

**Chapter 1**

**Examination Procedures**

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**INTERNAL REVENUE SERVICE  
TAX EXEMPT AND GOVERNMENT ENTITIES**

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## Form 5330 Procedures

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**Issues requiring filing of Form 5330**

Form 5330, Return of Excise Taxes Related to Employee Benefit Plans, are filed to report the following taxes:

- Failure to meet minimum funding standards (IRC 4971).
  - Nondeductible contributions to qualified employer plans (IRC 4972).
  - Excess contributions to individual retirement accounts (IRAs), certain individual retirement annuities, and IRC 403(b)(7)(A) custodial accounts (IRC 4973).
  - Prohibited transactions (IRC 4975).
  - Certain dispositions by employee stock ownership plans and certain cooperatives (IRC 4978).
  - Certain excess contributions (IRC 4979).
  - Certain reversions of plan assets (IRC 4980).
- 

**Due dates of 5330 for IRC 4971**

5330's filed for excise taxes under IRC §4971 are due by the later of:

- The last day of the 7th month after the end of the employer's tax year or
- 8 ½ months after the last day of the plan year that ends with or within the employer's tax year.

**Example illustrating due date for IRC 4971**

Both the employer and the plan are on a calendar year. The plan year ends with the employer's tax year. If the tax year in question is 200012, the Form 5330 is due on September 15, 2001.

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**Form 5330 Procedures, Continued**

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**Due dates of 5330 for IRC sections 4972, 4973(a)(3), 4975, 4976, 4978, and 4979A**

Forms 5330 filed for excise taxes under IRC sections 4972, 4973(a)(3), 4975, 4976, 4978, and 4979A are due by the last day of the 7th month after the end of the **tax year** of the employer or other person who must file the return. If the employer is on a calendar year tax year of 199912, the Form 5330 is due on July 31, 2000. If the employer is on a fiscal tax year ending October 31, 1999, the Form 5330 is due on May 31, 2000.

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**Due date of 5330 for IRC sections 4977**

Forms 5330 filed for excise tax under IRC §4977 are due by the last day of the 7<sup>th</sup> month after the end of the **calendar year** in which the excess fringe benefits were paid to the employees of the employer.

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**Form 5330 Procedures**, continued**Due dates of  
5330 for IRC  
sections 4979**

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Forms 5330 filed for excise tax under IRC §4979 are due by the last day of the 15th month after the close of the **plan year** to which the excess contributions or excess aggregate contributions relate.

**Example  
illustrating due  
date for IRC  
4979**

Excess contributions were made to a plan for the plan year ending December 31, 2000. The Form 5330 for such excess contributions is due by March 31, 2002.

**Due dates of  
5330 for IRC  
sections 4980**

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Forms 5330 for excise tax due under IRC §4980 are due no later than the last day of the month following the month in which the reversion occurred.

**Example  
illustrating due  
date**

Trust assets reverted back to an employer on May 16, 2002 for a plan having a plan year ending on December 31<sup>st</sup>. The Form 5330 is due for the reversion on June 30, 2002.

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## Form 5330 Procedures - Prohibited Transactions

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**When the SOL starts to run for PTs**

For Forms 5330 filed for IRC section 4975 excise tax, the three-year statute of limitations (SOL) will commence to run on the date the administrator files the Form 5500 series return in which the prohibited transaction (PT) is sufficiently disclosed to apprise the IRS of the existence and nature of such PT. See IRC section 6501(1)(1).

If the filed Form 5500 series return does not disclose the PT, the six-year statute period applies. The excise tax may be assessed, or collection begun without assessment, at any time within six years after the later of the date the Form 5500 series return was filed or due.

For IRC section 4975 purposes, the SOL commences to run when the applicable Form 5500 is filed. Even though the DP files the Form 5330 and pays the excise tax, it is the filing of the applicable Form 5500 series return that commences the running of the SOL for IRC section 4975 excise tax. See T.D. 7883. Also, see GCM 38846 and Treas. Reg. Section 301.6501(e)(1)(c)(4).

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**Form 5330 Procedures - Prohibited Transactions**, continued**Discrete transaction vs. continuing transaction**

To properly determine the return filed or due date for purposes of PTs, a distinction must be made between PTs that are discrete acts and those that are continuing transactions. The difference is highlighted as follows:

- Any PT that is a one-time occurrence, such as a sale, is a discrete act.
- Any PT that continues over time, such as a loan or lease, is a continuing transaction.

**Discrete transaction**

In a discrete transaction, a determination as to the running of the statute of limitations need only be made for the tax year in which the transaction occurred. See G.C.M. 38846 as modified by G.C.M. 39066 and by G.C.M. 39475.

With a discrete act, taxes are imposed annually on the PT beginning with the taxable period in which the PT originally occurred and ending only when the PT is corrected or the SOL expires.

Even though the PT may be a discrete transaction (single act), the agent must obtain extensions for each subsequent year. For discrete acts, the statute is technically extended for each affected taxable year if a consent is obtained with respect to the year in which the PT occurred. However, obtaining extensions for each year will resolve any questions as to whether later years have closed because specific extensions were not obtained for those years.

The extensions are valid only if obtained from the disqualified person involved in the PT. Do not secure extensions from the plan administrator unless the plan administrator is the DP. Again, if the statutory period expires for the particular act, tax may not be assessed in later years.

*Continued on next page*

**Form 5330 Procedures - Prohibited Transactions, Continued****Example illustrating discrete transactions**

Assume that a plan sold assets to the sponsoring employer on September 7, 1999. The sale, which was disclosed on the 1999 Form 5500, had not been corrected by the time the plan is audited in 2001.

The plan has a calendar year end. The disqualified person's tax year is also on the calendar year. Both parties to the sale are calendar year taxpayers. The plan has timely filed Form 5500, but the employer failed to pay any tax on the transaction.

The SOL for all years will expire on July 31, 2003. Therefore, the Service must obtain all required consents from the employer by July 31, 2003.

Under these circumstances, technically, a consent need only be requested for the taxable year 1999, the year in which the PT occurred. However, the agent should take a more conservative approach and request consents for 2000, 2001 and any subsequent open years and solicit Forms 5330 for all open years for which a return is due. (A single Form 872 that reflects all taxable periods may also be used.)

If consents are not secured prior to the expiration of the SOL, all years are barred from assessment

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**Form 5330 Procedures - Prohibited Transactions**, continued**Continuing transaction**

For a continuing transaction, such as a loan or lease, the situation is different. In addition to the original transaction, a new transaction is deemed to occur on the first day of each subsequent taxable year. The amount involved is reported and taxed in the originating year and again in each subsequent year until the originating transaction is corrected.

Thus, the filing of the Form 5500 return for the year in which the PT first occurred starts the running of the SOL for purposes of the tax on the actual transaction occurring in that plan year. However, such a filing does not start the running of the SOL for the transactions deemed to occur in subsequent plan years.

There are separate statutes for the transactions deemed to occur in each subsequent year. The filing of the Form 5500 return for each subsequent plan year starts the running of the SOL for transactions occurring in such years.

A prohibited transaction of a continuing nature may occur where the plan and the disqualified person are on different tax years. If the transaction is not corrected before the end of the plan year that overlaps the disqualified person's tax year the disqualified person will have engaged in two prohibited transactions within the same plan year.

**Example illustrating continuing transaction**

Assume that a prohibited transaction of a continuing nature (i.e., a loan) occurs on 7/31/99. Assume also that the plan year is 7/1 to 6/30 while the tax year of the disqualified person is a calendar year. Assume that the PT is corrected on 6/30/2000.

The disqualified person must file a Form 5330 for the 1999 calendar year and another Form 5330 for the 2000 calendar year. The original PT occurred on 7/31/1999. A new PT is deemed to occur on 1/1/2000.

Because both of the PTs occurred during the plan year ending 6/30/2000, the statute of limitations would be controlled by the Form 5500 filed for that plan year. Thus, in the case of a timely filed return without extensions and assuming a 3-year statute of limitations, the SOL would be 1/31/2004 for both Forms 5330.

*Continued on next page*

**Form 5330 Procedures - Prohibited Transactions** continued**Case example**

ABC Company sponsors the ABC 401(k) Profit Sharing Plan. The plan year is fiscal from 2/1 to 1/31, the employers tax year is fiscal from 5/1 to 4/30 and the individuals tax year is calendar. There are two owners, both of whom are plan trustees.

During 1999 the employer went into financial difficulties. Monies that were deferred by plan participants were not deposited into the trust and were subsequently spent. These salary deferrals were listed as receivables on the Form 5500 filed for the plan year ending 1/31/00, and 1/31/01. Form 5500 for the plan years ending 1/31/00, 1/31/01, and 1/31/02 were filed 11/13/00, 11/15/01, and 8/31/02, respectively.

In 2001 the DOL found both ABC Company and the 2 trustees liable for the amounts that should have been deposited into the trust. DOL settled with ABC and the trustees. Both trustees paid an agreed amount to all of the affected participants on 12/31/01.

In 2002 ABC submitted its 401(k) plan for a determination letter. During the DL review the settlement issue was noticed and the PT issue was raised. Forms 5330 were secured and processed. The 2 trustees and the employer were deemed to be the disqualified persons, all of which were joint and severally liable for the IRC 4975 excise taxes.

The first date of the PT was determined to be 10/21/99 (in this particular case, the last day deferrals could be deposited and considered to be timely by DOL). Because Forms 5500 listed the delinquent deferrals as receivables, the PT was treated as a continuing transaction (i.e., a loan).

All subsequent deemed PT dates would be the first day of the DP's tax year. Because the two trustees and the employer are all jointly liable, Forms 5330 could be solicited for any of the three; however Forms 5330 should not be secured from all of the three for the same prohibited transaction.

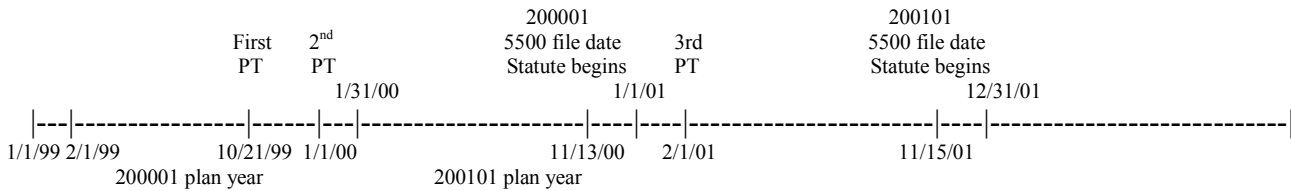
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**Form 5330 Procedures - Prohibited Transactions** continued

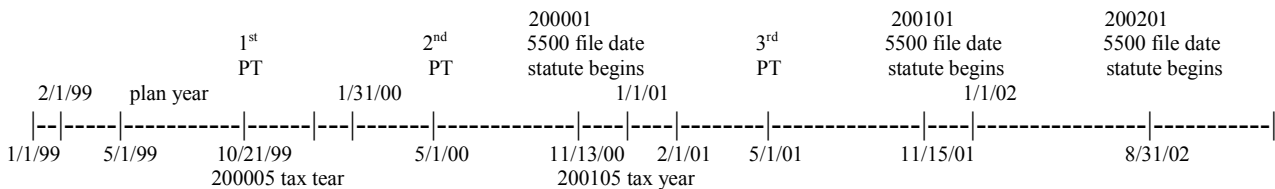
Due Dates and Statutes for the Individual Disqualified Persons in the Case Example:

<i>Date of Prohibited Transaction</i>	<i>Impacted Fiscal Plan Year End</i>	<i>Later of 5500 Due Date or Filed Date</i>	<i>Three Year Statute Date Form 5330</i>	<i>Tax Year End of PT for 5330</i>	<i>Due Date of 5330</i>
10/21/99	1/31/00	11/13/00	11/13/03	12/31/99	7/31/00
1/1/00	1/31/00	11/13/00	11/13/03	12/31/00	7/31/01
1/1/01	1/31/01	11/15/01	11/15/04	12/31/01	7/31/02



Due Dates and Statutes for the ABC Company in the Case Example:

<i>Date of Prohibited Transaction</i>	<i>Impacted Fiscal Plan Year End</i>	<i>Later of 5500 Due Date or Filed Date</i>	<i>Three Year Statute Date Form 5330</i>	<i>Tax Year End of PT for 5330</i>	<i>Due Date of 5330</i>
10/21/99	1/31/00	11/13/00	11/13/03	4/30/00	11/30/00
5/1/00	1/31/01	11/15/01	11/15/04	4/30/01	11/30/01
5/1/01	1/31/02	8/31/02	8/31/05	4/30/02	11/30/02



**Form 5330 Procedures**, continued**Initiating an exam**

In most instances, Form 5330 examinations are initiated as a result of issues discovered in a related Form 5500 examination.

Once adequate documentation has been gathered and the determination has been made to pursue an excise tax issue, the impacted taxpayer must be notified in writing of the Form 5330 examination.

Issue an individually designed letter (i.e. a modified Letter 1346 or Letter 1474) containing pertinent facts, law, government position, and excise tax calculations (also include penalty calculations if applicable). Send Publication 1 with the letter if not previously given to the taxpayer. Send a copy of the letter to any authorized power of attorney (POA).

The letter will solicit the filing of Forms 5330 with the examiner for all years in which returns are due or delinquent.

**When Forms 5330 are not yet delinquent**

In the case of prohibited transactions, if the taxable period extends into a taxable year for which a Form 5330 is not yet due, notify the taxpayer of the requirements to file Form 5330 and pay the tax shown thereon for such taxable year. Solicit payment of excise tax along with applicable penalties.

**Use of Form 870 to secure agreement**

If additional tax is being assessed on a year when Form 5330 was previously filed, Form 870 can be used to secure agreement on the additional assessment of tax. See the IRM Exhibit 4.71.5-1 for an example of a completed Form 870.

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**Form 5330 Procedures, Continued****Establishing  
Forms 5330 on  
EPIC and  
AIMS**

EPIC and AIMS establishment of Forms 5330 is required if the return is due, does not have statute problems, and any one year has tax due in an amount that exceeds the de-minimus amount as stated in the LEM.

Once it is determined that excise tax is due and Form 5330 will be examined, the agent should establish a Form 5330 return on EPIC. Form 5597 may also be input at the same time to establish the return on AIMS, although AIMS establishment at the group level is now optional (at the discretion of the group manager). If the decision is made to establish the Form 5330 on EPIC but not AIMS at the group level, the completed Form 5597 should be placed in the inside of the case file on top of everything so that the Brooklyn closing unit (for agreed returns) or Mandatory Review (for unagreed returns) can easily locate the form for input on AIMS when the case is closed out of the group.

See IRM 4.71.5.7 for instructions on processing agreed cases and IRM 4.71.5.9 for unagreed case processing.

**AIMS  
establishment  
on BMF**

All examined delinquent and substitute Forms 5330 will be established on AIMS as Business Master File (BMF) using Form 5597. This includes a taxpayer with an SSN as well as a taxpayer with an EIN. An AMDISA print will reflect a Transaction Code "424" once the Form 5597 has been input. A previously filed return that was processed by the Service Center on the Non-Master File (NMF) should be established on the NMF. A previously filed return that was processed by the Service Center on the BMF will be established on the BMF.

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**Form 5330 Procedures, Continued****IDRS research  
of filed Forms  
5330**

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When examining a Form 5330 return that was previously filed by the taxpayer (i.e. claims and instances where a determination is made that insufficient tax was reported), conduct research to determine if the return was processed by the Service Center on the BMF or the NMF.

Obtaining a BMFOL print for MFT 76 with the taxpayer's EIN/SSN for the applicable year will enable the agent to verify the filed status of the return.

The return was processed as BMF if a transaction code (TC) of 150 is present. When researching a Form 5330 with an EIN on BMF, do not put a file source (no "P" or "N") after the EIN

When researching a Form 5330 on BMF with an SSN, a file source of "V" must be used after the SSN (i.e. 123-45-6789V). If the BMFOL print reflects no TC 150 present, an ANMF print (formerly a MARS print) should be secured to determine if the return was processed as NMF.

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**Form 5330 Procedures, Continued****Establishing  
Forms 5330 on  
AIMS –  
Verifying the  
entity module**

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As previously stated, Form 5597 is used to establish a return on the BMF (See IRM section 4.71.5.7.2 for instructions on preparing Form 5597). Form 5588 is used to establish a return on the NMF (See IRM section 4.71.5.14.1 for instructions on preparing Form 5588). Returns established on NMF by the agent prior to 1/1/2002, will remain on NMF (the returns will not be put on BMF).

Before a return can be established on BMF, it is first necessary to verify that an entity module is present on the BMF. The case will not establish on AIMS until an entity module is present. The agent is responsible for securing an INOLES print to determine if an entity module is present on the BMF. The following should be noted regarding INOLES:

- When obtaining an INOLES print for an SSN, use a file source of “V” after the SSN (i.e. INOLES123-45-6789V).
- When obtaining an INOLES print for an EIN, do not use a file source (i.e. INOLES75-1234567).
- If INOLES produces a screen with at least the taxpayer’s name and address, an entity module has been established on the BMF.
- If INOLES produces a blank screen, the BMF entity has not been established. This will frequently be the case when dealing with an SSN.

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**Form 5330 Procedures - Prohibited Transactions** Continued**Preparing a Form 4442**

If there is no entity module on the BMF, prepare Form 4442 at the earliest possible time to establish one. Forward to the AIMS coordinator as noted below. See IRM § 4.71.5.7.1.

The following line items will be completed when preparing Form 4442:

1. Item 1 (Recipient's Name): Enter the name of the agent conducting the exam.
2. Item 2 (ID Number): Enter the agent's group number and BOD code for the Area. BOD codes are:
  - 401 for Northeast.
  - 402 for Mid-Atlantic.
  - 403 for Great Lakes.
  - 404 for Gulf Coast.
  - 405 for Central Mountain.
  - 406 for Pacific Coast.
  - 410 for Programs and Review.
3. Item 3 (Received Date): Enter the current date.
4. Item 8 (Taxpayer's Name): Enter the taxpayer's name.
5. Item 9 (TIN): Enter the taxpayer's SSN or EIN. If the taxpayer has an SSN, enter a "V" after the SSN.
6. Item 13 (Current Address): Enter the taxpayer's address.
7. Item 15 (Forms): Enter 5330.
8. Item 17 (Processing Campus): Enter OSC for Ogden Service Center.

Fax the completed Form 4442 to the EP AIMS Coordinator in Baltimore at 410-962-0650. Include a contact name and phone number on the fax cover sheet. The AIMS Coordinator will contact the agent once the entity is established. See the IRM Exhibit 4.71.5-2 for an example of a completed Form 4442.

*Continued on next page*

## Form 5330 Procedures, Continued

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### Preparing a Form 5597

Form 5597 is used to establish a delinquent 5330 on EPIC and AIMS. Establish the Form 5330 on EPIC once it is determined that excise tax will be pursued. The Form 5330 can be established on AIMS once it is determined that excise tax will be pursued and an entity module has been established. After the Form 5597 is input, an AMDISA print will reflect a “424”.

Complete the following line items on Form 5597 as noted:

1. Item 2: Enter a source code of 44.
2. Item 3: Enter the primary business code.
  - 401 for Northeast.
  - 402 for Mid-Atlantic.
  - 403 for Great Lakes.
  - 404 for Gulf Coast.
  - 405 for Central Mountain.
  - 406 for Pacific Coast.
  - 410 for Exam Programs and Review.
3. Item 4: Leave blank.
4. Item 5: Enter the examiner’s group code (i.e. 7653).
5. Item 6: Enter an MFT of 76.
6. Item 7: Enter a status code of 12.
7. Item 8: Enter 1 for return request indicator.
8. Item 9: Enter the project code of the related Form 5500. If there is none, enter 000.
9. Item 11: Enter a push code of 020 (delinquent return) or 021 (substitute return).
10. Form: Enter 5330.
11. Item 14A: Enter the taxpayer’s EIN or SSN.  
**Note:** Use a file source of “V” with an SSN (i.e. 123-45-6789V) and no file source with an EIN (i.e. 75-1234567).
12. Item 14B: Enter the taxpayer’s name.
13. Item 15: Enter the name control for the taxpayer.
14. Item 17: Enter the tax period.
15. Item 18: Enter an activity code of 310.
16. Item 20: Enter the plan number for the related plan.
17. Item 21: Enter the taxpayer’s address.
18. Item 22: Enter the reason for the establishment of the Form 5330.

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*Continued on next page*

**Form 5330 Procedures, Continued****Preparing a  
Form 5597  
(continued)**

- 
19. Item 23: Enter the examiner's name, organization and date.
  20. Item 24: Secure the group manager's signature.
- 

**Processing  
Forms 5330 to  
the Service  
Center**

When you have secured the delinquent Forms 5330, date stamp them all with the IRS received date as soon as possible after receipt from the taxpayer.

Verify the accuracy of the return, making sure tax amounts are reflected on the first page of the return. If payment is received, send the check along with the Form 5330 package express mail (next day) to the Ogden Service Center by the end of the next business day after receipt.

If no payment is received, send the Form 5330 package in a similar way as soon as administratively possible (preferably within three business days). Write in bold red letters on the top margin of the original return: "DELINQUENT RETURN SECURED BY TEGE EMPLOYEE PLANS".

**Reminder:** Leave room in the upper right corner for the DLN to be entered by the Service Center.

It is no longer required to enter a code at the bottom of Form 5330, therefore nothing should be written at the bottom of the return by the agent.

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*Continued on next page*

**Form 5330 Procedures, Continued****Preparing the Form 5330 package to the Service Center**

The prepared package forwarded to the Service Center will contain the following:

1. Form 3210 (Document Transmittal).
  - a. Address the Form 3210 to the address specified below.
  - b. In the body of the Form 3210 list:
    - The forms secured (5330), the taxpayer's name, taxpayer's TIN and the tax year(s) being sent.
    - If payment is received list the check number and the amount of the check. See the IRM Exhibit 4.71.5-6 for an example of a completed Form 3210.
2. Original return(s).
3. Payments received.
4. Form 13133 (Expedite Processing Cycle)
  - a. Check "Delinquent Return".
  - b. Check "See Form 3198 Attached..."
  - c. Complete your name, phone number and stop number. See IRM Exhibit 4.71.5-9 for an example of a completed Form 13133.
5. Form 3198 (Special Handling Notice)
  - a. List the name of the taxpayer and the tax year at the top of the form.
  - b. In the "Expedite" section, enter the statute of limitations expiration date.
  - c. Check the "Other" box and write, "Statute of limitations expires on \_\_\_\_\_".
  - d. In the "Special Instructions" section, provide instructions regarding the assessment or non-assessment of penalties.
  - e. If penalties are not being assessed, write "Do Not Assess Penalties, Reasonable Cause Established".
  - f. If penalties are being assessed, write "Assess Penalties Under IRC 6651(a)(1)&(2)".
6. Form 3244-A (Payment Posting Voucher) if payment is received. Complete Form 3244-A for each year in which payment is received. Complete these items with comments as noted:
  - a. SSN/EIN.
  - b. Form number/MFT: Enter 5330/76.
  - c. Tax period.
  - d. Transaction date: Enter the date the payment was received.
  - e. Taxpayer name, date, address and zip code.

*Continued on next page*

**Form 5330 Procedures**, Continued**Preparing the Form 5330 package to the Service Center**  
(continued)

- f. Transaction Data: List the entire amount received for the year under transaction code 610 (Remittance With Return) and the same amount under “Total payment”.
- g. Remarks:
- List the check number and the amount of the check. If the check is broken out over more than one year, list each year and the amount applied to each year.
  - List the plan number of the related plan.
  - Prepared by: Enter the examiner’s name, group number and phone number. See IRM Exhibit 4.71.5-6 for an example of a completed Form 3244-A.

Mail Form 5330 packages without remittance to:

IRS  
1973 N. Rulon White Blvd.  
Mail Stop 6061  
Ogden, Utah 84201

Mail Form 5330 packages with remittance to:

IRS  
1973 N. Rulon White Blvd.  
Mail Stop 1999  
Ogden, UT 84201

Before mailing the 5330 package, a copy of the entire package needs to be made for the case file.

Annotate in bold red letters on the top of the copy: “**COPY OF DELINQUENT RETURN SECURED BY TEGE: EP—ORIGINAL RETURN SENT TO OGDEN SC ON 00/00/00**” (list the date mailed).

If an entity module was not previously established, generate a Form 4442 and forward it to the AIMS Coordinator.

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## Form 5330 Procedures, Continued

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### Securing 5330 returns not yet due

In the case of prohibited transactions, if the taxable period extends into a taxable year for which a Form 5330 is not yet due notify the taxpayer of the filing requirement. If the taxpayer chooses to voluntarily file the 5330 return with the agent, then secure the return and check the accuracy of the return.

The 5330 package will be prepared and forwarded to the Ogden Service Center in accordance with IRM §4.71.5.7.3 with the following exceptions:

1. Write "RETURN SECURED BY TEGE: EMPLOYEE PLANS at the top of the return.
2. It is not necessary to prepare Forms 13133 or 3198.
3. The return can be established on AIMS and handled as an examination at the discretion of the group manager. However, if the return is established on AIMS the case should not be closed out of the group until the normal due date of the return. Failure to do so will create processing errors.
4. If the return is to be established on AIMS, the following should be noted:
  - A source code of 50 should be used instead of 44 on Form 5597.
  - A push code of 081 should be used on Form 5597.
  - A disposal code of 06 should be used on Form 5599.

**Note:** Until further notice use 06 even though the return is not actually delinquent.

If the return is not established on AIMS, list the excise tax for the 5330 years not established on line 602 of Form 5650 of the related Form 5500 exam. If the Form 5330 is not filed, prepare Form 5666 (EP/EO Referral Report) and forward to EP Classification for future follow-up.

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### Unagreed 5330s

The focus in this chapter has been on the processing of Forms 5330 that are agreed. From time to time a taxpayer either refuses to file a Form 5330 that is due or is unable to correct the situation that gave rise to the excise tax. In these instances the Form 5330 is considered to be unagreed. Unagreed procedures are not discussed in this chapter, but they are discussed in detail in IRM 4.71.5.9.

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### Summary of form 5330 procedures

The full text covering Forms 5330 exam procedures are found in IRM 4.71.5. A summary of those procedures is included in Exhibit 1 of this chapter.

## The Master File

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### Introduction

The Integrated Data Retrieval System (IDRS) is a useful tool for researching important case related information on taxpayer accounts and tax returns assigned to you.

Data can be obtained regarding a taxpayer, business or organization from filed tax returns that have been input on a computerized database, i.e. the Integrated Data Retrieval System (IDRS).

The following explains the process:

1. Information from a return is entered into IDRS at the service center where the return is filed.
  2. The information is transferred to the Martinsburg Computing Center (MCC) at Martinsburg West Virginia on magnetic tape where it is added to other taxpayer accounts forming the Master File (MF).
  3. Research for tax data is extracted from the Master File through the IDRS.
  4. The data is available via remote IDRS terminals located in local offices, at Service Centers, and in EP Support and Processing.
- 

### The four segments of Master File

The Master File is a central file divided into four segments:

1. IMF (Individual Master File),
  2. BMF (Business Master File),
  3. EPMF (Employee Plans Master File) and
  4. IRAF (Individual Retirement Account File).
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## The Master File, Continued

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**Modules**

Data for taxpayers is input into modules. A module is a portion of the Master File record that identifies certain information about the taxpayer. The Entity Module identifies the taxpayer name, address, location codes, filing requirement, tax period, etc.

The Tax Module is the part of the account that shows data for one Master File Tax code (MFT) and one tax period. For example, a plan sponsor who files a 5500 for two separate and related plans for 1999, 2000 and 2001 plan years would have 6 tax modules, one for each filing.

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**Examination steps and good customer service**

During your examination you may find errors or problems with the data on the Master File. As part of good customer service, we recommend that agents be aware of the data on the Master File and take the necessary steps to correct any errors.

The EP Entity unit in the Ogden Service Center is responsible for the input of Transaction Codes (TC) for the Employee Plans Master File.

The EPMF Tax Examiner is responsible for a variety of tasks. Such work includes inputting data for Form SS-4, Form 5330, consolidations of EINs and/or plan numbers, unpostables, correspondence, transcripts, Delinquency Notices and other duties.

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**Delinquency notices**

Delinquency notices are also known as Tax Delinquent Investigations (TDIs). When the Master File shows a 5500 return as open (still required to file) and overdue, a TDI letter is automatically generated and sent to the plan sponsor. It is EP Entity's job to follow up on these TDIs.

If it is determined that the 5500 return is no longer required, Entity will input a Transaction Code that will "satisfy the module" and shut off the filing requirement.

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## The Master File, Continued

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**Review the Master File**

As agents, when we are conducting an examination we should review the Master File data for all of the benefit plans sponsored by the employer.

When you find an error on the Master File (such as an open module showing a filing requirement when no return is due) you will need to work with EP Entity to correct it.

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**EFAST**

Although processing of Forms 5500 series is no longer performed by the Service Center, corrections and data input are still done in Ogden. The ERISA Filing Acceptance System (EFAST) project was moved. Processing of the 5500 series return is now done by a vendor contracted by the Department of Labor.

EFAST is a computerized processing system that is designed to simplify and expedite the receipt and processing of Form 5500 and Form 5500-EZ by relying on computer scannable forms and electronic filing technologies. Form 5500 and Form 5500-EZ are filed each year by more than one million pension, welfare and fringe benefit plans to satisfy annual reporting requirements under the ERISA and the Internal Revenue Code.

Beginning July 1, 2001, all Forms 5500 and 5500-EZ are processed by the vendor.

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## The Master File, Continued

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**Transaction codes**

Transaction Codes are input by Tax Examiners (TEs) in the EP Entity Unit in Ogden. Transaction Codes are three-digit numbers that identify a transaction being processed. This maintains a history of actions posted to a taxpayer's account on master file. A Transaction Code can be input from a coded document, and IDRS input, or it can be generated by the computer. Some Transaction Codes you should be familiar with are:

- 000 – Establishes a plan or an account.
- 011 – Changes the plan number
- 012 – Reopens a plan of an EPMF entity
- 013 – Changes a name of an account; Replaces the plan name for a plan of an EP entity
- 014 – Indicates an address change
- 015 – Indicates a location and or zip code change
- 020 – Closes and deactivates an account, future modules cannot be created
- 125 – Indicates the termination of a plan or that a plan merger occurred
- 127 – Administrator data change; Changes the name, address or EIN of the plan administrator
- 141 – Indicates a delinquency inquiry; Records the issuance of a delinquency notice
- 142 – Indicates a delinquency investigation;
- 150 – Indicates a return was filed and “posted”
- 154 – Indicates a Form 5330 was filed and posted
- 300 – Indicates a tax assessment was made
- 420 – Indicates an open examination
- 424 – Indicates an examination referral
- 590 – Satisfying transaction; Indicates a return is not required for the tax period; A TC 590 satisfies the one module
- 591 – Indicates a return is no longer required to file; Satisfies the current and all subsequent modules; Used to shut off the filing requirement
- 594 – Indicates a return was previously filed; Satisfies one module only
- 596 – Indicates a referral was made to Criminal Investigation (CI)

See Document 6209 section 8 for a complete list of Transaction Codes and explanations.

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## The Master File, Continued

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**Finding errors in the Master File**

When doing IDRS research on a plan you are examining or related plans, you may find errors with Master File data. For example the Master File may show a filing requirement for a 5500 return that is not due. You may find incorrect data such as the wrong plan number, EIN, plan name, sponsor name, etc.

To prevent the taxpayer from receiving TDI notices or having problems with the posting of future returns, agents can work with EP Entity to input the appropriate Transaction Code(s).

- To make corrections to the Master File agents should do the following:
  - Complete Form 4442 (see Exhibit 2 at end of chapter).
  - Describe to the TE what the problem is and your solution.
  - Recommend what Transaction Codes should be input.
  - Fax the completed 4442 to the EP Entity Unit in Ogden at 801-620-6900.
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**Example 1**

You are assigned to audit the ABC Company Profit Sharing Plan for the 200012 plan year. The plan number is 002 and the plan effective date is 1/1/97. The plan is a Master & Prototype.

During your pre-audit, you research IDRS and discover that plan number 001 was also a Profit Sharing plan. You notice that no 5500 return has been filed for plan number 001 since 1996. You also see a TC 141 for plan number 001 for the 1997, 1998, 1999 and 2000 modules. When you do the audit, you learn that in 1997 the employer changed prototype vendors. They erroneously changed the plan number to 002 and filed the 5500 as such.

**Solution:** There are two ways to resolve this situation. First, you should contact the EP AIMS Coordinator to discuss the need to merge the 1997 through 2000 modules for plan number 002 into plan number 001 and have the employer file future returns under plan number 001.

Second, you could suggest that a TC 590 be input for the 1997 through 1999 modules for plan number 001 and a TC 591 for the 2000 module, and then have the taxpayer file future returns under plan number 002.

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## The Master File, Continued

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**Example 2**

While working a determination (DL) case of a “Multiple Employer Plan Other”, you notice that the sponsoring employer filed the Form 5300 using plan number 001. You discover that the sponsoring employer is also a participating employer. There are 5 other participating employers, all of which file their Form 5500 returns using plan number 001.

Since the sponsoring employer is also a participating employer, they should be filing two returns for the plan. One complete return (except for coverage) is filed for the sponsoring employer using plan number 333 and Code E for line 4. All participating employers (including the sponsor) should file an abbreviated return (with coverage data) using plan number 001 and Code F for line 4. See the instructions to the Form 5500 for further details.

**Solution:** Instruct the employer the proper way to file. Contact the EP AIMS Coordinator to discuss the establishment of plan number 333 using TC 000

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**Example 3**

While reviewing related benefit plans you discover that the sponsoring employer of a “Welfare Benefit Multiple Employer Plan Other” erroneously filed using plan number 333 (they should use plan number 777).

**Solution:** Ask the AIMS Coordinator to input a TC 011 to change the plan number to 777.

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## Discrepancy Adjustments

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**Introduction**

IRM §4.71.4 gives procedures for Discrepancy Adjustments.

Chief Counsel has concluded that discrepancy adjustments do not constitute an inspection of the taxpayer's books and records within the meaning of IRC section 7605(b). Thus, discrepancy adjustments applied in accordance with these procedures will not constitute an examination of the taxpayer's book and records as long as these guidelines are followed.

If these guidelines are not followed, SB/SE, W & I, and LMSB (Examination Functional Units) may have to institute reopening procedures for a return that TE/GE Division is deemed to have examined.

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**Purpose of discrepancy adjustment**

In order to reduce the number of referrals to the Examination Functional Units for what may require essentially a minor recalculation of tax, the discrepancy adjustment program was established. This program allows EP agents to make certain line adjustments to income tax returns with respect to issues arising from an examination of a return of a qualified retirement plan or an exempt organization with respect to tax adjustments to:

- Form 1040, U.S. Individual Income Tax Return and
- Form 1120, U.S. Corporation Income Tax Return.

An adjustment may arise when there is a discrepancy between an income tax return and facts developed during an examination of an employee plan. An adjustment may also originate directly from a related TE/GE examination or any other information that TE/GE has access to, such as determination letter applications and /or compliance projects.

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**Authority**

Discrepancy adjustments fall within the scope of Rev. Proc. 85-13, section 3.02, which states the conditions under which a case closed after examination by the Service may be reopened to make an adjustment unfavorable to the taxpayer.

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**Discrepancy Adjustments**, continued**Form 4549-E**

Adjustments to income are reported on Form 4549–E, Income Tax Discrepancy Adjustments.

**Responsibility of agent to identify and initiate discrepancy adjustment process**

The EP agent is responsible for identifying the discrepancy during the course of an examination, and initiating the discrepancy adjustment process. The agent should determine that the correct amount of income has been reported on the subject income tax return by researching the appropriate internal systems. A RTVUE or BRTVU printout may be used as an original return for this purpose. Alternatively, the agent may order the original return from the Service Center using the ESTAB command code.

If a discrepancy adjustment is warranted, establish the tax return on AIMS with Form 5597, EO /GE IMF/BMF Request, and except in the circumstances described below, issue a discrepancy adjustment report. See the IRM Exhibit 4.71.4-1 for an example of a completed Form 5597.

**Examples of discrepancy adjustments**

Examples of EP Issues that result in a discrepancy adjustment are as follows:

- Unreported income due to unreported or incorrectly reported distributions from deferred compensation plans.
- Taxable allocations to participant accounts in defined contribution plans due to the revocation of the tax-exempt status of the plan trust.
- Taxable distributions to participants resulting from violations of IRC 72(p) loan limits.
- Distributions that become immediately taxable because the plan is being disqualified and issues cannot be resolved under CAP (rollovers are not allowed to another qualified plan or IRA from a plan that becomes nonqualified).
- Adjustment to taxpayer deductions for contributions to a deferred compensation plan due to non-payment, late payment, excess contributions, plan disqualification, etc.
- Unreported income from reversion of excess plan assets after a plan termination.
- 10% additional tax on early distributions from a plan per IRC 72(t).

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## Discrepancy Adjustments, Continued

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**Procedures upon discovering a discrepancy adjustment,**

When it is determined that a possible discrepancy adjustment exists, the agent should:

- Secure and review BMFOL/IMFOL transcripts of each affected income tax return to determine the status of any other Service actions and the time remaining on the statute of limitations. These transcripts will also identify the Service Center to which the data base is assigned. Refer to Chapter 8 of ADP and IDRS Handbook, Document 6209, for an explanation of Master File Codes.
- Obtain an INOLES print to determine the last known address of the taxpayer. Obtain an IRPTL print on the taxpayer (and taxpayer's spouse if the applicable return is a joint return) to determine total income and total tax withheld.
- Obtain an AMDISA print to determine if a 1040 or 1120 return has been established on AIMS by any Examination Functional Unit. If so, contact must be made to coordinate disposition of the issue. The discrepancy issue will generally be referred to that examiner for resolution. If the Examination Functional Unit agent/auditor has completed examination of the return, the EP specialist will process the discrepancy adjustment.
- Review the transcript to determine if any activities have occurred that affect the tax liability as stated on the filed return, and insure that the correct return line item amounts are utilized as a base prior to determining any deficiency.
- Ascertain that any post-filing adjustments such as Service Center adjustments, amended returns, etc., are properly accounted for when the return information is input into the 1040/1120 discrepancy program.

**Project and source codes for discrepancy adjustments**

The project code for a discrepancy adjustment on a related income tax return is the same as that for the related EP return. The source code is always 87.

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## Discrepancy Adjustments, Continued

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**Statute of limitation issues for discrepancy adjustments**

The EP agent has the responsibility to ensure that the statute of limitations date on any form 1040 and 1120 is correct and protected as necessary. See Chapter 2 of ADP and IDRS Handbook, Document 6209 for due date of returns.

Consents to extend the statute should be secured as needed. Form 895 should be properly prepared where the statute is less than 7 months.

**Note:** Restricted consents should rarely be accepted on discrepancy adjustment cases. See IRM Part 25.6.22.8 for the limited circumstances when restricted consents may apply and for special procedures to be followed.

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**Other statute of limitation issues**

The agent should ensure that the statute of limitations is protected on a tax return that has been established on AIMS. Statute procedures in IRM 4.71.9 should be followed. Specialists may propose adjustments on returns with short statutes if the adjustments are significant. Group Manager approval should be obtained prior to issuing a “30-Day Letter” on a return with less than 9 months left on the statute. Form 872, Consent to Extend the Statute, should normally be enclosed with the “30-Day Letter” in such cases.

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**Notices mailed to each spouse**

Any notices, including but not limited to, pattern letters and a notice of deficiency must be sent to each spouse. If the husband and wife live at the same address, send the notice to each spouse in a separate envelope, in accordance with the rules under RRA section 3201.

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**RTVUE, BRTVU, or original returns**

A RTVUE or BRTVU print will be accepted as the equivalent of a tax return if it provides sufficient detail to determine if there is a discrepancy, or if it gives sufficient line item detail to compute 1040 or 1120 income taxes.

For unagreed cases, the review staff will obtain the original return before the case is sent to the tax court or appeals.

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## Discrepancy Adjustments, Continued

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**Time reporting  
for discrepancy**

Discrepancy adjustment returns should be added to the agent's Form 6490 as soon as AIMS controls are requested. Any nominal time charges prior to establishment on AIMS should be charged to the related return or activity.

The appropriate activity code will depend on the type of return the adjustment applies to. See Document 6476, Employee Plans System Codes, and Document 6379, Exempt Organizations System Codes. The AIMS generated activity code should be verified and the code used on Form 6490 should be in agreement, prior to closing of the case.

The project code should be the same as the code used on the related examination. If no other code is warranted, use "000". No plan indicator is be used on Form 6490 for a return for which a discrepancy adjustment is being made.

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**Form 4549-E**

The discrepancy adjustment case will be established on the RGS 5500 Workcenter utilizing all applicable forms and letters. Up to date forms can be downloaded from the Multimedia website.

Form 4549-E is the report that will be utilized to communicate the discrepancy adjustment to the taxpayer to request their agreement with the proposed discrepancy adjustment. See IRM Exhibit 4.71.4-3 for an example of Form 4549-E.

Form 4549-E will be generated utilizing current RGS software. Letter 2652 (30-Day Letter) will be utilized as the cover letter for the discrepancy adjustment package mailed to the taxpayer. See IRM Exhibit 4.71.4-2 for an example of Letter 2652. The EP Specialist (not Mandatory Review Staff) will mail Letter 2652 (30-Day Letter) to the taxpayer, unless the discrepancy adjustment has been established because of a plan revocation that is unagreed. If an unagreed revocation results in discrepancy adjustments, the discrepancy adjustment reports will be issued by the Mandatory Review Staff (not the Group) simultaneously with the proposed revocation.

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## Discrepancy Adjustments, Continued

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**The 30-Day Letter and RAR**

The “30-Day Letter” notifies the taxpayer of their rights, including Appeal Rights. The “30-Day Letter” gives the taxpayer 30 days to respond. If there is no response within 30 days, the case can be closed “unagreed” to the Mandatory Review Staff. See IRM section 4.71.4.6.2 for details.

An explanation of the issue(s) being raised should be included in the discrepancy adjustment package. The issue(s) should be communicated in a Revenue Agent Report (RAR) with the facts, law and government position clearly stated. Form 886-A can be utilized for this purpose.

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**Discrepancy adjustment package**

The discrepancy adjustment package should consist of the following:

1. Letter 2652 with the following IRS Pubs. and Notices attached:
  2. Pub. 1, Taxpayer Bill of Rights
  3. Pub. 5, Appeal Rights
  4. Pub. 594, Understanding the Collection Process
  5. Pub. 504, Divorced or Separated Individuals (if the adjustment is to a Form 1040, Individual Income Tax Return)
  6. Notice 1214, Helpful Contacts for your Notice of Deficiency
  7. Revenue Agent Report (RAR) - An explanation of the issue(s), which includes the facts, law and government position.
  8. Two copies of Form 4549-E, Income Tax Discrepancy Adjustments.
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## Discrepancy Adjustments, Continued

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**Where to mail  
the discrepancy  
adjustment  
package**

The discrepancy adjustment package should be mailed to the taxpayer at their last known address.

- For the purpose of obtaining the taxpayer's last known address, the INOLES command code on IDRS should be utilized. INOLES will reflect the address last given to the Service through the most recent filing of a return by the taxpayer or other notification by the taxpayer.
- If knowledge is obtained through other sources that the taxpayer's address has changed subsequent to the address reflected on INOLES, then that address should be utilized.

If the applicable return is a Form 1040 return filed jointly, separate packages should be mailed to each spouse, even if they live at the same address. Utilize the last known address of each spouse (or former spouse if no longer married).

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## Discrepancy Adjustments - Penalties and Interest

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### Introduction

The agent must make a determination as to whether any penalties are appropriate. Any applicable penalties should be applied through the penalty menu in the Form 1040/1120 RGS program. The program will automatically compute the penalties and provide an explanation of the penalties as part of the 4549-E report.

Part 20 of the IRM provides guidance to all areas of the Service for all penalties imposed by the Internal Revenue Code. It sets forth procedures both for assessing and abating penalties and contains discussions on topics such as various types of relief from the penalties. The penalty manual serves as the foundation for addressing consistent administration of penalties by various Service functions.

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### IRC 6404(g) - Suspension of interest charge if taxpayer not timely notified

The Restructuring and Reform Act of 1998 brought about several changes regarding interest. IRC 6404(g) incorporates some of these changes. IRC 6404(g) provides for the suspension of interest when the IRS fails to provide a taxpayer timely and adequate notice of a tax liability. IRC 6404(g) applies *only to timely filed (including extensions) individual income* tax returns for taxable years ending after July 22, 1998.

---

### Timely notification defined

The taxpayer must be notified of the tax liability within 18 months (12 months for taxable years beginning after 12/31/03) after the later of:

1. The date on which the return is timely filed, or
  2. The due date of the return without regard to extensions.
- 

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## Discrepancy Adjustments - Penalties and Interest, Continued

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### Interest suspended for a certain time

If the IRS does not provide a notice to the taxpayer specifically stating the taxpayer's liability before the end of the 18/12-month notification period, the taxpayer is entitled to a period of time where interest is suspended. The suspension period begins 18 months (12 months for taxable years beginning after 12/31/03) after the later of:

1. The date on which the return is timely filed, or
2. The due date of the return without regard to extensions.

The suspension period ends 21 days after the date on which the IRS issues the required notice (i.e., the date Letter 2652 is mailed).

If the 18/12-month notification period ends on a weekend or holiday, the next day that is not a weekend/holiday is the date deemed to be the "end" of the notification period (pursuant to IRC 7503).

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### Exceptions to suspension of interest provision

The provision does not apply to:

- Any late filed return
  - Any penalty imposed by section 6651,
  - Any interest, penalty, addition to tax or additional amount in a case involving fraud,
  - Any interest, penalty, addition to tax or additional amount with respect to any tax liability shown on the return, or
  - Any criminal penalty.
- 

### IRC 6404(g) essentially applies only to suspension of interest

Section 6404(g) refers to the suspension of interest, penalties, and additions to tax. However, its **practical** effect is only on the suspension of interest. There are not any current penalties or additions to tax, which would be suspended by IRC section 6404(g). Interest on the tax and interest on penalties (except as described above) would be suspended if the conditions of 6404(g) occur.

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### IRC 6404(g) does not apply to late returns

Section 6404(g) does not apply (i.e., interest is not suspended) if the original return was filed late. A return is not considered late if the taxpayer has obtained an extension and the return is filed by the extension date.

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*Continued on next page*

**Discrepancy Adjustments - Penalties and Interest, Continued****IRC 6404(g) applies, even if additional tax liability is not paid**

It is significant to note that in order for IRC 6404(g) to apply, it makes no difference if the additional tax liability is actually paid by the time the case is closed and the assessment of tax is made.

**Adequate Notice**

The date adequate notice is provided is the section 6404(g) notice date. This is the date Letter 2652 is mailed to the taxpayer.

If the section 6404(g) notice date is not within the prescribed time period, interest is suspended beginning on the day after the close of the 18-month (12 months for tax years beginning after 12/31/2003) period.

Interest resumes on the 21st day after the notice stating the liability and basis for the liability (i.e., Letter 2652) is sent to the taxpayer. In determining the 21st day after the notice date, no consideration is given to grace periods (there are no extensions given on the 21 day period).

**Example 1 illustrating suspension of interest**

John Smith files Form 1040 for 1999 on March 31, 2000. Letter 2652 is mailed to Mr. Smith on 9/1/2002 proposing additional tax of \$10,000.

The notification period ends 18 months after the later of the return due date or the date Form 1040 is filed timely on extension. The 18-month notification period ends on 10/15/2001. Notification did not occur until 9/1/2002. Therefore, the suspension period begins on 10/16/2001 (one day after the end of the 18-month notification period) and ends on 9/22/2002 (21 days after the notice sent advising of the tax liability).

No interest would be assessed on the \$10,000 additional tax liability for the period beginning on 10/16/2001 and continuing through 9/22/2002.

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**Discrepancy Adjustments - Penalties and Interest, Continued****Example 2  
illustrating  
suspension of  
interest**

Bill Jones files Form 1040 for 2004 on July 15, 2005, assuming extensions were properly filed. Letter 2652 is mailed to Mr. Jones on 6/1/2007 proposing an addition to tax of \$12,000. Beginning with 2004 tax years, the suspension period begins 12 months after the later of the return due date or the date the return is filed timely on extension. The notification period ends on 7/15/2006.

Since 7/15/2006 is a Saturday, the suspension period ends on Monday, 7/17/2006 which is the next day that is not a weekend or holiday. The suspension period begins on 7/18/2006 (one day after the end of the notification period), and ends on 6/22/2007 (21 days after the notice date). Interest would be due for the period beginning 4/15/2005 through 7/18/2006. **No interest would be assessed** on the \$12,000 additional tax liability for the period beginning on 7/18/2006 and continuing through 6/22/2007.

**Example 3  
illustrating  
suspension of  
interest**

Assume the same facts in the previous example with the exception that Mr. Jones did not have a valid extension on his Form 1040. In this case, IRC 6404(g) does not apply and interest is not suspended.

**Procedures for  
documenting  
the IRC 6404(g)  
notice date**

The section 6404(g) notice date must be noted on a copy of the notice retained in the case file. This information should be recorded in the "Other Information" section of Form 4549, Income Tax Examination Changes. Suggested language is as follows: "IRC section 6404(g) does apply, and notice was provided on (date)." It should also be noted on Form 3198 attached to the outside of the case file that interest be suspended under IRC 6404(g). The period the interest is suspended should also be stated.

*Continued on next page*



**Discrepancy Adjustments - Penalties and Interest, Continued****Penalty calculations**

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Section 3306 of the Restructuring and Reform Act of 1998 (the ACT) provides that beginning with any notice issued or penalty assessed after December 31, 2000; the Service is required to include the name of the penalty, the Code section that imposes the penalty, and a computation of the penalty. Supervisory approval is required prior to assessment for any penalty that is not computer generated.

Penalties under IRC 6651, 6654, and 6655 are exempted from the approval requirement.

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**Interest calculations**

Section 3308 of the Act requires that, after December 31, 2000, every notice sent to an individual which includes an amount of interest due must also include a detailed computation of the interest charged and a citation to the Code section under which the interest is imposed. Interest calculations should be provided as follows:

- If IRC 6404(g) does not apply, interest calculations should be included with Letter 2652 reflecting interest due as of the response date of the letter (i.e., 30 days from the date of the letter). In example 3 above, interest should be calculated beginning 4/15/2005 and continuing through 6/30/2007.
  - If IRC 6404(g) applies, interest should be computed through the beginning of the suspension period with a statement that additional interest would continue to accrue until the balance due is fully paid.
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## Discrepancy Adjustments – Extension of Time

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**Assessing the taxpayer's response**

If the taxpayer submits information that changes the discrepancy amount (but does not eliminate it) or penalties, issue Letter 2657P with a revised report to the taxpayer. See IRM Exhibit 4.71.4-7 for an example of Letter 2657P.

If the taxpayer submits information that does not change the original report, issue Letter 2658P along with a copy of the original report. See IRM Exhibit 4.71.4-8 for an example of Letter 2658P.

If it is determined that a more detailed inspection of books and records is necessary to resolve an income tax issue, refer the case to the appropriate Examination Functional Unit.

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**Extensions to time to respond**

In general, 26 CFR 601.105(d)1 does not provide for any extension of time to reply to a “30-Day Letter”. However, as a matter of practice, extensions may be granted under reasonable circumstances such as:

- The taxpayer retains a representative and demonstrates a need for more time to prepare a meaningful protest.
- The taxpayer retains a new representative.
- Sickness or injury of the taxpayer or representative.
- Issues are complex and require extensive research.

Requests for extensions should be in writing and should state the reason(s) why additional time is needed. Since many requests are made by telephone, the extension may be granted verbally and confirmed in writing upon receipt of the written request.

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**Extensions not granted if SOL will expire within 150 days**

Extensions should not be granted if the statute of limitations will expire within 150 days and the granting of an extension will not leave sufficient time to process the case. Granting an extension to respond to a preliminary letter will be contingent upon securing an extension of the statute of limitations.

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*Continued on next page*

**Discrepancy Adjustments – Extension of Time**, continued**Approval of extension**

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Extensions should be approved by the group manager or a designated management official. The taxpayer should be notified in writing of the extension and the specific extended response date. Extensions are normally granted for no more than 30 days unless a specific reason supports additional time.

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**Additional 15 days granted under certain circumstances**

If the taxpayer does not protest within the 30 day period, but previously indicated his/her intention to do so, or if the report is returned as “undeliverable,” Letter 923 (DO) will be sent to the taxpayer to allow an additional 15 days to file a protest.

Letter 923 (DO) should be issued no later than seven calendar days after the response date of the original “30-Day Letter”. See the IRM Exhibit 4.71.4-9 for an example of Letter 923 (DO).

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**30-Day Letters returned undeliverable**

If the “30-Day Letter” is returned as undeliverable to the address on file, then an attempt will be made to obtain the correct address.

If the taxpayer’s correct address is determined, the “30-Day Letter” will be re-mailed to the new address. The period in which the taxpayer may reply starts with the date the letter was re-mailed.

If the taxpayer’s correct address cannot be determined, then the case will be closed “unagreed” to EP Mandatory Review Staff outlined in IRM section 4.71.4.6.2.

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## Discrepancy Adjustments - Agreed Tax Changes

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**Agreed cases**

If a signed Form 4549–E is secured from the taxpayer (and/or spouse, if a jointly filed Form 1040) or power of attorney (POA) under Form 2848 authorized representative, the case is agreed.

An agreed case may be closed without payment from the taxpayer; however, the agent should make a reasonable effort to secure full payment of taxes, interest and penalties.

If the taxpayer is unable to pay, see IRM section 4.71.4.11 for information on Installment Agreements. If there is an “agreed tax change”, the disposal code is 03.

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**Case processing time frames**

If the total discrepancy adjustment to one taxpayer results in an over-assessment, or an agreed but unpaid deficiency, of \$10,000 (pursuant to the changes enacted under RRA 3103) or more, the case must be processed within 22 calendar days (16 business days) after the agreement is filed or the over-assessment is determined.

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## Discrepancy Adjustments - Agreed Tax Changes, Continued

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**Procedures to close the case**

Form 3244-A (Payment Posting Voucher) should be completed for each payment secured (See the IRM Exhibit for an example of a completed Form 3244-A.). Payments are required to be sent directly to the Service Center the same day as received, or as soon as possible the next business morning to ensure receipt within 24 hours.

Form 3210 (Document Transmittal) should be prepared, including the taxpayer's name, SSN/EIN, Tax Return Form number, amount of payment, and check number. If the check applies to more than one tax period, it should be noted and itemized on the Form 3210.

The payment should be stapled to the front of the Form 3244-A, and sent along with Form 3210, via over-night mail to the appropriate Service Center where the taxpayer files his/her return. The mail service tracking number should be included on the Form 3210.

Copies of all forms should be retained in the case file. No closing letter is prepared for discrepancy adjustments when there is an agreed tax change. The case file should be assembled in accordance with IRM section 4.71.4.12.3 and closed to the designated ESS closing unit (normally Baltimore).

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**No change cases**

If information received during the 30 day period verifies that no adjustment is warranted, take the following actions:

- Retain the transcript and a copy of the return (or applicable IDRS prints) in the EP workpapers.
  - Include the original return (if secured) with the closed discrepancy adjustment folder.
  - Close the case off AIMS, disposal code 02 using Form 5599. Refer to the instructions under IRM section 4.71.4.12.1 for lines required to be completed. See IRM Exhibit 4.71.4-5 for an example of Form 5599.
  - Prepare Pattern Letter 2656P. See IRM Exhibit 4.71.4-6 for an example of Letter 2656P.
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## Discrepancy Adjustments - Unagreed and Partially Agreed Cases

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### Unagreed Case Procedures

Unagreed Case Procedures will be followed in two instances:

- The taxpayer disagrees and files a protest with Appeals (or petitions the Tax Court).
  - The taxpayer fails to submit a proper response to the “30-Day Letter”.
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### Disagreement by the taxpayer

If the taxpayer disagrees with the proposed adjustments, the agent must inform him/her of:

- The right to discuss the proposed adjustment with a supervisor.
- His/her appeal rights.

A taxpayer that does not agree with the proposed adjustment or penalties should be encouraged to file a written protest for the case to go to Appeals. Pub. 5 summarizes the protest procedure.

If the protest does not change the report, close the case to EP Mandatory Review Staff for forwarding to Appeals with disposal code 07 or 11.

- Use disposal code 07 when the taxpayer timely files a protest to Appeals.
- Use disposal code 11 when the taxpayer files a petition to the Tax Court.

If the taxpayer files a protest, the agent must review the protest to determine whether:

- The protest is adequate (See Pub 5 – protest may not be required to be in writing),
- The case requires further development,
- The agent’s report should be modified.

If a protest is filed, it is the responsibility of the agent to prepare a memorandum for Appeals with a brief response to all points raised in the taxpayer’s protest. Place this memorandum in the case file.

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## Discrepancy Adjustments - Unagreed and Partially Agreed Cases, Continued

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**Disagreement by the taxpayer (continued)**

The following actions should also be taken:

1. Update the status code on AIMS to 52,
  2. Attach Form 3198 to the outside of the case file, identifying the case as “Mandatory Review”, and notate: “Unagreed Discrepancy Adjustment”.
  3. If less than one year remains on the statute of limitations, see IRM 4.71.9, Statute Controls, for special instructions.
  4. Close the case to Mandatory Review.
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**Failure of taxpayer to respond**

For cases where the taxpayer has failed to properly respond, the case should be closed to EP Mandatory Review Staff for issuance of a statutory notice of deficiency in the following instances:

- It appears reasonable that the taxpayer or authorized representative received the “30-Day Letter”, and the taxpayer neither agrees nor protests within the 30 day period,
- Or, if not received, the Service exercised due diligence in determining the taxpayer’s last known address,
- The taxpayer is temporarily away and is not expected to return within a reasonable period of time, or has not returned after a reasonable extension has been granted, and
- Follow-up action was taken without success.

The following actions should be taken:

1. The case should be closed disposal code 10.
  2. Update the status code on AIMS to 52, “In transit between groups and review function”.
  3. Attach Form 3198 to the outside of the case file, identifying the case as “Mandatory Review”, and notate: “Unagreed Discrepancy Adjustment”.
  4. If less than one year remains on the statute of limitations, see IRM 4.71.9, Statute Controls, for special instructions.
  5. Close the case to Mandatory Review
- 

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## Discrepancy Adjustments - Unagreed and Partially Agreed Cases, Continued

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### Partial agreement procedures-form 4549-E

If agreement can be reached on one or more issues, the taxpayer should be encouraged to enter into a partial agreement by executing a 4549-E covering the agreed issues. A typical situation might be where the taxpayer agrees to the discrepancy adjustment; however, he does not agree to the penalty associated with the adjustment to his tax liability.

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### Preparation of two separate Form 4549-E reports

Partial agreement procedures are not appropriate if the taxpayer agrees to the proposed adjustments in a specific tax period and does not agree with proposed adjustments in a prior or subsequent tax period.

For partial agreements, the specialist will complete two separate Form 4549-E reports.

On the first report, the agent should:

- Write “Partial Agreement” on top of the 4549-E.
- Start with the taxable income per return, or as previously adjusted.
- Compute deficiency based on agreed adjustments only.
- Type in “Other Information” on Form 4549-E: “By executing this form, the taxpayer agrees to the above adjustments. The computations reflect the statutory deficiency agreed to at this time”.

The agent should prepare a second report that incorporates both the agreed and unagreed issues.

The specialist will forward both reports to the taxpayer, with the “30-Day Letter”. All enclosures listed on the “30-Day Letter” should be included.

If the taxpayer signs the partial agreement, the original signed 4549-E, plus 1 copy will be included in the closed case file.

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## Discrepancy Adjustments - Unagreed and Partially Agreed Cases, Continued

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**Preparation of two separate Form 4549-E reports**  
(continued)

If the taxpayer signs only the Form 4549-E “Partial Agreement” report but does not sign the report containing both agreed and unagreed issues, an explanation should be prepared of which items and amounts were agreed to by the taxpayer. This explanation should accompany the file to Mandatory Review Staff and should not to be sent to the taxpayer. The case should be closed as an unagreed case as outlined above.

The agent should attach Form 3198 with an entry that the discrepancy adjustment is “Partially Agreed”.

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## Discrepancy Adjustments – Other Procedures

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**Relief from joint and several liability**

If a discrepancy adjustment is warranted with respect to a joint return under IRC 6015, the agent should follow these procedures:

1. Verify the last known address for each spouse. Research IDRS to confirm the current address for each spouse and update the Master File if the address has changed. For detailed procedures on locating taxpayers and what constitutes proper notice, see IRM 25.15, Exam Relief from Joint and Several Liability.
  2. Send a copy of the discrepancy adjustment report to each spouse, even if they live at the same address.
  3. Indicate on Form 5464, Case Chronology, that information concerning IRC 6015 relief was provided. Note the taxpayer's response, if any, regarding pursuit of this relief.
  4. If IRC 6015 relief is requested, refer this matter to EP Classification for appropriate routing with Form 5666, EP Information Report.
  5. If Form 8857 (rev. 10/99), Request for Innocent Spouse Relief under IRC 6015, or a statement that contains substantially the same information which is signed under penalty of perjury is submitted, and the case is closed, date stamp the receipt date on the request and send the IRC 6015 relief request to: Internal Revenue Service, CSC, Stop 829, Unit 11, 201 West Rivercenter Boulevard, Covington, KY 41019.
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**Installment agreement procedures**

If the taxpayer is unable to pay the full amount owed, an installment agreement can be offered. Form 9465, Installment Agreement Request, should be sent to the taxpayer along with Form 4549-E. The taxpayer can request an installment agreement by returning the signed Form 9465 and the signed Form 4549-E to the agent. Unless local procedures provide otherwise, forward Form 9465 to the applicable Service Center as specified on page two of Form 9465 (the Service Center where the taxpayer files Form 1040). For more information on installment agreements see IRM 4.20.4, IRM 5.14.1 and IRM 5.14.5.

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**Bankruptcy**

If the taxpayer has filed for bankruptcy, appropriate steps must be taken to protect the government's interests. A timely claim must be submitted to the SBSE Insolvency Unit. See IRM 4.27 for further guidance on bankruptcy procedures.

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## Discrepancy Adjustments - Closing Procedures

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**Closing Procedures**

All discrepancy adjustment cases will be closed utilizing Form 5599, TEGE Examined Closing Record,. No closing letter is required to be prepared for either “Agreed Tax Change” cases or “Unagreed” cases. A closing letter (Letter 2656P) is only required when contact has been made with the taxpayer, and a determination has been made to close the case “No Change”. The case file should be assembled in accordance with IRM section 4.71.4.12.3. See assembly instructions below.

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**Form 5599**

Form 5599 should be completed for all discrepancy adjustment cases worked.

If the case is partially agreed, indicate in Part B (upper left portion of form) that the file is a partial agreement. Place a check mark in Box identified Partial=F.

If partial agreement is secured, the file should be closed to EP Mandatory Review with the words “discrepancy adjustment – partial agreement” written in the remarks section of Form 3198.

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**How to complete Form 5599**

Complete the line items on Form 5599 as follows:

1. P7-18: Enter the taxpayer’s EIN/SSN
  2. P21-22: Enter the MFT
    - a. 1040 = 30
    - b. 1120 = 02
  3. P24-29: Enter the tax period (YYYYMM)
  4. P31-34: Enter the name control
- 

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## Discrepancy Adjustments - Closing Procedures, Continued

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**How to  
complete Form  
5599 (continued)**

5. C: Enter the name of the taxpayer (Last, First)
6. 08–Agreement Date: Enter the date the signed 4549-E is received.
7. 12–Tax Liability: Insert transaction code (TC) “300” and the amount of the increase in tax that resulted from the discrepancy adjustment, OR insert TC “301” and the amount of decrease in tax that resulted from the discrepancy adjustment.
8. 12–Penalties:--Insert TC “320” for civil fraud penalty and amount of penalty. Insert TC “160” for the amount of any delinquency penalty to be assessed on late filed returns.  
**Note:** Accuracy related penalties should be reflected on line 15.
9. 12–Interest: Leave blank. Interest will be computed and input by the closing unit.
10. 13–Disposal Code: Enter the applicable disposal code.
  - 01 = Agreed claim disallowance
  - 02 = No Change
  - 03 = Agreed Tax or Penalty Change
  - 04 = Change to a Related Return
  - 05 = Delinquent Related Return Secured
  - 06 = Delinquent Return Secured
  - 07 = Unagreed – Protest to Appeals
  - 10 = Unagreed - Without Protest
  - 11 = Unagreed – Petition to Tax Court
  - 12 = Formal Closing Agreement
  - 13 = Issue Referred to Examination Functional Unit
11. 14–Statute: Insert current statute of limitations date if it has been extended.
12. 15–Increase in Adjustment Dollars: Insert TC “680” for accuracy related penalties being assessed under IRC 6662. Insert TC “806” to reflect tax withheld but not previously claimed by the Taxpayer.  
15–Decrease in Adjustment Dollars: Insert TC “765” if reducing an earned income credit.

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## Discrepancy Adjustments - Closing Procedures, Continued

### How to complete Form 5599 (continued)

13. 28–Examiner’s Time: Enter whole numbers only.
14. 30–Examination Technique:
  - 1 = Office Interview Examination
  - 2 = Office Correspondence Examination
  - 3 = Field Examination
15. 31–Examiner’s Grade: Enter applicable grade level.
16. 32–Grade of Case: Enter the actual grade of the case from left to right.
17. 33–Examiner’s Name: (Last, First)
18. 40–Project Code: Use same project code as used for Form 5500.
19. 41a–No Change Issue: Enter “99999999” for 1040 with disposal code “02”. Otherwise, no entry is required.
20. 42–Agreed Deficiency Indicator Code: Leave blank if case is being closed to Appeals or is “Unagreed”. Applicable codes are:
  - 1 = Fully Paid
  - 2 = Not Paid
  - 3 = Partially Paid
  - 4 = Installment Agreement With Payment
  - 5 = Installment Agreement Without Payment
21. 50–Employee Group Code: Enter group number.
22. 701–Principal Issue Code: Use code “34”

### Closing letters

Pattern Letter 2656P will serve as the closing letter in cases where the taxpayer’s response to the “30-Day Letter” results in the discrepancy adjustment issue being dropped. The “30-Day Letter” is the final letter on Agreed Tax or Penalty Change cases.

### Closed case assembly

A separate folder must be used for each taxpayer’s income tax return established on AIMS.

Label each folder with Taxpayer Name, EIN/SSN, Year and Return (1040 or 1120).

Red folders should be used to identify cases with less than 210 days remaining on the statute of limitations.

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## Discrepancy Adjustments - Closing Procedures, Continued

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**Outside the case file**

Staple the following to the outside of the file folder (where applicable) from top to bottom, as follows:

1. Form 895 – Notice of Statute Expiration (if applicable)
2. Form 3198 - Special Handling Notice. Indicate the following on Form 3198:
  - **DISCREPANCY ADJUSTMENT** in bold letters.
  - Whether the case is subject to “mandatory review”.
  - Whether the case contains a POA.
  - Whether the case involves a formal claim.
  - If the case involves multiple years, list all years.
  - If **the** case is “Unagreed” with less than one year remaining on the statute of limitations.
  - If the case is “Agreed” or “No Change” with less than 6 months remaining on the statute of limitations.
  - If **the** case is “Unagreed”.
  - If the case is a “Partial Agreement”.
  - **Reviewer’s** Memo and/or response to reviewer’s memo.

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## Discrepancy Adjustments - Closing Procedures, Continued

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**Inside, right of case file**

The following should be loose in the case folder on the right hand side, from top to bottom as follows:

1. Original closing letters.
2. For “Agreed Tax Change” cases, a signed Form 4549-E, Income Tax Discrepancy Adjustments.
3. For “Unagreed” cases closed from the group to EP Mandatory Review, clip together in one package:
  - a) Copy of the 30-Day Letter (Letter 2652)
  - b) Copy of the Revenue Agent Report (RAR). Also include a computer disk with a copy of the RAR.
  - c) Form 4549-E.
4. Closing document and return clipped together in one package as follows:
  - a) Form 5599.
  - b) AMDISA print stapled to the left side of the Form 5599. The top AMDISA print must reflect the most recent AIMS update. All prior AMDISA prints should be placed under the current AMDISA print for a history of AIMS updates.
  - c) Form 1040 or Form 1120 (or RTVUE or BRTVU print) return with the following documents (as applicable) stapled as described below:
    - Form 2848, Power of Attorney and Declaration of Representative, stapled face down to the back of the first page of the return.
    - Form 872, Consent to Extend the Time to Assess Tax, stapled face down to the back of the last page of the return with the most current Form 872 on top.
    - AIMS request forms. These forms include:
      - Form 5595, TE/GE Update.
      - Form 5597, TE/GE IMF/BMF/EPMF Request (if applicable).

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## Discrepancy Adjustments - Closing Procedures, Continued

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**Inside, right of  
case file**  
(continued)

- Form 3244, Payment Posting Voucher, if a tax payment was received.
5. All workpapers should be rubber-banded or clipped together and placed in the order below from top to bottom.
    - a) File copy of the closing letter.
    - b) File copy of the Revenue Agent Report.
    - c) Form 5772, EP/EO Workpaper Summary.
    - d) Form 5773, Workpaper Continuation Sheet.
    - e) Form 5464, Case Chronology Record.
    - f) Prints for all IDRS research.
    - g) Workpapers and exhibits indexed to Form 5772.
    - h) Form 5666, EP/EO Referral Information Report (file copy of Forms 5666 both made and received including any attachments).
    - i) Correspondence between the Service and the taxpayer assembled in chronological order with the most recent letter on top (initial contact letter at the bottom).
    - j) Miscellaneous items.
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## Third Party Contacts

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### Introduction

The Service's policy is to obtain information relating to the determination or collection of any tax liability directly from the taxpayer whenever possible.

Generally, contacts with third parties are made when we are unable to obtain the information from the taxpayer or his representative or to verify information provided by them.

Employees should make every effort to first obtain the information from the taxpayer or his representative. IRM §4.71.1.8 provides procedures that should be followed when it becomes necessary to make contact with a third party.

For third party contacts made for the purpose of determining or collecting a tax liability, IRC 7602(c) requires the IRS to:

1. Provide advance notice to the taxpayer that third party contacts may be made.
2. Periodically provide a list of all third party contacts to the taxpayer.
3. Provide a list of third party contacts to the taxpayer upon request.

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### Definition of third party contact

For purposes of IRC 7602(c), a third party contact has been made when an IRS employee:

1. Initiates contact with a person other than the taxpayer, and
2. Asks questions about a specific taxpayer with respect to that taxpayer's federal tax liability, including the issuance of a levy or summons to someone other than the taxpayer.

The statute does not apply to contacts initiated by third parties.

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## Third Party Contacts, Continued

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**Contacts with third parties**

Generally IRS employees will identify themselves when attempting to obtain information from third parties.

However, if an agent tries to call a taxpayer, but instead reaches a third party (i.e. the taxpayer's secretary or family member) and the IRS employee does not seek any information from such person, the IRS employee should **not** tell the third party that he works for the IRS unless expressly asked by the third party.

Employees can only seek additional information from the person answering the telephone if:

1. The appropriate Letter 3164 has been issued to the taxpayer,
2. The employee identifies himself as an IRS employee, and
3. The employee treats the telephone conversation as a third party contact.

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## Third Party Contacts, Continued

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**Contacts that are not considered third party contacts**

The following are **not** third party contacts:

1. Searches made on computer databases that do not require any personal involvement on the other end (e.g., LEXIS, Information America).
2. Contacts made with government officials to obtain information that is available to the public, i.e., contacting the Postal Service to obtain a taxpayer's current address.
3. Information received from a third party where the third party initiates the contact.
4. Information received pursuant to routine or spontaneous exchanges from a foreign country pursuant to an exchange of information clause in a tax convention between the United States and that foreign country or from a United States possession pursuant to an exchange of information clause in a tax coordinating agreement between the United States and that possession.
5. Information that the United States exchanges in routine or spontaneous exchange programs with a foreign country pursuant to an exchange of information clause in a tax convention between the United States and that foreign country or with a United States possession pursuant to an exchange of information clause in a coordinating agreement between the United States and that possession.
6. Exchanges of information via tape programs, e.g., State Income Tax Levy Program and Federal Payment Levy Program.
7. Contacts with individuals who have a valid Power of Attorney for the taxpayer.
8. Contacts made by the IRS to respond to a request from a treaty partner for information concerning a taxpayer and tax liability of the treaty partner.
9. Contacts made to obtain information regarding an industry or market segment where specific taxpayers have not yet been identified.

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**Third Party Contacts, Continued****Contacts that are not considered third party contacts**  
(continued)

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10. Contacts made by IRS employees during litigation if the contact relates to a matter and issue being litigated, including, but not limited to, the service of Tax Court subpoenas on third parties by employees.
  11. Contacts made with other IRS employees in the scope of an employee's official duties, including employees of the Office of Chief Counsel.
  12. Contacts made as the result of unsolicited requests for payoff of a Notice of Federal Tax Lien or to respond to requests for information regarding the priority of a lien (disclosure laws do apply).
  13. When the taxpayer under investigation is a business, contacts made with employees who are acting within the scope of their employment.
  14. Contacts made with third parties to collect taxes for another country as part of a Mutual Collection Assistance Agreement.
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**Returning an unsolicited call not considered to be a third party contact**

Returning an unsolicited call is not considered a third party contact.

However, a call made after the return call to gather additional information is considered a third party contact.

Therefore, remember to make a reprisal determination during an initial conversation with an informant. More information on reprisals is contained later in this chapter. Also see IRM 4.71.1.8.4.3 for specific requirements regarding reprisal determinations.

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## Third Party Contacts, Continued

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**Governmental entities**

The Final Treasury Regulations for IRC Section 7602(c) - Third Party Contacts, were published in the Federal Register, Vol. 67, No. 243 on December 18, 2002, as § 301.7602-2.

An item of particular interest to the Employee Plans Examinations function is subsection (f) (5) of the regulation. This states that code section 7602 (c) does not apply to a contact made with any entity of any government, except with regards to the taxpayer's dealings with (such as contracts with or employment by) the government entity being contacted.

The final regulations clarify the effect of our contacts with Department of Labor (DOL) now Employee Benefits Security Administration (EBSA) and the Pension Benefit Guarantee Corporation (PBGC). Section 301.7602-2(f)(5) provides that contacts with any office of local, state, federal or foreign governmental entity is not a third party contact under IRC § 7602 (c). Our issuance of a Form 6212-B and other referrals to EBSA and/or PBGC, or issuing a letter informing them of our intent to issue a 30 or 90-day letter to the taxpayer, are not to be considered third party contacts under IRC § 7602 (c).

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*Continued on next page*

## Third Party Contacts, Continued

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### Notification requirements for making third party contacts

Before making a third party contact IRS employees must first provide reasonable notice to the taxpayer that contacts with persons other than the taxpayer may be made. The agent will issue the notice to the taxpayer when it is determined that there is a reasonable likelihood that a contact will be made. Notification is made by issuance of the 3164 Letter. The Letter 3164 includes the following information:

- Date
- Taxpayer's name, address and TIN
- Person to contact, telephone number and ID Card number

The following versions of Letter 3164 are available for use by Employee Plans Examination employees. See IRM 4.71.1 for Exhibits.

1. **Letter 3164 E (DO)** is used for the Office Correspondence Examination Program (OCEP)
2. **Letter 3164 F (DO)** is used when a third party contact will be made to verify taxpayer information involving examination issues, e.g., large case (CEP)
3. **Letter 3164 G (DO)** is used when a third party contact will be made to obtain taxpayer information involving examination issues, e.g., large case (CEP)
4. **Letter 3164 K (DO)** is used when a third party contact will be made in a ruling or determination matter (including compliance statements, closing agreements, etc.)

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## Third Party Contacts, Continued

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**Recording third party contacts**

When a third party contact is made, complete Form 12175, "Third Party Contact Report Form." See IRM Exhibit 4.71.1-6 for a copy of the form and instructions. Multiple contacts with the same third party on different dates require a separate Form 12175 for each contact. If the same employee makes more than one contact with the same third party on the same day, only complete one Form 12175.

Include the following information on Form 12175:

- Taxpayer TIN
- Name control
- The telephone number, mail stop number and ID card number of the employee making the contact
- Secondary TIN. Indicate on Line 5 if the recorded contact is for the primary TIN, secondary TIN (spouse on a joint account), or both (joint accounts only).
- Date of the contact
- Reprisal Determination (check box if "fear" has been indicated)
- Name of third party contacted, if known. If the name of the third party is not known, please refer to the instructions to Form 12175, Third Party Contact Report Form, for the type of information to enter. **DO NOT** include the address or telephone number of the third party.
- Plan number or application form number and control date for certain EP accounts.
- Master File tax code and tax period relating to the primary TIN

When Form 12175 is completed:

1. Send it to the EP Examination Third Party Contact Coordinator in EP Special Review as soon as possible after it is completed.
2. Associate a copy with the case file.
3. Document the case history to show the action taken.

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## Third Party Contacts, Continued

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**Where to send  
Form 12175**

Laurence (Larry) Frogel has been designated the Third Party Contact Coordinator for EP Examinations. Form 12175, along with a completed Form 3210, should be forwarded to Larry, while retaining a copy in the case file as part of routine case documentation. Larry's address is-

Internal Revenue Service  
625 Fulton Street  
EP Special Review- Room 503  
ATTN: Larry Frogel  
Brooklyn, NY 11201

Be sure to use the most recent version of Form 12175. This is available, on the Intranet, in PDF format, with instructions. The information provided on the submitted forms will be entered into, and stored on, IDRS. All submitted forms must include the correct TIN and Name Control. All forms that are being submitted for 5500 series returns (MFT 74) must include the correct plan number.

If there are any questions regarding third party contacts, they should be directed to Larry by email or by telephone at (718) 488- 2385.

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## Third Party Contacts, Continued

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**Taxpayer  
authorized  
third party  
contacts**

When a taxpayer authorizes a third party contact:

1. Prepare Form 12180, Third Party Contact Authorization. List each third party the taxpayer authorizes the IRS to contact. A blanket authorization covering all third party contacts is not acceptable.
2. Secure the taxpayer's signature and date on Form 12180 (for joint returns, both spouses must authorize the contact).
3. Inform the taxpayer that the IRS will not maintain a record, provide advance notice, or provide a record of the third party contact.
4. Document the case history with the date the taxpayer provided the authorization.
5. Keep Form 12180 (or other written authorization) in the case file.
6. Continue with documentation of routine case actions, but Form 12175 and/or the database need not be updated with the third party contact information.

Taxpayer authorization can be expressed orally or in writing. Document the case file to reflect the date and method the taxpayer used to authorize the contact. If oral authorization is given, completion of Form 12180 is not required, but would be the best practice. A complete Form 12180, signed by the taxpayer, would avoid any subsequent disputes as to whether the taxpayer authorized a specific contact.

**Note:** IRC 7602(c) does not require an IRS employee to obtain authorization from the taxpayer in order to contact a third party. A taxpayer may not prevent an IRS employee from contacting a third party by refusing to provide authorization. Obtaining authorization only means that the employee is not required to provide the advance general notice to the taxpayer (if not already provided) or make a record of the contact that was authorized.

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## Third Party Contacts, Continued

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### Reprisal

If an IRS employee determines that providing the advance notice or a record of a specific contact to a taxpayer may result in reprisal (i.e., retaliation) against any person, prepare a separate Form 12175 to report the reprisal situation. Include **only** the following information:

- Taxpayer's TIN
- Taxpayer's name control
- Employee ID card number, employee telephone number, and employee stop number
- Date of contact
- Place a check in the REPRISAL box

Send the Form 12175 to the Coordinator for input to the database. The information will be retained in the database, but will not be included in the list of third parties contacted (Letter 3173) that is provided to the taxpayer.

**Caution: DO NOT INCLUDE THIRD PARTY INFORMATION ON THE FORM 12175.**

The employee making the contact must make a reprisal determination for all third party contacts. The reprisal determination is made on a case-by-case basis with no blanket determinations for different types of contact. A reprisal determination may be based on any information available to the employee. Employees must document the case file with the facts surrounding the reprisal determination.

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### Example 1

As part of a compliance check on a return preparer, an IRS employee visits the preparer's office and reviews the preparer's client files to ensure that the proper forms and records have been created and maintained.

This contact is not a third-party contact "with respect to" the preparer's clients. This contact is not for the purpose of determining the tax liability of the preparer's clients, even though the agent might discover information that would lead the agent to recommend an examination of one or more of the preparer's clients.

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*Continued on next page*

## Third Party Contacts, Continued

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**Example 2**

A revenue agent is assigned to examine a taxpayer's return, which was prepared by a return preparer. As in all such examinations, the revenue agent asks the taxpayer routine questions about what information the taxpayer gave the preparer and what advice the preparer gave the taxpayer. As a result of the examination, the revenue agent recommends that the preparer be investigated for penalties under section 6694 or 6695.

Neither the examination of the taxpayer's return nor the questions asked of the taxpayer are "with respect to" the determination of the preparer's tax liabilities within the meaning of section 7602(c) because the purpose of the contacts was to determine the taxpayer's tax liability, even though the agent discovered information that may result in a later investigation of the preparer. This is not a third party contact.

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**Example 3**

The taxpayer submits Form 5300. The IRS is asked to rule on whether a certain pension plan qualifies under section 401 so that contributions to the pension plan are excludable from the employees' incomes under section 402 and are also deductible from the employer's income under section 404.

Contacts made with the plan sponsor (and with persons other than the plan sponsor) are not contacts "with respect to" the determination of the tax liabilities of the pension plan participants because the purpose of the contacts is to determine the status of the plan, even though that determination may affect the participants' tax liabilities.

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## Package Audit

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**Introduction**

During the course of auditing an assigned return, the EP agent should determine whether the plan sponsor is filing or has filed all of the other federal tax or information returns he or she is required to file per Policy Statement P-4-4. IRM section 4.71.1.12 gives procedures for the package audit.

Some examples of the returns involved include, but may not be limited to:

- Related EP returns - 5500 series, 5330, 990-T
  - Employment Taxes - 940, 941, W-2, W-4
  - Form 1099 series - 1099-R, etc.
  - Plan sponsor returns - 1120, 1065, 990, 1040
- 

**Taxpayer failure to file a required return**

If the taxpayer has not filed a required return, the agent should attempt to obtain a delinquent return (unless fraud or willful failure to file is indicated). See IRM 4.71.3 for delinquent and substitute return procedures.

If the taxpayer refuses to file a required return and the returns are under the jurisdiction of EP, the agent will initiate an examination of the required returns or take other appropriate actions to enforce compliance with the filing requirements.

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**Potential referrals**

The agent should determine whether the taxpayer has properly handled transactions and consider submitting a referral (Form 5666, EP/EO Referral Information Report or Form 5346, Examination Information Report), to the appropriate function for consideration.

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**Related entities**

If the examination shows related entities, inspect their returns to determine whether examinations are warranted. If adjustments or issues arise on returns for which LMSB or SB/SE would usually have jurisdiction, refer to IRM 4.71.4 for information on discrepancy adjustments and IRM 4.71.6 for referral information.

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**Package Audit, Continued**

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**Proper  
workpaper  
documentation  
for package  
audit  
requirements**

To satisfy the package audit requirements, the workpapers should include documentation to support the audit steps taken and the conclusions reached. Specify on Form 5773 (EP/EO Workpaper Summary Continuation Sheet) that the package audit procedures were considered. List those returns/forms required to be filed and indicate whether filed by the taxpayer. The workpapers should indicate if any further action was warranted and what specific action was taken.

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**Prior and  
subsequent  
years Forms  
5500**

During the course of the examination, inspect both the prior and subsequent year 5500 series returns of the taxpayer for potential examination issues, such as recurring issues or transactions that may adversely affect the plan's exempt status for the year assigned for examination or tax liability of the plan sponsor. Be sure to document your review in your workpapers. You need not secure copies of the returns; you may view them on IDRS (command code ERTVU). Unless there are compelling reasons for examining prior or subsequent year(s) returns, they should not be examined.

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*Continued on next page*

**Package Audit, Continued****Prior and subsequent years Forms 5500 (continued)**

If an examination of a prior or subsequent year return is warranted, include a statement in the workpapers and set forth the reasons.

Obtain group manager approval to extend an examination into either the prior and/or subsequent years. The agent will document the group manager's approval to extend the examination to subsequent years in the workpapers or in the case chronology record.

If the examination is extended to a prior year, the group manager will prepare a written statement of approval for inclusion in the workpapers. Examine prior/subsequent year return(s) concurrently with the assigned return. Ensure sufficient time remains on the statute of limitations. Follow local procedures. See IRM 4.71.9 for information on statute of limitations.

Check IDRS to verify whether the subsequent or prior returns are under audit before expanding an examination. If not, then establish the case on AIMS. The taxpayer must be informed of the decision to examine a prior or subsequent year return.

Finally, if during the examination of the assigned return, the agent obtains information that indicates potential substantive noncompliance in subsequent year returns that have not yet been filed by the same taxpayer, prepare Form 5666 (EP/EO Information Report).

**Employment tax returns**

Occasionally you may find plans and trusts required to file employment tax returns (such as Form 940, Employer's Annual Federal Unemployment Tax Return, and Form 941, Employer's Quarterly Federal Tax Return). See IRM 4.23, Employment Tax, for detailed procedures on employment tax examinations.

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## Package Audit, Continued

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### Forms W-4 Filing requirements

Employers must comply with the W-4 requirements in accordance with Reg. 31.3402(f)(2)-1(g). Under IRC 6001 and Reg. 31.6001-5(a), employers are required to keep records of all remuneration paid to employees and make them available for inspection by authorized IRS personnel.

Whether they file Forms 940 and 941 payroll information electronically or by paper, employers are required to send the IRS quarterly copies of all Forms W-4 received during the quarter from employees:

- Still employed at the end of the quarter who claim more than 10 withholding allowances, or
  - Who claim exempt status and are expected to earn more than \$200 per week.
- 

### Scope of W-4 review

During an audit of a plan, Forms W-2 are reviewed to verify certain items relating to plan qualification, such as compensation and deferrals. While reviewing the W-2s, you may discover a W-4 withholding issue such as employees who have little or no income tax withholding.

If needed, request copies of the questionable W-4's to verify whether the employer properly sent the forms to the Service Center as required.

If the agent determines that the taxpayer submitted questionable Forms W-4 to the Service Center or failed to submit them as required, make copies of the Forms W-4 for those employees who are still employed by the taxpayer.

The following information must be contained on each W-4:

- Employee name, address, and Social Security Number (SSN)
  - Employer name, address, and Employer Identification Number (EIN)
  - Marital status and number of allowances claimed by the employee
  - Date of the W-4
  - Items pertaining to exempt status (complete when applicable)
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**Package Audit, Continued****Scope of W-4  
review  
(continued)**

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Forms W-4 submitted by the agent to the Service Center W-4 Coordinator must be legible, complete and the most current form on file with the employer.

1. Submit Forms W-4 to the Service Center where the taxpayer files his/her Form 941 at the earliest date possible. The instructions to the Form 941 list the appropriate Service Centers. Use Form 3210 to transmit the Forms W-4 to the SCCB W-4 Coordinator.
  2. State the employer's name, address, EIN, and the number of forms attached. In the event an employer has not filed any Forms W-4 with the IRS and the Forms W-4 are questionable, flag the Form 3210 with a transmittal indicating this involves multiple questionable W-4s from an employer.
  3. Specify in the workpapers that the Forms W-4 were sent to the Service Center, and continue with the rest of the audit.
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## Accountant's Workpapers

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### Introduction

Plans with more than 100 participants are generally required to attach an accountants opinion on the plan's financial statements to the 5500 return per ERISA section 103(a)(3)(A) and 29 CFR 2520.103-1(b). These financial statements and the opinion should be reviewed during the audit.

In addition to the plan workpapers, the agent, when verifying the IRC 404 deduction, may request the Tax Reconciliation Workpapers prepared for the employer's tax return. This request is to verify or substantiate the deductions taken on such return (i.e. whether deductions for plan contributions are taken on the pension line or cost of goods sold, etc.).

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### Tax reconciliation workpapers

The term "Tax Reconciliation Workpapers" means workpapers used in assembling and compiling financial data preparatory to placing it on a return. Typically, these will include final trial balances for each entity and/or a schedule of consolidating and adjusting entries. They include information used to trace financial information to the return.

Tax Reconciliation Workpapers, unlike Audit Workpapers, may be requested at the beginning of an examination.

There is a need for these workpapers since they include information tying the Form 5500 information to the plan's financial statements and other analyses necessary to complete the return.

Ordinarily, tax reconciliation workpapers are prepared and provided by the taxpayer. However, if these workpapers are unavailable from the taxpayer, access may be sought from the accountant.

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## Accountant's Workpapers, Continued

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**Audit workpapers defined**

The term "Audit Workpapers" means workpapers retained by the independent accountant as to the procedures followed, the tests performed, the information obtained, and the conclusions reached pertinent to his/her examination.

Workpapers may include work programs, analyses, memorandums, letters of confirmation and representation, abstracts of organization/plan documents, and schedules or commentaries prepared or obtained by the auditor.

These workpapers provide an important support for the independent certified public accountant's opinion as to the fairness of the presentation of the financial statements, in conformity with generally accepted accounting principles and demonstrate compliance with the generally accepted auditing standards. (See sections 338.02 and .03 of the Codification of Statements on Auditing Standards, as issued by the American Institute of Certified Public Accountants).

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**When audit workpapers may be requested**

In unusual circumstances, you may obtain access to the Audit Workpapers.

However, keep in mind that the taxpayer's records are the primary source of factual data to support the return.

Accountant's Audit Workpapers should normally be used only when such factual data cannot be obtained from the taxpayer's records and then only as a collateral source for factual data, access to which should be requested with discretion and not as a matter of standard examining procedure.

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## Accountant's Workpapers, Continued

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**Defining unusual circumstances**

The unusual circumstances exist under the following conditions:

- A specific issue(s) has been identified for which there exists a need for additional facts; and
- The agent has sought from the taxpayer all facts known to the taxpayer relating to the identified issue(s); and
- The agent has sought from the taxpayer's accountant supplementary analysis (not necessarily contained in the workpapers) of facts relating to the identified issue(s).

In any case where the unusual circumstances furnish a basis for requesting audit workpapers, limit the request only to the portion of the workpapers believed to be material and relevant to the examination.

Whether an item is considered to be "material" is based on the agent's judgment and an evaluation of the facts and circumstances in the case. However, materiality does not depend entirely on amount. The concept involves qualitative as well as quantitative judgments. The significance of an item or its impact on tax liability could be some of the factors to be considered in making a judgment regarding materiality

Note that the above provisions do not apply in cases referred to the Criminal Investigation Division.

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**Exceptions for matters involving VCP or audit CAP**

With respect to an Employee Plans matters involving a case under VCP or Audit CAP, see IRM 7.2 for special rules. Under this procedure, agents should not request copies of a plan sponsor's compliance audit report.

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**Guidance from Area Counsel**

Any questions about access to records should be directed to Area Counsel

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## Closing Procedures

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**Items to be completed on Form 5650**

IRM §4.71.1.18. offers direction on the procedures for closing of examination cases, such as the completion of Form 5650. The following line items on Form 5650, EP Examined Closing Record, should be completed as noted:

1. P7-18: Enter the taxpayer's EIN.
2. P20-22: Enter the three digit plan number.
3. P24-29: Enter the tax period.
4. P31-34: Enter the name control.
5. C: Enter the name of the taxpayer.
6. Item 13: Enter the applicable disposal code.
7. Item 14: If the statute of limitations has been extended, enter the statute expiration date.
8. Item 28: Enter the examiner's time on the case.
9. Item 29: Leave blank.
10. Item 30: Enter the Examination Technique Code, 2 for an OCEP. 4 for a Field Exam.
11. Item 31: Enter the examiner's grade.
12. Item 32: Enter the grade of the case.
13. Item 33: Enter the examiner's last name, leave a space and then first initial.
14. Item 40: Enter the Project Code. If there is none, enter 000.
15. Item 50: Enter the Examiner's Group Number.
16. Item 600: Enter 512 (for revenue agents).
17. Item 601: Enter the Examiner's Number:
  - a) The first three digits are the Primary Business Code (PBC), also referred to as BOD code:
    - 401 for Northeast.
    - 402 for Mid-Atlantic.
    - 403 for Great Lakes.
    - 404 for Gulf Coast.
    - 405 for Central Mountain.
    - 406 for Pacific Coast.
    - 410 for Classification.

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## Closing Procedures, Continued

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Items to be  
completed on  
Form 5650  
(continued)

- b) The fourth and fifth digits are the last two digits of the agent's group number.
- c) The sixth digit is always 0.
- d) The seventh and eighth digits are the two digit specialist number assigned to the agent.

**Example:** An agent in group 7653 in Dallas, TX with specialist number 25 would have an examiner number of 40453025.

- 18. Item 602: Enter excise tax picked up during the exam that is not reflected on Form 5650 or Form 5599 of a related Form 5330 exam.
- 19. Item 603: Enter any penalties picked up during the exam that is not reflected on Form 5650 or Form 5599 of a related Form 5330 exam.
- 20. Item 604: Enter totals from line 603.
- 21. Item 605: Enter the amount of proposed adjustments referred to Examination Functional Units.
- 22. Item 606: Enter deductions claimed for contributions to the plan.
- 23. Item 607: Enter total trust assets as of the end of the plan year.
- 24. Item 608: Enter the number of participants that were directly affected by the exam (i.e. a change in account balance or vesting percentage).  
**Note:** A participant is not considered directly affected merely because the plan could have been disqualified.
- 25. Item 609: Enter plan type:
  - 1 for a defined benefit plan.
  - 2 for a defined contribution plan.
- 26. Item 610: Enter the applicable Issue Code(s) that relate to the Disposal Code. Only one Issue Code for Disposal Code 02 should be entered. This Issue Code should relate to the primary classified issue on the EP Classification sheet. Up to three Issue Codes can be entered if each Issue Code relates to a Disposal Code other than 02. Any remaining spaces should be filled in with zeros.
- 27. Item 612: Enter the applicable NAICS Code (See Document 6476).

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## Closing Procedures, Continued

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**Disposal codes** The disposal code indicates the outcome of the examination. Refer to Document 6476, Employee Plans Computer Systems Codes, for a list of disposal codes and for the disposal code reporting priority.

Carefully select the correct disposal code to ensure that:

1. The accomplishments of the examination program are accurately reported for monitoring and reporting purposes, and
2. Returns with examination potential are identified for examination.

If more than one disposal code may apply, use the priority order specified in Doc. 6476 under the heading “Disposal Code Priority”.

**Note:** The priority order has been developed with field input and gives priority to examination actions that foster voluntary compliance with the qualification requirements reflecting our regulatory responsibilities to plan beneficiaries.

The following are examples which illustrate the appropriate disposal code to use under certain circumstances.

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**Example 1  
illustrating  
disposal codes**

This example illustrates the priority order. Assume an examination of Form 5500 results in both an agreed revocation, and in securing a delinquent Form 5330. Because a revocation is priority number 1, and securing a delinquent return is priority number 4, the appropriate disposal code is 09 (Revocation) and not 05 (Delinquent Related Return Secured).

---

**Example 2  
illustrating  
disposal codes**

Disposal code 03 is used for Form 5500 if the examination results in securing a delinquent Schedule B and a penalty is assessed for late filing.

Schedule B is not established on AIMS because all required attachments to Form 5500 (e.g., Schedule A, B, C, E, SSA), are considered part of one return. A penalty is assessed for late filing of Schedule B and is shown in item 603 of Form 5650, and the total of all penalties is shown in item 604.

For code 03 (Agreed Tax Change) to apply, an entry must appear in either item 602 (Tax) or item 604 (Penalty Total) of Form 5650.

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## Closing Procedures, Continued

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**Example 3  
illustrating  
disposal codes**

Disposal code 04 (Change to related return) is used to close the primary return if an adjustment was proposed or made to a related return including discrepancy adjustments. This code is used only for the primary return examined, and not for the related return. Disposal code 04 is used for Form 5500 if adjustments are made to a related 1040/1120 return. In such cases, Form 1040/1120 is closed using Form 5599 and the appropriate closing code. The closing code could be 03, 07, 10, or 11. The adjustment is also entered on Form 5650 of the Form 5500 file (the primary return).

**IMPORTANT:** In this case, enter in the remarks section of Form 5650 for the 5500 file, **“Do not assess tax and/or penalties”**. Failure to make this entry may result in the taxpayer being billed twice for the same assessment.

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**Example 4  
illustrating  
disposal codes**

Disposal code 05 (Delinquent Related Return Secured) is used to close the primary return if a delinquent related return was secured. This code is used for Form 5500 if the examination resulted in securing a delinquent Form 5330.

If established on AIMS, Form 5330 is closed using disposal code 06. The tax and/or penalties for the delinquent return are entered on Form 5650 for the 5330 file to which it relates. If the Form 5330 is not established on AIMS, then the tax and/or penalties are entered on Form 5650 for the Form 5500.

**IMPORTANT:** For the 5650 on which the tax and/or penalties are reflected, enter in the remarks section: **“Do not assess tax and/or penalties.”** Failure to make this entry may result in the taxpayer being billed twice for the same assessment, as the original assessment was made when the delinquent return was posted at the Service Center

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**Issue Codes**

Select an issue code that best relates to the AIMS disposal code. Issue codes are listed in Doc. 6476, Employee Plans Computer System Codes. The issue code must be carefully selected because it is used in conjunction with the Aims disposal code to validate the accuracy of our system for selecting returns having examination potential, and in reporting the accomplishments of the examination program.

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*Continued on next page*

## Closing Procedures, Continued

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**Example 1  
illustrating  
issue codes**

Assume that the examination of Form 5500 results in securing a delinquent Form 5330 for a prohibited transaction. A vesting defect was also corrected by a closing agreement. Finally, a coverage issue was pursued and dropped, after determining compliance with the coverage requirements.

The AIMS disposal code having the highest priority for the Form 5500 is disposal code (15), "Closing Agreement".

The issue code that relates to that AIMS disposal code is issue code (06), "Vesting". This code is used in the first two positions of item 610 of Form 5650 of the Form 5500.

Issue code 02, "Prohibited Transactions", is entered after issue code 06 for the Form 5500. As the prohibited transaction was not the subject of the closing agreement, the Aims disposal code having the highest priority for the Form 5330 is disposal code (06), "Delinquent Return Secured". The issue code that relates to that AIMS disposal code is issue code (02), "Prohibited Transactions".

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## Case File Assembly (IRM 4.71.12)

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**Introduction** IRM 4.71.12 covers case file assembly procedures. All related returns should be assembled and processed together as a group. Every examined return should be placed in its own folder.

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**Outside of case file** The following items should be stapled from top to bottom on the outside front of the case file:

1. Form 10329, Transmittal Sheet
  2. Form 895
  3. Form 4760, Processing Record
  4. Form 3198, Special Handling Notice
- 

**Inside left of case file** Attach the following from top to bottom to the inside left side of the file:

1. Computer Disk
  2. Form 5666, EP/EO referral
  3. Form 5346, Examination Information Report
  4. Copy of form 6533, Examination Referral Checksheet
  5. Copy of Form 6212-B, DOL Referral
  6. Copy of form 5457, Response to reviewers memo
  7. Copy of form 5456, Reviewers memo
- 

**Inside right of case file** The following goes to the inside right from top to bottom:

1. If the case is being returned to Mandatory Review attach form 5457 and 5456
  2. Signed original closing letters (do not date stamp)
  3. Form 5650 or Form 5599
- 

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**Case File Assembly (IRM 4.71.12), Continued**

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**Inside right of  
case file**  
(continued)

4. Applicable Return - Form 2848 Power of Attorney is stapled face down to the back of the first page of the return. Form 872 is stapled face down to the back of the first page of the return. Form 56 should be attached to the back of the Form 872 to which it applies.
  5. Workpapers clipped or banded together in the following order
    - a) Copy of closing letter
    - b) Copy of RAR
    - c) 5772
    - d) 5773
    - e) 5464
    - f) SCP approval form
    - g) All IDRS prints
    - h) Workpapers and exhibits indexed to Form 5772
    - i) 6212-B
    - j) 6533
    - k) 5666
    - l) All correspondence in chronological order with the most recent letter on top (initial contact letter at the bottom)
    - m) Copies of delinquent return processing documents
    - n) Copies of plan Document and amendments
    - o) Miscellaneous items
-

## Examination Tips

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**Introduction-  
primary and  
secondary  
sources**

Secondary source documents (such as the employee census and ADP/ACP reports prepared by the plan sponsor or plan administrator) are often helpful beginning points when conducting an examination of a plan. However, agents should verify compliance in each element of the examination (as outlined on Form 5772) by reviewing primary source documents during their examination.

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**Primary and  
secondary  
source  
documents  
defined**

Secondary source documents are reports prepared by the employer or plan administrator that were prepared from utilizing other first hand documentation (primary source documents). Examples of primary source documents are the plan document, personnel records, Forms W-2, and payroll records.

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**Reviewing  
primary and  
secondary  
source  
documents**

The correctness of the information on secondary source documents must be verified. Review of primary source documents is necessary in order to reach a proper conclusion in your examination.

For example, an agent might find the review of the summary plan description (a secondary source document) informative and helpful. However a review of the plan document and subsequent amendments (which some agents prefer to secure for review during their pre-audit) is critical.

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## Examination Tips - Cash or Deferred Arrangements

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**CODA exam tips**

Following is a list of examination tips or items to review when examining a 401(k) plan. The list is not intended to be all-inclusive.

1. Review corporate documents or other enabling instruments to verify that the CODA was adopted and effective prior to any election taking effect.
2. Determine whether the plan allows participants the right to elect to have contributions made to the plan in lieu of cash or some other taxable benefit. Also determine whether there is a pattern of allowing employees (including partners in a partnership plan) to elect, on a regular basis, into and out of plan participation in return for changes in compensation. This is a cash or deferred election unless it fits the one-time irrevocable election exception.
3. Review W-2s and payroll records to verify that contributions are not designated or treated as after-tax employee contributions.
4. Inspect the plan document to determine the maximum elective contributions that an employee can defer under the terms of the plan.
5. When testing for compliance with the IRC section 402(g) limit in effect for the year, the following actions and inspection of records should be taken to ensure compliance:
  - a. Inspect Form W-2's for purposes of testing the plan for compliance with the IRC section 402(g) limit. The 402(g) limit is measured on the individual's tax year (calendar year) rather than the plan year.
  - b. Compare Form W-2 (Box 12 beginning in 2001 or Box #13 before 2001—coded "D", which indicates the amount that the individual deferred under the plan) with payroll records and account statements for reconciliation and accuracy of the deferred amounts reported.
  - c. Inspect all Forms W-2 of each entity of a controlled group in order to ensure the limit has not been exceeded if an employee participates in more than one section 401(k) plan of the controlled group during the year.

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## Examination Tips - Cash or Deferred Arrangements, Continued

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### CODA exam tips (continued)

**Note:** The IRC section 402(g) limit follows the individual, and all deferrals must be aggregated to ensure compliance with this Code section and section 401(a)(30). In a mid-size or a large company, employees may be splitting time between the different companies that comprise a controlled group of corporations and that may have separate 401(k) plans. In these instances, the **individual cannot defer** more than the 402(g) limit to the employer's plans, therefore, the deferrals must be aggregated to determine whether the limit has been exceeded. Conduct an interview with your contact person to determine whether employees work for more than one company in the controlled group.

- d. If a larger employer gives you payroll data on electronic media you may need to solicit the help of a Computer Audit Specialist (CAS). Usually the CAS can assist you in downloading the data to an Excel spreadsheet or Access Database. The CAS can also help in conducting the testing or queries for different limitations such as IRC section 402(g).
  - e. After testing the section 401(k) plan for IRC sections 402(g) and 401(a)(30), it is important to ensure that any excesses were properly and timely corrected by April 15th of the following year. Inspect Form 1099-Rs for distributions made to correct, and inspect cancelled checks to determine when the distribution was actually made.
6. Review the plan language to identify eligibility requirements and ensure that the plan is operating in accordance with the plan document.
  7. Review plan financial audit reports and corporate minutes for comments relating to eligibility provisions.
  8. Review plan financial audit reports and corporate minutes for comments on ADP testing and correction.
  9. If the plan used a safe harbor method to satisfy the ADP/ACP tests, review the plan language and verify the employer made matching contributions or non-elective contributions that satisfied the safe harbor requirements. Also verify that the notice requirements were met.

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## Examination Tips - Cash or Deferred Arrangements, Continued

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10. Have the plan administrator explain policy/procedures for ADP/ACP/402(g) testing (including correction). Analyze the testing methodology and results confirming the accuracy of each ADP test.
11. Establish that all employees who are eligible under the plan to make Elective Contributions (ECs) are counted in the ADP test, even if some do not make ECs.
12. Check the overall group of eligible employees to determine whether those who have satisfied the plan's age and service requirements are allowed to make deferrals.
13. Also ask if any other benefits are contingent on a contribution to the CODA.
14. Compare the total number of eligible employees (including those who would be eligible but for a plan provision requiring a ministerial or mechanical act) with the number of employees used to run the ADP test. They should be the same.
15. Review the plan document to determine the eligibility requirements for the CODA. If the eligibility requirements are less than 1 year of service and/or less than age 21, the nondiscrimination testing may be applied on a disaggregation basis. Separate tests may be run; one for employees with less than 1 year of service and less than age 21, and one for all other employees.
16. Determine whether the following employees have been included when running the ADP test:
  - a. Employees who are eligible to make a deferral but cannot because they have been suspended from making deferrals (e.g. because of receiving a hardship distribution),
  - b. Employees who have not made elective deferrals and are allocated no Qualified Non-elective Contributions (QNECs) or Qualified Matching Contributions (QMACs) that are treated as ECs.

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## Examination Tips - Cash or Deferred Arrangements, Continued

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**CODA exam tips** (continued)

17. Examine payroll records, Forms W-2, time cards and personnel records, to verify employee compensation. If the plan year is not a calendar year, review the plan document to determine which period should be used and verify the operation of those provisions.
  18. If the employer limits compensation to the portion of the year in which the employee was eligible, verify that the plan's terms allow for such limitation and examine employees with such limited compensation. If limited, the amount of compensation should be that earned since participation in the plan.
  19. Verify that all compensation figures are limited in accordance with IRC section 401(a)(17). If the plan is not a safe harbor plan, examine the ADP test to verify that each individual's ADR is calculated using the properly limited compensation.
- Note:** Compensation used in the ADP test can either include or exclude elective contributions deferred during the year. The definition of compensation in Reg. 1.414(s)-1 makes reference to IRC section 415(c)(3), which includes elective deferrals in compensation (IRC section 415(c)(3)(D)). However, Reg. 1.414(s)-1(c)(3) contains a safe harbor alternative definition of compensation that satisfies IRC section 414(s) and does not count deferred compensation.
20. Reconcile the total participant deferral contributions shown on Form 5500, Schedule H or I, to the total deferral amount shown on the ADP test.
  21. Test check whether the highly compensated employee group was properly determined, using payroll and organization data. Verify that an employee was considered an HCE if he or she was a 5% owner during the year or preceding year, or had compensation above \$80,000 (indexed) for the preceding year, and if the employer so elected, was in the top-paid group that year.

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**Examination Tips - Cash or Deferred Arrangements, Continued****CODA exam tips** (continued)

22. If a plan is disaggregated under IRC section 410(b), make sure that the ADP test is also run separately on each disaggregated plan.
23. Apply the aggregation and disaggregation rules of Reg. 1.410(b)-7, as modified by Reg. 1.401(k)-1(g)(11), to find the “plan” (or plans) so that the ADP and ACP tests (or safe harbor or SIMPLE rules) can be applied to the proper employees. Ensure only plans with the same PYE are aggregated, if otherwise permitted.
24. If the plan is an ESOP, the ESOP portion of the plan must be disaggregated from the CODA in the same plan. This is true even if any HCE participates in the CODA portion of the ESOP and a CODA of another plan maintained by the employer.
25. Determine if any employees of the employer are covered by a collective bargaining agreement. If so, these employees must be disaggregated from employees not covered by a collective bargaining agreement for purposes of the ADP test.
26. Review any lists, which identify employees covered by a collective bargaining agreement, such as reports prepared for payment of union dues or payroll records showing union dues deductions. Compare these employees to the separate ADP testing for employees under the collective bargaining agreement.
27. While inspecting the 5500 returns for all plans, determine if any other plan maintained by the employer contains a CODA.
28. If so, the plans may be aggregated for purposes of the ADP testing, but only if they have the same plan year.
29. If two or more plans are aggregated for the ADP test, they must also be aggregated for coverage and discrimination testing. Inquire of the employer which plans were aggregated, if any.
30. Verify from payroll records whether employees counted for the coverage and discrimination testing are the same employees in the ADP test if the plans were aggregated.

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**Examination Tips - Cash or Deferred Arrangements, Continued**

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**CODA exam tips** (continued)

31. Determine if any HCE is participating in more than one plan, which contains a CODA.
32. If yes, the elective contributions for each HCE must be combined for purposes of determining the actual deferral ratios (ADRs). This ADR is then used in the ADP test for all CODAs.
33. Compare ADP calculations to compensation and deferral amounts shown on Forms W-2 (or payroll records if the plan year is a fiscal year). Trace the individual entries to source documents.
34. Verify that the ADP test for each group (HCE and NHCE) has been properly determined and that the ADP test was satisfied in accordance with the plan provisions describing the testing method (current year or prior year).
35. For ADP test failures, verify proper and timely correction. Consider:
  - a. Whether the correction method was specified in the plan document and whether the method was followed; and
  - b. Whether the amount of excess contributions was calculated using the correct leveling procedure.
36. For correction by distribution:
  - a. Inspect cancelled checks or trust statements to determine the date of distribution of the excess contributions (plus attributable earnings).
  - b. Inspect Form(s) 1099-R issued for distribution of excess contributions. Amounts distributed should include any gains or losses. For distributions made within the 2 1/2 month period following the plan year end, the distribution is includible in income for the employee's taxable year in which the excess occurred. Distributions made to an employee after 2 1/2 months or that are less than \$100 (not counting earnings) are includible in income for the employee's taxable year in which the distribution was made.
  - c. If the distribution was made after 2 1/2 months following the end of the plan year in which the excess arose, the IRC section 4979 tax applies. Inspect or solicit Form 5330 and verify remittance of the excise tax.

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**Examination Tips - Cash or Deferred Arrangements, Continued**

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**CODA exam  
tips (continued)**

37. For correction by recharacterization:
- a. Recharacterization must occur within 2 1/2 months following the end of the plan year in which the excess arose. Inspect recharacterization notices issued to HCEs. Recharacterization is “deemed” to have occurred on the date of the last notice.
  - b. Inspect Forms 1099-R to verify that recharacterized amounts were correctly reported. Earnings or losses on recharacterized amounts are not taxable and should not be included in the amount reported on the Form 1099-R.
38. If correction was by contribution of QNECs and/or QMACs, determine whether the contributions were made within 1 year after PYE by inspecting cancelled checks or trust statements.

**Note:** This correction method is not available for plans using the prior year testing method.

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## Examination Tips – Eligibility and Coverage

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### Eligibility and coverage exam tips

Following is a list of examination tips or items to review when examining a plan for eligibility and coverage. The list is not intended to be all-inclusive.

1. Inspect the plan document and review the sections concerning eligibility. An employer can have separate eligibility requirements for ECs, matching contributions and discretionary contributions.
2. Thus, review plan sections that define eligible employees and that specify age and service requirements and entry dates. A CODA cannot require that an employee complete more than 1 year of service in order to be eligible to make Ecs
3. When testing the plan for coverage, the following records should be reviewed to determine proper inclusion or exclusion of employees. The records for any related entities should be included in the review if the entity is a member of a controlled group or part of an affiliated service group.
4. Inspect the Form 5500 series return and extract the total number of employees of the employer, employees excluded and employees benefiting. Compare these numbers with the numbers from the employer's payroll records to determine if all employees have been accounted for on the return.
5. Inspect employer payroll records to extract the total employees, birth dates, hire dates, hours worked, union status and other pertinent information.
6. Inspect Form(s) W-2 and State Unemployment Tax Returns (compare the employees on these records with the employer's payroll records) to ensure all employees of the employer are counted for the coverage test.

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## Examination Tips – Eligibility and Coverage, Continued

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### Eligibility and coverage exam tips (continued)

7. Inspect participant election forms to verify the names of eligible employees who have elected not to have ECs made to the plan. These employees are considered as eligible employees with a zero percentage in the ADP calculations (and in the ACP calculations if no after-tax employee contributions are made). These employees also must be included for purposes of receiving an allocation of other, non-EC, and employer contributions if they are otherwise eligible.
8. Inspect payroll records and extract the names of those employees who terminated employment during the year. Many plans will require an employee to be employed on the last day of the plan year in order to receive an allocation of an employer discretionary contribution.
9. Any terminated employee with 500 or more hours of service must be included in the coverage test. Many small plans have a last-day requirement in their plans and can easily fail coverage because of it.
10. Inspect Schedule E, Compensation of Officers, of Form 1120 to gather names of officers and ownership percentages to help identify related entities.
11. Inspect any Form 851, Affiliation Schedule, attached to the Corporate Income Tax return to determine if there are any related entities.
12. Inspect a self-employed individual's Form 1040 Income tax return to determine whether there are any other entities operated and owned by the self-employed individual. Separate Schedule Cs, Profit or Loss from Business, should be filed for each business.
13. Inspect the plan document to determine whether the plan covers leased employees. If the employer has leased employees, the plan may state that these employees are excluded. However, certain rules apply under IRC section 414(n) that may require the employer to include these leased employees for purposes of certain code sections, such as coverage and discrimination.

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## Examination Tips – Eligibility and Coverage, Continued

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### Eligibility and coverage exam tips (continued)

14. Obtain contracts of the employer with any leasing organization and information/records for pension benefits received by the leased employee under the leasing organization's retirement plans.
15. Ensure the plan passes either the ratio percentage test or the average benefits test under IRC section 410(b).
16. For purposes of the coverage test, **all** employees of the employer must be considered, including all employees of entities that are part of a controlled group of corporations or affiliated service group that includes the employer. (See IRC section 1563(a) and the regulations there under for rules on aggregation of stock ownership for controlled group rules. See IRC section 414(m) and the regulations there under for rules pertaining to affiliated service groups. There are three common forms of controlled groups: parent-subsidiary, brother-sister and combined groups.
17. Ensure the plan includes leased employees if defined as eligible under the terms of the plan.
18. Ensure that the plan passes coverage when leased employees are required to be included in the coverage test.

**Note:** Generally, the employer will have to include a leased employee in the test when the leased employee is performing services on a substantially full-time basis and when the total number of leased employees constitute more than 20% of the non-highly compensated employee workforce of the employer. In these instances, these employees must be considered for the code sections noted under IRC section 414(n). However, an employer may include the benefits that the leased employee received from the leasing organization as being provided by the employer when testing for coverage.

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## Examination Tips – Vesting

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**Vesting exam tips**

Following is a list of examination tips or items to review when examining a plan for vesting. The list is not intended to be all-inclusive.

1. Verify that any amounts used to satisfy the ADP test (ECs, QNECs, and QMACs) are 100% vested at all times.
  2. Check that matching contributions that relate to corrective distributions of elective or employee contributions to satisfy the ADP or ACP test are forfeited (or distributed, if necessary to satisfy the ACP test).
  3. Review personnel records to verify dates of employment. Review hourly compensation rates to estimate hours worked per year for hourly employees that were not credited with a year of service in a given year in determining years of service.
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## Examination Tips - Top Heavy

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### Top heavy exam tips

Following is a list of examination tips or items to review when examining a plan for top heavy. The list is not intended to be all-inclusive.

1. Inspect the plan document to determine if the vesting schedule meets the requirements of IRC 416 and verify that it is followed in operation.
2. If another plan is maintained, determine which plan provides the top-heavy minimum benefit.
3. Verify that all non-key employees eligible to participate in the CODA who are employed on the last day of the plan year are receiving the top-heavy minimum benefit. If this benefit is provided in another plan, compare the allocation schedule to the list of eligible employees used for the ADP testing in the CODA plan. The list should include all employees who meet the eligibility requirements of the CODA including those who do not elect to contribute under the CODA. If discrepancies are noted, request a complete list of all employees employed on the last day of the plan year who met the eligibility requirements of the CODA. Inspect payroll or other employment records to verify information provided.
4. Verify that all eligible non-key employees under the plan are receiving an employer contribution of at least 3% of compensation, (or the highest contribution to any key employee, if less than 3%),
5. If the employer has made QNECs for the plan year, they may be used to satisfy the top-heavy minimum contribution requirements even if they were used to satisfy the ADP test.
6. Prior to 2002, QMACs used to satisfy the ADP test or the ACP test may not be used to satisfy the top-heavy minimum contribution requirements. If the QMACs are used to satisfy the top-heavy minimum, they may not be counted as a matching contribution for purposes of the ACP test prior to 2002.

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**Examination Tips - Top Heavy**, Continued**Top heavy  
exam tips**  
(continued)

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7. Elective contributions of non-key employees may not be counted to satisfy the top-heavy minimum contribution requirements. However, elective contributions made on behalf of key employees are counted to determine the percentage of compensation required under the top-heavy minimum contribution.
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## Examination Tips - 415 Limits

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**IRC 415 exam tips**

Following is a list of examination tips or items to review when examining a plan for IRC 415. The list is not intended to be all-inclusive.

1. Review Form 5500, Schedule H (Part II 2f) or Schedule I (Part I 2f) for disclosure of distributions made to correct IRC section 415 excess annual additions.
2. Review plan financial audit reports and corporate minutes for comments that address section 415 concerns.
3. Check the W-2 information for IRC section 415 excess amounts.
4. Determine whether the employer maintains more than one plan. If yes, verify that annual addition calculations reflect contributions made to all defined contribution plans and employee contributions to defined benefit plans maintained by the employer.
5. Ensure that the elective deferrals to all IRC section 401(k) plans and similar arrangements and salary reduction contributions to cafeteria plans are included in compensation for purposes of IRC section 415 testing.
6. Review the plan document for IRC 415 limitation language and methods of correction of excess amounts. If there were IRC section 415 excesses during the year, verify that the correction method was proper and complied with the plan document.
7. If the plan corrected an IRC section 415 problem by distributing elective contributions, determine whether:
  - a. The employer met the requirements for such correction (see Regs. 1.415-6(b)(6)),
  - b. Re-ran the ADP test without the distributed amounts, and
  - c. There were any matching contributions tied to those distributed amounts.

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**Examination Tips - 415 Limits, Continued**

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**IRC 415 exam tips (continued)**

8. Check the plan definition of compensation for allocation or elective contribution purposes. If the definition does not satisfy IRC section 415, and the overall contribution levels or percentages are high, determine whether the 415 limits have been met using the IRC section 415 definition of compensation.
9. Determine the limitation year for each plan? If the employer has elected to use a 12 consecutive month period other than the calendar year, was the election effected by one of the three methods discussed under the definition of limitation year:
  - a. Separate written resolution,
  - b. Adoption of a plan with a limitation year other than a calendar year, or
  - c. Adoption of a plan amendment changing the limitation year)?
10. If the limitation year has been changed and a short limitation period is created, has a prorated dollar limitation been used for the short limitation period? For purposes of determining the compensation limitation that applies for the short limitation period, has compensation earned (or accrued as applicable) during the short limitation period been used?
11. Determine whether the limitations on annual additions are tested using the sum of the annual additions for all DC plans of the employer. This determination includes features of plans which are to be treated as DC plans for purposes of IRC 415 testing (such as employee contributions under contributory DB plans), and all DC plans of any other employer(s) which are to be treated along with the employer's plan(s) as a single plan.
12. Are contributions allocated to any individual medical account that is part of a pension or annuity plan treated as an annual addition to a DC plan (although the IRC 415(c)(1)(B) compensation limitation will not apply to such amounts)? See IRC 415(l) and 401(h).

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**Examination Tips - 415 Limits, Continued**

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**IRC 415 exam tips (continued)**

13. Are amounts attributable to medical benefits allocated to accounts for post-retirement medical or life insurance benefits provided to key employees, under IRC 419A(d), treated as an annual addition to a DC plan for IRC 415(c) purposes (although the IRC 415(c)(1)(B) compensation limitation will not apply to such amounts)?
  14. Are all employees tested for satisfaction of the limitation on annual additions using the correct IRC 415 compensation?
  15. Is an IRC 415 definition of compensation used under the plan for purposes of determining whether the IRC 415 limitations have been exceeded?
  16. Does the plan specify which definition is used for purposes of determining IRC 415(c)(3) compensation?
  17. For limitation years beginning after December 31, 1997, does compensation for IRC 415 purposes include any elective deferral as defined in section 402(g)(3) (which includes elective deferrals under 401(k), 403(b), and 408(k) plans),
  18. Does such compensation include any amount which is contributed or deferred by the employer at the election of the employee and which is not includible in the gross income of the employee by reason of IRC 125 or IRC 457?
  19. For limitation years beginning after December 31, 2000, does compensation for IRC 415 purposes include any elective amounts that are not includible in the gross income of the employee by reason of IRC 132(f)(4)?
  20. Is the employee's compensation from all members of a controlled group taken into account?
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## Examination Tips - Valuation of Assets

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### Valuation of assets exam tips

Following is a list of examination tips or items to review when determining the value of plan assets. The list is not intended to be all-inclusive.

1. A valuation problem may exist if any of these items are found on Form 5500:
  - a. Determine whether the plan reports assets with level values in successive years.
  - b. If the same value for an asset was reported on Form 5500 for the prior year, it may indicate a yearly valuation was not performed, requiring further examination. The value of some types of investments may not change each year (e.g., certificates of deposit and U.S. government securities).
  - c. Determine whether there is a sudden jump in plan asset values in the same year a large distribution is made to highly compensated employees. The plan assets may not have been revalued in prior years, when distributions were being made to only non-highly compensated employees, indicating there might be discrimination under IRC 401(a)(4).
  - d. In the case of a plan termination, review Form 6088, Distributable Benefits from Employees Pension Benefit Plan, to determine whether only the accounts of highly compensated employees remain at plan termination. Compare it to Form 5500 for the current year to determine whether any nonhighly compensated employees participate in the plan. If none participate, look at Form 5500 for prior years to determine whether distributions were made to only non-highly compensated employees in such years.
  - e. If the plan is not terminating, check Schedule SSA, Annual Registration Statement Identifying Separated Participants With Deferred Vested Benefits, to determine whether mostly the accounts of highly compensated employees who have separated from service remain in the trust.
  - f. Refer to the question on Form 5500 on unrealized appreciation/depreciation. A valuation problem may exist if there is no response to this question when the plan reports investments in any corporate stock or security.

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## Examination Tips - Valuation of Assets, Continued

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### Valuation of assets exam tips (continued)

- g. Look at the Form 5500 question on non-cash contributions. If there is an exempt contribution of property, determine whether and by whom the property was valued in the year of the contribution.
    - h. Look at the Form 5500 question on non-publicly traded securities. If the plan purchased or received any non-publicly traded securities not appraised by an independent third-party appraiser, determine whether the securities were valued that year and by whom.
2. After careful review of the plan asset valuation, determine if the value assigned to an asset differs from what you expect.
3. Determine the value of publicly traded securities by checking their price as reported in a newspaper on the valuation date. A local business library has books that publish daily stock prices of all publicly traded companies, and may have a researcher who will provide market values in response to a telephone call as a public service.
4. In determining the FMV of closely held stock, determine how closely held company shares were valued.
  - a. Check whether the share prices as reported on Form 5500 rise and fall with its earnings. If the company's earnings have fallen but the report says the price per share has risen or remained constant, it may indicate an incorrect valuation. Request an explanation.
  - b. Determine whether there have been any recent sales of the company's stock. Check to ensure the sales price is consistent with the valuation.
  - c. If the current valuation relies on a previous valuation, check the employer's audit report to see if the company's earnings have fallen since the valuation report was written. If they have, it is likely the value of the shares should also have fallen. The plan fiduciary can no longer rely on the price per share from the valuation report because the facts on which it was based have changed. Similar principles apply if the company's earnings have risen since the valuation report was written.
  - d. Other factors to be used in determining the FMV of closely held stock include their book value, dividend paying capacity, and the goodwill value of the company.

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**Examination Tips - Valuation of Assets, Continued**

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**Valuation of  
assets exam tips  
(continued)**

5. In an investment or holding company, determine whether the valuation gave the greatest weight to the assets underlying the security to be valued. In a company that sells products or services, determine whether the valuation gave the greatest weight to earnings.
  6. If the valuation appears to be inadequate, its accuracy should be verified by asking for another valuation from a fiduciary or qualified appraiser.
  7. To ascertain the value of real estate held by the plan, check the appraisal report, tax assessment document, and the property insurance policy.
  8. Compare the loan or mortgage balance to the appraised value of the property.
  9. The property's best use is one criteria in valuing the asset. Determine what the property is actually used for. If the property's best use is different than the property's actual use, the property may not have been properly valued.
  10. In a defined contribution plan, ascertain if any sudden increases in value coincided with distributions to highly compensated employees.
  11. Determine whether a life insurance policy being distributed by a plan is a springing cash value policy:
    - a. Compare the premium(s) paid for the policy or the reserves with the cash surrender value as reported in the policy, especially in the year of distribution.
    - b. The cash surrender value should reflect the policy's replacement cost (which should be about equal to the premium(s) paid or the reserves) ensuring that the policy's value is included in gross income upon distribution to the recipient.
  12. Protect the statute of limitations on the related Form 1040 resulting from any adjustments to the recipient's taxable income.
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## Examination Tips - Joint and Survivor Annuities

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**J&S exam tips** Following is a list of examination tips or items to review when conducting the J&S portion of the exam. The list is not intended to be all-inclusive.

1. The agent should first determine whether the plan is subject to IRC section 412.
2. If the plan is subject to IRC section 412, the agent should determine whether such plan provides for qualified joint and survivor annuities (QJSAs) and qualified pre-retirement survivor annuities (QPSAs).
3. If the required survivor annuity language is not found, the plan is disqualified.
4. If IRC section 412 does not apply to the plan, determine whether the plan provides for the full nonforfeitable account balance of any deceased participant to be paid to the participant's spouse or that it will be paid to another beneficiary only with spousal consent.
5. If a plan that is not subject to IRC section 412 has become a transferee plan, determine whether there is an acceptable separate accounting for transferred assets. If there is not an acceptable separate method of accounting, determine whether the plan has made all benefits subject to the survivor annuity requirements.
6. If a plan that is not subject to IRC section 412 offers payment of benefits in the form of a life annuity, and a participant elects a life annuity, determine whether the annuity is a QJSA and whether its election meets the spousal consent requirements.
7. For distributions after October 17, 2000 determine whether there were any single sum distributions of more than \$5,000 without participant and, where required, spousal consent.
8. Determine whether there has been an immediate distribution of any amount to a participant after the annuity starting date without getting spousal consent. (For distributions prior to October 17, 2000 see the transition rules in the Notes after IRM 4.72.9.3.3(1)a. and IRM 4.72.9.3.5.1(1)a.)

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**Examination Tips - Joint and Survivor Annuities, Continued**

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**J&S exam tips  
(continued)**

9. Determine whether participants electing to defer receipt of a distribution have the same options available to other participants. If not, determine whether the unavailability of some options results in a significant detriment to the participants deferring receipt of distributions.
10. Determine, by looking at the consent forms of the participant and spouse, that any distribution made while the benefit is immediately distributable (and is over \$5,000) has the consent of the participant or the surviving spouse and is in the form of a QJSA or QPSA.
11. Determine, by looking at the plan's forms, whether the plan has obtained adequate written consent from a participant's spouse when a distribution from the plan is not in the form of a QJSA or QPSA. Check also to see whether the consent document is correct, in conformance with the plan document, and whether the distribution form is of a type permitted by the plan.
12. In the case of deceased participants, check whether such payments have actually been made to the participant's spouse or, with the spouse's consent, to the participant's designated beneficiary.
13. For single sum distributions, determine whether the participant and spouse were given the choice of a QJSA and that they waived it.
14. Determine whether distributions to unmarried participants were paid in the form of a life annuity, unless an appropriate election of another form of benefit was made by the participants.
15. Determine whether a plan otherwise subject to IRC section 417(a) is exempt from these requirements because it provides a fully subsidized QJSA and QPSA as described in IRC section 417(a) (5) and its regulations.
16. Review the explanation of the QJSA given to participants to determine whether the explanation was prepared in nontechnical language while still providing participants with enough facts to make an informed decision on the form of benefit selected.

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*Continued on next page*



**Examination Tips - Joint and Survivor Annuities, Continued**

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**J&S exam tips  
(continued)**

17. Determine whether the plan provided this explanation no more than 90 days from the annuity starting date and no less than 30 days prior to the annuity starting date.
18. If the plan provided the explanation after the annuity starting dates determine whether the required election period ended earlier than 30 days after the explanation was provided.
19. Also, if the explanation was provided during a period that was less than 30 days before the annuity starting date determine whether the distribution took place more than 7 days after the explanation was provided and whether the other requirements in section 1.417(e)(1)(b)(2)(ii) were satisfied.
20. Determine whether the participant and spouse elected in writing to waive the QJSA not more than 90 days before the annuity starting date if a benefit is paid in a form other than a QJSA.
21. Does the plan provide an adequate written waiver or have the participant and spouse made an adequate written election to waive the QJSA?
22. If the explanation was provided more than 90 days prior to distribution determine whether the participant was provided with a summary explanation, and provided with an opportunity to receive a full notice, within 90 days prior to the distribution.
23. Determine whether the spousal consent requirements outlined above were satisfied when a married participant is paid a benefit in a form other than a QJSA.
24. Determine whether:
  - a. A QPSA is being or will be paid to the surviving spouse (unless following the death of the participant the spouse waived the QPSA),  
or
  - b. An effective election waiving the QPSA was timely executed by the participant and consented to by the spouse when a participant dies prior to his annuity starting date.

## Examination Tips - Distributions

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**Distribution exam tips**

Following is a list of examination tips or items to review when conducting the distribution portion of the exam. The list is not intended to be all-inclusive.

1. Inspect the language in the plan document to determine when and under what circumstances distributions can be made.
2. Inspect the language in the plan document to determine if hardship distributions are allowed and under what circumstances (general or deemed standards).
3. Examine the plan document provisions pertaining to allowable distributions. If the plan provides for QNECs and QMACs, then these contributions are subject to the same restrictions as elective contributions, except that they generally cannot be distributed on account of hardship.
4. When hardship distributions are made from the plan, compare the amount distributed with the total elective contributions made by the participant to the plan to ensure the distribution was not in excess of total elective contributions.
5. Participant account statements should provide a separate breakdown of the elective contributions from other types of contributions.
6. Request from the Plan Administrator copies of hardship application files. Inspect these files to determine the reason the distribution was made.
7. If the plan uses the deemed hardship distribution standards, inspect the employee's individual account statement for the 12 months following the receipt of the hardship distribution.
8. The employee must be prohibited from making elective contributions (and after-tax employee contributions) for at least 12 months following receipt of the hardship distribution. EGTRRA has changed the limitation of elective contributions to 6 months.

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*Continued on next page*

## Examination Tips - Distributions, Continued

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**Distribution  
exam tips  
(continued)**

9. A distribution generally may be treated as necessary to satisfy a financial need if the employer relies upon the employee's written representation, unless the employer has **actual** knowledge that the need can be reasonably relieved:
    - a. Through reimbursement from insurance,
    - b. By liquidation of the employee's assets,
    - c. By cessation of elective contributions, or
    - d. By other distributions or nontaxable loans from plans maintained by the employer.
  10. Request copies of Form 1099-Rs for all distributions including hardship distributions. The hardship distribution amount may be increased for federal, state and local taxes.
  11. Inspect the plan document to determine whether loans are available. If the plan provides for loans, then all nontaxable loans should be made prior to making any hardship distributions.
  12. If the CODA has been terminated, determine whether the employer had another defined contribution plan in existence at the time of termination or established one in the 12 months following distribution of all the assets from the terminating plan. If so, the CODA is not qualified unless the assets are transferred to the other defined contribution plan or the 2% overlap rule is satisfied.
  13. If the CODA has been terminated, determine whether the employer had another defined contribution plan in existence at the time of termination or established one in the 12 months following distribution of all the assets from the terminating plan. If so, the CODA is not qualified unless the assets are transferred to the other defined contribution plan or the 2% overlap rule is satisfied.
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**Exhibit 1****Summary of Form 5330 Examination Procedures – IRM 4.71.5**

- (1) **Master File.** As a general rule Forms 5330 are now established on the Business Master File (BMF) at the Ogden Service Center. As you know, this is a substantial change for EP from past utilization of the Non-Master File (NMF). It is also an important change that provides better access to Form 5330 module results and history, and it also automates the assessment process for these returns.
- (2) **Deminimus Provision.** AIMS establishment of all agreed delinquent returns is required on original returns if one return has tax of \$500 or more. This requirement does not relieve the agent of the responsibility of obtaining correction or of requiring the taxpayer to file a delinquent return. It merely makes allowance for certain delinquent returns to not be established on AIMS. This deminimus provision only applies if:
  - a) The taxpayer makes correction. It applies only to agreed cases.
  - b) There is not excise tax due of \$500 or more in any one year. For example, if a prohibited transaction (PT) exists with excise tax due of \$400 in the 2000 tax year and \$700 in the 2001 tax year, both years must be established on AIMS. Conversely, if \$400 was due in 2000 and in 2001, neither year would need to be established on AIMS; although the agent should obtain correction of the PT and solicit Forms 5330.
- (3) **Entity Module.** An entity module must be present on the BMF before a Form 5330 return can be posted on BMF or established on AIMS. In most cases, an entity module already exists for the business sponsoring the plan. It is more likely that an entity module will need to be established on the BMF for individuals who you determine are required to file Forms 5330.
  - a. If a BMFOL print is secured and entity information is present then an entity module exists (A file source of “V” must be used with an SSN. No file source is used with an EIN).
  - b. If an entity module is not present then Form 4442 must be processed to establish an entity module. Form 4442 should be completed by the agent and mailed to the EP AIMS Coordinator for input.
- (4) **Preparation of Form 5597 to Establish Returns.** Form 5597 should be prepared by the agent and input to establish the Form 5330 on EPIC and AIMS. Although the agent must prepare Form 5597, it is not necessary for the group to input Form 5597 on AIMS (however, returns that are being examined must be established on EPIC by the group). At the discretion of the group manager, agreed Forms 5330 being examined can be established on AIMS by ESS in Brooklyn, and Mandatory Review can be utilized to establish unagreed cases on AIMS.
- (5) **AIMS Prints.** If Forms 5330 are input on AIMS by group, an AMDISA print reflecting a “424” transaction code (TC) should be included with the case file as it is processed. It is important to understand that this is not a full AIMS

account. A full AIMS account is not established until the Form 5330 is processed by the Service Center. A TC "150" indicates that a return has been processed. You will be able to close / process your case to the next level with a TC "424", but the return will not show up on the AIMS group inventory reports until there is a TC 150.

- (6) **EPIC Used to Control Examined Forms 5330.** EPIC, not AIMS must be used to control the group inventory of Forms 5330 because there is no full AIMS account (i.e., no TC "150") until the return is processed by the Service Center (which may take several weeks). Statutes cannot be updated until there is a TC 150.
- (7) **Ogden Service Center.** Forms 5330 secured by the agent are to be mailed to the Ogden Service Center for processing.
- (8) **Form 5599.** Form 5599 is the closing document used to close Forms 5330 established on AIMS.
- (9) **No Need to Wait for TC 150.** Agreed Forms 5330 examinations can be closed by the group immediately upon forwarding delinquent Forms 5330 to the Ogden Service Center. It is not necessary to hold the case until the return is processed and posted by the Service Center.
- (10) **Close Agreed Forms 5330 exams to Brooklyn.** Agreed Forms 5330 are to be closed to ESS in Brooklyn, New York instead of Baltimore.
- (11) **Unagreed Cases.** Before closing an unagreed case to Mandatory Review, the agent should:
  - a. Determine if an entity module is established on the BMF (per item 3 above),
  - b. Prepare and input Form 5597 (per item 4 above),
  - c. Prepare a Substitute for Return package (which is to remain in the case file), and
  - d. Prepare portions of the 30-Day Letter package including a Revenue Agent Report (RAR). A copy of the RAR should be included on a disk in the case file.

