Part 5. Collecting Process

Chapter 15. Financial Analysis

Section 1. Financial Analysis Handbook

5.15.1 Financial Analysis Handbook

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Manual Transmittal

November 17, 2014

Purpose

(1) This transmits revised IRM 5.15.1, Financial Analysis, *Financial Analysis Handbook*.

Material Changes

(1) IRM 5.15.1.1 Changed title of subsection to reflect the overview.

(2) IRM 5.15.1.1 (1) Added overview for Financial Analysis.

(3) IRM 5.15.1.1(5) Added note that tax examiners in Field Collection are exempt from the requirement to make field calls.

(4) IRM 5.15.1.2(4) Guidance for six-year rule and one-year rule has been moved to IRM 5.14.1, Installment Agreements, *Securing Installment Agreements*. Removed guidance and added a cross reference to IRM 5.14.1.

(5) IRM 5.15.1.3(2) Added note that tax examiners in Field Collection are exempt from the requirement to make field calls.

(6) IRM 5.15.1.4(1) Provided clarification of a non-liable person and commingled funds when determining shared expenses.

(7) IRM 5.15.1.4(2) Provided guidance for Taxpayer Advocate assistance and a note to contact Counsel for community property questions.

(8) IRM 5.15.1.4(4) Corrected the shared expense table.

(9) IRM 5.15.1.5(3) Changed Currency and Banking Retrieval System (CBRS) to Financial Crimes Enforcement Network Query (FCQ)

(10) IRM 5.15.1.8(5) Created an alpha list for out-of-pocket health care expenses for emphasis.

(11) IRM 5.15.1.9(1)(a) Clarified verification required for expenses claimed by a taxpayer for housing and utilities.

(12) IRM 5.15.1.10(4)(b)(1) Changed guidance in Note if net disposable income is less than $25.

(13) IRM 5.15.1.10(4)(b)(3) Changed guidance in Note if net disposable income is less than $25.

(14) IRM 5.15.1.10(4)(c) Removed reference to $25 monthly payment in paragraph and table.

(15) IRM 5.15.1.11(1) Changed non-liable spouse to non-liable person.

(16) IRM 5.15.1.16(1)(c) Added a cross-reference to IRM 5.11, *Notice of Levy*.

(17) IRM 5.15.1.16(2) Added issue related to the Federal Payment Levy Program for consideration when deciding the best case resolution.

(18) IRM 5.15.1.19(4) Added note that tax examiners in Field Collection are exempt from the requirement to make field calls

(19) IRM 5.15.1.27(1) Added a cross-reference to IRM 5.11.6.2, *Funds in Pension or Retirement Plans*.

(20) IRM 5.15.1.30 Added information regarding reverse mortgages.

(21) IRM 5.15.1.32(5) Added information for federal contracts.

(22) IRM 5.15.1.38 Added new subsection for Medicare/Medicaid Providers.

(23) Exhibit 5.15.1-1 Updated the question and answer for Question 14.

(24) Website addresses, legal references, IRM references, grammar and punctuation were reviewed and updated as necessary.

Effect on Other Documents

This material supersedes IRM 5.15.1 dated October 2, 2012. It also incorporates Interim Guidance Memorandum #SBSE 05-0614-0051, Tax Examiner Deviation Authority to Work Collection Field Function Corporate Inventory, dated June 17, 2014.

Audience

The intended audience is SB/SE Revenue Officers, Collection Management Officials and other IRS Collection personnel.

Effective Date

(11-17-2014)

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Small Business/Self Employed

5.15.1.1 (11-17-2014)
Overview and Expectations

1. This IRM provides instructions for securing, verifying and analyzing financial information. This analysis provides the basis for determining a taxpayer's ability to pay delinquent tax liabilities, which enables Collection employees to make appropriate collection decisions to resolve cases.

2. An interview should be conducted in order to determine the appropriate case resolution. Request full payment of the tax liability. Encourage taxpayers to pay off the tax liability as quickly as possible. If taxpayers are unable to pay in full (and do not qualify for a Guaranteed or Streamlined Installment Agreement) secure a complete Collection Information Statement (CIS).

3. The taxpayer's financial information may be secured on:

   A. Form 433-A, *Collection Information Statement for Wage Earners and Self-Employed Individuals*

   B. Form 433-B, *Collection Information Statement for Businesses*

   C. Form 433-F, *Collection Information Statement* - Used by the Automated Collection System (ACS) and the campuses for individuals.

      Note:

      Revenue officers may use Form 433-F:
      • For Trust Fund Recovery Penalty (TFRP) investigations when the individual is a wage earner and the potential TFRP is less than $100,000. See IRM 5.7.5.2, *Collectibility*, and
      • For self-employed and individual wage earners who owe for IMF liabilities only, with an aggregate balance of assessments less than $250,000.

      Exception:

      Form 433-F cannot be used for Offer-in-Compromise cases or for cases designated as Abusive Tax Avoidance Transactions (ATAT).

   D. A business taxpayer's own financial statement (income statement and balance sheet) can be used as a substitute for the income and expense section of the Collection Information Statement.

      Reminder:

      Cases on partnerships and single member owner limited liability companies, where the individual owner is identified as the liable taxpayer, require an analysis of the business income and allowable business expense reported on Form 433-B, as well as the individual income and allowable living expenses of the partners or owner reported on Form 433-A.

4. A CIS submitted by a taxpayer should reflect information no older than the prior six months. If during the investigation of the case, the information becomes older than 12 months, update the information. Updates can usually be pen and ink changes initialed and dated by the taxpayer and/or revenue officer. Additional supporting documents should be secured when appropriate. If there is reason to believe that the taxpayer's situation may have significantly changed, secure a new CIS.

5. Secure, review and discuss the financial statements in person whenever possible. While some aspects of the financial statement review process, such as securing financial information, can occur by phone or correspondence, a face-to-face meeting with the taxpayer and/or the taxpayer's representative is preferred to effectively facilitate the verification/validation of the financial statements provided. This face-to-face interview should be conducted at the taxpayer’s business, residence or in the office unless the taxpayer is physically unable to meet with the revenue officer. The physical verification of the business assets is required at some point early in the financial statement review process and should be conducted in the presence of the taxpayer and/or the taxpayer's representative.

   Note:

Tax examiners in Field Collection are exempt from the requirement to make field calls.

6. The Allowable Living Expense (ALE) Standards, also known as the Collection Financial Standards, include national and local standards, which are guidelines established by the Service to provide consistency in certain expense allowances such as food and household expenses, medical expenses, housing and transportation. Reference to these standards will be found throughout this section. *Exhibit 5.15.1-2* provides instructions for on-line access to the actual standards.

7. The standard amounts set forth in the national and local guidelines are designed to account for basic living expenses. In some cases, based on a taxpayer's individual facts and circumstances, it will be appropriate to deviate from the standard amount when failure to do so will cause the taxpayer economic hardship (See IRM 5.15.1.1(8)). The taxpayer must provide reasonable substantiation of all expenses claimed that exceed the standard amount.

   Note:

   Substantiation can consist of credible verbal communication or written documentation received from the taxpayer. Both types of substantiation should be thoroughly documented in the case history.

   Example:

   Taxpayer's income dropped significantly from the prior year and taxpayer explains that he went though a divorce and is no longer claiming two incomes. Verbal substantiation supporting the drop in income should be documented in the case history.

   Document the case file accordingly. For example:

   - Bank statements or canceled checks
   - Credit card vouchers
   - Rent/lease receipts and lease agreements
   - Payment coupons
   - Court orders
   - Contracts
   - Future expenses, e.g., the birth of a child or the necessary replacement of a car that will increase expenses
   - Taxpayer statements or written communications
   - Tax statements and tax returns that will provide evidence of actual expenses

   Example:

   A taxpayer with physical disabilities or an unusually large family requires a housing cost that is not anticipated by the local standard. The taxpayer is required to provide copies of mortgage or rent payments, utility bills and maintenance costs to verify the necessary amount.

8. Economic hardship occurs when a taxpayer is unable to pay reasonable basic living expenses. The determination of a reasonable amount for basic living expenses will be made by the Commissioner and will vary according to the unique circumstances of the individual taxpayer. Unique circumstances, however, do not include the maintenance of an affluent or luxurious standard of living. (26 C.F.R. 301.6343-1(b)(4)).

   Reminder:

   If a collection employee and taxpayer disagree about an economic hardship determination, the taxpayer should be referred to the Taxpayer Advocate Service. (See IRM 13.1.7.2, *Taxpayer Advocate Case Criteria.*)

9. The Allowable Living Expense standards are not applicable to corporations, partnerships, Limited Liability Companies (LLC) (where the LLC is identified as the liable taxpayer), or for any business expenses. Allowable business expenses are the costs of carrying on a business or trade. Generally, they must be necessary for operation of the business. Use bank statements, tax returns or other records to verify business income and expenses. Request additional documentation if assets, liabilities, expenses or income appear questionable.

10. Analysis and verification of a CIS should take place shortly after obtaining the CIS. The ability to pay determination based on a thorough financial analysis will be communicated to the taxpayer within a reasonable amount of time after obtaining the CIS.

11. Emphasize to the taxpayer how much the Service expects from them rather than how the Service expects them to spend their money.

    A. Advise the taxpayer that the Service expects a payment equal to the amount in excess of necessary expenses and any allowable conditional expenses and, explain to the taxpayer how the amount expected was calculated.

    B. Advise the taxpayer that he/she is responsible for determining what buying or spending modifications are needed in order to pay their liabilities. Do not tell the taxpayer what he/she can or cannot own or spend.

12. The analysis of a taxpayer's financial condition provides a basis to make one or more of the following decisions:

    A. Request payment in full or in part from available assets.

    B. Make a lien filing determination (IRM 5.12.2, *Lien Filing Requirements*).

    C. Initiate enforcement action if assets are available to pay the liability and the taxpayer is unwilling to voluntarily convert assets to cash (IRM 5.10.1, *Pre-Seizure Considerations*).

    D. Enter into an Installment Agreement (IRM 5.14.1, *Securing Installment Agreements*).

    E. Report the account Currently Not Collectible (IRM 5.16.1, *Currently Not Collectible*).

    F. Explain the Offer in Compromise provisions. In cases where an offer in compromise appears to be a viable solution to a tax delinquency, the Service employee assigned the case will discuss the compromise alternative with the taxpayer and, when necessary, assist in preparing the required forms (IRM 5.8.1, *Overview*).

13. If during the course of conducting a financial investigation, the taxpayer continues to accrue tax liabilities for additional tax periods (for example, a sole proprietorship that continues to fail to make federal tax deposits), enforced collection action should be considered, when appropriate. See IRM 5.7.8, *In-Business Repeater or Pyramiding Taxpayers*. For hardship situations, see IRM 5.16.1.2.9, *Hardship*.

5.15.1.2 (11-17-2014)
Analyzing Financial Information

1. Analyze the income and expenses to determine the amount of disposable income (gross income less all allowable expenses) available to apply to the tax liability.
2. Analyze assets to resolve the balance due accounts.
   A. Request immediate payment if the taxpayer has cash equal to the total liability.
   B. Identify key sources of funds.
   C. Identify liquid assets which can be pledged as security or readily converted to cash. (For example, equipment or factoring accounts receivable.)
   D. Consider unencumbered assets, equity in encumbered assets, interests in estates and trusts, and lines of credits from which money may be borrowed to make payment.
   E. Consider taxpayer's ability to get an unsecured loan.
   F. Determine the priority of the Notice of Federal Tax Lien when considering whether to allow or disallow payments to other creditors. See IRM 5.17.2.6 , *Priority of Tax Liens: Specially Protected Competing Interests*.
3. In some cases, payments on expense items are not due in regular monthly increments. Average necessary living expense items with varying monthly payments over 12 months.

   Example:

   Car insurance may be paid monthly, quarterly, twice a year or yearly. For purposes of calculating monthly income compute the total cost for the year and divide by 12.
4. Exceptions to verifying and allowing certain expenses when securing an installment agreement may apply. See IRM 5.14.1.4.1, *Six-Year Rule and One-Year Rule*.

5.15.1.3 (11-17-2014)
Verifying Financial Information

1. When conducting interviews to secure and/or review financial statements, ask pertinent questions to determine as much as possible about the taxpayer's financial condition and document the results. For example:
   A. How the taxpayer generates income, both foreign and domestic
   B. The nature of their business process
   C. The main products/services, type of customers, wholesale vs. retail, etc.
   D. Major suppliers and competitors
   E. Assets held in the name of the taxpayer or on their behalf, both foreign and domestic
   F. Type of internet presence the taxpayer may have
2. Observe and document the physical layout of the business, the number of employees, the type and location of equipment, machinery, vehicles and inventory. A brief tour of the business premises may help to gauge the business operation and the condition of assets.

   Note:

   Tax examiners in Field Collection are exempt from the requirement to make field calls.
3. A thorough verification of the CIS involves reviewing information available from internal sources and requesting that the taxpayer provide additional information or documents that are necessary to determine reasonable collection potential. Consider contacting third parties to verify or obtain information (see IRM 25.27, *Third Party Contacts*.)
4. Collection issues that have been previously addressed during a balance due investigation by field personnel in the preceding 12 months will not be re-examined unless there is convincing evidence that such reinvestigation is absolutely necessary.

   Example:

   If the previous revenue officer has completed a full CIS analysis within the last 12 months including verification of assets, income, and expenses and has made a determination of the Fair Market Value of assets, equity in assets and monthly ability to pay, the information should not be reinvestigated unless there is reason to believe the taxpayer's situation has significantly changed.
5. A taxpayer is not required to substantiate expenses that are categorized as National Standards unless they exceed the Standard.

   Exception:

   If a taxpayer claims more than the total allowable amount for the five categories of National Standards for Food, Clothing and Other Items, the taxpayer is only required to substantiate expenses for the categories that exceed the standards. The standard amounts will be allowed for the remaining categories without substantiation.
6. A taxpayer may be required to substantiate expenses that are categorized as Local Standards or Other Expenses (See *IRM 5.15.1.9*, *Local Standards*, and *IRM 5.15.1.10*, *Other Expenses*.)
7. Substantiation of expense amounts could include the following items: bank statements, credit cards vouchers, rent/lease receipts and leases, payment coupons, court orders, contracts, and canceled checks. Document how obligations are being met and the source of funds. Taxpayers who own real estate should provide documents showing the monthly payment, the purchase price, date of purchase, and the principal amount due. When obtaining documents for substantiation, ask the taxpayer for copies, not original documents. If necessary, secure telephone numbers and contact names of creditors. These can be used if verification is necessary.
8. When analyzing expenses for a business taxpayer, ensure that business expenses are not included under personal expenses. Compare Form 433-A and Form 433-B to income tax returns to verify assets and income or analyze bank deposits.

   Example:

   Taxpayer claims the lease payment of an automobile for business. That expense will not be allowed as part of the transportation expense on Form 433-A. If a taxpayer claims a vehicle for both business and personal use, ensure that the allowable expense is not duplicated.
9. Secure third party information such as bank deposit records, government agency records, competitors or suppliers to determine the source of funds of the taxpayer. Ensure that third party notice requirements are met (refer to IRM 25.27, *Third Party Contacts*.) Use summons authority to secure leads to assets and income (refer to IRM 25.5.1, *Summons*.)
10. Compare income to expenses. If expenses exceed income, ask the taxpayer probing questions to determine alternate sources of income that may be supplementing his/her income. Look for and consider:

- "Non-cash expenses" such as depreciation or amortization of assets
- "Book value" vs. Fair Market Value (FMV)
- Non-payment of accounts receivables (in dispute)
- Down-sizing/insolvent (a viable business)
- Roommate(s) or rental income
- Commingling of funds between related or unrelated entities

Examine prior year returns to detect sporadic income. Review bank deposits for at least 3 months to determine the taxpayer's stated income.

5.15.1.4 (11-17-2014)
Shared Expenses

1. Generally, when determining ability to pay, a taxpayer is only allowed the expenses he/she is required to pay. There may be cases where a taxpayer lives with a non-liable person (i.e., spouse, domestic partner, boyfriend/girlfriend) and bills are paid from commingled funds/joint checking account. In these cases, it may be necessary to review other income into the household and any expenses shared with the non-liable person in order to determine the taxpayer's allowable portion of the shared household income and expenses.

2. Although the assets and income of a non-liable person may be reviewed to determine the taxpayer's portion of the shared household income and expenses, they are generally not included when calculating the amount the taxpayer can pay. One notable exception is community property states. Follow the community property laws in these states to determine what assets and income of the otherwise non-liable spouse are subject to collection of the tax. The non-liable spouse can seek assistance from the Taxpayer Advocate Service.

   Reminder:

   Community Property States: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. In addition, Alaska is an opt-in community property state; property is separate property unless both parties agree to make it community property through a community property agreement or a community property trust. The territories of Puerto Rico, Guam and the Commonwealth of the Northern Mariana Islands also allow property to be owned as community property. See IRM 5.17.2.5.2.1, *Community Property*.

   Note:

   Since the facts of each individual case and state law determine if the taxpayer has a property right or right of reimbursement, Revenue Officers and Advisory should seek Counsel advice when these types of issues arise in determining the taxpayer’s interest for calculating income or equity in assets and any other collection alternative calculations.

3. Regardless of whether community property laws apply, secure sufficient information concerning the non-liable person to determine the taxpayer's proportionate share of the total household income and expenses. Review the entire household's information and:

   A. Determine the total actual household income and expenses.

   B. Determine what percentage of the total household income the taxpayer contributes, i.e., taxpayer's income divided by total household income.

   C. Determine allowable expenses.

   D. Determine which expenses are shared and which expenses are the sole responsibility of the taxpayer, e.g., child support, allowable educational loan, union dues.

   E. Apply the taxpayer's percentage of income to the shared expenses.

      Note:

      The investigating employees should judge each case based on its own applicable facts and circumstances.

   F. Verify the taxpayer actually contributes at least this amount to the total household expense. National Standard expenses do not require verification unless the taxpayer claims more than the standard amount.

   G. Do not allow the taxpayer any amount paid toward a non-liable person's discretionary expenses.

   Example:

   Taxpayer’s income of $20,000 plus non-liable person's income of $5,000 equals household income of $25,000. Divide the taxpayer's income of $20,000 by household income of $25,000 to determine the taxpayer’s share of the household income which would be 80% in this instance. Multiply the taxpayer’s allowable shared expenses by the calculated household income percentage of 80%. This represents the taxpayer’s shared allowable expenses. The taxpayer would also be allowed 100% of expenses which are his/her sole responsibility, unless they are expenses covered by the Allowable Living Expense standards.

4. Shared expense calculations between spouses are used when the parties live in a separate property state or state law permits the parties to separate their incomes and the non-liable spouse does not agree to use their income to pay the liable spouse’s tax debt (IRM 5.15.1.4(2)). Calculations of allowable expenses will depend on the circumstances of each taxpayer. The method used to calculate the liable taxpayer's ability to pay must be documented in the case history.

   Example:

   One method for calculating the liable taxpayer's ability to pay is to determine the income percentages as stated in IRM 5.15.1.4(3). After determining the percentage of income of the liable taxpayer, that percentage is multiplied against the ALE standard amounts for the household. If the taxpayer's calculated percentage amount for National Standards for Food, Clothing and Other Items and for Out-of-Pocket Health Care Costs, is less than the standard amount for one person, the liable taxpayer will be allowed the standard amount. For the other ALE expenses (Transportation and Housing/Utilities), the liable taxpayer will be allowed the calculated percentage amount or the standard amount, whichever is less. The calculated percentage can also be applied to other shared expenses, such as family health insurance. Consideration should also be given to any separate expenses the liable taxpayer may be solely responsible for paying, such as alimony, child care, etc.

Family of 4	Actual Amount Claimed	Maximum Allowable Amount for Family of 4	Maximum Allowable Amount for one Taxpayer	Taxpayer’s Percentage of Total Income and Expenses	Taxpayer Expenses Allowed for Computation
Gross Monthly Income	$6667 non- liable person $1667 liable taxpayer $8333 total income			20% ($1667/$8333)	
National Standard for Misc.	$1370	$1370	$565	$274 ($1370 x .20)	$565 the greater amount
Housing and Utilities	$2256	$2465	$1635	$451 ($2256 x .20)	$451 the lesser amount
Ownership Costs				$105	$105

- Car 1	$525 owned jointly	$517	$517	($525 x .20)	the lesser amount
Ownership Costs - Car 2	$480 owned jointly	$517	0 (See Note below)	$96 ($480 x .20)	$96 the lesser amount
Operating Costs - Both cars	$500	$488	$244	$100 ($500 x .20)	$100 the lesser amount
Out-of-pocket Health Care	$200	$240	$60	$40 ($200 x .20)	$60 the greater amount
Health Insurance	$400 for family paid by non- liable person			$80 ($400 x .20)	$80
Taxes	$1800 non- liable person $400 liable taxpayer				$400
Child Support Payments	$300 liable taxpayer				$300
Court Ordered Payments	$100 non-liable person				

Note:

If the vehicles are not owned jointly, the liable taxpayer would be allowed actual expenses paid for the vehicle he/she owns. The percentage method can be applied if two vehicles are jointly owned, but the maximum expense allowed for the liable taxpayer will be the standard amount for one vehicle.

5. When the taxpayer can provide documentation that income is not commingled (as in the case of roommates who share housing) and responsibility for household expenses is divided equitably between co-habitants, the total allowable expense should not exceed the total allowable housing standard for the taxpayer. In this situation, it would not be necessary to obtain the income or expense information of the non-liable person(s). Verification of expenses the taxpayer pays should be requested if the expenses appear unreasonable. The investigating employees should exercise sound judgment in these situations to determine which approach is more appropriate, based on the facts of each case.

Note:

In the situation where the taxpayer is renting an apartment or room and the owner of the property is the non-liable person, the rental agreement or signed statement from the owner of the property should support the decision to not require the owner to divulge any personal information regarding income or household expenses. In these cases, the investigating employee should accept the information provided by the taxpayer and make a determination based on that information.

Example:

Taxpayer shares expenses with a roommate. In this situation the taxpayer receives the full National Standard for one person and the full Out of Pocket Health Care Standard for one person. The taxpayer would receive the amount actually paid up to the maximum amount of the Local Housing and Utility Standard and Local Transportation Standard.

If an internal verification is conducted on the non-liable person, this information cannot be provided to the taxpayer. This is not an Unauthorized Access (UNAX) violation if the revenue officer's duties require the inspection or disclosure of this information for tax administration purposes. However, it is a disclosure violation under IRC 6103 if any information is shared with someone other than the non-liable person in question, unless consent to disclose the information is obtained from the non-liable person.

5.15.1.5 (11-17-2014)
Internal Sources and Online Research

1. When required, verify as much of the financial statement as possible through internal sources and online research (see table below).
2. When internal locator services are not available, or a discrepancy is indicated, request that the taxpayer provide reasonable information necessary to support the financial statement or verify using external sources (*IRM 5.15.1.6*, *External Sources*.)
3. Consider researching the information sources listed below to verify the CIS, in situations where a CIS is required. Tailor your research to the facts and circumstances of each case.

Internal Sources	Review
ENMOD and INOLES	Identify cross-reference TIN's for related business activity not declared on the CIS.
SUMRY, IMFOL and BMFOL	Verify full compliance.
RTVUE (IMF) or copy of the last filed return (1040)	• Compare the amount of reported income to that declared on the CIS. Identify past sources of income: A. Schedule A: itemized deductions such as mortgage interest B. Schedule B: interest and dividends C. Schedule C: self employment income D. Schedule D: capital gains or losses E. Schedule E: rental or other investment income, net operating loss deduction F. Schedule F : farm income G. Schedule K-1: partnership income/interest
BRTVU (BMF) or copy of last filed income tax return (1120)	• Compare the amount of reported income to that declared on the CIS. • Compare the value of assets and the amount of reported depreciation to the asset values declared on the CIS. The true value of an asset may not be shown on Form 4562, *Depreciation and Amortization (Including Information on Listed Property)* or the depreciation work papers. • Check the location of depreciable assets.
IRPTRO and/or copy of older year income tax	• Compare real estate tax and mortgage interest deductions to the amount declared on the CIS. Higher amounts may indicate present or past property ownership not declared on the CIS. Lower amounts may indicate that property has been recently sold or transferred. • Identify assets not reported on CIS such as certificates of deposit, investment accounts, etc. • Verify sources of income, such as employers, bank accounts, retirement accounts.

returns	• Identify recently dissipated assets. • Identify income reported on Form 1099-K, Payment Card and Third Party Network Transactions. • Identify Foreign Bank and Financial Account Report (FBAR) transactions.
Foreign Bank and Financial Account Report (FBAR)	• Check IRPTR to see if the taxpayer filed a Report of Foreign Bank and Financial Accounts, Form TD F 90-22.1, which indicates the taxpayer has a financial interest in, or signature authority over, a foreign financial account that has an aggregate value greater than $10,000, at any time during a calendar year. • Conduct Financial Crimes Enforcement Network Query (FCQ) research for specific information reported on the FBAR. See IRM 5.1.18.16, *Foreign Bank and Financial Account Report*.
State Motor Vehicle Records via online research	• Identify motor vehicles registered to the taxpayer but not declared on the CIS. See IRM 5.1.18.5, *Department of Motor Vehicles*. • Check for ownership in business names or lien holders. **Note:** Ownership of a trailer may lead to additional assets such as boats or jet skis
Real Estate Records via online research	• Check courthouse records for grantor/grantee, mechanic liens, mortgagee/mortgagor, divorce records, death certificate, and registered wills. • Identify real property titled to the taxpayer but not declared on the CIS. • Identify property held by transferee, nominee or alter ego (IRM 5.17.14, *Fraudulent Transfers and Transferee and Other Third Party Liability*.) **Note:** Check for ownership in business names on tax assessment records.
Credit Bureau Reports	• Identify past residences and employers. • Verify competing lien holders, balances due and payment history. • Identify property not listed on CIS. • Identify other creditors as leads to undisclosed assets. • Identify financial institutions which the taxpayer has conducted business with, both past and present. • Look for entities and associations with foreign banks and corporations. • See IRM 5.1.18.18, *Consumer Credit Reports,* for requirements and procedures for ordering credit reports.
Online Locator Service	• Identify current real property, transferred or sold property. • Identify vehicle ownership. • Identify interest in partnerships, corporations or other businesses. • Identify potential third parties residing with the taxpayer. • Look for vessels and crafts registered with the Federal Aviation Administration (FAA).
Other Internet Sources	• Look for income sources and assets on a taxpayer's web site. • Determine the value of assets when traditional sources have been unproductive. • Identify undisclosed business activity and assets. • Locate a taxpayer when traditional sources have been unproductive. • Gather news articles and publications on high profile taxpayers. • Secure general information about a taxpayer's industry, such as financial data and the legal environment for that type of business.
YK1 Information	• Identify related entities, including shareholders and partners. • Look for an analysis of the relationships between the associated entities. • Identify "footprints" which may indicate shelter activity. • Look for a visual representation of structure and linkages between the taxpayer and related entities.

5.15.1.6 (10-02-2012)
External Sources

1. Request appropriate documentation from the chart below to verify the CIS. Do not make a blanket request for information. Tailor your request to each taxpayer's specific situation. Do not require the taxpayer to provide information that is available from internal or online sources.

Documentation	Review
	• Compare average earnings to the income declared on the CIS.

Wage statements for the prior three months if the taxpayer is a wage earner. A statement with current year to date figures is also acceptable.	• Verify adequate tax withholding. • Identify payroll deductions to ensure the expense is necessary and not claimed again on the CIS. • Identify deductions to savings accounts, credit union accounts, retirement accounts, savings bonds and loans.
Proof of gross income (invoices, accounts receivable, commission statements, etc.) for the prior three months if the taxpayer is self-employed.	• Compare average earnings to the income declared on the CIS. • Identify deductions to ensure the expense is necessary and only claimed once on the CIS (for personal or business, not both.)
Annual Report to Shareholders, Meeting Minutes, and Stock Ledger Books if the taxpayer is a closely-held corporation.	To determine the value of closely held stock that is either not traded publicly or for which there is no established market, consider the following methods of valuing the company and assign a proportion of the company's value to the taxpayer's stock: • Secure and verify a CIS for the corporation or partnership. • Review recent year's annual report to stockholders, stockholder meeting minutes and stock ledger books. • Review recent year's corporate income tax returns. • Identify other stockholders, consider relationship to taxpayer (relative). • Review stock book and verify total amount of stock issued and outstanding. The Property Appraisal Liquidation Specialist (PALS) assigned to your area may be able to provide appraisal services when the FMV is not easily determinable, or request an appraisal of the business as a going concern by a qualified and impartial appraiser.
Bank statements for the last three months.	• Compare deposit amounts to income reported on tax return and CIS. • Identify source of deposits.
Cancelled checks and credit card statements for the last three months.	• Verify amount and frequency of declared expenses. • Identify unnecessary expenses. • Look for unusual activity. • Reconcile with other sources, e.g., tax returns and statements, invoices/bills, and taxpayer statements.
Retirement account statements, brokerage account statements, securities or other investments, annuity accounts, lottery winnings, trust information, inheritance and insurance proceeds.	Identify the type, conditions for withdrawal, sale or borrowing, and current market value.
Life Insurance Policies	• Identify the type, conditions for borrowing or cancellation and the current loan and cash values. • Verify the amount of required premiums and whether they are being paid. • Identify source of funds used to pay.
Motor vehicle (vessel or craft) purchase or lease contracts, the pay off amount from the lender.	• Verify equity, monthly payment expense, date of final payment and term of contract. • Check loan applications.
Real estate, warranty or mortgage deeds, HUD closing statements, quit claims, the pay off amount from the lender.	• Identify the type of ownership, amount of equity, monthly payment expense, and date of final payment. • Evaluate potential sale value.
Homeowner or renter insurance policies and riders.	• Compare the insured value to the value declared on the CIS. • Identify high value personal items such as jewelry, antiques or works of art.
Financial statement recently provided to lending institutions or others.	• Compare the financial information submitted to others with that declared on the CIS. • Check mortgage companies. • Check other lenders or creditors.
Divorce Court Orders	• Verify disposition of assets in the property settlement. • Secure copy of interlocutory agreement.
Court orders for child support and proof of payment.	• Verify responsibility for child support and that the payments are actually being made. • Check dependents claimed on Form 1040.
Bankruptcy Court Documents	• If appropriate consult with a Field Insolvency caseworker to review Schedules, Statement of Financial Affairs, Statement of Monthly Income and Means Test Calculation, and Other Court Documents such as motions, pleadings or filings from third parties. • Verify income and expenses. • Look for exempt, excluded or abandoned assets.

	• Review conversations of meetings with the taxpayer, the representative and possible third parties. • Review any statements made by the taxpayer to the bankruptcy trustee and creditors at the meeting of creditors and equity security holders, held pursuant to Bankruptcy Code section 341.
United States Passport Office	Passport checks may provide the following information: • The last known mailing and/or permanent address of the applicant • Applicant's occupation • Applicant's employer • Applicant's phone number • Emergency contact's name, address and phone number • Spouse's name and birthplace See IRM 5.1.18.13 , *United States Passport Office*.
Treasury Enforcement Communications System (TECS)	TECS is a database maintained by the Department of Homeland Security (DHS), and is used extensively by the law enforcement community. It contains information about individuals and businesses suspected of, or involved in, violations of federal law. For IRS Field Collection, TECS provides two sources to help make contact with taxpayers or locate assets. See IRM 5.1.18.14, *Treasury Enforcement Communications System*.
Utility Companies	Utility company information can: • Determine who occupies a certain building when there is an indication that the taxpayer resides at an address • Provide a taxpayer's new address if the taxpayer transferred services from an old address to a new one

5.15.1.7 (10-02-2012)
Allowable Expense
Overview

1. Allowable expenses include those expenses that meet the necessary expense test. *The necessary expense test is defined as expenses that are necessary to provide for a taxpayer's and his or her family's health and welfare and/or production of income*. There are three types of allowable expenses:
   - Allowable Living Expenses - based on National and Local Standards
   - Other Necessary Expenses - expenses that meet the necessary expense test, and are normally allowed
   - Other Conditional Expenses - expenses, which may not meet the necessary expense test, but may be allowable based on the circumstances of an individual case
2. The Allowable Living Expense (ALE) Standards, also known as Collection Financial Standards, provide for a taxpayer's and his or her family's health and welfare and/or production of income. These expenses must be reasonable in amount for the size of the family and the geographic location, as well as any unique individual circumstances. The total necessary expenses establish the minimum a taxpayer and family needs to live.

   Reminder:

   The ALE standards are not applicable to corporations, partnerships, LLCs, (where the LLC is identified as the liable taxpayer), or for any business expenses.

   Note:

   The ALE standards are not available for international taxpayers or the U.S. Territories, except for housing and utilities in Puerto Rico. In the absence of standardized figures for foreign countries, a fair and consistent approach should be applied to what is allowed as living expenses for international taxpayers. Collection employees should not use any other non-ALE figures as pre-determined guideline figures or arbitrarily select any location in the United States as a starting point for allowances. In those cases where there are no ALE standards or leverage to enforce collection of a balance due, the taxpayers' submission of living expenses should generally be accepted, provided they appear reasonable.
3. **National Standards**: These establish standards for Food, Clothing and Other Items and Out-of-Pocket Health Care Expenses.
   A. *Food, Clothing and Other Items* - These establish reasonable amounts for five necessary expenses: food, housekeeping supplies, apparel and services, personal care products and services, and miscellaneous. These standards come from the Bureau of Labor Statistics (BLS) Consumer Expenditure Survey. Taxpayers are allowed the total National Standards amount monthly for their family size, without questioning the amounts they actually spend.

      Note:

      All five expenses are included in one total national standard amount.

   B. *Out-of-Pocket Health Care Expenses* - These establish reasonable amounts for out-of-pocket health care costs including medical services, prescription drugs, and medical supplies (e.g., eyeglasses, contact lenses). The table for health care allowances is based on Medical Expenditure Panel Survey data. Taxpayers and their dependents are allowed the standard amount monthly on a per person basis, without questioning the amounts they actually spend.
4. **Local Standards**: These establish standards for two necessary expenses: 1) housing and utilities and 2) transportation. Taxpayers will normally be allowed the local standard or the amount actually paid monthly, whichever is less.
   A. *Housing and Utilities* - Standards are established for each county within a state and are derived from Census and BLS data. The standard for a particular county and family size includes both housing and utilities allowed for a taxpayer's primary place of residence. Housing and Utilities standards include mortgage (including interest) or rent, property taxes, insurance, maintenance, repairs, gas, electric, water, heating oil, garbage collection, cable television, internet services, telephone and cell phone.

   B. *Transportation* - The transportation standards consist of nationwide figures for loan or lease payments referred to as ownership costs, and additional amounts for operating costs broken down by Census Region and Metropolitan Statistical Area. Operating costs include maintenance, repairs, insurance, fuel, registrations, licenses, inspections, parking and tolls. If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. If a taxpayer has a car, but no car payment only the operating cost portion of the transportation standard is used to figure the allowable transportation expense. There is a single nationwide allowance for public transportation for taxpayers with no vehicle.

      Note:

      Vehicle Operating standards are based on actual consumer expenditure data obtained from the United States Bureau of Labor Statistics (BLS) which are adjusted with Consumer Price Indexes (CPI) to allow for projected increases throughout the year. (These CPI are used to adjust all ALE standards.) Vehicle operating standards are not based on average commuting distances. Fuel costs, which are part of Vehicle Operating Costs, have a separate fuel price adjustment which is based on Energy Information Administration (EIA) data which allows for projected fuel price increases.

5. National and local expense standards are guidelines. If it is determined a standard amount is inadequate to provide for a specific taxpayer's basic living expenses, allow a deviation. Require the taxpayer to provide reasonable substantiation and document the case file.

   Note:

   If the taxpayer or the Service believes reviewing the last three months of expenses are not reflective of the actual yearly expenditures, additional months, up to one year, may be reviewed.

6. Generally, the total number of persons allowed for national standard expenses should be the same as those allowed as exemptions on the taxpayer's current year income tax return. Verify that exemptions claimed on the taxpayer's income tax return meet the dependency requirements of the IRC. There may be reasonable exceptions. Fully document the reasons for any exceptions. For example, foster children or children for whom adoption is pending.

7. A deviation from the local standard is not allowed merely because it is inconvenient for the taxpayer to dispose of valued assets or reduce excessive necessary expenses.

8. Other Necessary Expenses - These expenses meet the necessary expense test and normally are allowed. The amount allowed must be reasonable considering the taxpayer's individual facts and circumstances.

9. Other Conditional Expenses - These expenses **may not** meet the necessary expense test, but may be allowable based on the circumstances of an individual case. Other conditional expenses may also be allowable if the taxpayer qualifies for the six-year rule. See *IRM 5.15.1.2*(4), *Six-Year Rule*.

5.15.1.8 (11-17-2014)
National Standards

1. **National Standards: Food, Clothing and Other Items** - These include the following expenses:

   A. Apparel and services. Includes shoes and clothing, laundry and dry cleaning, and shoe repair.

   B. Food. Includes all meals, home and away.

   C. Housekeeping supplies. Includes laundry and cleaning supplies; other household products such as cleaning and toilet tissue, paper towels and napkins; lawn and garden supplies; postage and stationery; and other miscellaneous household supplies.

   D. Personal care products and services. Includes hair care products, haircuts and beautician services, oral hygiene products and articles, shaving needs, cosmetics, perfume, bath preparations, deodorants, feminine hygiene products, electric personal care appliances, personal care services, and repair of personal care appliances.

   E. Miscellaneous. Is a percentage of the other categories and is based on BLS data. The miscellaneous allowance has been established for living expenses not included in any other standards or allowable expense items. Some examples include credit card payments, occupational expenses, bank fees and charges, reading material, school books and supplies for elementary through high school age dependents, etc. The miscellaneous allowance can also be used for any portion of expenses that exceed the ALE standards and are not allowed under a deviation.

2. Allow taxpayers the national standard amount for their family size without questioning the amount actually spent.

   Note:

   Money amounts in all the Allowable Living Expense examples are for illustrative purposes only. Check the ALE web page at http://mysbse.web.irs.gov/Collection/toolsprocesses/AllowExp/default.aspx for current expense amounts.

   Example:

   National Standard Expense amount is $1,100 - The taxpayer's actual expenditures are: housekeeping supplies - $100, clothing - $100, food - $500, personal care products - $100, and miscellaneous - $200 (Total Expenses - $1,000). The taxpayer is allowed the national standard amount of $1,100, even though the amount claimed was less.

3. A taxpayer who claims more than the total allowed by the national standards must provide documentation to substantiate and justify as necessary those expenses that exceed the total national standard amounts. Deviations from the standard amount are not allowed for miscellaneous expenses.

   Example:

   National Standard Expense amount is $1,100. The taxpayer's actual expenditures are: housekeeping supplies - $100, clothing - $100, food - $700, personal care products - $100, and miscellaneous - $200 (Total Expenses - $1,200). The taxpayer is allowed the national standard amount of $1,100, unless the higher amount is justified as necessary. In this example the taxpayer has claimed a higher food expense than allowed. Justification would be based on prescribed or required dietary needs. The taxpayer must substantiate and verify only the food expense. The taxpayer is not required to verify expenses for all five categories if a higher expense is claimed for one category. The standard amounts will be allowed for the remaining categories.

4. All deviations from the national standard expenses for food, clothing and other items must be verified, reasonable and documented in the case history.

5. **National Standards: Out of Pocket Health Care Expenses** – These include:

   A. Medical services,

   B. Prescription drugs, and

   C. Medical supplies (e.g., eyeglasses, contact lenses).

   Medical procedures of a purely cosmetic nature, such as plastic surgery or elective dental work are generally not allowed.

6. The out-of-pocket health care standard amount is allowed in addition to the amount taxpayers pay for health insurance.

7. Taxpayers and their dependents are allowed the standard amount monthly on a per person basis, without questioning the amounts they actually spend. Taxpayer verification of out-of-pocket expenses is not required unless the amount claimed exceeds the standard.

8. Taxpayers who claim more than the total allowed by the out-of-pocket health care standard, may be allowed more than the standard if they provide documentation to substantiate and justify the additional expenses. This situation may be encountered in situations involving taxpayers with no health insurance.

9. All deviations from the national standards for out-of-pocket health care expenses must be verified, reasonable and documented in the case history.

5.15.1.9 (11-17-2014)
Local Standards

1. Local standards include the following expenses:

   A. **Housing and Utilities** - Housing expenses include: mortgage (including interest) or rent, property taxes, necessary maintenance and repair, homeowner's or renter's insurance, homeowner dues and condominium fees. The utilities include gas, electricity, water, heating oil, bottled gas, trash and garbage collection, wood and other fuels, septic cleaning, cable television, internet services, telephone and cell phone. Usually, these expenses are considered necessary only for the

primary place of residence. Any other housing expenses should be allowed only if, based on a taxpayer's individual facts and circumstances, disallowance will cause the taxpayer economic hardship.

- Generally the total number of persons allowed for determining family size should be the same as those allowed as exemptions on the taxpayer's most recent year tax return. There may be reasonable exceptions, such as foster children or children for whom adoption is pending.
- An allowance for cell phone, cable television and internet service expenses is included in the Housing and Utilities standard.
- Taxpayers are allowed the standard amount for housing and utilities or the amount actually claimed and *verified* by the taxpayer, whichever is less. If the amount claimed is more than the total allowed by housing and utilities standards, the taxpayer must provide documentation to substantiate those expenses are necessary.
- When deciding if a deviation is appropriate, consider the cost of moving to a new residence; the increased cost of transportation to work and school that will result from moving to lower-cost housing and the tax consequences. The tax consequence is the difference between the benefit the taxpayer currently derives from the interest and property tax deductions on Schedule A to the benefit the taxpayer would derive without the same or adjusted expense.
- All deviations from the housing and utilities standards must be verified, reasonable and documented in the case history.

B. **Transportation** - This includes vehicle insurance, vehicle payment (lease or purchase), maintenance, fuel, state and local registration, required inspection, parking fees, tolls, driver's license and public transportation. Public transportation includes mass transit fares for a train, bus, taxi, etc., both within and between cities.

- Transportation expenses are considered necessary when they are used by taxpayers and their families to provide for their health and welfare and/or the production of income. Employees are expected to exercise appropriate judgment in determining whether claimed transportation expenses meet these standards. Expenses that appear to be excessive should be questioned and, in appropriate situations, disallowed.
- When determining the allowable amounts, allow the full *ownership* standard amount, or the amount actually claimed and *verified* by the taxpayer, whichever is less. Allow the full *operating* standard amount, or the amount actually claimed by the taxpayer, whichever is less. Substantiation for the operating allowance is not required unless the amount claimed exceeds the standard.
- There is a single nationwide allowance for public transportation. This allowance is established as a floor for individuals with no vehicle. Taxpayers with no vehicle are allowed the standard, per household, without questioning the amount actually spent. The taxpayer is not required to provide documentation unless the amount claimed exceeds the standard. See *Exhibit 5.15.1-1*, Question 16.
- If a taxpayer owns a vehicle and uses public transportation, expenses may be allowed for both, provided they are needed for the health and welfare of the individual or family, or for the production of income. However, the expenses allowed would be actual expenses incurred. Documentation would not be required unless the amount claimed exceeded the standards.
- If a taxpayer has a car, but no car payment, only the operating costs portion of the transportation standard is used to figure the allowable transportation expense.
- A single taxpayer is normally allowed ownership and operating costs for one vehicle. The taxpayer is allowed the standard for ownership and operating costs, or the amounts actually spent, whichever is less.
- If a husband and wife own two vehicles, they are allowed the amount claimed for each vehicle up to the maximum allowances for ownership and operating expenses. The taxpayers are allowed the standard for ownership and operating costs, or the amounts actually spent, whichever is less.

Note:

Money amounts in the Allowable Living Expense examples below are for illustrative purposes only.

Example 1: If the loan payment for each car is below the standard allowable amount and the operating costs for both cars are below the standard allowable amount, they are allowed the amount claimed.

	Claimed	Standard	Allowed
1st Car Ownership	$427	$478	$427
2nd Car Ownership	$470	$478	$470
Total Ownership Allowed			**$897**
Total Operating (for 2 cars)	$325	$340	**$325**
Total Ownership and Operating Allowed			**$1,222**

Example 2: If the loan payment for each car exceeds the standard allowable amount and the operating costs for both cars exceed the standard allowable amount, they are limited to the standard allowable amount unless the claimed amount is substantiated and verified as necessary.

	Claimed	Standard	Allowed
1st Car Ownership	$525	$478	$478
2nd Car Ownership	$480	$478	$478
Total Ownership Allowed			**$956**
Total Operating (for 2 cars)	$380	$340	**$340**
Total Ownership and Operating Allowed			**$1,296**

Example 3: If the loan payment for one vehicle exceeds the standard allowable amount for one car and the second loan payment is less than the standard allowable amount for one car, the allowable amounts are calculated separately.

	Claimed	Standard	Allowed
1st Car Ownership	$550	$478	$478
2nd Car Ownership	$460	$478	$460
Total Ownership Allowed			**$938**
Total Operating (for 2 cars)	$360	$340	**$340**
Total Ownership and Operating Allowed			**$1,278**

Example:

If a taxpayer takes a train to work, but drives a vehicle from home to the train station, the actual expenses incurred for vehicle ownership and operating costs and the train fare would be allowable.

- If a taxpayer claims higher amounts of operating costs because he commutes long distances to reach his place of employment, he may be allowed greater than the standard. The additional operating expense would generally meet the production of income test and therefore be allowed if the taxpayer provides substantiation.
- If the amount claimed is more than the total allowed by any of the transportation standards, the taxpayer must provide documentation to verify and substantiate that those expenses are necessary. All deviations from the transportation standards must be verified, reasonable and documented in the case history.

5.15.1.10 (11-17-2014)
Other Expenses

1. Other expenses may be Necessary or Conditional. Other Necessary expenses meet the necessary expense test and normally are allowed. The amount allowed must be reasonable considering the taxpayer's individual facts and circumstances. Other Conditional Expenses **may not** meet the necessary expense test, but may be allowable based on the circumstances of an individual case.
2. There may be circumstances where expenses may be allowed even if they do not meet the necessary expense test. If the IRS tax liability including accruals can be paid within six years and within the CSED, all expenses may be allowed if they are reasonable. If the taxpayer cannot pay within six years, it may be appropriate to allow the taxpayer up to one year in order to modify or eliminate one or more expenses. See *IRM 5.15.1.2*, *Analyzing Financial Information*.
3. If other conditional expenses are determined to be necessary and, therefore allowable, document the reasons for the decision in your history.

Expense Item	Expense is Necessary:	Notes/Tips
Accounting and legal fees	• The fees are for representation before the Service (i.e., to resolve current balances due, delinquent returns, examinations, etc.), or • The fees meet the necessary expense test. • The amount should not be excessive and must be reasonable given the complexity of the case.	• Fees related to business operations (i.e., reported on Schedule C) should not be claimed as personal expenses. • Fees may vary; an accountant will charge less for a wage earner with all returns filed that just needs a CIS completed, than he/she would charge for a self-employed individual that needs several returns prepared along with a CIS. Fees vary across the country so allowable amounts may also differ depending on where the taxpayer lives.
Charitable contributions *(Donations to tax exempt organizations)*	If it is a condition of employment or meets the necessary expense test. Example: A minister is required to tithe according to his employment contract.	Disallow any other charitable contributions that are not considered necessary. Example: Review the employment contract.
Child Care *(Baby-sitting, day care, nursery and preschool)*	If it meets the necessary expense test. Only reasonable amounts are allowed.	Cost of child care can vary greatly. Do not allow unusually large child care expense if more reasonable alternatives are available. Consider the age of the child and if both parents work.
Court-Ordered Payments*(Alimony, child support, including orders made by the state, and other court ordered payments)*	If alimony and child support payments are court ordered, reasonable in amount, and being paid, they are allowable. If payments are not being made, do not allow the expense unless the non-payment was due to temporary job loss or illness. Restitution payments made to other victims pursuant to a court order are allowable expenses.	Review the court order. Payments that are included in a state court order are not necessarily allowable (such as a child's college tuition that would not otherwise be allowable as a necessary expense.) See *Exhibit 5.15.1-1*, Question 15.
Dependent Care *(For the care of the elderly, invalid, or handicapped.)*	If there is no alternative to the taxpayer paying the expense.	
Education	If it is required for a physically or mentally challenged child and no public education providing similar services is available. Education expenses are also allowed for the taxpayer if required as a condition of employment.	**Example:** An attorney must take a certain amount of education credits each year or they will not be accredited and could eventually lose their license to practice before the State Bar. A teacher could lose their position or in some states their pay is commensurate with their education credits.
Involuntary Deductions	If it is a requirement of the job; e.g., union dues, uniforms, work shoes.	To determine monthly expenses, the total out of pocket expenses would be divided by 12.
Life Insurance	If it is a term policy on the life of the taxpayer only.	If there are whole life policies, these should be reviewed as an asset for borrowing against or liquidating. Life insurance used as an investment is not a necessary expense.
Secured or legally perfected debts	If it meets the necessary expense test.	Taxpayer must substantiate that the payments are being made.
Credit Card Debts	• Credit cards are generally considered a method of payment, rather than a specific expense. A taxpayer may be paying for necessary living expenses using cash or a credit card, e.g. food, clothing, gas, etc. Consequently, payments for the portion of the credit card debt reflecting necessary living expenses are provided for as allowable expenses under the national and local standards. • It is important that taxpayers be informed of the above, and be advised that the IRS National Standards for Food, Clothing and Other Items provides an amount for miscellaneous expenses that can be applied to credit card debt. • Generally, minimum payments on credit cards are allowed under the six-year rule.	• If a taxpayer is paying for necessary expenses that exceed the standards, and those expenses are justified, a deviation under the expense item on Form 433-A, *Collection Information Statement for Wage Earners and Self-Employed Individuals,* should be allowed. • If a credit card payment is only partially allowed or not allowed at all, the taxpayer should be advised that the IRS allows an amount monthly for miscellaneous expenses that can be used to make credit card payments. See *Exhibit 5.15.1-1*, Questions 19-21.
Other Unsecured Debts	If the taxpayer substantiates and justifies the expense, the minimum payment may be allowed. The necessary expense test of health and welfare and/or production of income must be met. Except for payments required for the production of income, payments on unsecured debts will not be allowed if the tax liability, including projected accruals, can be paid in full within 90 days.	Examples of unsecured debts which may be necessary expenses include: payments required for the production of income such as payments to suppliers and payments on lines of credit needed for business, and payment of debts incurred in order to pay a federal tax liability.
Current Year Taxes	If it is for current federal, FICA, Medicare, state and local taxes. Payments for delinquent state and local (county or municipal) tax liabilities may be allowed in certain circumstances: • When a taxpayer does not have the ability to full pay the tax liability.	Current taxes are allowed regardless of whether the taxpayer made them in the past or not.

Delinquent State and Local Taxes	• When a taxpayer provides complete financial information. • When a taxpayer provides verification of the state or local tax liability, and agreement if applicable	See IRM 5.15.1.10(4) and *Exhibit 5.15.1-1*, Question 18 for additional guidance.
Optional Telephones and Telephone Services *(pre-paid long distance telephone cards/minutes or pre-paid cellular cards/minutes)*	If it meets the necessary expense test.	
Student Loans	If it is guaranteed by the federal government and only for the taxpayer's post-high school education. • Taxpayers must substantiate that the payments are being made. • Taxpayers who have student loan debt, but are unable to make payments on the debt because they are suffering an economic hardship or have medical problems, should be advised to request a deferment or forbearance of the student loan payments. • The Installment Agreement (IA) amount will be established without allowing for a student loan payment. • Taxpayers must be advised that if they later make arrangements to pay the student loan, they can request the installment agreement be revised.	• Taxpayers with student loan debt, who have not yet made arrangements to repay the loan, should be allowed 10 days to set up a payment plan for the student loan and provide verification so the loan payment can be allowed. • Additional time may be allowed if a taxpayer has extenuating circumstances. • Taxpayers must be advised that if they do not respond by the due date, the IA amount will be established without allowing for a student loan payment. • Taxpayers must also be advised that if they later make arrangements to pay the student loan, they can request the installment agreement be revised.
Repayment of loans made for payment of Federal Taxes	If the IRS has received the proceeds of the loan and the taxpayer can document the loan, the payment amount should be allowed.	

4. Delinquent State and Local Taxes. Payments for delinquent state and local (county or municipal) tax liabilities may be allowed in certain circumstances:
   - When a taxpayer owes both delinquent Federal taxes and delinquent state or local taxes, and does not have the ability to full pay.
   - When a taxpayer is cooperative and provides complete financial information.
   - When a taxpayer advises the IRS that he/she owes delinquent state or local taxes and provides verification of the state or local tax liability, and agreement, if applicable.

   A. Follow the procedures in this table to determine the allowable payment for delinquent state or local tax debts.

IF	AND	THEN
the taxpayer **does not** have an existing agreement for payment of the delinquent state or local tax debts,	provides a complete Collection Information Statement (CIS) and verification of state or local tax debts,	follow procedures in IRM 5.15.1.10(4)(b) to determine the calculated percentage amount that will be listed as the allowable monthly payment for delinquent state or local taxes on the CIS.
the taxpayer has an existing agreement for delinquent state or local tax debts, and that agreement was established **after** the earliest IRS date of assessment,	the payment amount on the state or local agreement is **less** than the calculated percentage amount,	the monthly amount due on the existing state or local agreement will be listed as the allowable delinquent state or local tax payment on the CIS. The payment to IRS will be increased by the amount allowed for the monthly state or local payment one month after the date the state or local liability is scheduled to be fully paid.
the taxpayer has an existing agreement for delinquent state or local tax debts, which was established **after** the earliest IRS date of assessment,	the payment amount on the agreement, is **more** than the calculated percentage amount,	the amount listed as the delinquent state or local tax payment on the CIS will be the calculated percentage amount. Advise the taxpayer that he/she can use the amount IRS allows for Miscellaneous expenses under National Standards to pay the additional amount due for the delinquent state or local tax payment. The payment to IRS will be increased by the amount allowed for the monthly state or local payment one month after the date the state or local liability is scheduled to be fully paid.
the taxpayer has an existing agreement for delinquent state or local tax debts, which was established **prior to** the earliest IRS date of assessment,	allowing the amount on the existing state or local agreement will not result in the case being reported uncollectible,	allow the existing state or local tax payment and increase the IRS payment one month after the date the state or local liability is scheduled to be fully paid. See IRM 5.15.1.10(4)(c) and (d) if allowing the state payment will result in the account being reported Currently Not Collectible (CNC) due to hardship.

   B. Follow these procedures to calculate an allowable payment amount for delinquent state or local tax debts.

   1) Determine net disposable income on Form 433-A, *Collection Information Statement for Wage Earners or Self-Employed Individuals*, or Form 433-F, *Collection Information Statement*. Do not include any amount that is being paid for outstanding state or local tax liabilities in the calculation. Net disposable income is the difference between gross income and allowable living expenses.

   Note:

   If the taxpayer's net disposable income is less than $25, prepare a backup Form 53 due to hardship along with the installment agreement in case of eventual default and termination.

   2) Calculate the dollar amounts for the IRS and state or local payments based on the total liability owed to each agency (including penalties and interest to date).
   3) Use the net disposable income and a percentage of IRS and state or local liabilities to total liability to calculate the payment amounts.

   Example 1:

IRS Tax Liability	$10,000.00
State or Local Tax Liability	$5,000.00
Total	$15,000.00
IRS percentage	10,000.00/15,000.00 = .67

State or Local percentage	5,000.00/15,000.00 = .33
Taxpayer's net disposable income (see Note below)	$400.00
IRS Payment (400 x .67)	$268.00
State or Local Payment (400 x .33)	$132.00

Note:

If the Net disposable income is less than $25, prepare a backup Form 53 due to hardship along with the installment agreement in case of eventual default and termination.

Example 2:

IRS Tax Liability	$1,000.00
State or Local Tax Liability	$500.00
Total	$1,500.00
IRS percentage	1,000.00/1,500.00 = .67
State or Local percentage	500.00/1,500.00 = .33
Taxpayer's net disposable income	$35.00
IRS Payment (35 x .67)	$23.45 (Actual IRS IA payment = $25.00)
State or Local Payment (35 x .33)	$11.55 (Actual State or Local IA payment = $10.00)

C. If allowing even a minimal monthly payment for delinquent state or local taxes will result in the account being reported Currently Not Collectible due to hardship:

AND	THEN
the taxpayer does not have an existing agreement for the delinquent state or local tax debts,	a payment for delinquent state or local taxes **will not** be allowed. Advise the taxpayer that he/she can use the amount the IRS allows for Miscellaneous expenses under National Standards to pay the delinquent state or local tax payment.
the taxpayer has an existing agreement for the delinquent state or local tax debts, which was established **after** the earliest IRS date of assessment,	a payment for delinquent state or local taxes **will not** be allowed. Advise the taxpayer that he/she can use the amount the IRS allows for Miscellaneous expenses under National Standards to pay the delinquent state or local tax payment.
the taxpayer has an existing agreement for delinquent state or local tax debts, which was established **prior to** the earliest IRS date of assessment,	the amount allowed for state or local taxes on the CIS should be reduced to allow for an IRS Installment Agreement payment . Advise the taxpayer that he/she can use the amount the IRS allows for Miscellaneous expenses under National Standards to pay the additional amount due for the delinquent state or local tax payment. The payment to the IRS will be increased by the amount allowed for the monthly state or local payment one month after the date that the state or local liability is scheduled to be full paid.

Example:

The taxpayer’s net disposable income (not including the state or local payment) is $70. The state or local payment due on an existing agreement that was established prior to the earliest IRS date of assessment is $100. The amount allowed for delinquent state or local taxes on the CIS is $45. The payment for the IRS IA is $25. Advise the taxpayer that he or she can use the Miscellaneous allowance to pay the difference between what the IRS has allowed ($45) and what is owed monthly for the state or local payment agreement ($100), which is $55 ($100 - $45 = $55). One month after the date the state or local agreement will be fully paid at $45 monthly, increase the IRS’ IA amount to $70 monthly ($25 + $45).

Note:

Document all calculations in the case history.

D. Allowing payments for delinquent state or local taxes when establishing an Installment Agreement has no effect on lien or levy priorities. This guidance only impacts determinations of ability to pay. Employees should use existing procedures and lien law to determine the IRS interest in assets. If a taxpayer refuses to establish an Installment Agreement or defaults on an Installment Agreement, IRS employees should follow existing procedures and lien law to determine the appropriate course of action, including pursuing collection.

E. Minimal payments for delinquent state or local taxes are allowed for Installment Agreements using the six-year rule. If the six-year rule applies, taxpayers are required to provide financial information, but do not have to provide substantiation of reasonable expenses. If the taxpayer meets all other requirements for the six-year rule, the amount claimed for state or local taxes may be allowed. Employees would not be required to obtain verification of the state payment or calculate an amount due based on the percentage basis discussed above.

F. If a state already has a Federal/State Memorandum of Understanding (MOU) for establishing joint Federal and State agreements, follow the MOU guidelines.

5.15.1.11 (11-17-2014)
Determining Individual Income

1. Generally all household income will be used to determine the taxpayer's ability to pay. In cases where a liable taxpayer lives with a non-liable person, refer to *IRM 5.15.1.4*, *Shared Expenses*, for a complete explanation of determining proportionate income and expense calculations.

2. Income consists of the following:

   A. *Wages* - Wages include salary, tips, meal allowance, parking allowance or any other money or compensation received by the taxpayer as an employee for services rendered. This includes the taxpayer and the taxpayer's spouse.

   Note:

   Use the following formulas to calculate gross monthly wages or salaries:
   If paid weekly, multiply weekly gross wages by 4.3.
   If paid biweekly (every 2 weeks), multiply biweekly gross wages by 2.17.
   If income is sporadic or seasonal, use the annual income figure from the Form W-2 or the Form 1040 and divide by 12 to determine the average monthly income.

   B. *Interest and Dividends* - Includes any interest or dividend that the taxpayer receives or that is credited to an account and can be withdrawn by the taxpayer and used for household expenses. The annual total should be divided by 12 to determine the average monthly income. Look for brokerage accounts for dividends from publicly traded corporations and look for undisclosed bank accounts for interest payers.

Note:

If the interest bearing accounts are used as an asset, and the taxpayer will be withdrawing the funds from the account to reduce the tax liability, the dividends or interest should not be used in the income stream.

C. *Net Income from Self-Employment or Schedule C* - The amount the taxpayer earned after paying ordinary and necessary business expenses. This amount may be determined from an analysis of the income and expense section of Form 433-A or Form 433-B. It may also be determined using the net profit on Schedule C from the most recent year's Form 1040 if all duplicate deductions are eliminated (e.g., expenses for business use of home already included in Allowable Living Expense for Housing and Utilities). Deductions for depletion and depreciation on Schedule C are not cash expenses and these amounts must be added back to the net income figure. In addition, interest cannot be deducted if it is already included in any other installment payments allowed. If the net business income is a loss, enter "zero" . Do not enter a negative number.

Note:

The income and expense information provided must reflect a sufficient time frame to accurately determine the monthly average that could be expected for the entire year.

D. *Net Rental Income* - The amount earned after paying ordinary and necessary monthly rental expenses. If using Schedule E from the most recent year's Form 1040, do not include depreciation or depletion as an expense item. If net rental income is a loss, enter a "zero" . Do not enter a negative number.

E. *Pensions* - Includes Social Security, IRA, profit sharing plans, etc. Pensions could be used as an asset or as part of the income stream. See *IRM 5.15.1.17*, *Business Expenses*.

F. *Child Support* - Include the actual amount received in addition to other debts or bills the non-custodial parent is paying pursuant to a child support order. For example, the court order assigns $200 a week for support but also requires all medical bills to be paid. The child support income would include the $200.00 plus any additive support payments received for medical bills.

G. *Alimony* - Include the assigned payments made by the non-resident spouse. However, consider if other bills are being paid, such as the mortgage, and adjust the allowable expenses accordingly.

H. *Other* - This could include payments from a trust account, royalties, renting a room, gambling winnings, sale of property, rent or oil subsidies, etc. Tax return information could include various sources of income.

Note:

A rent subsidy paid directly to the taxpayer from a government agency should be reflected as income on Form 433-A and the full amount of rent paid should be deducted as an expense under housing and utilities. A subsidy paid directly to a landlord by a government agency should not be included in income on Form 433-A, and the taxpayer should only report the actual expenses he or she pays for rent under housing and utilities.

5.15.1.12 (10-02-2012)
Business Entity and Collection

1. The Internal Revenue Code does not include specific provisions for liability collection from most state law business organizations. The provisions of state law that shield certain persons or entities from liability are used as guidance for determining the entity liable for taxes incurred in a business.
2. State law is also the determining factor for defining property and rights to property. Therefore, the attachment of a federal lien to property is highly dependent upon state law.
3. Classification principles must be used to first determine the identity of the liable party. State law definitions of property are then used to determine what property the federal tax lien attaches to.
4. Generally, an assessment of tax in the name of a business entity can be taken as evidence of liability on the part of the party assessed. However, partners who are not assessed may be liable under state law - e.g., general partners may be liable for partnership liabilities.
5. Single owners of certain limited liability companies (LLCs), with respect to employment taxes on wages paid prior to January 1, 2009, could file returns in the name of the LLC even though only the owner was liable. This has created problems since assessments where the single owner is liable are indistinguishable from assessments where the LLC is liable.

   Note:

   See IRM 5.1.21, *Collecting from Limited Liability Companies*, for additional information.

5.15.1.13 (10-02-2012)
Business Entity Types

1. Business entities fall into five broad categories:
   - Proprietorships
   - Partnerships
   - Corporations
   - Limited liability companies
   - Limited liability partnerships
2. The proprietorship is the simplest form of business organization.
   - The proprietorship is a business name for the owner.
   - It is not protected from the liabilities of its owner under state law; because the proprietorship and the owner are considered the same entity, the owner is likewise not protected from the liabilities of the proprietorship under state law.
   - A proprietorship cannot own property in its own name distinct from its owner.
   - The owner and the proprietorship are essentially one and the same.
   - Income of a proprietorship is allocated to the owner for federal income tax purposes.
3. Partnerships are organized under state law through partnership agreements.
   - Partners may be individuals or business entities recognized under state law, e.g., a corporation.
   - State law normally specifies that general partners are liable for the debts of the partnership.

- Partnership assets generally cannot be attached for liabilities incurred by the partners separately.
- Partnerships are further categorized into general partnerships and limited partnerships in state law.
- In general partnerships, the partners are generally held liable for partnership debts as provided in state law.
- In limited partnerships, a general partner, sometimes referred to as a managing partner, is designated the operating partner and is generally held liable for the consequences of actions taken on behalf of the partnership.
- The managing partner is therefore often held responsible for the trust fund recovery penalty authorized by IRC § 6672.
- Partnership Income is allocated to the partners based upon the percentages specified in the partnership agreement by filing Form 1065, *U.S. Return of Partnership Income*, with associated Schedule K-1s, *Partner's Share of Income, Deductions, Credits, etc.* Schedule K-1 income is in turn reported on the partners' income tax returns.

4. Corporations are chartered by the states under specific incorporation statutes.
    - They are organized under the provisions of a corporate charter filed with a designated state official (secretary of state or equivalent position) that specifies the business rights and privileges given the corporation. The corporation is represented by an official registered agent, often the attorney who represented the entity in its incorporation proceedings.
    - The charter specifies the duties of corporate officers and the right to issue corporate stock.
    - Corporations have a separate legal existence under state law, own property in their own right and have limitation of liability relative to the debts of the owners/stockholders.
    - Corporate assets cannot be attached for debts of the owner/stockholders except in circumstances when transferee liability or state law alter ego and/or nominee theories are successfully pursued.
    - Corporations are usually taxed on the income produced by their activities.
    - Subchapter S corporations pass the income to their shareholders using Schedule K-1. The shareholders, in turn, report their distributive share of the corporation's income on their personal returns.
5. Limited liability companies (LLCs) are business organizations chartered by the states under specific limited liability company statutes.
    - An LLC is owned by one or more persons known as members. Members may be individuals or other legal entities.
    - An LLC is organized as a distinct legal entity under state law by filing articles of organization or a similar document with a designated state official.
    - An LLC may own property in its own right and has limitation of liability relative to the debts of the owner(s).
    - Assets of the LLC cannot be attached for debts of the owner(s) except in circumstances where transferee liability or state law alter ego and/or nominee theories are successfully pursued. The IRS may levy on the owner's distributive interest in the LLC, levy on the owner's membership interest in the LLC and sell it, or file suit to foreclose the federal tax lien against the ownership interest.
    - Under the provisions of Treas. Reg. 301.7701-3, an LLC is classified as a partnership if it has two or more members or disregarded as an entity separate from its owner, if it has a single owner, for federal income tax purposes, unless it elects to be treated as an association taxable as a corporation.
    - Unlike state partnership law, state LLC law specifically limits the liability of owners for debts of the LLC.
    - Single-member LLCs are generally disregarded as taxable entities, meaning that the owner is the taxpayer. For wages paid prior to January 1, 2009, the employment tax liability of the single-member owner of a disregarded LLC may be reported in the name of the LLC, which creates complications for collection of the tax. The individual owner of the disregarded LLC is still the liable taxpayer for any employment tax liability incurred before January 1, 2009, regardless of whether the LLC's name and EIN were used to report the liability.
    - For wages paid on or after January 1, 2009, employment taxes will be the liability of the single-member LLC. In other words, the single-member LLC is not disregarded for employment tax purposes.
    - Depending on the facts and circumstances, a member of an LLC may be responsible for the trust fund recovery penalty under IRC 6672.

      Note:

      See IRM 5.1.21, *Collecting from Limited Liability Companies*, for additional information.
6. Limited liability partnerships (LLPs) are formed under a state limited liability partnership law.
    - Generally, a partner in an LLP is not liable for the debts of the LLP or any other partner.
    - A partner is not liable for the acts or omissions of any other partner, solely by reason of being a partner.
    - An LLP is required to file Form 1065, *U.S. Return of Partnership Income.*
    - Depending on the facts and circumstances, a member of an LLP may be responsible for the trust fund recovery penalty under IRC 6672. Refer to IRM 5.17.7.1.1.3, *Partners/Members.*

5.15.1.14 (10-02-2012)
Business Financial Statements

1. The analysis of a business taxpayer's financial condition provides the basis for the majority of case resolutions. Revenue officers are expected to perform and document a thorough and accurate analysis of the taxpayer's financial information. This assessment of the overall financial condition of the business should indicate the most appropriate case resolution.
2. A complete CIS, Form 433-A, *Collection Information Statement for Wage Earners and Self-Employed Individuals*, or Form 433-B, *Collection Information for Businesses*, enables revenue officers to make sound decisions to resolve cases and to take the appropriate enforcement action when warranted.
3. Many businesses employ accounting firms to maintain records and books or use over the counter software programs. Because of the complexity of business entities, acquiring and reviewing these records are very important in determining the true value of an asset. The statements that may be secured from business entities are described below. While these other financial statements may help clarify or verify Form 433-A and Form 433-B and may provide additional sources of collection, they do not replace Form 433-A and Form 433-B. They may include expenses, such as depreciation, that are not considered an allowable business expense on Form 433-A or Form 433-B. Allowable business expenses are the cost of carrying on a business or trade. Generally, they must be necessary for the operation of the business.
4. The Income Statement or Profit and Loss Statement is a financial statement that shows revenue, expenses and profit during a given accounting period, usually either a quarter or a year. Along with the balance sheet, the income statement is a tool used to assess the health and prospects of a company. The income statement shows revenue and expenses, including operating expenses, depreciation, income taxes and extraordinary items. Using the income statement, a taxpayer or revenue officer can

quickly figure cash flow, profit margins and other important indicators of how the business is doing.

5. A business' balance sheet is a snapshot of its financial picture on a given day. A balance sheet shows the financial position of a company by indicating the resources that it owns, the debts that it owes and the amount of the owner's equity in the business. One side of the balance sheet totals up assets, moving from most liquid (cash) to least liquid (plant and equipment or goodwill). The other side of the balance sheet lists liabilities in order of immediacy. Remember that assets must equal liabilities plus shareholder's/owner's equity. The balance sheet, along with the income statement, is an important tool for analyzing the financial health of a company. Using the balance sheet, compare current assets and current liabilities to assess equity; and consider hidden value in assets.

    A. Assets are any item of value owned by a business. A firm's assets are listed on its balance sheet, where they are set off against its liabilities. Assets may include factories, land, inventories, off-shore accounts, vehicles and other items. However, not all assets are created equal. Some assets, such as cash, are easy to value and liquidate. In addition to cash, there are assets called cash equivalents.

    B. Cash Equivalents are short term, highly liquid investments (three months maturity or less) that are made with idle cash. These can be included as equivalents of cash for cash flow purposes.

    C. Others assets, such as buildings and farmland are somewhat more difficult to value accurately. These kinds of assets are collectively known as tangible assets.

    D. Intangible assets, such as goodwill, also can be important to the success of the enterprise. Goodwill, for instance, could include a valued brand gained in an acquisition (a famous brand, such as Coca-Cola, doesn't normally show up on balance sheet otherwise). Other examples of intangible assets are patents, franchises, licenses, domain names of web sites and customer lists.

    E. In general, firms are required to carry assets on their books at cost less depreciation. This conservative principle means that the balance sheets of most companies understate the true value of their holdings.

    F. Liabilities are the opposite of assets. A liability is a debt, an obligation to pay. Thus, short-term debt (less than 1 year to maturity), long-term debt and certain other obligations appear as liabilities on a company's balance sheet.

    G. Consult local revenue agents with questions about adjusting the financial information for a particular item.

6. When determining ability to pay, the income and expense information provided must reflect a sufficient time frame to accurately determine the monthly average that could be expected for the entire year. Seasonal variations in business income must be considered, as well as extraordinary events that can lead to excessive increases or decreases in income or expenses at a particular time.

7. Information provided on the CIS, as it pertains to income, assets, and expenses, should match the information provided on other financial statements, tax returns and schedules, and other sources used to verify assets or encumbrances. Discrepancies must be addressed and documented in the case history.

5.15.1.15 (10-02-2012)
Cash Flow Analysis

1. Taxpayers may substitute business financial statements for the income and expense section of the 433-B, *Collection Information for Businesses*. If the taxpayer does not submit the income and balance sheet, they should be requested, if available, in order to review the viability of the business.

2. The taxpayer may also be asked to submit a cash flow analysis. These are often completed when taxpayers seek loans or investors and may already be available for the revenue officer's review.

3. Cash flow projections are used by a business to forecast future income to meet upcoming expenses. They are based on comparing money owed to expected revenues. This information is most useful when dealing with a business that does not have the ability to full pay on first contact or over a short period of time. Use this to determine if the business can remain current with operating expenses and taxes, and also pay the delinquent taxes.

   Example:

   The cash flow analysis may show that the business can enter into an installment agreement with increasing payments, as the cash flow of the business improves. There are instances when it may be appropriate to temporarily suspend collection on a business, if the taxpayer cannot pay the delinquent taxes, but current expenses and taxes can be met and the cash flow projections indicate future ability to pay.

4. Cash flow is net income minus preferred dividends plus depreciation (as given in the income statement). Generally speaking, cash flow is the best measure of a company's profits. It is usually calculated by adding depreciation and any other non-cash charges to earnings after taxes. Investors look to cash flow for several reasons:

    - Firms have accounting leeway when it comes to reporting net income;
    - Depreciation charges, while substantial in many industries, aren't genuine bills that have to be paid; and
    - Cash flow is the key to a company's ability to pay dividends, cover debts and so forth. Thus, some analysts focus on the ratio of price to cash flow rather than the traditional price/earnings (P/E) measure. Cash flow is especially useful in assessing firms in capital-intensive industries where huge depreciation charges can hide healthy profits.

5.15.1.16 (11-17-2014)
Making the Collection Decision

1. The analysis of the taxpayer's financial condition provides a basis for making one or more of the following decisions:

    A. Request payment in full or a partial payment based on the liquid equity in available assets.

    B. Consider filing a notice of federal tax lien. See IRM 5.12, *Federal Tax Liens*.

    C. Enforce Collection. After taxpayers have been given the opportunity to resolve their accounts and failed to do so, consider enforcing collection. See IRM 5.10, *Seizure and Sale* and IRM 5.11, *Notice of Levy*.

    D. Installment Agreement. See IRM 5.14, *Installment Agreements*.

    E. Currently Not Collectible. When financial analysis indicates no means of payment, see IRM 5.16.1, *Currently Not Collectible (CNC) Handbook*.

    F. Offer-in-Compromise. For detailed Offer in Compromise information see IRM 5.8, *Offer in Compromise*.

2. The following issues should be considered when deciding the best case resolution:

    - Past compliance history — How long has the taxpayer been in business? Is there a history of non-compliance?
    - Reason for non-compliance — Was the current tax problem related to a specific, identifiable event, e.g. loss of a key supplier, failure of a primary customer, impact from a natural disaster, etc.? Is there reason to believe the taxpayer is recovering from this event?
    - Current compliance — Is the taxpayer current and has the cause of past non-compliance been corrected?
    - Current financial condition — Can the taxpayer meet current obligations, including FTDs?

- Future financial condition — Can financial adjustments help the taxpayer experience future profits?
- Collection statute — Does the case resolution being considered provide for payment within the collection statute?
- Interest in assets— Is the government's interest in assets protected, will the value of assets increase or decrease, and will the taxpayer's interest in assets change?
- Impact — What impact will the case resolution being considered have on third parties?
- Collection Potential— Will potential for collection increase or decrease for the case resolution being considered?
- Federal Payment Levy Program (FPLP) versus Form 668-A, Notice of Levy - Should federal contractor and vendor payments be systemically levied through the FPLP or by using Form 668-A? See IRM 5.11.6.5, *Federal Contractors*, for additional information.

3. Address full compliance and ensure taxpayer is current with all filing and paying requirements, including federal tax deposits and estimated tax payments.
4. When analyzing and verifying the financial data, be alert to any indications of fraud. If indications of fraud are identified, refer to IRM 25.1, *Fraud Handbook* or contact the Fraud Referral Specialist (FRS) before further contact with the taxpayer or representative.
5. Trust Fund Recovery Penalty (TFRP). If the delinquency includes trust fund employment taxes, a TFRP investigation must be completed. The finances of any responsible person would be considered in analyzing the potential payment of the account. See IRM 5.7, *Trust Fund Compliance*.

5.15.1.17 (10-02-2012)
Business Expenses

1. The IRC permits a taxpayer entity to reduce its income by deducting expenses paid to earn that income. Often these expenses help to identify assets to pay the tax liability.
2. Deductions may not necessarily be allowed as an expense in determining the ability to pay -- only actual cash expenses are used. If the taxpayer submits their own income and expense statement, the non-cash expenses should be removed from the analysis.

   Example:

   The taxpayer takes a 10K deduction for depreciation - this amount would not be allowed as an expense when determining ability to pay because depreciation is a non-cash expense.

3. Substantiation and verification is required for cash expenses.
4. In analyzing and verifying the business income and expenses or deductions, real or potential assets may be identified. The following charts provide an explanation of the income or expense item and other considerations for identifying assets.
5. **Compensation of Officers** - This amount represents compensation paid to corporate officers during the taxable year.

Expense	Assets/Other Considerations
The compensation paid to the officers in the form of cash.	Compensation is not always in the form of cash. Corporate officers may have compensation packages that include: • Stocks and stock options • Insurance • Automobiles or airplanes • Townhouses or condos located in vacation areas

   Tip: Often the officers are also shareholders or close relatives of the shareholders. Make certain:

   - The benefits provided during the year are not for personal gain
   - The compensation is not excessive for the corporation's ability to pay or the local economy
   - The corporation is not inflating the officers' salaries to reduce the net gain

   Reminder: If a revenue officer encounters the commingling of corporate and individual assets and/or income, coordinate with Area Counsel and consider pursuing alter ego or transferee assessments. Since sufficient detail is not always present on Schedule E of Form 1040, obtain it from the representative or taxpayer.

6. **Bad Debt** - Bad debts are amounts owed to the corporation but uncollectible.

Expense	Asset/Other Considerations
Bad debts are never an expense item.	This deduction represents the amount that remains uncollected after the corporation exhausts all avenues to collect the debt. Determine the relationship between the debtor and the corporation. For example: • Loans to officers or shareholders that were not repaid. • Absence of a note or security agreement that proves the existence of the loan to the officer or shareholder. • The corporation chooses not to pursue the debtor because of a close relationship. For example, a loan made to an officer or shareholder's child. • The corporation did not attempt to collect the debt. • The debtor is insolvent and unable to pay the debt.

   Tip: This section is critical if the taxpayer is a defunct or bankrupt corporation. Bad debt may have caused the corporation to become insolvent. Determining the next action would depend on how the bad debt was incurred.
   Example: *A customer files bankruptcy leaving the taxpayer with an unmanageable bad debt and subsequent bankruptcy, or a taxpayer that transferred assets to a relative then files bankruptcy. In the first example, do not pursue; in the second example, review IRC § 6901, Transferred Assets, and proceed accordingly.*

7. **Taxes and Licenses** - This represents deductible taxes and license fees paid on assets by the corporation.

Expense	Assets/Other Considerations
	They can represent any asset deemed taxable by local, county and state taxing authorities. For example: • Land and buildings

Determine the type of taxes and licenses included and for which assets they are paid.	• Machinery and equipment • Vehicles • Taxi or Liquor License

Tip: Ask the taxpayer for the location of the assets. Contact or research city, county and state offices to verify the location, description, valuation and other pertinent data for possible enforced collection against the assets. If corporate assets are being used by a shareholder, officer or employee without proper compensation, get the full details. Consider an alter ego or transferee relationship.

8. **Interest** - Interest deduction represents any interest paid or payable on corporate debt.

Expense	Asset/Other Considerations
Interest may be charged on loans of cash to purchase real estate, machinery, or equipment.	Make certain that the interest deduction is not on any asset used by the corporate shareholders or officers for personal gain. For example: • Interest payments to corporate officers on loans they made to the corporation. This is potentially preferential treatment of creditors if other priority debt is not paid, e.g., taxes. • Interest payments to corporate officers on the capital investment they made to the corporation, again a preferential treatment. • Interest payment for personal debts of the corporate officers or other subsidiaries. • Interest payments on fictitious loans from corporate officers.

Tip: Revenue officers who encounter these arrangements, should consider the possibility of corporate assets being dissipated. Pursue the beneficiary of this arrangement with a transferee or alter ego assessment.

9. **Depreciation** - Depreciation is a method to deduct the purchase price or basis of an asset over its useful life.

Expense	Asset/Other Consideration
Depreciation is never an expense item.	Form 4562, *Depreciation and Amortization*, is used to list the basis and depreciation of assets for tax purposes. Ask for the depreciation work papers or schedules for the prior, current and subsequent years. Comparing one year to another can help determine the true value of the assets. The disappearance of an asset from one year's depreciation schedule could mean the asset was: • Discarded, sold, traded-in or exchanged. • Fully depreciated for tax purposes. There should be either an asset or proceeds from the disposition of the asset.

Tip: The true value of an asset is not necessarily shown on the Form 4562 or the depreciation work papers. Although the asset may have been fully depreciated, it may have some market value.

10. **Depletion** - Depletion is similar to depreciation, but applies to assets such as oil, gas, coal or gemstones. Since the asset is removed from the ground, the depletion allowance is computed to account for this removal from the source.

Expense	Asset/Other Considerations
Depletion is never an expense item.	Depletion discloses the availability of an asset or a right to an asset. Identify the source of the asset and: • Locate the source of the depletion. • Gather the necessary information to levy on the proceeds generated from the depletion deduction. For example, name and address of the payor.

Tip: The right to the asset can be sold. The best customer will be the payor or company removing the item from the ground.

11. **Pension Plans, Profit Sharing Plans and Employee Benefit Programs** - Generally, pension plans, profit-sharing plans and employee benefit programs indicate a retirement account for the employees and corporate officers.

Expense	Asset/Other Considerations
Determine the corporation's interest in the plans.	Some corporations use investment firms for these accounts. Other corporations maintain and operate their own plans. Refer to IRM 5.11.6.2, *Funds in Pension or Retirement Plans* for details on the possibility of pursuing collection action on this asset. For example: • The sole beneficiaries for these accounts are the officers or shareholders whose funds may be used to offset the tax liability or the Trust Fund Recovery Penalty assessment. • The deposits are to hide corporate assets under the officers' or shareholders' names. • The deposits can be borrowed against to pay the outstanding tax liability.

Tip: Get the specific details on the owners and share amounts for each contributor and check with an Employee Plans specialist before proceeding.

12. **Other deductions** - Other deductions represent the cumulative total of all deductions that do not have a line entry on the return.

Expense	Asset/Other Considerations
Review schedule of other expenses in order to verify necessary business expenses.	This may disclose assets not previously identified. Clarify questionable or excessive deductions. Look for business expenses that were actually for the personal gain of the officers or shareholders. For example: • Bonuses • Excessive travel and related expenses • Luxury vehicles • Boats • Real property not related to business use

TIP: Commingling of personal and business expenses may lead to an alter ego or transferee assessment. Duplicate expenses should be eliminated.

13. **Net Operating Loss (NOL) Deduction** - The net operating loss is not an "out-of-pocket" expense but an artificial amount based upon tax law.

Expense	Asset/Other Considerations
NOL is never considered an expense. This discloses that the corporation may be able to make a larger payment on the tax liability.	

TIP: Do not let the accountant or the corporation reduce its ability to pay by this amount. This represents a "paper loss" only and not a real reduction in value.

5.15.1.18 (10-02-2012)
Determining Business Income

1. Income represents the return in money from a business, labor or capital investment.

2. **Gross Receipts or Sales**

Income	Other Considerations
Gross receipts represent money received by the corporation for the goods sold or services rendered. This figure is the total before any expenses are reported.	Gross receipts may be deposited in an operating account at regular intervals, such as daily, weekly, or any other time based on business practices.

TIP: Comparing the prior year's gross receipts with the current year's gross receipts gives revenue officers a good idea of the cash flow. This is helpful when projecting future cash flow and considering an installment agreement. Payments from merchant cards and third party networks will be reflected on IRPTRO as Form 1099-K, *Payment Card and Third Party Network Transactions*. Address situations where reported income from sales is significantly lower than the amount reported for Form 1099-K transactions.

3. **Dividends**

Income	Other Considerations
Dividends represent receivables or money received by the corporation.	These funds may be investment or security accounts; or, they may be reinvested in the entity paying them. This amount may not reflect an entire year's earnings.

TIP: Determine the length of time needed to earn the amounts reported. A revenue officer may determine that an amount initially thought to be nominal, is in fact worth pursuing. Review bank statements, Forms 1099, and brokerage statements.

4. **Interest**

Income	Other Considerations
Interest income represents money received from bank accounts or investments.	The reported interest income discloses the source that generated the income. Examples include cash, savings accounts and bonds. These interest amounts may be credited to the account on which they were paid; deposited after receipt; or, used to purchase additional investments.

TIP: A revenue officer may determine that an amount initially thought to be nominal, is in fact worth pursuing. The amount could have been earned over a short period of time, while the corporation was looking for somewhere to invest its money. Ask if the sources of interest are still available to pay or reduce the tax liability. If the taxpayer says "no " , then ask what happened to the funds and when it happened. If the taxpayer says "yes" , ask where the funds are located, and when the taxpayer can pay.

5. **Gross Rents**

Income	Other Considerations
Gross rents represent payments received for the use of corporate assets and may be in the form of monies, services, assets, bartering or any combination of these.	Establish how payments are made to determine which assets are available and the location and value of assets. For example, the corporation leases space to other businesses.

TIP: Gross rents disclose the existence of an asset. Determine the asset and the payor, then levy on the receivable or seize the asset if necessary.

6. **Gross Royalties**

Income	Other Considerations
Similar to gross rents but is normally earned on assets such as recordings, films, or mineral rights.	Royalty income can lead to an account receivable that can be levied or the right to that receivable that can be sold.

TIP: For recordings look for a production company; for films look for a distributor; and for minerals, look for a site or buyer of rights.

7. **Capital Gain Net Income**

Income	Other Considerations
Represents the net of the short-term and long-term gains and losses reported on Schedule D, *Capital Gains and Losses*.	Schedule D discloses proceeds from the sale of an asset and may indicate the taxpayer disposed of an asset. Determine what was sold; to whom it was sold; what happened to the money; if the asset was replaced, and where it is.

TIP: It is not unusual for someone who sells stock to own other stock and reinvest the sale proceeds into more stock. If land was sold, it could be a portion of a larger parcel still held by the taxpayer. Identify the asset and payor to determine possible levy sources.

There may be a fraudulent conveyance if assets are sold for a nominal amount to a friend or relative to prevent IRS collection action.

8. **Net Gain (or Loss)**

Income	Other Considerations
Form 4797, *Sales of Business Property*, is used to report the gain or loss generated from the sale of business assets.	This form would include assets that were partially or fully depreciated and then sold.

TIP: If the funds generated from the sale are still available, apply the funds to the tax liability. If the funds generated from the sale are not available, determine what happened to them.

9. **Other Income**

Income	Other Considerations
Other income represents items that do not fit into one of the specific categories on the business' tax return. For example: • A construction company may have income from scrap construction materials. • A legal firm may have referral fees.	The other income sources can disclose a wide spectrum of items depending on the nature of the business. Request an explanation of the amount shown and then proceed according to the findings.

- A Medical Professional Corporation may have expert witness fees for serving at a trial.

5.15.1.19 (11-17-2014)
Assets

1. As described in the previous sections, analysis of the income and expenses identifies many of the assets the taxpayer may have. Additionally, each section of the Collection Information Statement (CIS) should be reviewed to ensure that all sections are completed and all assets have been identified.
2. Secure the location (foreign or domestic) for each asset, any debts owed on the assets, the date the debt was acquired and the date the debt will be satisfied.
3. Proper valuation of the assets is necessary to determine the total collection potential of the taxpayer.
4. A field call should be made to locate and personally observe the condition of assets based on the merits and circumstances of the investigation.

   Note:

   An exception can be made to this requirement when the expense to the government for the revenue officer to personally observe the assets is cost prohibitive. Group Manager concurrence is needed. Tax examiners in Field Collection are exempt from the requirement to make field calls.

5.15.1.20 (10-02-2012)
Determining Equity in Assets

1. To determine equity of an asset, revenue officers must determine the value of the asset, encumbrances against the asset and priority of the Notice of Federal Tax Lien.
2. Businesses and individuals have similar types of assets. For example, cash is the same for a corporation or an individual. However, some assets that are unique to businesses can be more complex or difficult to value.
3. The Fair Market Value (FMV) of an asset is the price set between a willing and able buyer and the seller in an arms length transaction with full knowledge of the relevant facts. The FMV can be influenced by market conditions, age of the asset, condition of the asset, zoning requirements, technology, demand, fitness for use, and other factors.
4. The Quick Sale Value (QSV) of an asset is an estimate of the price a seller could get for the asset in a situation where financial pressures motivate the seller to sell in a short period of time, usually 90 days or less. Generally, the QSV is calculated at 80% of the fair market value. A higher or lower percentage may be appropriate depending on the type of asset and current market conditions.
5. Encumbrances can be verified using internal sources, online research and external sources. See *IRM 5.15.1.5*, *Internal Resources and Online Research*, and *IRM 5.15.1.6*, *External Sources*. Refer to the Legal Reference Guide for Revenue Officers (IRM 5.17.2,*Federal Tax Liens*), to determine priority of the Notice of Federal Tax Lien.

5.15.1.21 (10-02-2012)
Jointly Held Assets

1. When taxpayers own assets jointly with others, allocate equity in the assets equally between the owners, unless the joint owners demonstrate their interest in the property is not equally divided. In this case, allocate the equity based on each owner's contribution to the value of the asset.
2. Although the IRS may determine not to execute the lien on jointly held assets, that would not prohibit the IRS from requesting the taxpayer attempt to secure a loan against the asset, at least to the equity that is allocated to the taxpayer.

5.15.1.22 (10-02-2012)
Income-Producing Assets

1. When determining the reasonable collection potential, an analysis is necessary to determine if certain assets are essential for the production of income. When it is determined that an asset or a portion of an asset is necessary for the production of income, it may be appropriate to adjust the income or expense calculation for that taxpayer to account for the loss of income stream if the asset were either liquidated or used as collateral to secure a loan.
2. When valuing income-producing assets:

IF	THEN
There is no equity in the assets.	There is no adjustment necessary to the income stream.
There is equity and no available income stream (i.e., profit) produced by those assets.	There is no adjustment necessary to income stream.
There are both equity in assets that are determined to be necessary for the production of income and an available income stream produced by those assets.	Compare the value of the income stream produced by the income producing asset(s) to the equity that is available. Consider the impact on the viability of the business if the assets are liquidated. If assets are used as collateral to secure a loan or income producing assets are liquidated, make the appropriate adjustment to the income and expense analysis.
An asset used in the production of income will be liquidated to reduce the tax liability.	After the asset is liquidated and IRS is paid, adjust the income to account for the loss of the asset.
A taxpayer borrows against an asset that is necessary for the production of income, and devotes the proceeds to the reduction of the tax liability.	After the IRS has been paid the proceeds of the loan, adjust the expense analysis to account for the loan payment.
The taxpayer is either unable or unwilling to secure a loan on the equity in income producing assets.	Compare the equity in the assets with income produced by those assets. Refer to IRM 5.10.1.6, *Will Pay, Can't Pay and Won't Pay Factors*, if seizure is being considered. If income producing assets are seized and sold, make the appropriate adjustment to the business income.

3. These considerations should be fully documented in the case history. For example:

IF	THEN
A self-employed construction tradesman sells a truck, which he used to haul materials, and devotes the proceeds to the reduction of the tax liability.	Allow the expected cost of delivery services as a business expense.
Instead of selling the truck, the tradesman borrows against it and devotes the proceeds to the reduction of the tax liability.	Allow the loan repayment as a necessary expense.
A loan cannot be secured and loss of the truck would create an economic hardship.	Circumstances warrant allowing the taxpayer to retain the asset without requiring him to borrow. Document the case history accordingly.
An outside salesman drives a luxury car when all that is necessary is a moderate value sedan.	Include the equity in the analysis. Consider allowing only the portion of the loan repayment on the luxury car that would be required to purchase a moderate value replacement vehicle. If the taxpayer can sell the luxury car and purchase a less expensive replacement vehicle, consider the costs associated with the sale and with the purchase of the replacement vehicle, i.e. taxes, tags, title, etc., when determining ability to pay.

A business owns a vacation property that is used for annual board meetings.	Include the equity in the analysis. Do not allow any loan repayment.

5.15.1.23 (10-02-2012)
Assets Held By Others as Transferees, Nominees or Alter Egos

1. A critical part of the financial analysis is to determine what degree of control the taxpayer has over assets and income in the possession of others.
2. When these issues arise, apply the principles in the Legal Reference Guide for Revenue Officers (IRM 5.17.14, *Fraudulent Transfers and Transferee and Other Third Party Liability*) or request an opinion from counsel.

5.15.1.24 (10-02-2012)
Cash

1. Cash assets include currency on hand and bank account balances, including checking, savings, online, mobile and any other accounts. Determine the location (foreign or domestic) of the bank accounts.
2. Determine the taxpayer's interest in bank accounts by ascertaining the manner in which they are held. Apply the principles described in the Legal Reference Guide for Revenue Officers (IRM 5.17.3, *Levy and Sale*).
3. Verify whether deposits in escrow or trust accounts are actually held for the benefit of others.

5.15.1.25 (10-02-2012)
Securities

1. Financial securities are considered an asset and their value should be determined.
2. To determine the value of publicly traded stock, research a daily paper, the internet, or inquire with a broker for the current market price.

5.15.1.26 (10-02-2012)
Life Insurance

1. Life insurance as an investment is not considered a necessary expense. However, reasonable premiums for term life policies may be allowed when the policy is for the life of the taxpayer.
2. Whole life policies should be reviewed as an asset for borrowing against or liquidating. Taxpayer's can also own whole life insurance policies, with cash value, on the lives of other people.
3. When determining the value in a taxpayer's insurance policy consider:

IF	THEN
The taxpayer will cash out the policy and apply the proceeds to the tax liability.	Equity is the cash surrender value.
The taxpayer will borrow on the policy.	Equity is the cash loan value less any prior policy loans or automatic premium loans required to keep the contract in force.

5.15.1.27 (11-17-2014)
Retirement or Profit Sharing Plans

1. Funds held in a retirement or profit sharing plan are considered an asset and may be reachable by levy. See IRM 5.11.6.2, *Funds in Pension or Retirement Plans*. Consider consulting TE/GE for any questions concerning the validity or qualifications of a plan and to determine if the assets are available for collection. See the Legal Reference Guide for Revenue Officers, IRM 5.17.3.9.19, *Pension and Retirement Benefits*.
2. Contributions to voluntary retirement plans are not a necessary expense. Review of the retirement plan document is generally necessary to determine the taxpayer's benefits and options under the plan.
3. When determining the value of a taxpayer's pension and profit sharing plans consider:

IF	AND	THEN
The account is an Individual Retirement Account (IRA), 401(k) or Keogh Account.	The taxpayer is not retired or not close to retirement and age 59 1/2.	Equity is the cash value less any expense for liquidating the account and early withdrawal penalty.
The account is an Individual Retirement Account (IRA), 401(k) or Keogh Account.	The taxpayer is retired.	Determine if the taxpayer needs the income from the plan to provide for necessary living expenses. If not, equity is the cash value less any expense for liquidating the account (and early withdrawal penalty, if under age 59 1/2).
The account is an Individual Retirement Account (IRA), 401(k), or Keogh Account.	The taxpayer is close to retirement and age 59 1/2.	Determine if the taxpayer will need the income from the plan to provide for necessary living expenses. If so, consider the impact on income and expenses when the taxpayer is expected to retire. If income from the plan will not be needed when the taxpayer retires, determine if the plan should be liquidated now or at the time the taxpayer retires to avoid the early withdrawal penalty. If the plan is liquidated early, equity is the cash value less any expense for liquidating the account and early withdrawal penalty.
Contribution to a retirement plan is required as condition of employment.	The taxpayer is able to withdraw funds from the account.	Equity is the amount the taxpayer can withdraw less any expense associated with the withdrawal.
Contribution to an employer's plan is required as a condition of employment.	The taxpayer is unable to withdraw funds from the account but is permitted to borrow on the plan.	Equity is the loan value.
The plan may not be borrowed on or liquidated until separation from employment.	The taxpayer is not eligible to retire and is not being separated.	The plan has no equity.
The plan includes a stock option.	The taxpayer is eligible to take the option.	Equity is the value of the stock at current market price less any expense to exercise the option.

4. When the taxpayer will liquidate the retirement plan, allow any penalty for early withdrawal and the current year tax consequence. Consider requiring the taxpayer to submit an estimated tax payment as applicable.

5.15.1.28 (10-02-2012)
Furniture, Fixtures, and Personal Effects

1. The taxpayer's declared value of household goods is usually acceptable unless there are articles of extraordinary value, such as: antiques, artwork, jewelry, or collector's items. Exercise discretion in determining whether the assets warrant personal inspection.

2. There is a statutory exemption from levy that applies to the taxpayer's furniture and personal effects and an exemption that applies to the value of tools used in a trade or business. These separate exemption amounts are updated on an annual basis. The levy exemption for tools of the trade does not apply to corporate entities, but only to individual business taxpayers.

3. When determining the value consider the following:

IF	THEN
The taxpayer qualifies as head of household, single, or married	Grant a reduction in the value of personal effects for the levy exemption amount.
The property is owned jointly with any person who is not liable for the tax	Determine the value of the taxpayer's proportionate share of property before allowing the levy exemption.
Some of the furniture or fixtures are used in a business	They are not personal effects, but they may qualify for the levy exemption as tools of a trade.

5.15.1.29 (10-02-2012)
Motor Vehicles, Aircraft and Vessels

1. Motor vehicles, aircraft and vessels (boats) are considered assets. Equity in these types of vehicles must be determined and should be considered as possible collateral for loans.

2. Generally, it is not necessary to personally inspect automobiles used for personal transportation since their value is easily determined by consulting trade association guides. If the values are in dispute, the taxpayer should be instructed to secure an appraisal from a knowledgeable and impartial dealer or the revenue officer may adjust the value based on the condition of the vehicle. Adjustments to value based on condition should be documented in the case file.

3. Assets such as airplanes and boats may require an appraisal to determine FMV unless the items can be located in a trade association guide. An explanation of how these values were determined should be documented in the case file.

4. When these assets are used for business purposes they may be considered income producing assets. See *IRM 5.15.1.22*, *Income Producing Assets*, for a full discussion of the treatment of income producing assets.

5.15.1.30 (11-17-2014)
Real Estate

1. When determining equity in real estate, FMV of the property must be established. FMV is defined as the price a willing buyer will pay for the property in an arm's length transaction with full knowledge of the relevant facts based on the property's current condition and use. The following methods may be used to establish FMV:

   - Recent purchase price or an existing contract to sell
   - Recent appraisals
   - Real estate tax assessment
   - Market comparables
   - Homeowners insurance replacement cost
   - Observation

2. In determining the interest of the liable party, and the value of the interest, refer to the Legal Reference Guide for Revenue Officers (IRM 5.17.1.2, *Local Law Section*) and state law for additional guidance. The basis for the valuation should be documented in the case history.

3. In certain situations, the equity in real estate should be pursued as a means to full pay or reduce the tax liability. In these situations, the taxpayer should be asked to secure a loan, or sell the real estate. If enforcement actions are being considered, refer to IRM 5.10., *Seizure and Sale*.

   Exception:

   Taxpayers will not be required to pursue equity in real property if borrowing on the equity in the property or selling the property will impose an economic hardship.

4. In certain cases, a reverse mortgage may enable a taxpayer to pay the tax liability. A reverse mortgage is a loan where the lender pays the homeowner (in a lump sum, a monthly advance, a line of credit, or a combination of all three) while the homeowner continues to live in his/her home. With a reverse mortgage, the homeowner retains title to the home. Depending on the plan, the reverse mortgage becomes due with interest when the homeowner moves, sells the home, reaches the end of a pre-selected loan period, or dies. Because reverse mortgages are considered loan advances and not income, the amount the homeowner receives is not taxable. See IRM 5.12.10.6.2.2, *Subordination to Reverse Mortgages*, if a NFTL has been filed.

5.15.1.31 (10-02-2012)
Mortgage and Real Estate Loans

1. Mortgage and real estate loans represent money loaned to pay for real property. This may disclose real property or real estate notes previously unreported.

2. Determine the status of the loan and who holds the note or mortgage. Determine if the real estate note can be used as collateral for a loan to satisfy the tax liability or be factored or sold to the debtor.

5.15.1.32 (11-17-2014)
Accounts and Notes Receivable

1. Trade notes and receivables are income or "account receivable" amounts owed to the taxpayer by others. Consider the value of accounts for purposes of potential enforcement.

2. To determine the value of accounts receivable:

   A. When the receivables have been sold at a discount (factored) or pledged as collateral on a loan, apply the provisions of IRC 6323(c) to determine the lien priority of commercial transactions financing agreements. See Legal Reference Guide, IRM 5.17.2.6.6.1, *Commercial Transaction Financing Agreements.*

   B. Determine if the receivable has previously been secured by a lender. Refer to IRC 6323(d), *45-day Period for Making Disbursements*.

C. Examine the age of the receivable. While businesses generally intend to receive payment on these accounts within 30 days, the longer it takes for payment the less likely the business will receive full payment.

D. Examine accounts of significant value from which the taxpayer is not pursuing collection.

E. Examine accounts that are receivables from officers, stockholders or relatives.

3. Careful consideration should be given prior to serving a Notice of Levy on an account receivable when it is determined that liquidation of the receivable would be detrimental to the continued operation of an otherwise profitable business.

4. Secure a complete listing of accounts receivable:

   A. Name, address and telephone number

   B. Amount due

   C. Age and date due

5. Consider federal contracts for potential enforcement. Identify the federal payment source and determine if there is a specific payment schedule. Secure a copy of the contract/agreement if needed.

5.15.1.33 (10-02-2012)
Inventory

1. Inventory is property held for sale by the business entity.

2. The most common inventories are:

   - Merchandise or stock in trade
   - Raw materials
   - Work in process
   - Finished products
   - Supplies that physically become a part of the item intended for sale.

3. Determine the value of the inventory. This may be used as collateral for a loan or may be seized and sold in the event enforcement action becomes necessary.

5.15.1.34 (10-02-2012)
Machinery and Equipment

1. To determine the value of business assets:

   A. For automobiles and trucks, consult trade association guides, such as Blue Books, Automobile Dealers, newspapers, etc.

   B. For specialized machinery and equipment, consult a trade association guide, secure an appraisal from a knowledgeable and impartial dealer, or contact the manufacturer.

   C. Contact the Property Appraisal and Liquidation Specialist (PALS) to assist with the valuation of property.

   D. For especially difficult valuation problems where no other resource will meet the need, follow local procedure to request the services of an IRS valuation engineer.

5.15.1.35 (10-02-2012)
Tax-Exempt Securities

1. Tax-exempt securities are investments which pay interest which is not taxable.

2. However, these securities are assets. Since they are not taxable, they are not always listed on the return. The earnings from these securities should be listed on line 8b of the Form 1040.

3. These securities can include:

   - Municipal bonds
   - State and local government bonds that are exempt from Federal taxes
   - U. S. Government bonds exempt from state taxes

5.15.1.36 (10-02-2012)
Loans to Shareholders

1. These assets represent an account receivable due to the corporation by its shareholders. Sometimes the corporation grants a loan to a shareholder or relative of the shareholder with no intention of repayment.

2. Determine the following to verify the existence of the loan:

   A. Is there a written note?

   B. Are there periodic payments made to the corporation by the shareholder?

   C. Is a reasonable rate of interest received or paid?

   D. Does the loan represent funds or assets?

   E. Has the loan been forgiven subsequent to this return?

   F. Make sure no corporate money is used for the personal gain of corporate officers or shareholders. Think about the factors that would indicate the commingling of assets.

5.15.1.37 (10-02-2012)
Intangible Assets

1. Intangible assets are those without physical form or substance. The most common are:

- Patents
- Trademarks
- Franchises
- Licenses
- Goodwill
- Domain Name of a web site

2. The existence of an intangible asset can indicate a potential future benefit. While not "physical" , these are valuable assets and thus subject to amortization.
3. Amortization, like depreciation, is the write-off of an investment expense over a specified period or the economic useful life of the intangible asset. The amount on the return is the unamortized residual balance of the intangible. In other words, it is the amount that has not been written off.
4. The value of the intangibles can be obtained through the sale of the asset. Examples include:
    - Restaurants and bars that may have a liquor license
    - TV or radio stations that have an FCC license
    - Athletic teams that may possess a league franchise
    - A manufacturer that may have a trademark or patent
    - A long time and well established operation may have "goodwill " , that is a favorable consideration shown by its customers. In other words, a good reputation that is valuable for business income.

5.15.1.38 (11-17-2014)
Medicare/Medicaid Providers

1. Consider Medicaid/Medicare payments paid to providers for potential enforcement.
2. Information regarding Medicaid payments:
    - States have traditionally provided Medicaid benefits using a fee-for-service system. The providers submit their claims to the state for payment and the state is responsible for claim processing and payment. Under fee-for-service arrangements, states pay providers directly for services.
    - Recently, many states have implemented a managed care delivery system for Medicaid benefits. In a managed care delivery system, beneficiaries get most or all of their Medicaid services from an organization under contract with the state.
    - When considering a Medicaid provider levy, determine if the provider is paid directly by the state (fee-for-service) or through a managed care program. The levy should be served on either the state or the appropriate managed care program, not both.
3. For information regarding Medicare payments, see IRM 5.11.6.6.2, *Medicare Payments Paid to Providers*

Exhibit 5.15.1-1
Questions and Answers to Assist in Financial Analysis

1. **Question.** If, as a condition of employment, a minister is to tithe, a business executive is required to contribute to a charity, or an employee is required to contribute to a pension plan, will these expenses be allowed?

Answer. Yes. The only thing to consider is whether the amount being contributed equals the amount actually required and does not include a voluntary portion.

2. **Question.** A taxpayer has a child in a university. She has already paid the university $25,000 for tuition and housing for the school year. and she intends to pay another $25,000 next July for the following school year. Should this expense be allowed?

Answer. Yes, if the taxpayer can pay the liability plus accruals within six years, and prior to the CSED. Otherwise, the expense will not be allowable. The taxpayer may be eligible for an allowable expense to cover the child's enrollment at a local college if the reduced education expense could make it possible for the taxpayer to take advantage of the six-year rule. When an expense is not allowed the taxpayer is responsible for deciding what expense modifications or eliminations are needed to pay the tax liability.

3. **Question.** A taxpayer is starting the second year of two-year lease for a luxury car. Car payments are $1,200 a month. Should the taxpayer be allowed this expense?

Answer. Maybe. The taxpayer must justify the expenses in excess of the local transportation standards. There are rare exceptions where an occupation may require a luxury car. The type of car can also depend on the location. A real estate agent will probably drive a more expensive car if she is working a suburb with very expensive homes rather than a middle class suburb. If the taxpayer could be expected to drive a more reasonably priced car, then steps should be taken to eliminate the expense. Ask the taxpayer what the penalty would be to return the car to the dealer. With only one year left on the contract, the penalty may or may not be negligible compared to the amount the IRS could receive if the taxpayer leased a moderately-priced car. If the car payment of $1,200 is allowed, the installment agreement amount should be increased when the lease is scheduled to expire in one year.

4. **Question.** A taxpayer is living in an apartment which rents for $2,000 per month. The lease has another six months to run. The lease agreement includes a termination penalty equal to the lesser of two months rent or the monthly rent due for the balance of the lease. The taxpayer has a $500 security deposit. Local rental data indicated that an acceptable rental apartment in the same general neighborhood can be rented to house the family at a cost of $1,500 per month. The taxpayer cannot full pay within six years. Should the taxpayer be required to move to cheaper living quarters as a condition of an installment agreement?

Answer. Since breaking the lease would cost more than keeping it until expiration, an installment agreement may be written which allows the taxpayer to live in his present quarters for the balance of the lease but which requires an increase of $500 with the seventh month.

5. **Question.** A taxpayer is a commissioned sales person living in a home with a $3,000 monthly mortgage. The property was purchased in 2002 at the peak of the local real estate market and has lost approximately 25% of its value in that time due to local market declines. The present value is approximately equal to the mortgage balance. A single family home of a size adequate to house the family is available in a middle class neighborhood convenient to work and schools for $1,800 per month, including utilities. If the taxpayer remains in his home, income and expenses are approximately equal, leaving no disposable income to apply to the delinquent federal taxes. Should the account be reported currently not collectible?

Answer. Maybe. The difference between the cost of renting and owning indicates that a significant payment can be made if the residence were sold; however, the loss of equity, as well as the costs of sale and moving should be considered. Options for resolution may include:

- recommending the taxpayer try to restructure their mortgage to reduce the monthly payment,
- asking the taxpayer to sell the property if there is adequate equity for the taxpayer to pay the mortgage, costs of sale and moving costs,
- securing an installment agreement for a minimal amount until the taxpayer can adjust expenses (See IRM 5.14.2.1, *Partial Payment Installment Agreements*) , or
- recommending the account be reported CNC with a mandatory follow-up if property values are expected to increase.

6. **Question.** A taxpayer claims that she needs more for food than the amount provided by the National Standards because she has five teenage children. Can she get an increased amount?

Answer. Yes, if she can fully pay the tax liability plus accruals within six years, and prior to the CSED. Otherwise, she has to substantiate and justify the higher food expenses included within the National Standards. She would still be allowed the standard amounts for housekeeping supplies, apparel and services, personal care products and miscellaneous.

7. **Question.** Should a self-employed taxpayer who is currently making contributions to an Individual Retirement Account (IRA) be allowed to continue the contributions if it will take seven years for her to fully pay the tax liabilities?

Answer. The IRA payments would not be listed on Form 433-A as an allowable expense. Advise the taxpayer that if she wishes to continue making IRA payments, she must divert the money from allowed expenses, or use the amount allowed for miscellaneous expenses.

8. **Question.** A married couple owes a joint tax liability. They have submitted a Form 433-A. The financial analysis indicates that it will take a four-year installment agreement to fully pay the tax liability. The husband is a truck driver who is responsible for his own food and lodging expenses on the road. He usually pays as he goes with a personal credit card. He requests that this monthly payment be allowed. Should this expense be allowed?

Answer. The expenses for food and lodging are allowed as business expenses and should appear on Form 433-B or the business section of Form 433-A. These expenses should not appear on the personal expense section of Form 433-A. The business expenses would have already been deducted from business income to arrive at personal income. How the expenses are paid, cash or credit card, do not change the financial analysis. If the taxpayer needs to pay an additional amount on his credit card, he should be told that the IRS includes a monthly Miscellaneous allowance under the National Standards to be used for any expenses not included as allowable in the determination of ability to pay.

9. **Question.** A taxpayer completed a CIS which indicates that she can fully pay the liability plus accruals within six years. Since the assessment of the tax liability, she has purchased a car for personal use, which has increased her expenses by $2,000 a month. Should the provisions of the six-year or the one-year rule apply?

Answer. If it appears the taxpayer was aware of the tax liability and still committed part of her disposable income to excessive or conditional expenses, the Service is not obligated to allow these expenses even though the liability could be fully paid within six years. The excessive car payment would not be an allowable expense. Allow the standard amount for ownership costs on the CIS.

10. **Question.** A taxpayer has a child in a parochial school. Should the taxpayer be allowed this expense?

Answer. Yes, if the taxpayer can pay the liability plus accruals within six years, and prior to the CSED. Otherwise, the expense will be allowed only if it is for a physically or mentally challenged child and no public education providing similar services is available. If the expense is not to be included among allowable expenses, tell the taxpayer that he or she is responsible for deciding what expense modifications or eliminations are needed to pay the tax liability.

11. **Question.** Because of budget constraints, a public school district has begun charging fees for certain services which were previously provided for free. Should a taxpayer be allowed the expense of paying these fees?

Answer. Yes, if the fees are required of all children in the school district. Fees for optional services, such as music lessons, are allowable if the tax liability including projected accruals will be paid within six years.

12. **Question.** An area has an arrangement with Consumer Credit Counseling Services (CCCS) in which CCCS submits installment agreement proposals on behalf of the taxpayer. Are these cases subject to the allowable expense procedures?

Answer. Yes, unless the agreement falls under the streamlined installment agreement procedures. Any installment agreement in which financial analysis is required will be subject to the allowable expense guidelines. The area office must share allowable expense procedures with CCCS.

13. **Question.** A corporation owes a $75,000 tax liability of which $55,000 is trust fund. The corporation does not have sufficient assets to pay, but two of the officers have in excess of $100,000 in assets. Does IRS need to assess the Trust Fund Recovery Penalty (TFRP) before pursuing payment of the liability from the responsible persons?

Answer. No, the IRS does not need the TFRP assessed before looking to the responsible officers for payment of the corporate liability. The investigation of the corporation should include an investigation of the officers or responsible persons. In this scenario, the officers should be asked to loan the full payment to the corporation. However, no enforcement actions could be taken against the officers until the assessment is made. Also, the IRS would be limited to the collection of the trust fund only from the officers.

14. **Question.** A taxpayer lives with his fiancé. Both of them are wage earners. The home is owned by the fiancé but the taxpayer claims he pays all the household bills, including the mortgage. They have a joint checking account and all wages are electronically deposited to that account. The taxpayer's proportionate share of household income is 64%. The house has a Quick Sale Value of $35,000 after encumbrances. How is the excess income determined and should the real property be considered when making a determination of payment ability?

Answer. The total allowable and conditional expenses would be determined for the entire household the same as a married couple. The taxpayer would then be allocated 64% of those expenses when determining the monthly installment agreement amount. A determination must be made on how income is allocated to expenses whether or not the occupants have a legal relationship (e.g., roommates, spouses) or the liability is joint or not. Unless it can be substantiated that the expenses are entirely separated, the IRS will generally allocate expenses proportionate to income. In regards to the home, additional information is needed. If the taxpayer transferred the home to the fiancé or if the taxpayer has an interest in the property, IRS may be able to pursue the equity in the property. If the taxpayer has no interest in the real property, none of the equity can be used in determining the taxpayer's ability to pay. This does not preclude the fiancé from borrowing against the equity in the property to assist the taxpayer, but it should not be viewed as equity within the reach of the taxpayer.

15. **Question.** A taxpayer submits a state court order that specifies the taxpayer will pay for his daughter's college tuition and other expenses of his former spouse that would not otherwise be considered necessary expenses. Should the taxpayer be allowed these expenses?

Answer. Yes, if the taxpayer can fully pay the liability plus accruals within six years. Otherwise, the expenses will not be allowable. He is responsible for deciding what expense modifications or eliminations are needed to pay the tax liability. If additional guidance is required, consult with area counsel.

16. **Question.** If a taxpayer does not own a vehicle, but uses a vehicle owned by a parent or friend, is the taxpayer allowed any vehicle expenses or only the standard amount for Public Transportation?

Answer. At a minimum, a taxpayer who does not own a vehicle, is allowed the Public Transportation Allowance. He/she can use the allowance for public transportation or to pay someone for the use of a vehicle. If the taxpayer claims to spend more than that, employees must use their judgment to determine what should be allowed. For example, if the taxpayer cannot afford to buy a vehicle, and pays a friend for insurance, gas, and repairs which exceed the Public Transportation Allowance, it may be appropriate to allow the additional amount, especially if public transportation is not readily available between the taxpayer's home and work. However, if it is apparent that the vehicle is in the name of someone other than the taxpayer to avoid collection actions, the taxpayer would only be allowed the standard amount for Public Transportation.

17. **Question.** If a taxpayer does not own a vehicle, but uses a vehicle owned by a spouse or live-in girlfriend/boyfriend and they share expenses, is the taxpayer allowed any vehicle expenses or only the standard amount for Public Transportation?

Answer. If a taxpayer is using a vehicle that is titled to the non-liable person, and the taxpayer's shared expense calculation for transportation operating costs exceeds the Public Transportation Allowance, the additional amount may be allowed. However, if it is apparent that the vehicle is in the name of someone other than the taxpayer to avoid collection actions, the taxpayer would only be allowed the standard amount for Public Transportation.

18. **Question.** If a taxpayer defaults on an installment agreement and had previously been allowed a payment for delinquent state taxes, which was never paid, should payment for state taxes be allowed a second time if the installment agreement is being reinstated or a new installment agreement is granted?

Answer. No, a payment to the state would not have to be allowed, unless the non-payment of the state tax liability is due to circumstances of financial hardship, e.g. reduced income, unemployment, medical expenses, etc.

19. **Question.** A taxpayer completes a CIS that includes a minimum payment on a credit card. The taxpayer can full pay the liability including accruals in six years, and within the CSED. Should the payment be allowed?

Answer. Yes, under the six-year rule, if the liability can be full paid within six years or prior to the CSED, whichever is earlier, a minimum payment on a credit card should be allowed.

20. **Question.** A taxpayer completes a CIS that includes a credit card payment. The taxpayer cannot full pay the liability including accruals in six years. Should the payment be allowed?

Answer. No, the full amount of the credit card payment would not be allowed. It may be appropriate to reduce the credit card payment to an amount that would allow the taxpayer to pay within six years. If the credit card is being used for necessary expenses that exceed the standards, a deviation may be appropriate, and the expense item would be increased. This would allow the taxpayer to use the extra amount allowed for expenses to pay the credit card. Advise the taxpayer that any additional amount needed to pay the credit card payment would come from the miscellaneous allowance.

21. **Question.** A taxpayer completes a CIS that includes a credit card payment. The taxpayer can full pay the liability including accruals in six years, but the payment is excessive. For example, the taxpayer is paying $400 monthly on a credit card, but the minimum payment required is $100. Should the payment be allowed?

Answer. No, even if the liability can be full paid within six years, the payment is excessive. Only the minimum payment required would be allowed. Advise the taxpayer that if he wants to pay more than the minimum payment, he would have to use the miscellaneous allowance.

Exhibit 5.15.1-2
Financial Analysis: Online Access to the Allowable Expense Tables (Reference 5.15.1)

The Allowable Living Expense Tables (Collection Financial Standards) are web-based and are located on the following URLs:

- Internet access: http://www.irs.gov/individuals/article/0,,id=96543,00.html
- Intranet access: http://mysbse.web.irs.gov/Collection/toolsprocesses/AllowExp/default.aspx

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