



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

SMALL BUSINESS/SELF-EMPLOYED DIVISION

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MEMORANDUM FOR DIRECTOR, SPECIALTY EXAMINATION AND ALL SB/SE
SPECIALTY EXAMINATION, EMPLOYMENT TAX TERRITORY
MANAGERS, GROUP MANAGERS AND EXAMINERS

FROM: Barbara J. Fiebich /s/ *Barbara J. Fiebich*
Director, SB/SE Specialty Examination Policy

SUBJECT: Procedures for Required Filing Checks and Scope of
Employment Tax Examinations

The purpose of this memorandum is to provide clarification for and updates to the examiners' responsibilities regarding required filing checks and scope of all employment tax examinations. Please ensure this information is distributed to all affected employees within your organization.

Background

This guidance memo amends IRM 4.23.3.7.4 and is effective upon issuance. Its content will be incorporated into the next IRM revision. Examiners must follow the interim guidance provided in this memorandum until IRM 4.23.3.7.4 is revised and published.

Effective Date:

This interim guidance is effective upon issuance.

Procedural Changes

1. **Required filing checks:** Examiners must determine whether:
 - a. The taxpayer under audit filed the information returns required. Examiners must address whether the appropriate information returns were filed for any reportable payments (e.g. Form 1099-MISC; Form 1099-K; Form 1099-INT; Form W-2, etc.)¹. If the appropriate forms were not correctly filed, the examiner must consider expanding the audit to include a penalty case file and/or Form 945,

¹ Form 1099-MISC, Miscellaneous Income; Form 1099-K, *Payment Card and Third Party Network Transactions*; Form 1099-INT, *Interest Income*; and Form W-2, *Wage and Tax Statement*.

Annual Return of Withheld Federal Income Tax, for the development of the backup withholding issue;

- b. The taxpayer properly withheld FICA² (including Additional Medicare tax for the tax periods beginning January 1, 2013 and thereafter) from wages and/or backup withholding from reportable payments. See IRM 4.23.8.4.1, *IRC 3102(f)(3) – Relief for Employer When Employees Have Paid Additional Medicare Tax on Wages*; IRM 4.23.8.6, *FICA Tax*; and IRM 4.23.8.13, *IRC 3406 – Backup Withholding*; and,
- c. All other federal return reporting requirements have been met. Examiners must ensure all required returns, including non-employment tax and information returns, have been filed properly. Any unfiled returns must be addressed. If the unfiled returns are employment tax returns, the audit will generally be expanded to include those years as part of the current examination. Other unfiled returns (e.g. income, excise, etc.) will generally be solicited as part of the package audit. If received, the examiner must date stamp the return, review for any Large, Unusual and Questionable (LUQ) items, and submit the return to the address the taxpayer would normally mail the return if it had been timely filed. If the return is not received by the time the employment tax examination is complete, or if LUQ items are noticed on the review of a submitted return, then a Form 5346, *Exam Information Item*, must be completed and forwarded to Employment Tax – Centralized Workload Selection and Delivery (ET-CWSD). ET-CWSD will forward the referrals to the appropriate location. All actions and decisions relating to unfiled returns MUST be fully documented in the case file.

NOTE: The mailing address for ET-CWSD is:

Internal Revenue Service
201 W. RiverCenter Blvd., Stop 5702-A/Employment Tax
Covington, KY 41011

NOTE: In cases where LUQ items are identified in a return submission, the examiner will make a copy of the return and attach it to the referral. The original return will be mailed to the address the taxpayer would normally mail the return. In no case should the original return be attached to the referral.

2. Scope of an Employment Tax Examination:

- a. All employment tax cases contain a classification sheet detailing the issues identified during classification. The classification sheet will indicate if a case has been designated by ET-CWSD to be a limited scope examination. Examples of limited scope employment tax examinations include all Employment Tax – Tax Compliance Officer (ET-TCO) examinations or cases with special circumstances specifically directed by management to be a limited scope exam. Examiners will follow the steps shown in (b) below for limited scope examinations. When the scope is not limited during classification or by management, the examiner will follow steps shown in (c) below.

² Federal Insurance Contributions Act.

- b. In all cases designated as limited scope examinations, regardless of source, the examiner must still address and document certain audit steps, including:
- Interviewing the taxpayer and touring the business. A tour of the business is only applicable for field examinations and is not applicable when remote audit procedures are used;
 - Completing the required filing checks addressed in (1) above;
 - Considering applicable penalties such as failure to file, failure to pay, failure to deposit, and negligence;
 - Fully developing the limited scope issue(s);
 - Preparing workpapers that support the proposed adjustments. See IRM 4.23.4, *Employment Tax – Workpapers, Employment Tax Examinations*, for additional information.

If the above steps reveal a material potential non-compliance issue, the examiner will use his or her judgment regarding whether to expand the examination to include that item. If the examiner determines expansion of a limited scope examination to address additional issues is warranted, the examiner must discuss this recommendation with the manager and document the decision in the case file.

Examples of examinations assigned as limited scope audits:

- 1) A management directive was issued allowing specific cases to be converted from full employment tax examinations to limited scope examinations. A copy of the directive must be included in the case file to show why the exam was treated as a limited scope examination.
 - 2) During the classification process a specific issue is identified that needs to be addressed; however, because of the cycle or statute of limitations the case would not be assigned for a full employment tax examination. The classification sheet is clearly marked “limited scope” for the appropriate issue.
 - 3) Cases classified for ET-TCOs are limited to issues appropriate to their experience and training. The issue(s) included in the limited scope are clearly reflected on the classification sheet and the sheet is clearly marked “limited scope.”
- c. In examinations **not** designated as limited scope examinations, the examiner will use facts learned during the pre-audit, interview of taxpayer, and review of books and records to determine the scope of the examination. The examiner will limit the scope of the examination if, in the examiner’s judgment, it is not in the Government’s best interest to pursue the issue further. The examiner will expand the scope of the examination to other issues found if, in the examiners judgment, expansion is warranted to ensure all items necessary for a substantially proper determination of the tax liability have been considered. All examiners must document the basis for any decision to change the scope of the examination.

3. Controlling the Employment Tax Returns

- a. Employment tax examinations generally cover an entire calendar year; therefore, the examiner must establish audit controls on all return(s) to address the entire calendar year. This generally means all four quarters of Form 941, *Employer's Quarterly Federal Tax Return*, will be opened when the examination is started. This applies even if the case results in a no-change, as it will more accurately reflect the audit work conducted. Additionally, any subsidiary or related employment tax return(s) must be opened for examination and established on ERCS if related taxpayers' records have been requested and reviewed;
- b. Examiners must document the reasons for controlling less than all four quarters of a calendar year, if applicable. For example, the examiner may determine that it is appropriate to control less than all four quarters of a calendar year when the examination involves a claim filed for a certain period, when bonuses were paid in a specific quarter, or when the business was not operating for a full year;
- c. Generally, examiners should not start an examination for a calendar year until after the last filing date for all employment tax returns of that year. Normally, this is January 31 following the end of the calendar year;
- d. Examiners should not secure control of any quarter for the current year, unless there are unique circumstances requiring inclusion of the current year quarter(s) (e.g. the taxpayer is no longer in business and the audit is expanded to resolve all remaining employment tax matters). Generally, the examiner will inform the taxpayer to correct any errors for the current year in accordance with IRC 6205 and the applicable Administrative and Procedural Regulations. For example, if the examination was concluded on November 1, 2014, an examination report will be prepared for 2012 and 2013. If the same issue(s) exist for 2014 the examiner will advise the taxpayer to correct them by filing the appropriate amended returns in accordance with IRC 6205. This procedure is consistent with Policy Statements 4-4 and 5-133; and,
- e. Examiners should expand any employment tax examination to include prior and subsequent years if the issue(s) under development are material and recurring, or if there appear to be other LUQ items, unless there are reasons for not doing so (e.g. statute concerns). All reasons must be fully documented.

Adhering to the guidance provided in this memorandum will assist examiners in meeting quality standards and ensuring appropriate and consistent audit procedures are followed in all examinations.

For questions related to this interim guidance, please contact Lynne McCoy, Acting Program Manager, Employment Tax Policy.

Effect on Other Documents

This guidance will be incorporated into IRM 4.23.3.7.4, *Scope of Employment Tax Examination*, within one year from issuance.

This memorandum also supersedes ICM 2013-004, *Additional Medicare Tax – Required Filing Check Procedures*, issued August 6, 2013. All copies of ICM 2013-004 should be obsolete.

Distribution:

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