

# Understanding the Substitute for Return

If your taxpayer forgot to file, IRS may do it for them!

By: Angelene Wierzbic, EA, CTRS

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## About Your Presenter

I am an Enrolled Agent and Certified Tax Resolution Specialist who has spent my career working resolution cases at Lawler & Witkowski CPAs. I have learned so much from the greatest in this industry, Larry Lawler, John Witkowski and LG Brooks.

If you have previously attended an ASTPS webinar or seminar, I may have been answering your questions in the background or presenting the materials. I also teach portions of the ASTPS Accelerator.

I am a cat mom. I've hidden images of 3 of my babies in the picture. In my spare time, I enjoy taking photos of nature and all the images in today's class are photos I have taken.

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## Fall 2023



Inflation Reduction Act has given more funds for staffing, so IRS has more ability to implement various programs



Fall 2023, IRS launched new initiative to pursue high income, high wealth individuals who failed to pay or failed to file (High Income – More than \$1 Million in income or More than \$250K in recognized debt).



IRS was able to collect \$38 million from 175 high income high wealth individuals (Average \$217K per person)

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## Expanding Targets – Fall 2023

Expanded  
efforts for  
high  
income,  
high wealth  
individuals

1,600 millionaires went into  
collections

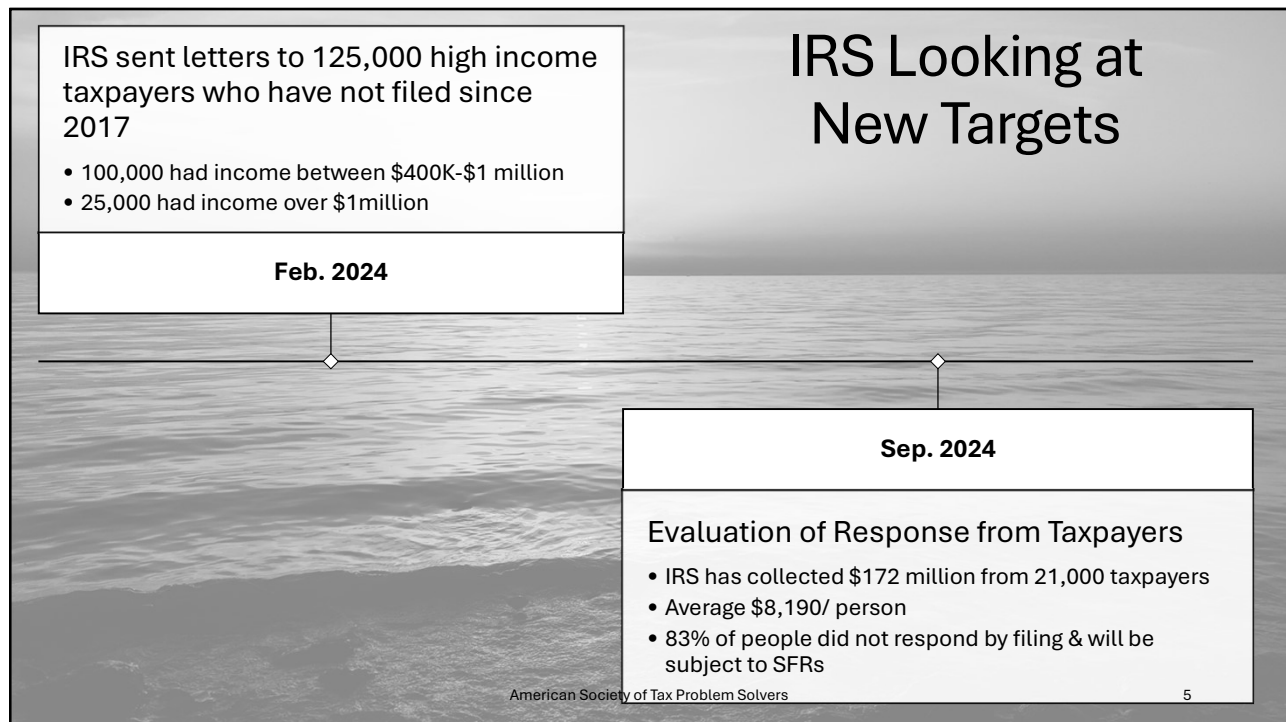
IRS was able to collect \$1.1  
billion from these individuals

Average amount collected  
\$687K/person

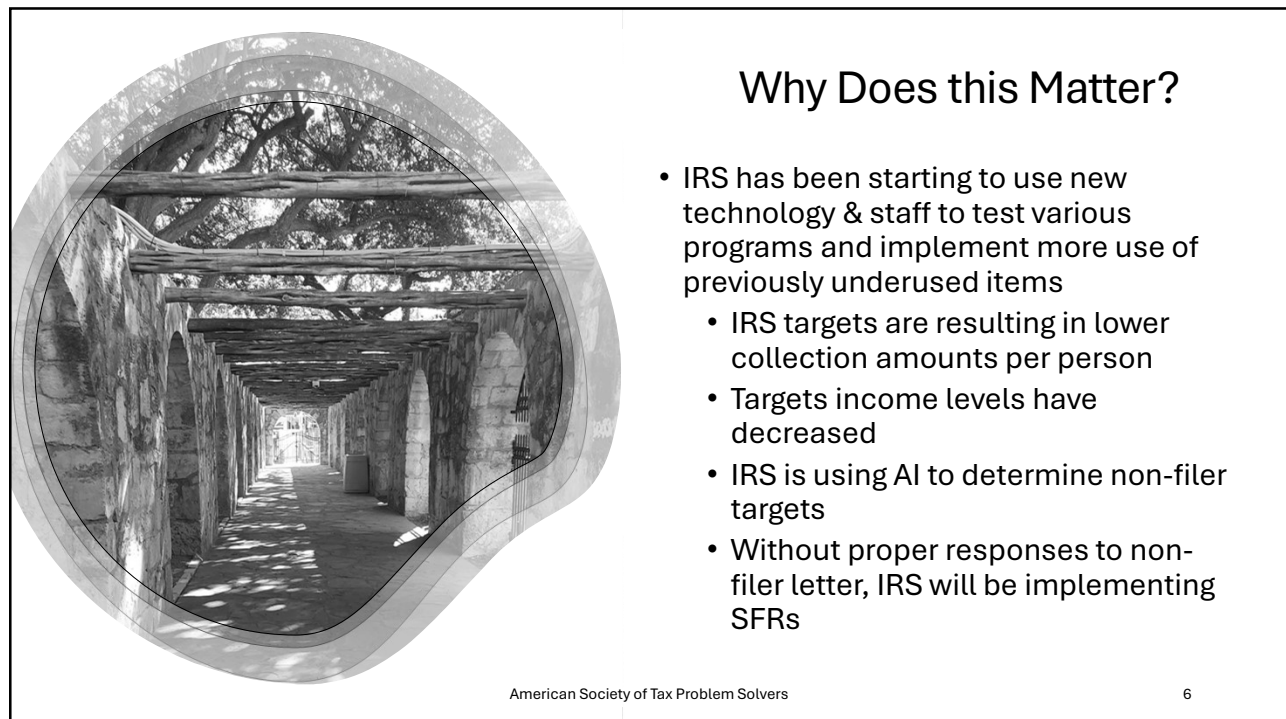
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## Non-Filers & Substitute For Return Procedures

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## Non-Filer Issues

- If taxpayers have income records with the IRS and have not filed, IRS may contact them to file
- If they do not file, IRS can file a Substitute for Return (SFR)
  - Based upon IRC §6020(b) the secretary can file on behalf of a taxpayer

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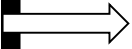
## IRC §6020

- **(a) PREPARATION OF RETURN BY SECRETARY**

- If any person shall fail to make a return required by this title or by regulations prescribed thereunder, but shall consent to disclose all information necessary for the preparation thereof, then, and in that case, the Secretary may prepare such return, which, being signed by such person, may be received by the Secretary as the return of such person.

- **(b) EXECUTION OF RETURN BY SECRETARY**

- **(1) AUTHORITY OF SECRETARY TO EXECUTE RETURN**

- 
- If any person fails to make any return required by any internal revenue law or regulation made thereunder at the time prescribed therefor, or makes, willfully or otherwise, a false or fraudulent return, the Secretary shall make such return from his own knowledge and from such information as he can obtain through testimony or otherwise.

- **(2) STATUS OF RETURNS**

- Any return so made and subscribed by the Secretary shall be prima facie good and sufficient for all legal purposes.

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## SFR Process IRM 4.12.1.1

Meant to either:

1. Secure a proper tax return filing from the taxpayer or
2. Prepare an estimate of the tax, penalties, and interest to be collected based upon available IRS records



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## SFR Process IRM 4.12.1.2

Cases come from:

- Spinoff exams
- Related cases
- Project cases
- Referrals from other departments

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## SFR Process IRM 4.12.1.3

SFRs usually created relating to the most recent 6 years filings, unless other factors warrant older SFRs

- History of Non-compliance
- Illegal Income
- Effect on compliance
- Anticipated Revenue & efforts to collect
- Any special circumstances

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## Policy Statement P-5-133 - IRM 1.2.1.6.18

### Policy Statement 5-133, Delinquent returns—enforcement of filing requirements

#### Delinquent returns—enforcement of filing requirements

1. Taxpayers failing to file tax returns due will be requested to prepare and file all such returns except in instances where there is an indication that the taxpayer's failure to file the required return or returns was willful or if there is any other indication of fraud. All delinquent returns submitted by a taxpayer, whether upon his/her own initiative or at the request of a Service representative, will be accepted. However, if indications of willfulness or fraud exist, the special procedures for handling such returns must be followed.
2. Where it is determined that required returns have not been filed, the extent to which compliance for prior years will be enforced will be determined by reference to factors ensuring compliance and evenhanded administration of staffing and other Service resources.
3. Factors to be taken into account include, but are not limited to: prior history of noncompliance, existence of income from illegal sources, effect upon voluntary compliance, anticipated revenue, and collectibility, in relation to the time and effort required to determine tax due. Consideration will also be given any special circumstances existing in the case of a particular taxpayer, class of taxpayer, or industry, or which may be peculiar to the class of tax involved.
- ⇒ 4. Normally, application of the above criteria will result in enforcement of delinquency procedures for not more than six (6) years. Enforcement beyond such period will not be undertaken without prior managerial approval. Also, if delinquency procedures are not to be enforced for the full six year period of delinquency, prior managerial approval must be secured.

## Policy Statement P-5-133 - IRM 1.2.1.6.18

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## Pre-Contact Investigation

**Polling Question**

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## Pre-Contact Considerations

1. Discovery of the non-filer
2. IRS reviews the taxpayer's filing history
3. IRS reviews the income records for the taxpayer
4. IRS determines the viability of preparing an SFR



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## Discovering Non-Filers

Before requesting a return, IRS will:

- Review history
- Determine if filings needed
- Try to figure out why taxpayer did not file
- Look for any possibility of fraudulent non-filing
- Check both taxpayer and spousal ID taxpayer Identification numbers

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## Potential Fraudulent Actions

Review for badges of fraud

Case Manager will be consulted

Fraud Technical Advisor could be brought into the case

IRS will not solicit returns during the fraud case

SFRs will not be prepared

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## Researching Non-Filers

- Determine taxpayer's last known address is correct
- Make sure no return was filed or is in the queue for posting
- Consider if tax due could be collected
- Verify the assessment statute has not begun

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## Where Does SFR Calculation Come From?

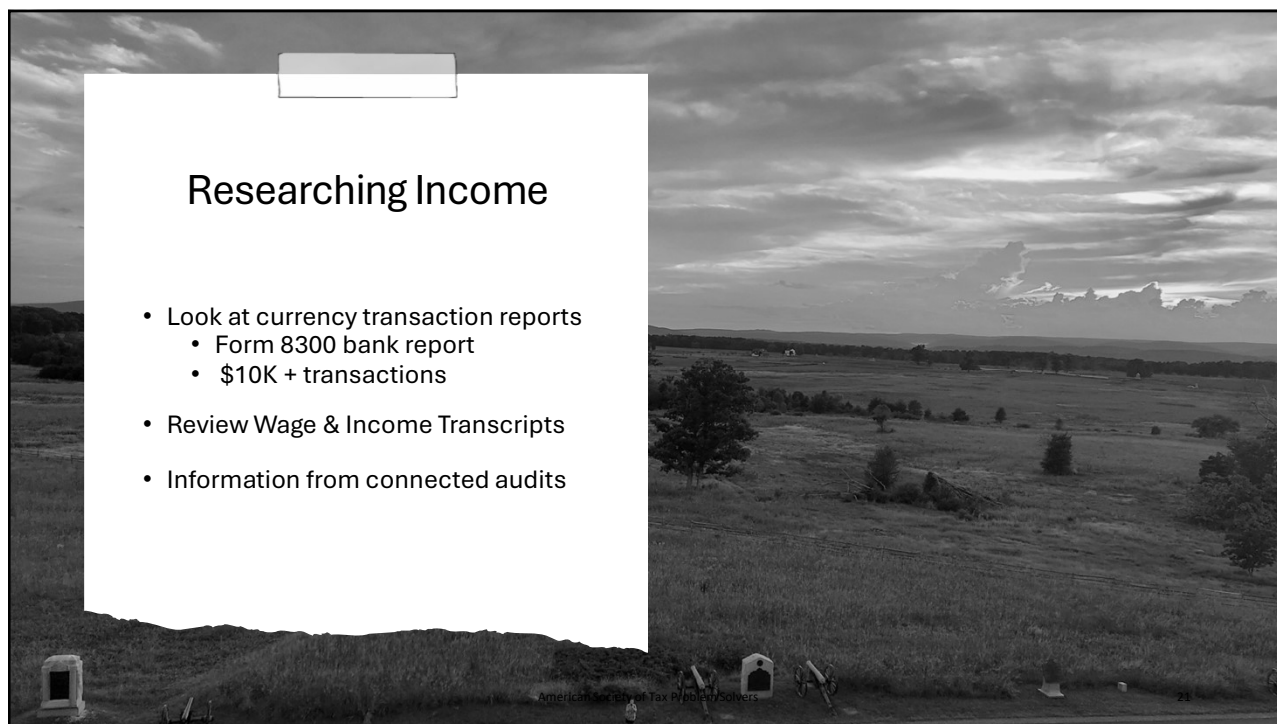
IRS utilizes the following to prepare the return

- Wage & Income Records on file
- Either Single or Married Filing Separate status
- Generally, no dependents
- No itemized
- No expenses for businesses
- Averages based upon prior filings

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## Researching Income

- Look at currency transaction reports
  - Form 8300 bank report
  - \$10K + transactions
- Review Wage & Income Transcripts
- Information from connected audits

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## Income Considerations

Consider if 3<sup>rd</sup> party contacts needed to verify income, may require IRS verification of correctness under IRC § 6201(d)

- If taxpayer contests that income reported to IRS is incorrect
- IRS must attempt to contact source of the income document to verify
- If they do not respond, IRS must concede income source is not correct

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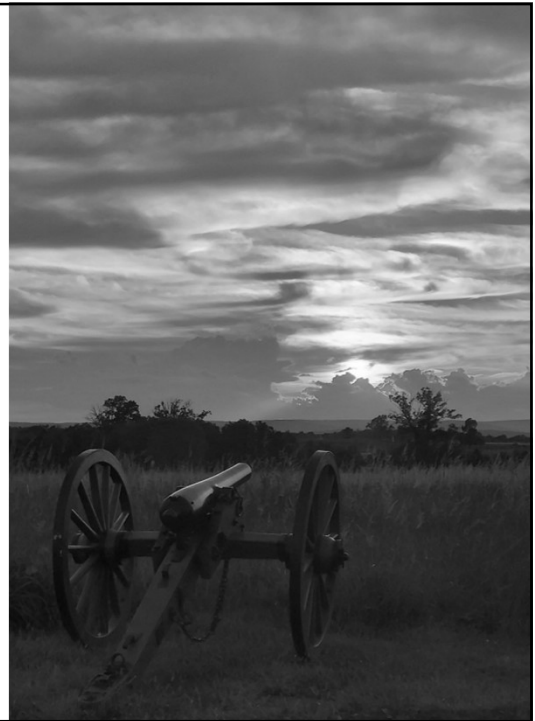
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## Expense Considerations

If taxpayer has a business:

- IRS not required to estimate or consider business expenses in preparation of the SFR
- Taxpayer must either substantiate with business expenses the year of the proposed SFR or provide proof of same type expenses in prior years
- Will not just allow industry standards (even for Cost of Goods Sold)

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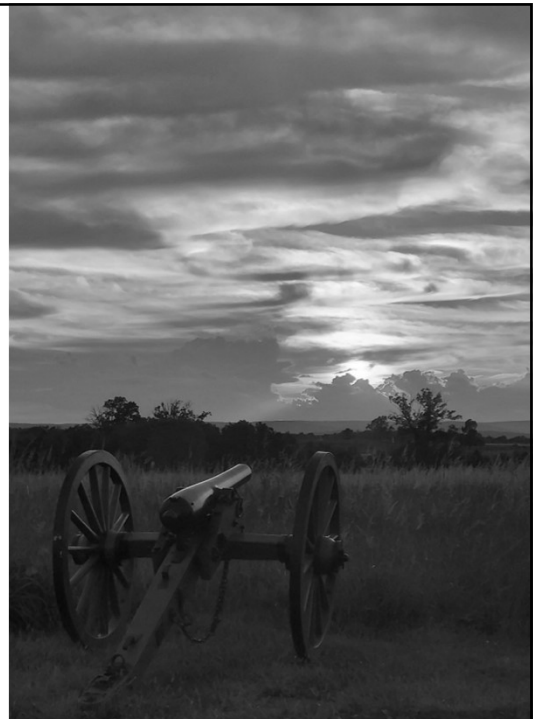


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## Deduction Considerations

- Wage & Income records show 1098 mortgage interest
- IRS will not itemize the taxpayer even if 1098 warrants it
- Needs a taxpayer signed return to take itemized deductions rather than the standard deduction

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## Fishing for Information: Taxpayer Contacts & the SFR Process

**Polling Question**

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### SFR Process IRM 4.12.1.8.4

- SFRs are created when the taxpayer does not file the return after requested
  - Form of an examination
  - IRS will create return based upon income records

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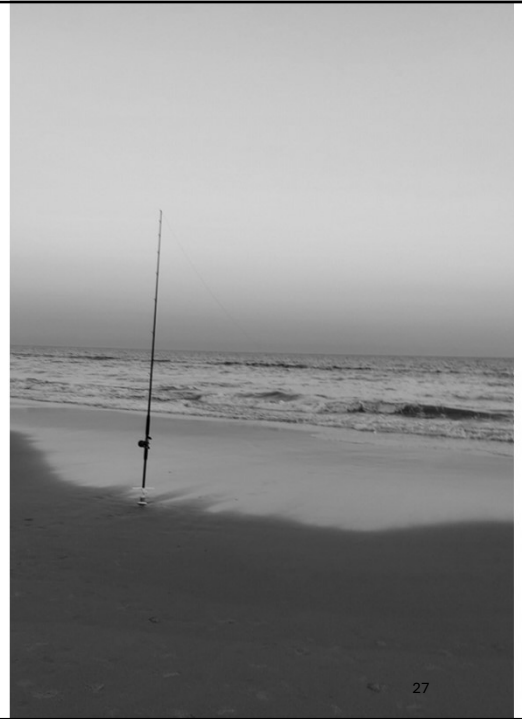
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## How Does IRS Contact an Individual Taxpayer?

1. CP59 Notice – Requests copy of returns
2. CP2000 Notice – Proposed tax return changes to report the income
3. CP3219N Letter – Notice of Deficiency

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## Notice CP59 Non-Compliance Alert


- Indicates to taxpayer they have not filed
- Requests they file return immediately
- If no filing requirement, send Form 15103 back with explanation

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Department of the Treasury  
Internal Revenue Service  
Fresno, CA 93888-0025

Notice	CP59
Tax year	December 31, 2017
Notice date	January 28, 2019
Social Security number	nnn-nn-nnnn
To contact us	Phone nnn-nnn-nnnn
Your caller ID	Nnnn
Select code	nn

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TAXPAYER NAME  
ADDRESS  
CITY, STATE ZIP

Message about your 2017 Form 1040  
**You didn't file a Form 1040 tax return**

Our records show that you haven't filed your tax return for the tax year ending on December 31, 2017.

File Now

Why Not?

**What you need to do immediately**  
If you're required to file a tax return for 2017, please do so immediately.

- Using your current address, complete and sign your return, include a payment for any taxes due, and mail to us using the envelope provided.
- File electronically through an e-file provider if it's within 2 years from the original due date of the return.
- Pay online now at [www.irs.gov/payments](http://www.irs.gov/payments) or mail a payment with your return.

**If you don't think you had to file a tax return for 2017**  
Complete the enclosed Form 15103, Form 1040 Return Delinquency, to indicate whether any of the circumstances apply to you. Send us the form with the stub below in the enclosed envelope or fax it to xxx-xxx-xxxx


Indicate whether:

- You already filed a tax return for 2017 (if so, send us a signed and dated copy of the return along with your Form 15103)
- You don't think you are required to file for one of the reasons listed on the Form 15103

## If Taxpayer Responds

During initial contact to the taxpayer:

- Request non-filed returns
- Interview taxpayer regarding collectability of tax
- Request written statement of why taxpayer did not file
  - Potential review for penalty abatement



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## Notice of Underreported Income CP2000

- For Non-filers CP2000 shows proposed return amounts
  - No dependents
  - Single or Married Filing Separate status
  - Standard deduction
  - No Business Expenses
- Lists income sources & amounts
  - Should match Wage & Income transcript records

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## Reviewing a CP2000

- Watch the following items
  - Dividends – Sometimes IRS duplicates counting both the ordinary & qualified dividend figures for the same item as income. Also check that qualified are taxed at lower rates.
  - 1099-B items – Check to make sure IRS included any basis they have, items without basis may need to get docs from broker
  - Withholding – Check that all withholding is shown
  - Tax – Verify tax is calculated correctly

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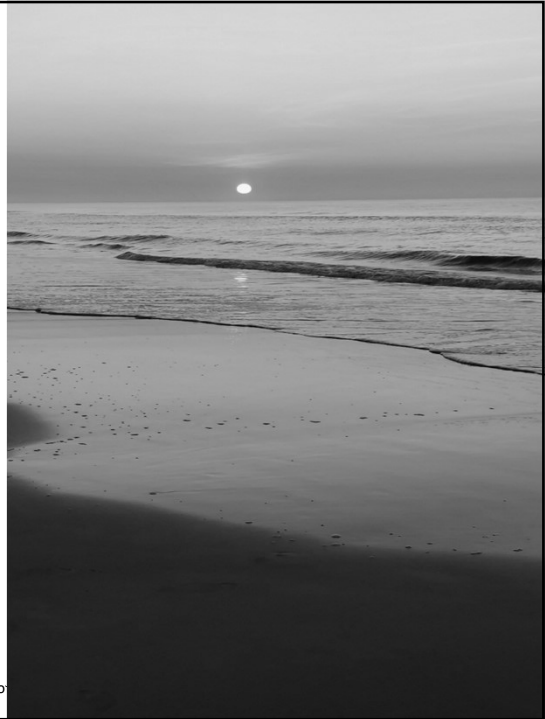
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## Refund/No Tax Due Process

- If the IRS calculates taxpayer is due a refund during the SFR process and the taxpayer does not respond in 30 days, they will close the case
- If no balance due or minimal balance, with manager approval case will be closed without return

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## What if the Taxpayer Submits a Return During the SFR Process?

- Calculation of SFRs is an audit process
- Returns submitted could be subject to audit procedures
- Returns with businesses subject to extra scrutiny
  - Review for W-2s/1099s filed by business & submitted to payees
- May hold returns with refunds to review



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## Agreeing vs. Disagreeing to the CP2000


- If the taxpayer does not submit a return but signs in agreement with the proposed tax, it begins the assessment statute
- If the taxpayer does not sign, then the unagreed amounts would be subject to 90-day letter (Statutory Notice of Deficiency -SNOD)
  - Assessment statute does not begin if no response or agreement to tax

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## CP3219N Statutory Notice of Deficiency

 <b>Department of Treasury</b> <b>Internal Revenue Service</b> PO BOX 149338 Austin TX 78714-9338	<b>Certified Mail Number</b>	<table border="1"><tr><td colspan="2">2D-Bar Code</td></tr><tr><td>Notice</td><td>3219N</td></tr><tr><td>Tax year</td><td>2017</td></tr><tr><td>Notice date</td><td>January 28, 2019</td></tr><tr><td>Social Security number</td><td>XXX-XX-XXXX</td></tr><tr><td>To contact us</td><td>800-829-1040</td></tr><tr><td>Hours of operation</td><td>7:00 a.m. to 7:00 p.m., CT</td></tr><tr><td>Your caller ID</td><td>123456</td></tr><tr><td>Last day to petition</td><td>April 27, 2019</td></tr><tr><td>Tax Court</td><td></td></tr><tr><td>Page 1 of 8</td><td></td></tr></table>	2D-Bar Code		Notice	3219N	Tax year	2017	Notice date	January 28, 2019	Social Security number	XXX-XX-XXXX	To contact us	800-829-1040	Hours of operation	7:00 a.m. to 7:00 p.m., CT	Your caller ID	123456	Last day to petition	April 27, 2019	Tax Court		Page 1 of 8	
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<b>TAXPAYER NAME</b> <b>ADDRESS</b> <b>CITY, STATE ZIP</b>																								
<b>Notice of Deficiency</b> <b>Increase in tax and notice of your right to challenge</b>																								
<p>We have determined that there is a deficiency (increase) in your 2017 income tax.</p> <p>You have the right to challenge this determination in the United States Tax Court. This notice explains how the increase in tax was calculated and how you can challenge it in the Tax Court. Your petition to the Tax Court must be filed by April 27, 2019.</p> <p>Our records indicate you have not filed your 2017 tax return. We will still accept your return and filing your return may reduce the amount due.</p>	<table border="1"><tr><td colspan="2"><b>Summary</b></td></tr><tr><td>Your tax liability (deficiency)</td><td>\$5,500.00</td></tr><tr><td>Payments you made</td><td>-2,000.00</td></tr><tr><td>Failure-to-file penalty</td><td>100.00</td></tr><tr><td>Failure-to-pay penalty</td><td>150.00</td></tr><tr><td>Estimated tax penalty</td><td>100.00</td></tr><tr><td>Interest charges</td><td>150.00</td></tr><tr><td><b>Amount due</b></td><td><b>\$4,000.00</b></td></tr></table>		<b>Summary</b>		Your tax liability (deficiency)	\$5,500.00	Payments you made	-2,000.00	Failure-to-file penalty	100.00	Failure-to-pay penalty	150.00	Estimated tax penalty	100.00	Interest charges	150.00	<b>Amount due</b>	<b>\$4,000.00</b>						
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<b>You have the right to petition the Tax Court</b>	<p>You have the right to challenge our deficiency determination, including penalties, before making any payment by filing a petition with the U.S. Tax Court. You must file your petition within 90 days (or 150 days if the notice is addressed to a person outside of the United States) from the date of this letter, which is January 28, 2019. The Court can't consider your case if the petition is filed late, so you should consider filing your petition as early as possible. If you decide to file a petition, send that petition to the following address:</p> <p>United States Tax Court 400 Second Street, NW Washington, DC 20217</p> <p>You can download a petition form and rules from the U.S. Tax Court's website (<a href="http://www.ustaxcourt.gov">www.ustaxcourt.gov</a>) or by contacting the Clerk of the United States Tax Court at the address directly above or at 202-521-0700 (not a toll-free number).</p> <p>Attach a copy of this letter including attachments to your petition. The Tax Court has a simplified procedure for small tax cases when the amount in dispute is \$50,000 or less (including penalties) for any one tax year. You can obtain a copy of these simplified procedures on the Tax Court's website or by contacting the Tax Court.</p>																							

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**Calculation**

**Tax Court Rights**

### Notice of Deficiency Increase in tax and notice of your right to challenge

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Summary	
Your tax liability (deficiency)	\$5,500.00
Payments you made	-2,000.00
Failure-to-file penalty	100.00
Failure-to-pay penalty	150.00
Estimated tax penalty	100.00
Interest charges	150.00
<b>Amount due</b>	<b>\$4,000.00</b>

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You have the right to challenge our deficiency determination, including penalties, before making any payment by filing a petition with the U.S. Tax Court. You must file your petition within 90 days (or 150 days if the notice is addressed to a person outside of the United States) from the date of this letter, which is January 28, 2019. The Court can't consider your case if the petition is filed late, so you should consider filing your petition as early as possible. If you decide to file a petition, send that petition to the following address:

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Washington, DC 20217

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## Options Once the SNOD is Issued:

One of four things can happen:

- The taxpayer can sign in agreement to the SNOD, then the IRS will post the assessment
- The taxpayer can send a return to file in response, it will be subject to audit procedures. If it is not processed within the 90-day SNOD window, taxpayer should file tax court petition
- If the taxpayer disagrees, they can file a tax court petition within 90 days, the taxpayer's return can be filed in pre-trial appeals or resolved in tax court
- If taxpayer does not respond by signing the SNOD or filing a tax court petition within 90 days, the IRS will post the tax form the SNOD

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## Audit of Returns Submitted After a SNOD

- If the amounts are substantially correct, IRS will accept them and close the case
- If the IRS is not accepting the amounts, the return should be assessed and then a revised report should be submitted to the taxpayer in place of the SNOD



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## Other SFR Issues

**Polling Question**

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## Preparers Beware

IRS will review returns submitted during SFR process for IRC §6695 penalties


- Preparer signatures
- PTIN
- Copy of return was provided to taxpayer

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## Other SFRs

- Can be used to expand the audit scope into a year which the return was not filed and is officially “late”
  - Ex: 20X2 return is under audit, IRS expanding due to issues into 20X3, but the 20X3 return was not filed by deadline and not extended. IRS will enter there is an SFR into the 20X3 year and begin the audit process
- Taxpayer did not provide return or comply
- Examiner must get manager approval to do SFR process



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## Calculating Payroll SFRs - IRM 4.12.1.19

- IRS may estimate payroll if returns not filed
- May use average of the annual amount of prior returns
- May use average of filed W-2 wages & withholdings to calculate

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## Handling Non-Filer & SFR Cases

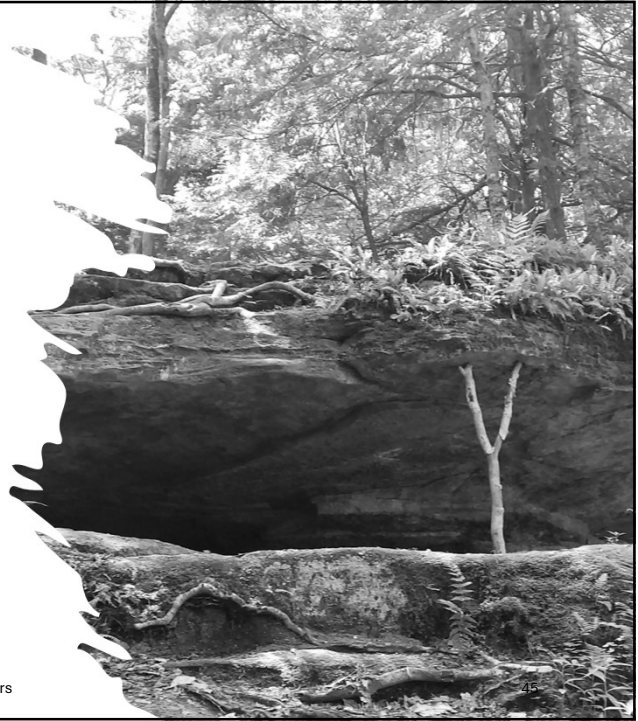
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## Verification of Non-Filing

- Account Transcripts
  - Will either not have any records on file, OR
  - Show No Return Filed if there are payments or extensions on file

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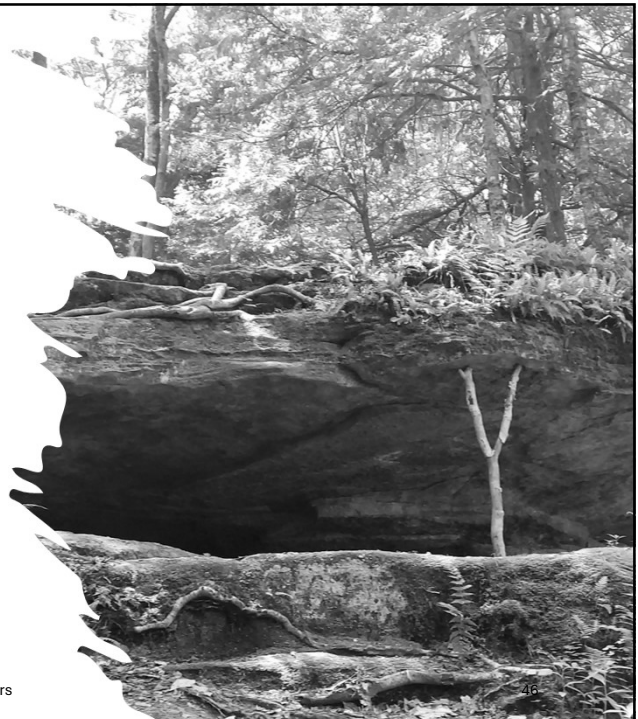


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## How We Can Check If IRS Filed an SFR

- Account Transcripts
  - Will show Substitute for Return
  - May also see duplicate or amended return if taxpayer filed

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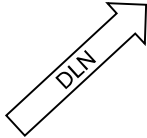


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## After the SFR Was Filed: Getting the Records

- If there is tax from an SFR but the taxpayer does not know how IRS calculated figures or lost notices showing calculations
  - Can do a Freedom of Information Act (FOIA) Request of the Document Locator Number (DLN) found on the account transcript
  - Use FOIA.gov or send through the Disclosure unit (more info on IRS website)

CODE	EXPLANATION OF TRANSACTION	CYCLE	DATE	AMOUNT
150	Substitute for return		04-15-2022	\$19,237.00
n/a	49000-000-00000-5			



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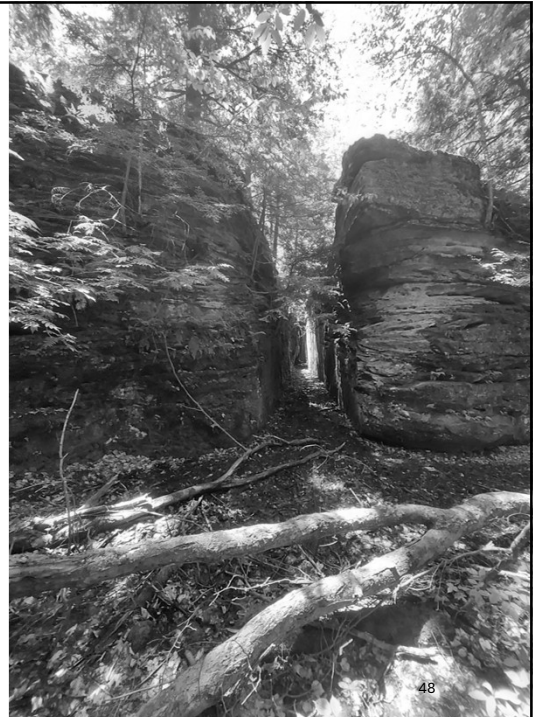
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## Navigating a Posted SFR

- Should we file?
  - Is the SFR correct?
  - Does the taxpayer benefit from correcting the filing?
  - Are we looking at an Offer in Compromise?

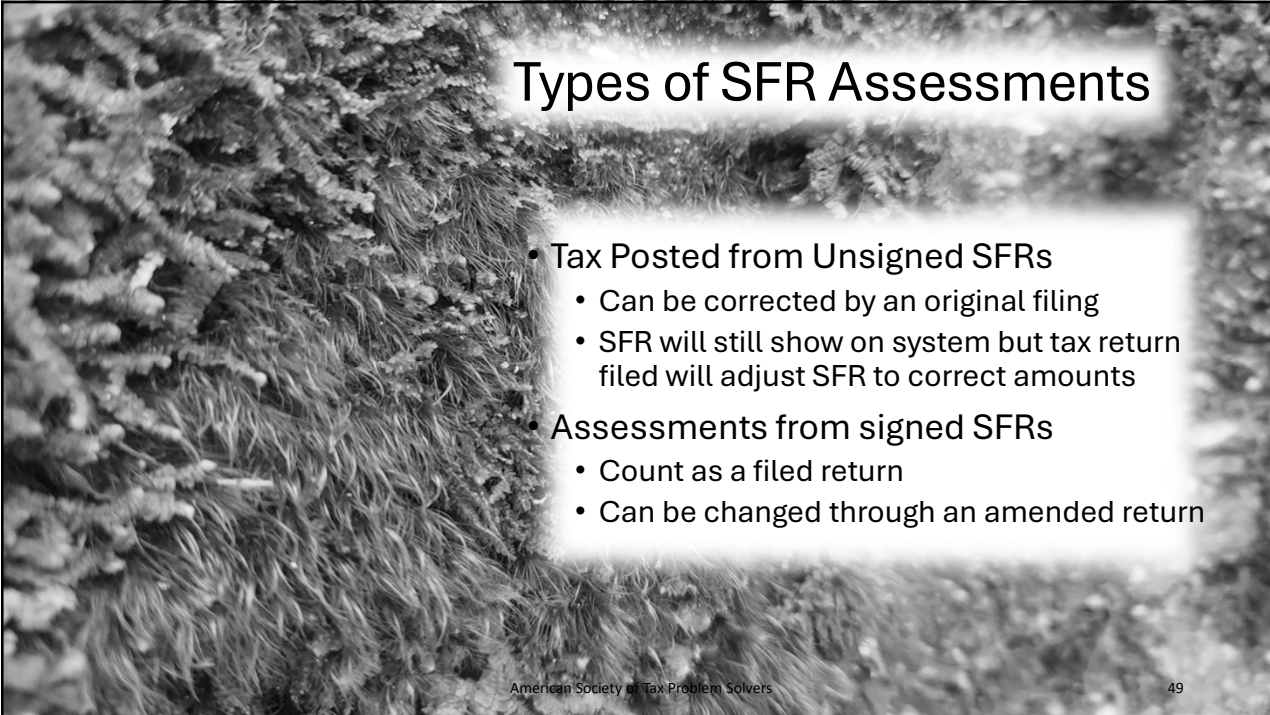
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## Types of SFR Assessments

- Tax Posted from Unsigned SFRs
  - Can be corrected by an original filing
  - SFR will still show on system but tax return filed will adjust SFR to correct amounts
- Assessments from signed SFRs
  - Count as a filed return
  - Can be changed through an amended return

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## SFRs in Collection Cases

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## Assessment Statutes of Limitations & SFRs

An SFR DOES NOT start the assessment statute UNLESS the taxpayer signs it in agreement

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## Collection of Agreed SFR Assessments

- IRS will attempt to fully collect once agreed
- May allow for Installment Agreements
- If taxpayer cannot do either and owes over \$100K, case will be assigned directly to collections
- Examiner to fill out Form 9440 Taxpayer Levy Source & Contact Information for all agreed and unagreed SFR cases
  - Gives collections a jump start on known assets & income sources

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## Collection Statute

- Once a tax is posted from either a signed or unsigned SFR, the collection statute will begin
- Tax due on an SFR will be subject to penalties & interest
- 10 years to collect

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## Penalties on Calculated SFRs

- Failure to File – 5% per month, max of 25% of tax assessed from original due date or extended due date of return
  - If fraudulent failure to file 5% increases to 15% per month with a maximum of 75% of tax assessed
- Failure to Pay – 0.5% per month, max of 25% of the tax assessed from the original due date of the return (no consideration for extensions)
- Penalties may be abated if Reasonable Cause exists

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## Collection Statute

- If SFR corrected and additional tax due, there will be a second collection statute
  - Example: SFR with tax due of \$30K posted 12/2023 – IRS has until 12/2033 to collect the \$30K, if a return was filed 5/2025 to correct and taxpayer owed another \$20K, IRS would have until 5/2035 to collect the \$20K
- If SFR corrected & less tax due, reduction of assessment will be processed and original collections statute will stand
  - Example: SFR with tax due of \$30K posted 12/2023 – IRS has until 12/2033 to collect the \$30K, if a return was filed 5/2025 to correct and taxpayer owed \$20K less, IRS would have until 12/2033 to collect the \$10K

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## SFRs in Collection Cases

- Will count as a return for compliance purposes
- Any balance due can be handled with most resolutions
  - Installment agreement
  - Offer in Compromise
  - Currently Non-Collectible
- Related penalties may be abated with reasonable cause
- **Remember: IRS may already have a roadmap to levy sources**

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# Key Take Aways

- **IRS will investigate Non-filers before contact**
- **IRS will open an audit to create an SFR**
- **If a taxpayer does not file IRS can prepare an SFR**
- **SFRs can be corrected even if tax posted**
- **Unsigned SFRs can be corrected with an original return filing**
- **Balances from SFRs are subject to collections**
- **IRS resolution programs can be used to handle SFR balances**

