Part 5. Collecting Process

Chapter 15. Financial Analysis

Section 1. Financial Analysis Handbook

5.15.1 Financial Analysis Handbook

5.15.1.1 (05-09-2008)
Expectations

1. This chapter provides instructions for analyzing the taxpayer's financial condition.
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.
3. 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)
    - 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)
    - D. Enter into an Installment Agreement (IRM 5.14.1)
    - E. Explain the Offer in Compromise provisions (IRM 5.8.1)
    - F. Report the account Currently not Collectible (IRM 5.16.1)

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

   A. Form 433-A, Collection Information Statement (CIS) 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.

   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.

5. National and local standards are guidelines established by the Service to provide consistency in certain expense allowances such as groceries 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.

6. 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 may be appropriate to deviate from the standard amount when failure to do so will cause the taxpayer economic hardship (see Note below). The taxpayer must provide reasonable substantiation of all expenses claimed that exceed the standard amount. 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.

   Note:

   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.

   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.*

7. Analysis and verification of a Collection Information Statement (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.

8. Collection Information Statements submitted by taxpayers 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. If there is reason to believe that the taxpayer's situation may have significantly changed, secure a new Collection Information Statement.

9. 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 his/her 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 representative.

10. Emphasize to the taxpayer how much we expect from them rather than how we expect them to spend their money.

    A. Advise the taxpayer that we expect an amount equal to that amount in excess of necessary expenses and any allowable conditional expenses and, if requested, explain to the taxpayer how the amount expected was calculated.

    B. Advise the taxpayer that he or 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 or she can or cannot own or spend.

5.15.1.2 (05-09-2008)
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. (For example, credit card advances or loans.)

   E. Consider taxpayer's ability to get an unsecured loan.

   F. Consider the taxpayer's ability to defer payment of certain other debts in order to pay the tax liability.

   G. Determine the priority of the NFTL when considering whether to allow or disallow payments to other creditors. See Legal Reference Guide IRM 5.17.2.5, Priority of Tax Liens

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. One Year Rule: Taxpayers who cannot full pay their accounts within five years may be given up to one year to modify or eliminate excessive necessary expenses. By modifying or eliminating some conditional expenses, a taxpayer may be able to full pay the liability plus accruals within the five-year limit. This would enable a taxpayer to retain some conditional expenses.

5. Five Year Rule: All expenses may be allowed if:

   A. Taxpayer establishes that he or she can stay current with all paying and filing requirements.

   B. Tax liability, including projected accruals, can be paid within five years.

   C. Expense amounts are reasonable.

6. Agreements will be based on a taxpayer's maximum ability to pay, i.e., how quickly a taxpayer can fully pay the tax liability. Do not automatically allow agreements based on the five-year maximum if expenses are unreasonable (*See IRM 5.15.1.2.*(5)).

5.15.1.3 (05-09-2008) 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.

3. A thorough verification of the Collection Information Statement (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 5.1.17).

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 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.

6. A taxpayer may be required to substantiate expenses that are categorized as Local Standards or Other Expenses (*See IRM 5.15.1.10.*).

7. Substantiation of expense amounts could include items like 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 the 433-A and 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. The expense will not be allowed as part of the transportation expense on the 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 5.1.17, 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 unrelated entities

On business accounts, determine if there are "non-cash " expenses such as depreciation or amortization. Also consider a commingling of funds between related 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 (05-09-2008)
Shared Expenses

1. Generally, a taxpayer will be allowed only the expenses they are required to pay. Consideration must be given to any other income into the household and any expenses shared with a non-liable person.
2. Generally, the assets and income of a non-liable person are excluded in the computation of the taxpayer's ability to 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.

   Note:

   Community Property States: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. (IRM 5.17.2.4.2.1) 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 and Guam also allow property to be owned as community property.
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.
   F. Except for those expenses categorized as National Standards, unless the taxpayer claims more than the standard amount, verify the taxpayer actually contributes at least this amount to the total household expense.
   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 expenses by the calculated household income percentage. This represents the taxpayer's allowable expenses.

4. 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 are divided equitably between co-habitants (as documented by rental agreements, bank statement analysis, etc.), 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 information of the non-liable person(s), however sufficient financial information must be secured to verify the total household expenses and prove that the taxpayer is paying his/her proportionate share. The investigating employees should exercise sound judgment in these situations to determine which approach is most 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.

   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 (05-09-2008)
Internal Sources

1. Verify as much of the financial statement as possible through internal sources.
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.
3. Consider securing a full credit report as additional verification of the taxpayer's financial situation if warranted by the facts and

circumstances. See IRM 5.1.18.5

4. Regardless of the amount of the liability consider the following:

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
IRPTRO and/or copy of older year income tax returns	• 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. • Identify recently dissipated assets.
BRTVUE (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 or the depreciation work papers. • Check the location of depreciable assets.
FBAR	• Check to see if the taxpayer filed a Foreign Bank and Financial Account Report (FBAR), Form TD F 90-22.1, which indicates he/she 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. See IRM 5.1.18.16
State Motor Vehicle Records	Identify motor vehicles registered to the taxpayer but not declared on the CIS. Note: Check for ownership in business names or lien holders. Ownership of a trailer may lead to additional assets such as boats or jet skis.
Real Estate Records	• 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). Note: Check for ownership in business names on tax assessment records. Check courthouse records for grantor/grantee, mechanic liens, mortgagee/ mortgagor, divorce records, death certificate, registered wills, and Uniform Commercial Code (UCC).

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.
On-Line 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 (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 (05-09-2008)
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 sources.

Taxpayer Documentation	Review
Wage Earner - Wage statements for the prior three months. A statement with current year to date figures is also acceptable.	• Compare average earnings to the income declared on the CIS. • 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.
Self-employed - proof of gross income (invoices, accounts receivable, commission statements, etc.) for the prior three months	• 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).
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. 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.
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.
Homeowners 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	• 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.

5.15.1.7 (05-09-2008) 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*. The expenses must be reasonable. The total necessary expenses establish the minimum a taxpayer and family needs to live.
2. There are three types of necessary expenses:
   - National Standards
   - Local Standards
   - Other Expenses
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 standards are included in one total national standard expense.

   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: housing and utilities and transportation. Taxpayers will normally be allowed the local standard or the amount actually paid, 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, 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.

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.
6. Other - Other expenses may be allowed if they meet the necessary expense test. The amount allowed must be reasonable considering the taxpayer's individual facts and circumstances.
7. Conditional expenses. These expenses do not meet the necessary expense test. However, they are allowable if the tax liability, including projected accruals, can be fully paid within five years.
8. 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.
9. 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.
10. Revenue officers should consider the length of loan payments. Although it may be appropriate to allow for payments made on a secured debt that meets the necessary expense test, if the debt will be fully repaid in one year only allow those payments for one year.

5.15.1.8 (05-09-2008)
National Standards

1. National Standards: Food, Clothing and Other Items 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 stationary; 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.

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

   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.

   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 medical services, prescription drugs, and medical supplies (e.g. eyeglasses, contact lenses). Elective procedures 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 *with no health insurance* 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.
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 (05-09-2008)
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, 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 expenses has been included in the Housing and Utility standards. If a taxpayer claims a separate cell phone expense on the financial statement, the amount would be added to the housing and utility expense claimed and subject to the allowable amount for the Housing and Utility standards. Ensure the taxpayer is not duplicating this expense.
      - Taxpayers are allowed the standard amount for housing and utilities or the amount actually spent, 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.

      - Consider availability of public transportation if car payments (purchase or lease) will prevent the tax liability from being paid in part or full. Public transportation could be an option if it does not significantly increase commuting time and its use is not unrealistic. You should also consider the age, health and needs of minor children when requesting the taxpayer use public transportation in lieu of vehicle expenses.
      - 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.

   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

- 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.

  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 (05-09-2008)
Other Expenses

1. Other expenses may be considered if they meet the necessary expense test - they must provide for the health and welfare of the taxpayer and/or his or her family or they must be for the production of income. This is determined based on the facts and circumstances of each case.

2. If other expenses are determined to be necessary and, therefore allowable, document the reasons for the decision in your history.

3. The amount allowed for excessive necessary or conditional expenses depends on the taxpayer's ability to full pay the liability plus projected accruals within five years and on the taxpayer's individual facts and circumstances. If the liability plus accruals can be paid within 5 years, it may be appropriate to allow the taxpayer the excessive necessary and conditional expenses. If the taxpayer cannot pay within 5 years, it may be appropriate to allow the taxpayer the excessive necessary and conditional expenses for up to one year in order to modify or eliminate the expense. *(See IRM 5.14.1, Installment Agreements)*

Expense Item	Expense is Necessary:	Notes/Tips
Accounting and legal fees.	If representation before the Service is needed or meets the necessary expense test. Amount must be reasonable.	Disallow accounting or legal fees that are not related to remaining current, solving the current liability or do not meet the necessary expense test.
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.	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 16.*
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 so many 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.
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.

Taxes	If it is for current federal, FICA, Medicare, state and local taxes.	Current taxes are allowed regardless of whether the taxpayer made them in the past or not. Delinquent state and local taxes are allowable depending on the priority of the FTL and/or Service agreement with the state and local taxing agencies.
Optional Telephones and Telephone Services *(Pager, Call waiting, caller identification or long distance)*	If it meets the necessary expense test.	
Student Loans	If it is secured by the federal government and only for the taxpayer's education.	Taxpayer must substantiate that the payments are being made.
Internet Provider/E-mail	If it meets the necessary expense test - generally for production of income.	
Repayment of loans made for payment of Federal Taxes	If the loan is guaranteed by the taxpayer's assets when those assets are of reasonable value and are necessary to provide for the health and welfare of the family.	

5.15.1.11 (05-09-2008)
Determining Individual Income

1. For purposes of determining the taxpayers' ability to pay, total household income must first be determined. Refer to *See IRM 5.15.1.4.*, Shared Expenses, for a complete explanation of determining proportionate income and expense calculations. If the taxpayer refuses to provide total household income, allocate 50% (or an appropriate percentage based on the number of household individuals) of household expenses to the taxpayer.

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 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 bi-weekly (every 2 weeks), multiply bi-weekly gross wages by 2.17.
   If income is sporadic or seasonal, use the annual income figure from the W-2 or the 1040 and divide by 12 to determine the average monthly income.

   B. Interest and Dividends. Includes any interest or dividends 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 would 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-Aor 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. Refer to *See IRM 5.15.1.13.*, Business Expenses.

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

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

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

5.15.1.12 (05-09-2008)
Business Entities

1. Businesses and individuals both have the same type 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. 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 you should secure from business entities are described below.

2. Income Statement. 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.

3. Balance Sheet. A firm's 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 websites 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.

5.15.1.13 (05-09-2008)
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.*

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 or other considerations.

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 local 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 case 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
Determine the type of taxes and licenses included and for which assets they are paid.	They can represent any asset deemed taxable by local, county and state taxing authorities. For example: • Land and buildings • 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 you locate corporate assets 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 4562or 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 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. Be alert to expenses made 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.

5.15.1.14 (05-09-2008)
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.

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, Sale 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 Form 1120. For example: • A construction company may have income from scrap construction materials. • A legal firm may have referral fees. • A Medical Professional Corporation may have expert witness fees for serving at a trial.	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.

5.15.1.15 (05-09-2008)
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. The value should be based on the fair market value (FMV).
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.

5.15.1.16 (05-09-2008)
Determining Equity in Assets

1. Determine the Fair Market Value (FMV). The FMV 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.
2. Quick Sale Value (QSV) 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, QSV is calculated at 80% of fair market value. A higher or lower percentage may be appropriate depending on the type of asset and current market conditions.

5.15.1.17 (05-01-2004)
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 we may determine not to execute our lien on jointly held assets, that would not prohibit us from requesting the taxpayer to attempt to secure a loan against the asset, at least to the equity we have allocated to the taxpayer.

5.15.1.18 (05-09-2008)
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. Determine if an adjustment to income or expenses is appropriate.
An asset used in the production of income will be liquidated to reduce the tax liability.	Consider adjusting 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.	Consider the effect that loan will have on future expenses and the future income stream.
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. Determine if an adjustment to the income stream is appropriate to account for the potential levy or seizure of the assets.

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.	Consider allowing 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.	Consider allowing 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.
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.

5.15.1.19 (05-09-2008)
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) or request an opinion from counsel.

5.15.1.20 (05-09-2008)
Cash

1. Cash assets include currency on hand and bank account balances, including checking, savings and any other account. 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).

3. Verify whether deposits in escrow or trust accounts are actually held for the benefit of others.

5.15.1.21 (05-09-2008)
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 or inquire with a broker for the current market price.

5.15.1.22 (05-01-2004)
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. When determining the value in a taxpayer's insurance policy consider:

IF	THEN
The taxpayer will retain or sell the policy to reduce 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.

5.15.1.23 (05-09-2008)
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 the Legal Reference Guide for Revenue Officers, IRM 5.17.3.5.24, 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.	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 or close to retirement.	Equity is the cash value less any expense for liquidating the account and early withdrawal penalty, or consider the plan as income, if the income from the plan is necessary to provide for necessary living expenses.
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.

5.15.1.24 (05-01-2004)
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.

5.15.1.25 (05-09-2008)
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. The case file should document how these values were determined.

4. When these assets are used for business purposes they may be considered income producing assets. See *See IRM 5.15.1.18* , Income Producing Assets for a full discussion of the treatment of income producing assets.

5.15.1.26 (05-09-2008)
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 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) and state law for additional guidance. The basis for the valuation should be documented in the case history.

3. The equity in real estate should be pursued as a means to full pay or reduce the tax liability. The taxpayer should be asked to secure a loan. Refusal to pro-actively seek a loan will be considered refusal to pay and appropriate enforcement actions should be pursued. See IRM 5.10.1 , Seizure and Sale.

5.15.1.27 (05-09-2008)
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.

5.15.1.28 (05-09-2008)
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 and financing agreements. See Legal Reference Guide IRM 5.17.2.5.3.1, Commercial Transactions Financing Agreement.

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

    D. 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 account receivables:

    A. Name, address and telephone number

    B. Amount due

    C. Age and date due

5.15.1.29 (05-01-2004)
Inventory

1. Inventory is property held for sale by the corporation.

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.

5.15.1.30 (05-01-2004)
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.

5.15.1.31 (05-09-2008)
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 list 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

5.15.1.32 (05-01-2004)
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.

5.15.1.33 (05-09-2008)
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 website

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.

5.15.1.34 (05-09-2008)
Cash Flow Analysis

1. Taxpayers may substitute the corporate financial statements for the income and expense section of the 433-B. However, if the taxpayer does not submit the income and balance sheet of the corporation, they should be requested in order to review the viability of the corporation and to complete a cash flow analysis if appropriate as discussed in *See IRM 5.15.1.12.*, Business Entities.
2. The taxpayer may 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. 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 such as cable TV, in which huge depreciation charges can hide healthy profits.

5.15.1.35 (05-09-2008)
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.
   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, Currently Not Collectible (CNC) Handbook.
   F. Offer-in-Compromise. For detailed Offer in Compromise information see IRM 5.8, Offer in Compromise. Also, Treasury Regulation § 301.7122-1 authorizes the Service to consider offers when the tax liability is less than the taxpayer's reasonable collection potential. For more information on Effective Tax Administration offers, refer to the Offer in Compromise IRM 5.8.11, Effective Tax Administration
2. Address full compliance and ensure taxpayer is current with all filing and paying requirements, including federal tax deposits and estimated tax payments.
3. 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.
4. 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 Handbook.

5.15.1.36 (05-09-2008)
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 establish limitation for liability for business types are used as guidance for determining the entity liable for taxes incurred in a business.
2. Since state law is also the determining factor for defining property and rights to property, the attachment of a federal lien to property is highly dependent upon factors outside federal law. The principle of state law definition for property and rights to property is one that has been confirmed repeatedly in decisions of the federal courts.
3. Determining an effective course of collection action requires the application of classification principles to first determine the identity of the liable party and then to determine if state law definitions of property are sufficient to justify attachment of a federal lien.
4. Application of these principles is not a significant concern for treatment of most tax assessments. An assessment of tax in the name of a business entity can be generally taken as evidence of liability on the part of the party assessed.
5. Reporting options available under federal regulations to the single owner of certain limited liability companies (LLCs) with respect to employment taxes on wages paid prior to January 1, 2009 have created problems for determining the party liable for these taxes.

5.15.1.36.1 (05-09-2008)
Entity Types

1. Business entities fall into four broad categories:
   - Proprietorships
   - Partnerships
   - Corporations
   - Limited liability companies
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.
- 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 ownership agreements.

   - Partners may be individuals or state law business entities.
   - 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 with associated Schedule K-1s. 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 via Schedule K-1 who in turn report their distributive share of the corporation's income on their personal returns.

5. Limited liability companies (LLC) 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.
   - Unlike state partnership law, state LLC law specifically limits the liability of owners for debts of the LLC.
   - Income tax may be allocated to the LLC itself or to its owner(s), depending on the classification of the LLC for federal tax purposes. An LLC can elect to be classified as a corporation. 26 CFR 301.7701-03
   - Excise and/or employment taxes may be the liability of the LLC itself or its owner.
   - Under some circumstances, the employment tax liability of the owner of an LLC may be reported in the name of the LLC, which creates complications for collection of the tax.
   - For wages paid on or after January 1, 2009, employment taxes will be the liability of the LLC.
   - Depending on the facts and circumstances, a managing 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.

Exhibit 5.15.1-1 (05-09-2008)
Questions and Answers to Assist in Financial Analysis (Reference: 5.15.1.3)

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 an expensive 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 five years. 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 five-year rule. Tell the taxpayer that we expect an amount equal to the tuition. She 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.Yes, if the taxpayer can full pay the liability plus accruals within five years. Otherwise, the taxpayer must justify the expenses in excess of the local 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 we could receive if the taxpayer leased a moderately-priced car.
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 five 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. No. The difference between the cost of renting and owning indicates that a significant payment can be made if the residence were sold. The loss of the taxpayer's equity is not the primary consideration. Advise the taxpayer he will have up to one year to adjust his expenses so that the Service will then receive an amount equal to the excessive housing expense. Make an installment agreement for a lesser amount in the interim, with an increase in payment at the date the house is supposed to be sold. Advise the taxpayer that enforcement may be taken at the end of a year if the installment agreement defaults for any reason, including failure to pay the required increase. If there is a default, the taxpayer will have to demonstrate that a good faith effort was made to sell or borrow on the property.
6.Question. A taxpayer claims her cable TV expense of $40 per month is a necessary expense because she lives in a remote area where reception is poor. Should this expense be allowed?	Answer. Yes, if we can get a full pay within five years. But it is not a necessary expense. Also, the National Standards include an amount for "miscellaneous" expenses which could cover cable TV.
7. 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 five years. 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.
8. 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 six years for her to fully pay the tax liabilities?	Answer. No. Tell the taxpayer to apply the amount going to the IRA to the tax liability, in addition to other identified disposable income. If the taxpayer wishes to continue making IRA payments, she must divert the money from allowed expenses.
9. Question. We have a joint tax liability against a married couple. They have submitted a Form 433-A. Our 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 credit card. He requests that this monthly payment be allowed. Should we allow the expense?	Answer. First, we need to determine if these are business expenses. If they are, they should not appear on the Form 433-A. The income which appears on the 433-A should not reflect business expenses which have already been deducted from business income to arrive at personal income. If they are not business expenses and it's determined they are necessary, they should be allowed. How they are paid, cash or credit card, doesn't concern us. If the taxpayer needs to make minimal payments to keep his credit card active, he should be told that the payments should come from the amount allowed by the National Standards, which includes a miscellaneous amount. Then monthly additions to the credit card should be fully paid from the amount allowed for the expense.
10. Question. A taxpayer completed a CIS which indicates that she can fully pay the liability plus accruals within five years. Since the assessment of the tax liability, she has purchased a luxury car which has increased her expenses by $2,000 a month. Should the provisions of the five-year or the one-year rule apply?	Answer. If it appears that she, although aware of the tax liability, committed part of her disposable income to excessive necessary or not-allowable conditional expenses, the Service is not obligated to allow the excessive expenses even though the liability could be fully paid within five years. It may be appropriate to inform the taxpayer that for the Service to consider an agreement, she will have to pay us immediately an amount equal to the down payment on the car and to pay us, as part of an installment agreement, an amount equal to the increased monthly costs for the car. This amount would be in addition to her other disposable income.
11.Question. A taxpayer has a child in parochial school. Should the taxpayer be allowed this expense?	Answer. Yes, if we can get a full pay within five years. 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.
12.Question. Because of budget constraints, a public school district has begun charging fees for certain services which were previously provided 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 five years.
13. 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	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

subject to the new allowable expense procedures?	area office must share allowable expense procedures with CCCS.
14. Question. The 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. Do we need to assess the Trust Fund Recovery Penalty (TFRP) before we pursue payment of the liability from the responsible persons?	Answer. No, we do not need the TFRP assessed before we look to the responsible officers for payment of the corporate liability. Our 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, we would be limited to the collection of the trust fund only from the officers.
15. 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. 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 QSV of $15,000 after encumbrances. How would you determine the excess income and would you consider the real property in making a determination of payment?	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 for purposes of the monthly installment agreement. In a situation such as this consideration should be given to asking the taxpayer if he has talked with his fiance' about securing a loan on the equity of the home. A determination must be made on how income is allocated to expenses whether or not the occupants have a legal relationship (roommates, marriage) or the liability is joint or not. Unless it can be substantiated that the expenses are entirely separated, we will generally allocate expenses proportionate to income.
16. 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 full pay the liability plus accruals within five 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 your local counsel attorney.

Exhibit 5.15.1-2 (05-09-2008)
Financial Analysis: On-Line 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/AllowExp/default.aspx

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