

IRM PROCEDURAL UPDATE

DATE: 01/23/2024

NUMBER: wi-04-0124-0115

SUBJECT: Added Language for Calendar Year 2023 for Form 1099-K Transition Year; Added Note for Tracking Code 4231

AFFECTED IRM(s)/SUBSECTION(s): 4.19.14

CHANGE(s):

IRM 4.19.14.6.3, EITC - Schedule C Responses - Added language to acknowledge calendar year 2023 as an additional transition year for the Form 1099-K.

(1) The Form 1040 Schedule C, Profit or Loss from Business (Sole Proprietorship), is used to report business income and expenses.

(2) The purpose of the correspondence examination is to determine whether the taxpayer has substantiated they are engaged in a business when the facts and circumstances of the case are considered.

(3) An activity qualifies as a business if the primary purpose for engaging in the activity is for income or profit, and the taxpayer is involved in the activity with continuity and regularity. However, the determination of whether the taxpayer is engaged in a business for profit is not conducive to correspondence examination and should not be used to allow or disallow the Schedule C business.

(4) When the taxpayer is being examined for the profit or loss reported on Schedule C, Form 11652, Questionnaire and Supporting Documentation Form 1040 Schedule C (Profit or Loss from Business), will be sent as an enclosure with the CP 75 or Letter 566-S, Initial Contact Letter.

(5) Examiners should use Form 11652 as a guide to manage the outcome of the Schedule C examination when considering the response received to the examination query letter.

(6) Form 11652 assists the taxpayer with substantiating their Schedule C business. Descriptive information is requested for the business that is not required to be reported on the Schedule C. This information includes:

- Business activity, location business is conducted, website, and hours of operation
- Business licenses or permits held

- Method of advertisement
- State or Local sales tax returns filings

(7) The taxpayer is requested to select or fill-in the type of business records that are created, received, and/or maintained for income and expenses on the Form 11652. The record types listed include:

- Form 1099-MISC, Miscellaneous Information, and Form 1099-NEC, Nonemployee Compensation
- Accounting records and Ledgers
- Business bank account statements
- Paid invoices/receipts

Note: Beginning with tax year 2020, taxpayers with Non-employee Compensation will receive Form 1099-NEC. Prior to tax year 2020, NEC was reported on Form 1099-MISC.

(8) Form 1099-K, Payment Card and Third Party Network Transactions, may be issued to some Schedule C taxpayers if they received payments by a payment card. Payment cards include credit, debit, and gift cards. There is no reporting threshold for payment card transactions.

- Taxpayers may also receive Form 1099-K from third party settlement organizations (TPSO), subject to certain reporting thresholds.
- Section 9674(a) of the American Rescue Plan Act of 2021 provides that, for returns for calendar years beginning after December 31, 2021, a TPSO is required to issue Form 1099-K where aggregate payments to a taxpayer exceed \$600. The IRS delayed the implementation of the \$600 threshold until tax years beginning after December 31, 2022.
- Common examples of TPSOs include phone apps for driving a car for booked rides, property rentals, and online auctions, as well as certain apps that are used to transfer money if the TPSO takes custody of the funds, such as by using an online “wallet” within the app.
- A TPSO may issue a Form 1099-K for sales of personal items or other non-business transactions, depending on the nature of a taxpayer’s business. However, a Form 1099-K issued by a TPSO may not reliably substantiate the taxpayer’s Schedule C business like a Form 1099-NEC, Form 1099-MISC, or Form 1099-K reporting payment card transactions would.

On December 23, 2022, the IRS announced that calendar year 2022 will be treated as a transition year for the reduced reporting threshold of \$600 for the Form 1099-K. On November 21, 2023, the IRS announced that calendar year 2023 will also be treated as a transition year for the reduced reporting threshold of \$600 on the Form 1099-K. For calendar year 2022 and 2023, TPSOs who issue Forms 1099-K are only required to report transactions where gross payments exceed \$20,000 and there are more than 200 transactions.

- Some taxpayers may still receive a 2022 or 2023 Form 1099-K below the reporting threshold, which could report gross proceeds from business related transactions or from non-business transactions, such as the sale of personal items.
- In some circumstances, e.g., if the TPSO is an app that is used to transfer money, the Form 1099-K may report proceeds from a mix of business and non-business activity.
- Taxpayers are provided instructions about how to report these proceeds on [What to do with Form 1099-K | Internal Revenue Service \(irs.gov\)](#).

(9) The taxpayer is instructed to send in the records they selected or indicated they maintained on Form 11652. For example, taxpayers may submit Form(s) 1099, receipts from suppliers, invoices to customers, mileage logs, or bank account statements.

(10) If the taxpayer fails to provide any documentation to substantiate the business or to support information they provided on Form 11652, but indicates business records exist, ask the taxpayer to submit these records for verification. If the taxpayer indicates records have been lost or destroyed, inform the taxpayer that they are allowed to re-create records for the examination, which includes but is not limited to, requesting replacement records from banks, suppliers, or payers.

(11) It should be noted that a business license alone would NOT substantiate Self Employment (SE) income. The taxpayer would have to provide additional records noted above to validate the Schedule C.

(12) It is not necessary to verify every expense reported on the Schedule C, rather examiners should ensure the types and amounts of expenses reported and substantiated are ordinary and necessary for the business activity reported on Schedule C.


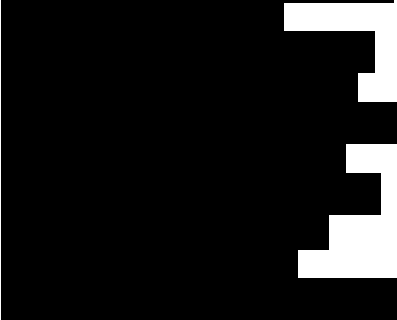

(13) An ordinary expense is one that is common and accepted in the business. A necessary expense is one that is helpful and appropriate for the business.

(14) Throughout the Schedule C examination, examiners should use judgment, based on substantiation received and taxpayer statements, to limit or expand the examination scope. Refer to IRM 4.19.13.3.1, Standard 1 - Adequate Consideration of Significant Issues.

(15) Refer taxpayers to Pub 334, Tax Guide for Small Business (For Individuals who Use Schedule C), and Pub 583, Starting a Business and Keeping Records, for additional information. The taxpayer may also reference the Small Business and Self-Employed Tax Center on [irs.gov](#).

(16) The following guidelines are used to determine if the taxpayer's activity qualifies as a business:

If	And	Then
<p>Schedule C response is received</p>	<p>Taxpayer submits only one of the following:</p> <ul style="list-style-type: none"> • Form 1099-NEC • Form 1099-MISC • Form 1099-K that reports payment card transactions such as credit, debit, and gift cards • Form 1099-K that reports third party settlement network payments for services, such as for driving a car for booked rides <p>If you receive a Form 1099-K that reports third party settlement network payments for goods or that are issued by a money transfer app, consider if the taxpayer submitted any other record of income or expenses as shown below and on the Form 11652, to determine if there is a business activity. # [REDACTED]</p>	<p>Verify Entity of Payer (CC BMFOL) and Payer Master File (CC PMFOL).</p> <p>Note: See IRM 2.3.53, Command Code PMFOL, for input screen and additional information on command code PMFOL.</p> <p>If the entity is valid and PMFOL matches, accept the Schedule C.</p> <p>If the entity is not valid and PMFOL does not match, do not accept the Schedule C.</p> <p>Inform the taxpayer that our records did not validate taxpayer information.</p> <p>Inform the taxpayer that acceptable payer information will be a letter on business letterhead verifying the amount paid.</p> <p>If the taxpayer is unable to obtain a letter from the payer, offer other options to verify income. See additional guidance below.</p>

Schedule C response is received	<p>Taxpayer submits written records of income, such as,</p> <ul style="list-style-type: none"> • Business/Personal bank account statements • Electronic payment records • Books and other accounting records • Payer records • Some, a variation or all of the above 	<p>Accept the Schedule C if it appears that the information provided substantiates the business.</p> <p>Note: If statements or other records indicate more income than reported on the Schedule C, issue a revised report to reflect the correct amount.</p> <p>Caution: Do not adjust gross receipts for Form 1099-K amounts reported on Form 8949 (carried to Schedule D) or on Schedule 1, line 8z, as Other Income. # </p> <p></p> <p># </p>
Schedule C response is received	<p>Taxpayer sends verification of expenses that would substantiate the business, such as,</p> <ul style="list-style-type: none"> • Car and truck expense receipts or mileage log • Contract labor payments • Business insurance/rental contracts • Supply receipts • Business/Occupational licenses • Payer records • Other expense receipts • Cost of goods sold, etc. • Some, a variation, or all of the above 	<p>Accept the Schedule C if the types of expenses are ordinary and necessary for the business activity reported on the return.</p>
Schedule C response is received	<p>Taxpayer submits copies of state tax returns (and/or local) (not personal income tax returns)</p>	<p>Accept the Schedule C if the state tax return shows revenue comparable to the Schedule C income.</p>

Schedule C response is received	Taxpayer indicates that the Schedule C was reported in error (no evidence of recklessness or fraud), i.e., preparer included without taxpayer knowledge	Remove the Schedule C from the return.
Schedule C response is received	Taxpayer indicates that the Schedule C was made up (some indication of recklessness or fraud)	Forward the case to your site's Fraud Coordinator. If not accepted into the fraud program, remove the Schedule C and consider asserting the 2-year ban.

Note: When deciding to remove the Schedule C, the taxpayer's credibility should be part of the decision process. Do you believe them or not? A 2-year ban and/or penalty can be asserted based upon the facts and circumstances of the case.

(17) Follow the procedures for working responses to Schedule C Classifier identified issue(s).

If	And	Then
Schedule C expenses are identified by the classifier	The taxpayer sends in receipts and cancelled checks to verify expenses	Accept the expenses.
Schedule C expenses are identified by the classifier	The taxpayer does not send in receipts and cancelled checks	Deny the expenses
Schedule C Income is identified by the classifier	The taxpayer submits a Form 1099	Verify Entity of Payer (CC BMFOL) If valid Accept Schedule C. If Not valid, Do not accept Schedule C.
Schedule C Income is identified by the classifier	The taxpayer submits written records of income books, bank statements	Accept Schedule C.
Schedule C Income is identified by the classifier	The taxpayer submits verification of certain expenses that would prove the existence of a business (e.g., advertising, commissions paid, wages paid, appropriate licenses, permits, insurance, cost of goods sold, etc.)	Accept Schedule C.

(18) If documentation is received that substantiates the business after the issuance of the Statutory Notice of Deficiency (SNOD) and the case is open, process the case as outlined below:

If	And	Then
The time to petition Tax Court has not expired	Sufficient time left in the statute	<p>Prepare a supplemental report with the corrected income.</p> <p>If the Taxpayer signs, close with the agreed deficiency.</p> <p>If Taxpayer does not sign or respond, allow the SNOD to expire, purge on the 105th day, prepare corrected Form 4549 and reissue the SNOD for the correct deficiency.</p> <p>In the explanation to Taxpayer, there must be a statement: This Notice of Deficiency supersedes the Notice of Deficiency dated MMDDYYYY (date of previously issued SNOD).</p>
The time to petition Tax Court has expired	Sufficient time left in the statute	<p>Allow the 105th day purge, prepare corrected Form 4549 and reissue the SNOD for full amount of deficiency.</p> <p>In the explanation to Taxpayer, there must be a statement: This Notice of Deficiency supersedes the Notice of Deficiency dated MMDDYYYY (date of previously issued SNOD).</p>

(19) If the taxpayer responds with request to remove Schedule C income and Schedule C income is not an issue on the original examination, process the case as outlined below:

If	And	Then
Taxpayer responds with request to remove Schedule C income	Taxpayer indicates that Schedule C income was reported in error (no indication of recklessness or fraud), e.g., Preparer included without the Taxpayer knowledge. There is no record of Form 1099, NEC income.	Remove the income from the return.
Taxpayer responds with request to remove Schedule C Income	Taxpayer indicates that Schedule C income was made up (some indication of recklessness or fraud). There is no record of Form 1099, NEC income.	Forward the case to your Fraud Coordinator. If not accepted into the Fraud program, remove income and consider asserting a 2-year ban.

Note: When deciding to remove income, the taxpayer's credibility should be part of the decision process. Do you believe them or not? A 2-year ban and/or Penalty can be asserted based upon the facts and circumstances of the case.

(20) If the taxpayer responds with a request to remove Schedule C income on a Claim, process the case as outlined below:

If	And	Then
Taxpayer requests to remove Schedule C Income when EITC was disallowed, and the Schedule C was not an issue on the original examination	Taxpayer indicates that Schedule C income was reported in error (no indication of recklessness or fraud), e.g., Preparer included without the Taxpayer knowledge. There is no record of Form 1099, NEC income.	Remove the income from the return.
Taxpayer requests to remove Schedule C Income when EITC was disallowed and the Schedule C was not an issue on the original examination	Taxpayer indicates that Schedule C income was reported in error (indication of recklessness or fraud). There is a record of Form 1099, NEC income.	<p>Inform the taxpayer that they should contact the payer and request a corrected document, Form 1099, removing the erroneously reported income.</p> <p>Inform the taxpayer that some payers make documents available on the payer's website.</p> <p>If the taxpayer is not able to contact the payer, or if the payer refuses to send a corrected document; have the taxpayer send or fax a letter of explanation to the address on their letter and the examiner will evaluate the response.</p> <p>If the taxpayer cannot verify the income should be removed, leave the income on the return and follow procedures for issuing a Statutory Notice of Deficiency (if applicable).</p>

(21) If documentation is received that substantiates the business on Reconsideration, process the case as outlined below:

If	And	Then
Schedule C and EITC were disallowed on the original audit. There is time left in the statute	Taxpayer verifies Schedule C and qualifying children for EITC	Allow the Reconsideration.
Schedule C and EITC were disallowed on the original examination. There is time left in the statute	Taxpayer verifies Schedule C but does not verify qualifying children for EITC	Allow the Schedule C. Do not allow the EITC. Input TC 290 for the Self-Employment Tax (SET). Taxpayer must sign for the tax increase. If signature not received, issue SNOD.
Schedule C and EITC were disallowed on the Original Audit. There is time left in the statute	Taxpayer verifies qualifying children for EITC but does not verify Schedule C	If there is no other income other than the Schedule C disallowed income, then no EITC should be input. But if there is other income on the return, allow the EITC based on the allowable income.
Schedule C and EITC was disallowed on the original audit. The statute has expired.	Taxpayer verifies Schedule C and qualifying children for EITC	Allow the Reconsideration. TC 290 cannot be input for the SET increase due to the expiration of the statute. Input TC 764 for the refundable amount of the EITC (difference between the SET and EITC). Move the remaining SET monies to Excess Collections. In the explanation to the taxpayer, include the statement: The tax return was timely filed within the prescribed time frame when the income was earned. Note: Do not increase the SE income reported. The Social Security Administration will not use this information when computing the taxpayer's Social Security payment amount unless the ASSED is still open for the assessment of social security tax on the increase in SE income. Refer to IRM 25.6.1.9.11.2, SECA Procedures, for additional information.

	Form 3999, Statute Expiration Report, must be prepared to report the barred SET amount.
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(22) If the taxpayer responds with a request to remove income on Reconsideration and the Schedule C was not an issue on the original examination, process the case as outlined below:

If	And	Then
Taxpayer responds with request to remove Schedule C Income	Taxpayer indicates that Schedule C income was reported in error (no indication of recklessness or fraud), i.e., Preparer included without the Taxpayer knowledge.	Remove the Schedule C from the return.
Taxpayer requests to remove Schedule C Income when EITC was disallowed on original audit but Schedule C was not questioned.	Taxpayer indicates that Schedule C income was reported in error (indication of recklessness or fraud). There is a record of Form 1099, NEC income	<p>Inform the taxpayer they should contact the payer and request a corrected document, Form 1099, removing the erroneously reported income.</p> <p>Inform the taxpayer that some payers make documents available on the payer's website.</p> <p>If the taxpayer is not able to contact the payer, or if the payer refuses to send a corrected document; have the taxpayer send or fax a letter of explanation to the address on their letter and the examiner will evaluate the response.</p> <p>If the taxpayer cannot verify the income should be removed, leave the income on the return and follow Audit Reconsideration closing procedures.</p>

IRM 4.19.14.8.4, Non-EITC Filters - Added Note for Tracking Code 4231.

(1) # [REDACTED]
 [REDACTED] #

(2) The table below provides a description of each Non-EITC DDB rule that will be displayed on IDRS using Command Code DLITE.

Note: Tracking Code 4231 should be used on all Non-EITC programs when EITC is included as an audit issue.

Rule ID	Rule Description
CTCA #	[REDACTED] #
CTCB #	[REDACTED] #
CTCC #	[REDACTED] #
CTCD #	[REDACTED] #
RCTA #	[REDACTED] #
RCTB #	[REDACTED] #
RCTC #	[REDACTED] #
RCTD #	[REDACTED] #
RCTE #	[REDACTED] #
AOCA #	[REDACTED] #
AOCB #	[REDACTED] #
AOCC #	[REDACTED] #
AOCD #	[REDACTED] #
AOCE #	[REDACTED] #
AOCR #	[REDACTED] #
CMBA #	[REDACTED] #
FTCA #	[REDACTED] #

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FTCB	# FTC: Fuel Tax Credit (FTC) and AOTC are being claimed and there is no partnership income present on Schedule E, and no farming income present on Schedule F. #
FTCC	# FTC: Fuel Tax Credit is being claimed and there are no Schedules C, E or F present. #
FTCD	# FTC: Fuel Tax Credit is being claimed, specific NAICS codes are present on Schedule C, there is no partnership income present on Schedule E and no farming income is present on Schedule F. #
HCTA	# HCTC: HCTC is being claimed and eligibility indicator (TC 971 AC 172) is not present. #
HCTB	# HCTC: HCTC is being claimed and eligibility indicator is present but taxpayer has not provided proof of qualifying insurance. #
HCTD	# HCTC: HCTC is being claimed and Taxpayer appears to be claiming HCTC on F 8885 when the credit was already paid as an advanced credit. #
CDCA	# CDCC: Refundable Child & Dependent Care Credit (CDCC) is being claimed and all children are over 12 years of age for entire tax year. #
CDCB	# CDCC: CDCC is being claimed and one or more children is over 12 years of age for entire tax year. #
CDCC	# CDCC: CDCC is being claimed and a child turned age 13 during first half of the tax year. #
CDCD	# CDCC: CDCC is being claimed and one or more children is over 12 years of age for entire tax year. #
CDCE	# CDCC: CDCC is being claimed and no relationship determined. #
CDCF	# CDCC: CDCC is being claimed and provider EIN/TIN field is blank (not transcribed). #
CDCG	# CDCC: POST-REFUND: CDCC is being claimed and child was born after the tax year. #
CDCH	# CDCC: POST-REFUND: CDCC is being claimed and the care provider TIN field is blank. #
CDCI	# CDCC: POST-REFUND: CDCC is being claimed and need to verify the provider's EIN/SSN. #
CDCJ	# CDCC: POST-REFUND: CDCC being claimed for adult who may not be disabled. #
SFLC	# SFLA: Sick & Family Leave Credit (SFLC): SFLC is being claimed and there is no self-employed income reported or present on return. #
CORA	# Claim of Right (COR) is being claimed and credit is greater than or equal to 50% of tax paid over the last three years. #
CORB	# COR and first-time filer. #
CORC	# COR and no prior year tax. #
CORD	# COR and Schedule C income. #

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