker*
Director, Examination

SUBJECT: Interim Guidance on Verification Requirements for No Show/No Response

The purpose of this memo is to issue interim guidance regarding verification requirements for no show/no response cases. Please share this information with all effected employees within your organization.

IRM 1.4.40.4.6.12, No Show/No Response Cases, lists two instances in which a taxpayer may fail to appear for an examination, they are No Show and No Response cases. Both require different consideration and are explained in the attachment.

Minimum Income Probes Must be Addressed in No Show/No Response Cases

All examinations, including no show/no response cases, must address the minimum income probes required by IRM 4.10.4, Examination of Income. The minimum income probes may include Specific Item or an Indirect Methods, such as a Cash-T, to determine whether the taxpayer accurately reported income.

Specific Item Probes Using Information Returns Program (IRP) Cases

When using the Specific Item Method for adjustments based on unreported Information Return Program (IRP) income, failure of the taxpayer to respond or raise a "reasonable dispute" regarding the correctness of the IRP data, means the burden of proof remains with the taxpayer and does not shift to the government.

In unreported income cases based on IRP information, there is a legal requirement pursuant to I.R.C. § 6201(d) to contact third parties to verify income items only where the taxpayer reasonably disputes the income and has fully cooperated with the Service. In no show/no response cases where the taxpayer has not responded or raised a frivolous dispute (wages are not income, etc.), there is no legal requirement for further

verification with third parties and an income adjustment in the amount reflected on the IRP document is appropriate.

Verification with third parties is required when IRP information is relied upon to support the fraud penalty or where the taxpayer disputes the IRP income information.

Verification with third parties should also be made in no show/no response cases where there is an inconsistency noted in the file that would cause the examiner to question the validity of the IRP information. For example, verification should be attempted if there is some obvious inconsistency in the IRP information (such as Forms 1099 or W-2) that appears to be out of line in dollar amount from previous years, or there is some aspect of the Forms W-2 or 1099 that is unusual on its face (such as Form W-2 or 1099 income that is completely inconsistent with the known profession or occupation of the taxpayer).

In cases involving large dollar income items (e.g., 1099-MISC amounts greater than \$100,000), examiners in consultation with their manager, should use their professional judgment in deciding whether it makes good business sense (given the circumstances) to verify IRP information. This discussion should be documented in the workpapers.

Indirect Methods in which the Preliminary Cash-T has a material imbalance:

If an Indirect Method is used, the use of statistical data must be tailored to the individual taxpayer. If an indirect method reveals an understatement of income in excess of \$10,000 and the case is a no show, the examiner will take the following steps:

- Examiners must use all available administrative tools, including summons enforcement, to gather necessary information before statistical data is used.
- If a Cash-T is used, do not reduce the expense side for disallowed expenses. Assume (even though disallowed) that the taxpayer spent the money.
- Refer to IRM 4.10.4.6.1.3, Use of Bureau of Labor Statistics Data or Other Statistical Information to Reconstruct Taxable Income, to determine when income may be reconstructed using Bureau of Labor Statistics (BLS) data or comparable statistics from a reliable source (such as the Allowable Living Expenses (ALE)). The analysis is completed using the tables for annual expenses, not income, because determining the expenses represents a better reflection of the actual costs to maintain a household.
- The examiner and manager must determine if an income adjustment will be pursued based on the information contained in the indirect method, and if so, document it in the case file.
- Prior and subsequent year's returns should be considered for similar imbalances.
- Discussion and review by the manager to determine applicability of transfer to the field. This would include any cases that are beyond the scope of an office audit for reasons such as the complexity of the issues or complex additional related businesses such as flow-through entities. See IRM 4.11.29 (Transfer of Returns Open for Examination).

Estimated Business Expenses

In no show/no response cases the Service has no legal requirement to estimate expenses, including cost of goods sold. If the examiner has actual taxpayer information regarding expenses, then taxpayer specific information (not industry averages) should be used to determine expenses. If the sale of securities is an issue and in cases where the taxpayer does not substantiate stock basis, the Service has no legal requirement to obtain basis information from third party sources, despite the fact that the proceeds of stock sales are included in income.

Penalties

Penalties such as negligence will not be asserted solely due to the taxpayer's failure to appear for an audit or respond to an inquiry or notice. However, the facts and circumstances from the return and the case file may warrant assertion of the accuracy-related penalty attributable to negligence (IRM 20.1.5.7.1, Negligence). All actions and decisions should be documented, as appropriate, on Form 9984, Examining Officer's Activity Record, Form 4700, Examination Workpapers, lead sheets and workpapers.

Effect on Other Documents: Interim Guidance Memorandum SBSE-04-1108-058 will be incorporated into IRM 4.10.4 by November 24, 2009.

If you have questions, please contact Mindy Pezik, Senior Policy Analyst or Milton Pagan, Senior Program Analyst

Expiration Date: November 24, 2009

CC: www.irs.gov

**Attachment to
Interim Guidance on Verification Requirements for No Show No Response**

No Response occurs when a taxpayer fails to respond to the initial contact letter or telephone call. The field and office examiner must determine why the taxpayer is not responding:

- The field examiner will follow the procedures in IRM 4.10.2.7.3.1(3)-(4), Field Examination Initial Contact.
- If the initial appointment letter has been returned undeliverable, both the field and office examiner will follow the steps in IRM 4.10.2.7.2, Locating the Taxpayer, to secure a current address or telephone number. If unsuccessful, the mandatory steps in IRM 4.10.2.7.2.2 Unlocatable Taxpayers -Mandatory Steps to Locate must be taken and documented on Form 1900-B, Unlocatable Taxpayer Check sheet.
- If the steps above do not result in a current address for the taxpayer, ensure the minimum income probes have been conducted, and income is not an issue. The examiner and group manager must consider whether an audit report is appropriate when the taxpayer cannot be located using the criteria in IRM 4.10.2.7.2.7 Case Closing Procedures if the Taxpayer Can Not be Located
- If a decision is made to issue a report, disallow all classified issues only, consider prior and subsequent years, and mail it to the taxpayer's last known address as reflected on IDRS (IRM 4.10.2.7.2.1 Undeliverable Initial Contact Letters).

Cases where the taxpayer fails to respond to the initial contact letter or telephone call are not classifiable as no-contact, therefore they may not be surveyed (IRM 4.10.2.10.1 Confirmation of the Initial Appointment). If an assessment is not appropriate the case should be closed using Non-examined Disposal Code 42, Return Filed - Unable to locate. Form 1900, Income Tax Survey After Assignment should be completed. The examiner should also document steps taken to locate the taxpayer on Form 1900-B in the work papers.

No Show occurs when a "deliverable" address exists, but the taxpayer does not respond to the correspondence or does not "show" for any scheduled appointment.

- Follow-up, attempts must be made to contact the taxpayer to encourage him/her to schedule and keep the appointment or to solicit an agreement (IRM 4.10.2.7.2.8 Case Closing Procedures for No-Show Cases).
- After all attempts to get the taxpayer to respond are unsuccessful (or the taxpayer raises a frivolous dispute) and minimum income probes have been considered, a report may be issued if income is not an issue. If income is an issue, the examiner must first conduct research to determine possible sources of the taxpayer's income before preparing the report.

When a report is prepared, generally, only classified issues will be disallowed. If certain issues were declassified at the group level, due to time constraints, these items should be disallowed as well. All the necessary related or automatic adjustments will be made. Consideration will be given to picking up prior and subsequent years.