DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
Washington, DC 20224

SMALL BUSINESS / SELF-EMPLOYED DIVISION

February 27, 2017

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MEMORANDUM FOR DIRECTOR, EXAMINATION - CAMPUS

FROM: Michael Damasiewicz
Director, SB/SE Examination Field and Campus Policy

SUBJECT: Pilot Program Auditing Mortgage Interest Paid to Individuals

The purpose of this memorandum is to issue guidance on a pilot program for Mortgage Interest Paid to Individuals for SB/SE Correspondence Examination (Corr. Exam). Although this pilot will only be worked in the Brookhaven Campus, phone calls may be received in all SB/SE Campuses. Please distribute this information to all affected employees within your organization.

The pilot is expected to begin April 1, 2017 and conclude April 1, 2018.

The attached document contains additional details. If you have questions you may contact me or Program Manager Miriam Gottlieb at 402-233-7329.

Attachment

Attachment 1

Purpose: This interim guidance communicates temporary procedures for a pilot program auditing Mortgage Interest Paid to Individuals not reported on Form 1098, claimed on line 11 of Schedule A. The pilot will focus on verifying the interest amount claimed as a deduction on the payers return, as well as verifying the interest income is reported on the recipients return.

Background/Source(s) of Authority: There has been limited coverage of Schedule A, line 11 Mortgage Interest Paid to an Individual in recent years in Correspondence Exam (Corr Exam). We believe there may be compliance issues such as deducting interest the taxpayer is not entitled to and recipients not reporting the interest income.

This pilot consists of 50 TY 2015 cases. Project Code 0197 will be used to monitor pilot cases. Any related recipient cases will be opened in Project Code 0198.

Procedural Change: In addition to the current Mortgage Interest program guidelines, Interim Guidance (IG) procedures are being added to IRM 4.19.15.20.3, *Home Mortgage Interest Deductions,* to provide guidance for working the pilot program.

Effect on Other Documents: Pending the outcome of this pilot, this guidance may be incorporated into IRM 4.19.15.20.3, *Home Mortgage Interest Deductions*, at the conclusion of the pilot.

Effective Date: April 1, 2017

Contact: Nancy Higgs, SBSE Campus Exam Program Analyst, by email, OCS or phone (801-612-4409).

Attachments: Interim procedures

Distribution:
IRS.gov

SBSE-04-0217-0013 Attachment
Mortgage Interest Pilot Instructions

Mortgage Interest Paid to Individuals

In addition to the guidance posted in IRM 4.19.15.20.3.1, paragraph (5) has been created for this pilot program.

(5) **Documentation requested from the taxpayer:** Home mortgage interest reported on Form 1098. Provided for each loan Forms 1098 and statements showing the beginning and ending loan amounts for the tax year.

Home mortgage interest not reported on Form 1098. Send copies of mortgage interst statements, equity credit lines/loans, land and mortgage contracts, and amortization schedules for loan outstanding. Send copies of cancelled checks, receipts or other evidence of payments made for the year under examination. Provide the debt instrument that shows the receipts or statements from creditor's aount of interest paid and names of payees (e.g. including land contracts, written proof of interest paid by taxpayer on the loan, etc.)

Documents must show the following:

- Name of the borrower(s)
- Location of the property securing the loan
- Financial institution making the loan
- Terms of the loan agreement
- A copy of the settlement sheet
- A copy of the year end statement indicating the interest paid for the year
- If the interest was paid to an individual, provide a statement indicating the interest paid, recipients name and social security number
- Proof that you made loan payment such as copies of cancelled checks, bank statements, or receipts

In addition to the guidance posted in IRM 4.19.15.20.3.2, paragraph (8) has been created for this pilot program.

(8) If the interest was paid to an individual recipient, on line 11 of Schedule A, review the recipient's Schedule B to verify the interest paid was claimed as income on the recipient's Form 1040. If the recipient did not claim the interest income, [redacted] open an audit on the payee under PC 0198. [redacted]

a) Create the recipient case on AIMS no later than 30 days after closure of the related payer case.

b) Initiate recipient case in Status 10, with Letter 5930, *Unreported Mortgage Interest Income*. Payers name and SSN will be included in the Letter 5930.

c) Suspend case 45 days.

d) After the suspense period, the case will be manually updated to Status 22 and Letter 525 along with the Form 4549 will be mailed manually by the campus. The case can be introduced into ACE after the Status 22 action is completed.

e) Recipients work papers must detail the supporting information for the unreported income providing the payer's name, SSN and any supporting documentation.

f) Include a copy of all relevant supporting documents provided by the payer in the recipient's case file.

g) Examiners should consider the application of penalties from initial contact.

h) Complete appropriately the *Related Return Information Section* on Form 5344, *Examination Closing Record*.

Form 5344 Field:	**Overwrite the default entries. Form 5344 entry should be:**
405	Payer's SSN
406	Payer's MFT (Master File Tax)
407	Payer's tax period

(9) If requested you may share the following information provided by the payer, with the recipient to verify the mortgage interest income:

a. Payer's address
b. Bank account number funds were deposited in
c. Copies of canceled checks or bank statements showing payments made to the payee
d. Copies of mortgage statement provided by the payer

(10) **Recipient Return Not Filed** – If the recipient has not filed a return, initiate a non-file case, manually, [redacted] no later than 30 days after closure of the related payer case. Open on AIMS in PC 0198 following guidance in IRM 4.19.17.3.3, *Non-filer source and Project Codes*, and follow,

examination procedures per IRM 4.19.17, *Non-filer Program*. [redacted]