

1. We are hearing reports of increased audit activity, especially S corporations and sole proprietorships. I would like to know if they are planning to increase partnership audits as well, and if so, if they are targeting specific kinds of partnerships (such as real estate holding companies or development entities). I am also curious as to whether any of the Triad agents have been trained in the IRS partnership market segment specialization program.

Answer: The Service is looking at Schedule C businesses. Many of the businesses include returns that are reflecting operating losses which appear to be out of character with the type of business activity. Many of these returns are being examined by office examiners and some of the more complex returns are being assigned to the field as part of the cases assigned to the newer agents.

During Fiscal year 06, examiners will be concentrating on flow-through entities such as Sub -S Corporations and partnerships. By examining these flow-through entities, the Service also achieves increased examination of individual returns by picking up the related shareholders/partners to pass through any adjustments made at the entity level. This fiscal year we are also beginning the next NRP (National Research Project) phase which involves flow-through entities (S-Corporation and partnerships).

Currently there are no partnership specialists in the Triad groups. However, as part of the NRP project all the agents assigned these returns will receive additional training on partnership and 1120-S issues.

2. When a taxpayer whose return has not been audited receives a notice from the Service asserting that tax/interest/penalties are due, and further stating that all of the taxpayer's refund on a later return has been applied to payment of part of the asserted penalties/interest/tax (rather than to estimated taxes as the taxpayer directed), what procedures, if any, are in place that afford the taxpayer due process on the issue of whether he or she owed the tax asserted in the notice?

Answer: First, we should determine what situation caused an assessment of tax that the taxpayer did not know about. If the

taxpayer had made an error in filing the return (an error that comes under the definition of a "mathematical error") the Campus would assess the corrected tax and any interest due. However, in this situation there would likely not be any penalty.

The more likely situation would be a taxpayer with an interest in a partnership that has been audited under the TEFRA procedures. Under the unified audit procedures, the individual taxpayer may not be aware of an audit (assuming they are a non-notice partner – less than 1% interest). Generally non-notice partners under the TEFRA rules are subject to the Tax Matters Person and their authority. Depending on the facts, the taxpayer may have to pay the tax and additions to tax and then file a claim for refund.

3. Since I've had some real problems with certified mail and proof, I have a practice of sending almost everything to the IRS via private courier (FedEx). Proof of receipt is so much easier with their online confirmations. However, each year it's a wild goose chase to get non-Post Office physical addresses for the IRS's various filing sites. We should request that the IRS publish, or at least provide to practitioners, a list of the physical addresses.

Answer: See attached

4. I would like information on the S Corp audit initiative announced in July, including the criteria used for identifying the "random" S corp to be audited, the scope of the audit, and any particular issues they are looking at.

Answer: The NRP Form 1120-S sample will consist of approximately 5,000 Sub-Chapter S returns for the tax years 2003 and 2004. In the NRP classification process every item on the return will be *considered* for audit potential. Items would include the income section, balance sheet items, property distributions, and dividend distributions. The examiner will review all items classified and may expand the scope to other items if warranted.

The focus of our exam efforts fall into two broad categories:

- 1) Core audit coverage across the entire spectrum of SB/SE filers
- 2) Areas of egregious non-compliance including:
 - a. Domestic and offshore abusive tax avoidance transactions – promoters and participants
 - Civil injunctions issued by the courts against scheme promoters and abusive preparers now exceed 125 – courts generally also order them to turn over client lists
 - More than 1,000 promoter investigations still ongoing
 - Thousands of participant audits completed and ongoing
 - Almost 50,000 leads shared to date with 48 state partners
 - During the week of 10/27/05, IRS announced our latest settlement initiative for participants in abusive transactions.
 - **Announcement 2005-80 provides settlement for 21 transactions**
 1. **Must file election between 10/26/05 and 1/23/06 on Form 13750**
 2. **Will have to pay all tax and interest**
 3. **Penalties will range from zero to 20 percent**
 4. **Transaction costs allowed as ordinary loss**
 - b. High income – high risk taxpayers
 - Generally not wage earners
 - Returns are often more complex
 - Often have the resources to engage in flow-through entities which makes income and deductions more difficult to verify
 - c. High income non-filers

- Examiners file returns for non-filers under IRS's substitute for return authority – servicewide almost 200,000 substitute returns filed for individual non-filers in 2004
 - Continue to improve ability to identify non-filers – testing data sharing with states to help identify non-filers
- d. Unreported income
- A high-risk area we have been focusing on for at least three years and now NRP/tax gap data has confirmed this is a major non-compliance issue
 - Data sharing and improved audit selection tools are helping us to better pinpoint returns likely to have unreported income. Continued analysis of NRP data is also expected to yield assistance to us in this area.