



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

SMALL BUSINESS/SELF-EMPLOYED DIVISION

November 25, 2008

Control No: SBSE-04-1108-064  
Expires: November 25, 2009  
Impacted IRM: 4.23.8.4  
IRM 4.23.10.16

MEMORANDUM FOR EMPLOYMENT TAX TERRITORY MANAGERS, GROUP  
MANAGERS AND SPECIALISTS

FROM: John Tuzynski /s/ *John Juzynski*  
Chief, Employment Tax Operations

SUBJECT: Interim Guidance on IRC 3402(d) Relief in an Examination

The purpose of this memorandum is to issue revised procedures for granting IRC 3402(d) relief when Forms 4669, Statement of Payments Received, and Form 4670, Request for Relief from Payment of Income Tax Withholding, are secured during an examination. This guidance applies to backup withholding under IRC 3406 and income tax withholding under IRC 3402.

Internal Revenue Code Section 3402(d) provides, in part, that when an employer/payor fails to deduct and withhold income tax, they will not be held liable for the tax if it is shown that the recipient paid the appropriate income tax attributable to the withholding. This payment does not relieve the employer/payor from any liability for penalties or interest with respect to the failure to deduct and withhold.

IRC 3406(h)(10) provides that the payments subject to backup withholding shall be treated as if they were wages paid by an employer to an employee under IRC 3402.

In brief, to properly assess both income taxes under IRC 3402 and backup withholding under IRC 3406, together with the any applicable penalties and interest, examiners will follow a modified Partial Assessment procedure which will generate an initial billing notice for the gross amounts shown on the Form 2504 prior to the case being processed for closing. The taxpayer will subsequently receive a second notice containing the abatements allowed in the examination upon final processing of the Forms 4669 by Centralized Case Processing (CCP). This modified Partial assessment procedure requires two Forms 5344 to be completed.

Four documents are attached to this memo:

The first attachment, Report Writing Instructions for IRC 3402(d) Abatements, provides additional instructions for report writing. Included are specific instructions for Form 4666, Form 4668, a description of the proper format for Form 2504, and a payee spreadsheet summary description.

The second attachment, Instructions for Form 5344 Completion in Processing Abatements for IRC 3402(d) Cases, provides special processing instructions for the initial and final Forms 5344.

The final two attachments, Partial Assessment Processing Instructions for IRC 3402(d) Abatements – Income Tax and Backup Withholding Cases and Partial Assessment Processing Instructions for IRC 3402(d) Abatements – Backup Withholding Cases, provide step-by-step processing instructions for assessments for Forms 945 and Forms 941.

A toolkit consisting of these same attachments and examples will also be posted on the SB/SE Employment Tax webpage at:

<http://sbse.web.irs.gov/SP/EmploymentTax/Default.html>. This toolkit serves as a one-stop internal resource for examiners processing this audit adjustment by providing the processing instructions and examples of all forms.

Effect on Other Documents: This Interim Guidance Memorandum will be incorporated in:

- IRM 4.23.8.4.2, Procedures for Granting Relief Under IRC 3402(d) by Examiners,
- IRM 4.23.10.16.2, Examination Procedures for IRC 3402(d) Relief, and
- 4.23.10.16.3, Examination Report Forms 4666, 4668, and 2504 for IRC 3402(d) Examinations.

The above guidance is effective immediately. If you have any questions, please contact Laird MacMillan, Senior Tax Analyst, SB/SE Employment Tax Policy.

Attachments:

1. Report Writing Instructions for IRC 3402(d) Abatements
2. Instructions for Form 5344 Completion in Processing Abatements for IRC 3402(d) Cases
3. Partial Assessment Processing Instructions for IRC 3402(d) Abatements – Income Tax and Backup Withholding Cases
4. Partial Assessment Processing Instructions for IRC 3402(d) Abatements – Backup Withholding Cases

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

## **Report Writing Instructions For IRC 3402(d) Abatements**

This attachment provides additional instructions for report writing in IRC 3402(d) abatement cases for backup withholding and income tax withholding.

### **Form 4666**

The examiner should discuss with the taxpayer the process involved and the timing of both notices. A statement should be included on the Form 4666 as notification to the taxpayer of the process involved:

This report reflects the agreed total income tax under IRC 3402 (including applicable assessments of IRC 3406, Backup Withholding), without consideration of any abatements provided by the taxpayer on Forms 4669.

Forms 4669, Statement of Payments Received, have been provided by the taxpayer to abate all or part of the total income/backup withholding tax assessment per the abatement procedures of IRC 3402(d). A credit for this tax abatement is shown as a credit memo on the Form 2504 agreement. A listing of all payments and the abatements allowed in the examination are attached to this report.

To accurately reflect the examination results, the Service Center will mail two notices to the taxpayer:

1. The first notice will show total tax and penalties due without regard to the Forms 4669's solicited in exam.
2. The second notice will be issued 4 to 6 weeks later reflecting the net tax due after the Form 4669 abatements are processed.

### **Form 4668**

For examinations using the Form 4668, Employment Tax Examination Changes Report, Line 17, Maximum tax available for abatement under IRC 3402(d), should be identified by quarter. Both the maximum available credit and the IRC 3402(d) credits allowed in the examination from the payee Form 4669's should be identified by quarter on the payee spreadsheet. The total IRC 3402(d) credit allowed for the year should match the total IRC 3402(d) credit amounts listed on the Form 2504.

### **Form 2504**

The total amount available for IRC 3402(d) credit should be listed as a separate line item in the "Kind of Tax and Internal Revenue Code Section" as "IRC 3402(d) Credit for Abatement \$\_\_\_\_\_." It is not to be shown as a reduction of the gross tax.

In addition, examiners are reminded to use the correct version of the three Forms 2504 available. If the IRC 3402(d) abatement applies to a worker reclassification case, use the Form 2504-WC. (Note: Examiners are reminded that IRC 3402(d) abatements are not available for worker reclassification issues computed using IRC 3509.)

For examinations that did not involve a determination of worker status, i.e., Form 945 for Backup Withholding, Form 2504 with the section 530 disclaimer should be used.

### **Spreadsheet**

A spreadsheet of payments should be created by the examiner and included in the workpapers and as a cover sheet for the secured Forms 4669. This spreadsheet should identify the payee, the amount paid to each payee by quarter, the amount of payment eligible for IRC 3402(d) consideration, and the Forms 4669 accepted in examination.

**Instructions for Form 5344**  
**Completion in Processing Abatements**  
**IRC 3402(d) Cases**

To properly assess the IRC 3406 tax, penalties, and interest, two Forms 5344 must be completed using this modified Partial Assessment Process for each tax period to be assessed. This will ensure that the gross penalties and interest are not affected by the IRC 3402(d) abatement. The first Form 5344 should be labeled:

**“PARTIAL ASSESSMENT - GROSS TAX & PENALTIES”**

**Special instructions:**

1. Only the left side of Page 1 of the Form 5344 is input – You do not need to complete Items 16-43 or attach Page 2 of the Form 5344
2. **All** adjustments for the examination, including any other employment tax issues other than the IRC 3402(d) items (fringe benefits, IRC 3509, etc.), are to be included on this initial Form 5344.
3. Special Item instructions are:
  - a. ITEM 11:  
Enter if TC 308 is entered in Box 12
  - b. ITEM 12:  
Include gross tax amount as TC 300 (or 308 if Interest-free). Also enter any applicable penalties
  - c. ITEM 15:  
Include all reference codes and amounts corresponding to the entire assessment.

Upon verification of the partial assessment processed using the initial Form 5344, continue with final closing of the case from the exam group. The second Form 5344 must be entirely completed. The second Form 5344 should be labeled:

**“FINAL CLOSURE - F4669 ABATEMENT”**

**Special instructions:**

1. Complete both the left and right sides of Form 5344, including Page 2, per normal closing procedures
2. The only adjustments to be reflected on the left side of Page 1 are the IRC 3402(d) abatement adjustments allowed in the examination.
3. Special Item instructions for the Final Closure Form 5344::
  - a. ITEM 11:  
Enter if TC 309 is entered in Box 12
  - b. ITEM 12:  
Include the abatement tax amount as TC 301 (or 309 if Interest-free)
  - c. ITEM 15:  
Include corresponding reference amounts for the IRC 3406 backup withholding abatement portion **only**.

These procedures will generate an initial billing notice for the gross amounts shown on the Form 2504 prior to the case being processed for closing. The taxpayer will receive a second notice containing the abatements allowed in the examination upon processing of Forms 4669 by Centralized Case Processing (CCP).

**Partial Assessment Processing Instructions**  
**IRC 3402(d) Abatements**  
**Income Tax and Backup Withholding Cases**

To properly assess IRC 3402 and IRC 3406 taxes, penalties and interest, examiners will follow these modified Partial Assessment procedures. This will generate an initial billing notice for the gross amounts shown on the Form 2504/Form 2504-WC prior to the case being processed for closing. The taxpayer will receive a second notice containing the abatements allowed in the examination upon processing of Forms 4669 by Centralized Case Processing (CCP).

The examiner should discuss this process with the taxpayer using the statement included on the Form 4666. This should alleviate taxpayer concerns that the Forms 4669 were not properly processed upon receipt of the first notice.

**NOTE:** To avoid delays between the issuance of the two taxpayer notices, the Partial Assessment procedures should be made **prior** to final group closing procedures. Upon receipt of confirmation from CCP of processing, the case can be closed from the group.

**Partial Assessment Process**

- (1) Contact the appropriate CCP campus (refer to the CCP Website below for contact information) to inform that the assessment document is being sent.  
<http://sbse.web.irs.gov/CCP/>
- (2) Prepare a fax cover sheet for transmittal with all relevant information, including identification of all parties, the forms attached and the number of pages. The fax will consist of:
  - a. Fax cover sheet,
  - b. Completed Form 3198 with the "Partial Assessment" box checked,
  - c. Appropriate Form 2504 and/or Form 2504-WC signed by the taxpayer,
  - d. Completed agreed report including Form 4666, Form 4667 and Form 4668 supporting the waiver, and
  - e. Form 5344 for each period to be assessed. Complete the form as necessary. (See #3 below and "Instructions for Form 5344 Completion in Processing Abatements for IRC 3402(d) Cases" for additional instructions)

Upon completion of the partial assessment, CCP will:

- i. Stamp Form 5344 "Request Completed"
  - ii. Fax a copy back to the field for association with the original case file to show that the assessment was completed within 5 days.
- (3) All adjustments for the examination, including any other employment tax issues other than the IRC 3402(d) items (fringe benefits, IRC 3509, etc.) should be included on the initial "Partial Assessment – Gross Tax and Penalties" Form 5344.
- (4) Upon verification of the partial assessment, continue with final closing of the case from the exam group. The second Form 5344 must be entirely completed. Enter the amount of abatement based on Forms 4669 allowed in exam as a 301 or 309 item in Box 12, and the corresponding reductions of line items in Box 15. See attached "Instructions for Form 5344 Completion in Processing Abatements for IRC 3402(d) Cases"
- (5) In order to avoid duplicate processing of Forms 4669, the Forms 4669 accepted in exam will be identified by writing "Form 4669 accepted in exam on (MM/DD/YY)" on each form. The Payee listing will be the cover sheet for the accepted Forms 4669, and this package will remain in the case file. Identify on Form 3198, "FORM 4669 - ADJUSTMENTS ALLOWED BY EXAMINATION."
- (6) Additional instructions for Form 5344 for partial assessments can be found in IRM 4.4.12.

**Partial Assessment Processing Instructions**  
**For IRC 3402(d) Abatements**  
**Backup Withholding Cases**

To properly assess the IRC 3406 tax, penalties and interest, examiners will follow these modified Partial Assessment procedures. This will generate an initial billing notice for the gross amounts shown on the Form 2504 prior to the case being processed for closing. The taxpayer will receive a second notice containing the abatements allowed in the examination upon processing of Forms 4669 by Centralized Case Processing (CCP).

The examiner should discuss this process with the taxpayer using the statement included on the Form 4666. This should alleviate taxpayer concerns that the Forms 4669 were not properly processed upon receipt of the first notice.

**NOTE:** To avoid delays between the issuance of the two taxpayer notices, the Partial Assessment procedures should be made **prior** to final group closing procedures. Upon receipt of confirmation from CCP of processing, the case can be closed from the group.

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  - (a) Fax cover sheet,
  - (b) Completed Form 3198 with the "Partial Assessment" box checked,
  - (c) Form 2504 (with 530 statement) signed by the taxpayer,
  - (d) Completed agreed report including Form 4666, Form 4667 and Form 4668 supporting the waiver, and
  - (e) Form 5344 for each period to be assessed. Complete the form as necessary. (See #3 below and "Instructions for Form 5344 Completion in Processing Abatements for IRC 3402(d) Cases" for additional instructions)

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