



# MANUAL TRANSMITTAL

Department of the Treasury  
Internal Revenue Service

8.17.5

MARCH 13, 2025

## EFFECTIVE DATE

(03-13-2025)

## PURPOSE

- (1) This transmits a revised IRM 8.17.5, Settlement Computations and Statutory Notices of Deficiencies, Special Computation Formats, Forms and Worksheets.

## MATERIAL CHANGES

- (1) Added new IRM 8.17.5.1, Program Scope and Objectives, to include Internal Control information required by IRM 1.11.2, Internal Revenue Manual (IRM) Process.
- (2) IRM 8.17.5.1.5, Related Resources, TBOR content updated based on guidance from the Division Counsel/Associate Chief Counsel (National Taxpayer Advocate Program) and Branch 3 of the Associate Chief Counsel (Procedure and Administration). Added content related to IRM 25.30.2.3, Statement of Commitment, Service Level Agreement (SLA) between Appeals and Taxpayer Advocate Service (TAS).

## EFFECT ON OTHER DOCUMENTS

Supersedes IRM 8.17.5 dated 03/07/2014.

## AUDIENCE

Appeals

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8.17.5

Special Computation Formats, Forms and Worksheets

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8.17.5.1  
(03-13-2025)  
**Program Scope and Objectives**

- (1) Purpose: The purpose of this IRM section is to provide guidance to Appeals Tax Computation Specialists (TCSs) for the accurate and efficient preparation of settlement computations on cases worked in the IRS Independent Office of Appeals (Appeals).
- (2) Audience: The primary users of the IRM section are Appeals TCSs and Appeals Technical Employees (ATEs).
- (3) Policy Owner: Policy, Planning, Quality and Analysis (PPQ&A) is under the Director, Operations Support.
- (4) Program Owner: Appeals Policy is the program office responsible for providing technical and procedural guidance to the Appeals organization and is under the Director of PPQ&A.
- (5) Contact Information: Appeals employees should follow established procedures on *How to Contact an Analyst*. Other employees should contact the Product Content Owner shown on the Product Catalog Information page for this IRM.

8.17.5.1.1  
(03-13-2025)  
**Background**

- (1) This section covers procedures for preparing settlement computations involving special computation formats, forms and spreadsheets on cases worked in Appeals.
- (2) As stated in IRC 7803(e)(3), the Appeals mission is to resolve Federal tax controversies without litigation on a basis that is fair and impartial to both the Government and the taxpayer, promotes a consistent application and interpretation of, and voluntary compliance with, the Federal tax laws, and enhances public confidence in the integrity and efficiency of the IRS. Appeals accomplishes its mission by considering protested and Tax Court cases and negotiating settlements in a manner which ensures Appeals employees act in accord with the Taxpayer Bill of Rights (TBOR) in every interaction with taxpayers.

8.17.5.1.2  
(03-13-2025)  
**Authority**

- (1) IRM 8.17, Settlement Computations and Statutory Notices of Deficiency, establishes the TCS policy framework for Appeals.

8.17.5.1.3  
(03-13-2025)  
**Responsibilities**

- (1) The Appeals TCS is responsible for the accurate preparation of tax computations, including all applicable computation schedules.
- (2) The Appeals TCS Program Analyst is responsible for:
  - a. Updating the applicable IRM sections as needed
  - b. Reviewing training modules
  - c. Responding to inquiries

8.17.5.1.4  
(03-13-2025)  
**Acronyms**

- (1) See IRM 8.1.1-1, Common Terms Used in Appeals, for common terms and definitions used in IRM Part 8.

## 8.17 Settlement Computations and Statutory Notices of Deficiency

8.17.5.1.5  
(03-13-2025)

### Related Resources

- (1) The Taxpayer Bill of Rights (TBOR) lists rights that already existed in the tax code, putting them in simple language and grouping them into 10 fundamental rights. Employees are responsible for being familiar with and acting in accord with taxpayer rights. See IRC 7803(a)(3), Execution of Duties in Accord with Taxpayer Rights. For additional information about the TBOR, see <https://www.irs.gov/taxpayer-bill-of-rights>.
- (2) In accordance with IRM 25.30.2.3, Statement of Commitment, Appeals will work collaboratively with the Taxpayer Advocate Service (TAS) to enhance the taxpayer experience. For more information, see IRM 25.30.2, Service Level Agreement between the IRS Independent Office of Appeals and the Taxpayer Advocate Service.

8.17.5.2  
(09-24-2013)

### Introduction to Special Computation Formats, Forms and Spreadsheets

- (1) IRM 8.17.2, General Settlement and Rule 155 Computations, provides general procedures for Appeals Tax Computation Specialists (TCS), Appeals Officers (AO) and Appeals Team Case Leaders (ATCL). This section covers instances where it is necessary to prepare settlement computations that include information or require the use of formats that differ from the normal formats used.

**Note:** References to an Appeals Officer (AO) within this IRM section include both an AO and an ATCL.

- (2) This section also details the information to include on the “Form 5403 Instructions to APS” spreadsheet, referred to as the “Form 5403 Worksheet” throughout this IRM section. The Form 5403 Worksheet is accessed from a link on the Appeals TCS web site.
- (3) Account and Processing Support (APS) is responsible for completing Form 5403, *Appeals Closing Record*. The Form 5403 Worksheet helps APS with some of the entries involving technical issues. The TCS or AO completes the Form 5403 Worksheet when a settlement computation, Rule 155 computation, or statutory notice of deficiency is prepared.
- (4) Many of the forms, worksheets and spreadsheets discussed in this section are found on the Appeals Technical Support Sharepoint site. The Appeals Technical Support Sharepoint site is accessed through the “Spreadsheets Sharepoint” link on the Appeals TCS web site.
- (5) Some of the forms, worksheets and spreadsheets discussed in this section are found on the RGS web site. The RGS web site spreadsheets are also accessible through a link on the Appeals TCS web site. (See the RGS page on the TCS web site for the link.)
- (6) The following table gives a brief listing of where the forms are found:

Form, Worksheet or Spreadsheet	Technical Support Sharepoint Site	RGS Web Site
Form 5403 Worksheet (fillable)	X	
IRC 6404(g) Worksheet	X	X
Form 1914, Computation of Allowable MACRS-ACRS Depreciation Deduction	X	X

Form, Worksheet or Spreadsheet	Technical Support Sharepoint Site	RGS Web Site
Form 3621, Net Operating Loss Computation	X	
Form 3621-A, Computation of Net Operating Loss Deduction for Intervening Years Modifications	X	
Schedule A and B - Form 1045, Application for Tentative Refund (Individual NOL Worksheets)		X
Form 6251, Alternative Minimum Tax—Individuals		X
Form 8801, Credit For Prior Year Minimum Tax - Indi- viduals, Estates, and Trusts		X
SRLY Worksheets	X	
Corporate NOL and NOL Deduction Spreadsheets		X
Corporate Contribution Limitations Spreadsheet	X	
Individual Charitable Contribution Limitations Spread- sheet		X
Life Insurance Taxable Income spreadsheet	X	

- (7) The following subsections describe the use of the forms, worksheets and spreadsheets in the preparation of settlement computations.

8.17.5.3  
(03-07-2014)  
**Form 5403 Instructions  
to APS Worksheet**

- (1) The employee who prepares the settlement computations is responsible for completing the Form 5403 Worksheet at the time the computations are prepared.
- (2) The Form 5403 Worksheet is also required for Rule 155 computations and statutory notices of deficiency. Generally the TCS prepares the Rule 155 computation or the statutory notice of deficiency and will prepare the Form 5403 Worksheet at the same time.
- (3) If an AO sustains the Compliance report (RAR) or the statutory notice of deficiency, and settlement computations aren't prepared, then the AO must prepare a Form 5403 Worksheet when closing the case unless an exception applies under IRM 8.17.5.3.1.
- (4) If a Counsel case is received by APS and no worksheet was previously completed in Appeals or a revised worksheet is needed, APS may prepare a Request for Audit Work, Form 3608, requesting that TCS complete the Form 5403 Worksheet.
  - a. Counsel's IRM is called the Chief Counsel Directives Manual, or CCDM. *CCDM 35.5.2.9* allows Counsel attorneys to settle small cases on the basis of a specific dollar amount agreed upon by both parties without preparing any computations.
  - b. APS may request that TCS prepare a Form 5403 Worksheet for these cases. A Form 5278 is not required for these cases, so most of the Form 5403 entries such as AGI and taxable income changes, etc. may not be determinable. The TCS should footnote reference code amounts that cannot be computed with a comment similar to the following:

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“AGI and TXI can’t be determined due to Counsel settlement for specific dollar amount.”

- (5) Each worksheet has the capacity for three tax years but use additional worksheets if needed.
- (6) The AO is responsible for attaching completed worksheets to the inside left flap of the administrative file folder.
- (7) Show the following information on the Form 5403 Worksheet:
  - IRC 6621(c) “Notice Date”
  - Reference numbers for Form 706 and Form 709
  - Ref. Number 886 amount
  - Ref. Number 887 amount
  - Ref. number 888 amount
  - FICA adjustments to tip income
  - Self employment tax adjustments
  - Personal holding company tax
  - Restricted interest provisions
  - Applicability of May/Sequa
  - Applicability of IRC 6404(g)
  - Certain refundable credit (prepayment credit) adjustments
  - Additional entries, when required by written directives
- (8) Form 5403 entries are used to update IDRS so the transcript of account reflects the correct information based on the Appeals computations. Always check a TXMODA, IMFOLR, or BMFOLR to see what amounts were posted for the various reference numbers.

**Note: If the Reference Number amounts on the transcript are not correct, the Form 5403 Worksheet adjustment amount may need to incorporate a correction to them along with any changes due to the Appeals or Counsel determination. The transcript amounts for the reference numbers plus or minus the Form 5403 entries must equal the correct amount shown in the Appeals or Counsel computation, except when the corrected taxable income amount for a Form 1040 case is negative.**

- (9) The Form 5403 Worksheet has a section for the Item 15 Reference Number information. If RGS is used for the computation, instead of entering the Item 15 Reference Number information on the Form 5403 Worksheet, the TCS or AO may print either the RGS Form 5403 or the RGS Form 5344 (if these forms have the correct Item 15 information) and attach one of them to the Form 5403 Worksheet.
  - a. The Form 5403 Worksheet has a line to indicate that either the RGS Form 5403 or the RGS Form 5344 is attached. This line should be marked in the appropriate tax year column by the TCS or AO when the RGS Form 5403 or Form 5344 is attached to the Form 5403 Worksheet, to alert APS of the attachment.
  - b. The RGS Form 5403 that can be attached to the Form 5403 Worksheet by the TCS or AO will only contain some of the information that APS is



required to enter on the Form 5403. APS is still responsible for the preparation of the Form 5403 used to close the case.

8.17.5.3.1  
(03-07-2014)  
**When the Form 5403  
Worksheet is Not  
Required**

- (1) The Form 5403 Worksheet is not required for certain cases. Some examples of cases which don't require a Form 5403 Worksheet are discussed below:

- a. **No change cases** - When no adjustment is made to the taxpayer's return, a Form 5403 Worksheet is not needed.

**Caution:** A Form 5403 Worksheet could be required for a "no change with adjustments" case, where there is no tax adjustment, but changes are made to some of the fields on the Form 5403 Worksheet such as taxable income and AGI. Plus no change cases with a change to self employment income and/or self employment tax require entries on the Form 5403 Worksheet.

- b. **Excise Tax Computations:** IRM 8.7.10, *Excise Tax Cases and IRA Adjustments*, does not require the preparation of the Form 5403 Worksheet for adjustments to excise tax returns. Per this IRM, information is provided for Form 5403 using other schedules such as the tax computation Form 5384 and Form 5385, and the Form 5402, *Appeals Transmittal and Case Memo*.
- c. **Form 4667 Employment Tax Computations:** IRM 8.7.16, *Appeals Employment Tax Procedures*, does not require the preparation of the Form 5403 Worksheet for Form 4667 computations. APS is given instructions on how to compute the Form 5403 entries in IRM 8.20.7, *Account and Processing Support (APS), General Closing Procedures*.
- d. **Form 4668 and Form 4668-B Employment Tax Computations:** IRM 8.7.16 does not require the preparation of the Form 5403 Worksheet for Form 4668 or Form 4668-B computations. Per the IRM, certain information APS needs in order to prepare the Form 5403 can be provided by the TCS or AO on Form 4668, Form 4668-B, on the face sheet, or by the AO on Form 5402.
- e. **Form 1120-S:** Form 1120-S is closed by APS using Form 5403 but a Form 5403 Worksheet is not required. (Even if there is a change to the Form 1120-S taxable income, or the Form 1120-S pays tax, a Form 5403 worksheet is not required by APS.)

**Note:** When a Form 5278 is prepared for a conversion from a Form 1120-S to a Form 1120, then a Form 5403 Worksheet will be required if there are adjustments to taxable income or other Form 5403 Worksheet entries are needed.

- f. **Form 1065:** Form 1065 is closed by APS using Form 5403 but a Form 5403 Worksheet is not required.
- g. **Innocent Spouse cases:** Generally a Form 5403 Worksheet is not required for innocent spouse cases. APS uses information from other sources (Form 5402, a tax computation form, an allocation worksheet, etc.) to make any necessary account adjustments.

**Exception:** The Form 5403 Worksheet *is* still needed for pre assessment innocent spouse cases when innocent spouse relief is denied, or when a notice of deficiency is being issued by Appeals.

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- (2) The above list of cases is not all inclusive. There are other types of cases that don't require a Form 5403 Worksheet. Refer to the specific IRM for the type of case you are working to determine the Form 5403 Worksheet requirements.

### 8.17.5.3.2 (09-24-2013) Interest 6621(c) Notice Date

- (1) The definition of the 2% trigger date is the *notice date plus 30 days*. The employee who prepares the settlement computations provides the notice date, also called *trigger notice*. APS then adds 30 days to that date to arrive at the 2% trigger date.
- (2) Attaching a copy of the document showing the letter date to the worksheet is very beneficial for APS and is highly encouraged.
- (3) See IRM 8.17.6.6.1.4, *Start Date or "Applicable" Date Requirement*, for more information on computing the notice date.

### 8.17.5.3.3 (11-02-2007) Reference Numbers for Estate and Gift Cases

- (1) Provide the following reference numbers for Form 706 and Form 709.
- a. Ref. number 074 — Generation skipping tax for 8610 and subsequent years (MFT's 51 and 52)
  - b. Ref. number 075 — IRC 4981A tax (MFT 52)
  - c. Ref. number 076 — Net estate tax (MFT 52)
  - d. Ref. number 077 — Net gift tax (MFT 51)

### 8.17.5.3.4 (03-07-2014) Computation of Reference Number 886 - Taxable Income

- (1) Corporate returns: Reference Number 886 is the total adjustment to taxable income. Transcripts for corporations can show negative taxable income amounts (amounts below zero).
- (2) Individual returns: Reference Number 886 is the total adjustment to taxable income. The taxable income field on TXMODA or IMFOLR cannot be reduced below zero.

**Note:** A TXMODA does not show a zero when taxable income on a Form 1040 is zero or negative. (There is no field for taxable income on the TXMODA when taxable income is zero or negative.) However, an IMFOLR does show a Reference Number 886 amount of zero when taxable income is zero or negative.

- (3) The following table provides four different scenarios of how Reference Number 886 is determined. Examples of how to compute the Reference Number 886 amount when taxable income is less than zero only apply for Form 1040 returns.

IF	THEN
Taxable income is positive per the return, and positive in the Appeals or Counsel settlement	Reference Number is amount of the adjustment to taxable income per the Appeals or Counsel settlement.
Taxable income is positive per return, and negative per Appeals or Counsel settlement	Reference Number is amount of adjustments necessary to reduce taxable income per return to zero. See Figure 8.17.5-1.

IF	THEN
Taxable income is negative per return, and positive per Appeals or Counsel settlement	Reference Number is amount of positive taxable income shown in the Appeals or Counsel settlement. See Figure 8.17.5-2.
Taxable incomes per return and per settlement are negative	Reference Number is zero. See Figure 8.17.5-3.

**Positive Income per Return - Negative Income per Appeals Settlement**

Taxable income per return	2,000
Adjustment to taxable income	<u>(3,000)</u>
Taxable income per Appeals settlement	(1,000)
	=====
Reference Number 886 amount	(2,000)

**Figure 8.17.5-1** The taxable income field cannot be reduced below zero on the transcript, so the negative taxable income of \$1,000.00 shown in the settlement is reflected as a zero on the transcript.

Since the taxable income on the transcript is the amount per return of \$2,000.00, an adjustment of (\$2,000.00) results in a \$0.00 TC 886 after the transaction posts to the module.

**Negative Income per Return - Positive Income per Appeals Settlement**

Taxable income per return	(1,000)
Adjustment to taxable income	<u>4,000</u>
Taxable income per Appeals settlement	3,000
	=====
Reference Number 886 amount	3,000

**Figure 8.17.5-2** Again, the taxable income field cannot be reduced below zero on the transcript. So even though the taxable income per the return is (1,000.00), it is reflected as zero on the transcript. The revised taxable income per the settlement is \$3,000.00. An 886 reference number adjustment of \$3,000.00 increases the zero taxable income on the transcript by \$3,000.00 and results in \$3,000.00 taxable income shown on the module after the adjustment posts.

**Negative Income per Return - Negative Income per Appeals Settlement**

Taxable income per return	(6,000)
Adjustment to taxable income	<u>4,000</u>

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Taxable income per Appeals settlement	(2,000) =====
Reference Number 886 amount	0.00

**Figure 8.17.5-3 Since taxable income can't be reduced below zero on the transcript, the return taxable income reflected on the transcript is zero, not (\$6,000.00). The revised taxable income figure per settlement of (\$2,000.00) is shown on the transcript as zero. So since the taxable income shown on the transcript is zero based on the return, and will remain zero, the 886 amount is zero.**

- (4) In the examples above, if prior adjustments to taxable income were assessed, use taxable income from the latest assessment rather than taxable income per the return. In addition, if the amount of taxable income shown on the transcript is not correct, use Reference Number 886 to correct it. Below is an example of a method of computation that accomplishes this and easily computes the correct Reference Number 886 adjustment for all situations:

1. Taxable income per transcript.
2. Taxable income per settlement.
3. Reference Number 886 amount if line 2 is negative: Subtract the amount on line 1 from zero (TC 886 equals zero less line 1).
4. Reference Number 886 amount if line 2 is positive: Subtract the amount on line 1 from the amount on line (2). (TC 886 equals line 2 less line 1).

- (5) When the amounts computed for the Reference Number 886 and 888 entries on the Form 5403 Worksheet are the same, no Reference Number 886 entry is required. An entry is only required on the Form 5403 Worksheet for the Reference Number 888 amount.
- a. If a Reference Number 888 amount is input onto IDRS without a Reference Number 886 amount, then the taxable income is automatically adjusted by the Reference Number 888 amount. The taxable income on the module will not be adjusted below zero.
  - b. In this situation, the Form 5344 or Form 5403 generated by RGS will only show an entry for Reference Number 888, and no entry is required for Reference Number 886 on the Form 5403 Worksheet.

### 8.17.5.3.5 (09-24-2013) Computation of Reference Number 887 (Exemptions)

- (1) This reference number reflects the change in the number of exemptions allowable. It does not reflect the adjustment to taxable income as a result of a change in the number of exemptions.

**Example:** The taxpayers claim 3 exemptions on their return. One exemption is disallowed. The amount to enter for reference number 887 should be shown as (1) on the Form 5403 Worksheet.

- (2) The deduction for exemptions is reduced if adjusted gross income (AGI) is more than a certain amount. The computation of tax can reflect an adjustment for exemptions, and yet the total number of allowable exemptions per the return remains unchanged.
  - a. If an exemption adjustment results only because of AGI changes, but the total number of exemptions remains the same as the return, no entry in Reference Number 887 is required on the Form 5403 Worksheet.

8.17.5.3.6  
(11-02-2007)  
**Computation of  
Reference Number 888  
(Adjusted Gross Income)**

- (1) Enter the amount of the adjustment to AGI on the Form 5403 Worksheet. AGI can be reduced below zero on a transcript of account.
- (2) If there is no change to AGI, no entry is required.

8.17.5.3.7  
(09-24-2013)  
**Tip Income Adjustments  
(FICA)**

- (1) FICA adjustments due to tip income are transmitted on Form 5403 using the following reference numbers:
  - a. Ref. 891 — Increase or (decrease) tip income for the primary taxpayer.
  - b. Ref. 892 — Increase or (decrease) tip income for the secondary taxpayer.
  - c. Ref. 898 — Increase or (decrease) Medicare tip income for the primary taxpayer.
  - d. Ref. 899 — Increase or (decrease) Medicare tip income for the secondary taxpayer subject.

8.17.5.3.8  
(09-24-2013)  
**Self Employment Tax  
Adjustments**

- (1) Use the following reference numbers to update self employment adjustments:
  - a. Ref. 878 — Self employment income adjustment (primary taxpayer)
  - b. Ref. 879 — Self employment income adjustment (secondary taxpayer)
  - c. Ref. 889 — Change in self employment tax
  - d. Ref. 895 — Self employment Medicare adjustment (primary taxpayer)
  - e. Ref. 896 — Self employment Medicare adjustment (secondary taxpayer)
- (2) The above reference numbers must be input on no change cases with a change to self employment income and/or self employment tax.
- (3) When using RGS for computations, check the “Sch SE” tab in the RGS Return setup:
  - a. Verify self employment income, especially where there is more than one Schedule C.
  - b. Joint returns - verify that the self employment income for the husband and wife is correctly input.
  - c. Verify FICA wages is properly input.
  - d. Be alert for possible problems when the return has negative self employment income.

8.17.5.3.8.1  
(09-24-2013)  
**Reference Numbers 878  
and 879 (Self  
Employment Income)**

- (1) Use Reference Number 878 (primary taxpayer) and Reference Number 879 (secondary taxpayers) for the net increase or decrease to the self employment income subject to the social security portion of the self employment tax.
- (2) Generally, 92.35% of the self employment income is subject to the social security portion of the self employment tax.

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**Note:** For the 2010 year, the self-employment income was reduced by the self-employed health insurance deduction on line 29 of Form 1040 and then multiplied by 92.35%.

- (3) The amount entered with Reference Number 878 or 879 cannot cause the taxpayer's total self employment income to exceed the maximum amount subject to the social security portion of the self employment tax.
- (4) The reference number amount is the lesser of:
  - a. Total adjustment to earnings subject to social security; or
  - b. Amount that brings total earnings subject to social security to the maximum dollar limitation.

**Note:** Remember, earnings subject to social security are the amounts after the self employment income is multiplied by 92.35%. Also, the maximum earnings subject to social security must be reduced by social security wages and tips from Form W-2, unreported tips from Form 4137, and (starting in 2007) wages subject to social security tax from Form 8919.

- (5) If the revised self employment income is less than \$400 (after the 92.35% limitation):
  - a. Enter whatever amount is needed to reduce the self employment income on the transcript to zero.
  - b. No entry is required for these reference numbers if no reference number amounts are currently shown on the transcript.
  - c. If the taxpayer has church employee income or uses the optional method to compute self employment income, the \$400 may not apply. Refer to the Form 1040, Schedule SE Instructions.

8.17.5.3.8.2  
(11-02-2007)

### Reference Number 889 (Self Employment Tax)

- (1) Use Reference Number 889 for the total adjustment to self employment tax.
- (2) If both taxpayers on a joint return have self employment income adjustments, the net increase or decrease to this Reference Number must reflect the total self employment tax adjustment for both taxpayers.
- (3) If Reference Number 878 or 879 is entered but there is no adjustment to self employment tax because the adjustments to income did not change the tax, enter a zero in Reference Number 889.

8.17.5.3.8.3  
(09-24-2013)

### Reference Numbers 895 and 896 (Self Employment Medicare)

- (1) Use Reference Number 895 (primary taxpayer) and Reference Number 896 (secondary taxpayer) for the net increase or decrease in self employment income subject to Medicare tax.
- (2) There is currently no maximum limitation on self employment income subject to Medicare tax.
- (3) 92.35% of self employment income is subject to the Medicare tax rate.



8.17.5.3.9  
(11-02-2007)  
**Reference Number 321  
(Personal Holding  
Company Tax)**

- (1) Because this is embedded in the body of the settlement computation and is seldom seen, provide the amount of the personal holding company tax in Reference Number 321.
- (2) This requirement is valid for MFT 02 returns.

8.17.5.3.10  
(09-24-2013)  
**Restricted Interest  
Provisions**

- (1) Form 2285 (Income tax cases):
  - a. When a Form 2285 is prepared for a tax year and restricted interest applies, check the "Yes" box on the Form 5403 Worksheet in the appropriate column(s) for each year it applies. This will alert APS to look for a Form 2285.
  - b. See IRM 8.17.6.4, *Preparation of Form 2285*, for detailed information about Form 2285.
- (2) Form 1366 (Estate tax cases):
  - a. When a Form 1366 is prepared for a tax year and restricted interest applies, check the "Yes" box on the Form 5403 Worksheet in the appropriate column(s) for each year it applies. This will alert APS to look for a Form 1366.
  - b. See IRM 8.7.4, *Appeals Estate and Gift Tax Cases*, for more information about Form 1366 and restricted interest for estate tax cases.
- (3) The AO is responsible for ensuring that the Form 2285 or Form 1366 is attached to the Form 5403 Worksheet and that both documents are attached to the inside left flap of the administrative file folder when the case is closed.

8.17.5.3.11  
(09-24-2013)  
**Applicability of  
May/Sequa**

- (1) Determine if May/Sequa is applicable when preparing the settlement computation. If it is, check the "Yes" box on the Form 5403 Worksheet in the appropriate column(s) for each year it applies. This will alert APS to look for the Sequa Worksheet.
- (2) The AO is responsible for ensuring that the Sequa Worksheet is attached to the Form 5403 Worksheet, and that both documents are attached to the inside left flap of the administrative file folder when the case is closed.
- (3) See IRM 8.17.6.10.2, *Completing the Sequa Worksheets*, for detailed information on the Sequa worksheets.

8.17.5.3.12  
(09-24-2013)  
**Applicability of IRC  
Section 6404(g)**

- (1) If IRC 6404(g) applies, check the "Yes" box on the Form 5403 Worksheet in the appropriate column(s) for each year it applies. This will alert APS to look for the IRC 6404(g) Worksheet.
- (2) The AO is responsible for ensuring that the 6404(g) Worksheet is attached to the Form 5403 Worksheet and that both documents are attached to the inside left flap of the administrative file folder when the case is closed.
- (3) See IRM 8.17.6.9, *IRC 6404(g) Suspension of Interest*, for detailed information on IRC 6404(g). See IRM 8.19.3, *Appeals Pass-Through Entity Handbook, Guidance for Appeals Officers*, for more information about IRC 6404(g) notices involving TEFRA adjustments.

## 8.17 Settlement Computations and Statutory Notices of Deficiency

8.17.5.3.13  
(09-24-2013)

### Refundable Credit Adjustments

- (1) See the following IRM sections for detailed procedures to follow for certain refundable credit adjustments made to income tax returns:
- (2) IRM 8.17.5.18 - General discussion of refundable credits.
- (3) IRM 8.17.5.18.1 - Adjustments to refundable credits not included in the statutory deficiency.
- (4) IRM 8.17.5.18.2 - Adjustments to refundable credits included in the statutory deficiency.

8.17.5.4  
(07-15-2011)

### Tentative Allowances and Other Carryback Claims

- (1) Taxpayers may report a net operating loss or credit carryback loss as a tentative allowance on Form 1045, *Application for Tentative Refund*, (individuals) or Form 1139, *Corporation Application for Tentative Refund*. This is called a tentative allowance or tentative carryback.
  - a. A tentative allowance is identified on an account module with TC 295. When this transaction code is present, either a Form 1045 (individual) or Form 1139 (corporation) was filed.
- (2) Taxpayers may claim a net operating loss or unused credit carryback on an amended return using Form 1040X (individuals) or Form 1120X (corporation). This is called a claim for credit or refund.
  - a. A claim for credit or refund is identified on the account module by TC 291 or TC 299. When this transaction code is present, either a Form 1040X (individuals) or Form 1120X (corporation) was filed.
  - b. Generally a TC 299 indicates the Form 1040X or Form 1120X was filed to carry back an unused loss or credit. A TC 291 may or may not be the result of the Form 1040X or Form 1120X being filed to carry back an unused loss or credit.
- (3) Compliance usually secures Form 1045/1139 or Form 1040X/1120X and places it in the case file along with the return. If the form is not in the case file, the Appeals Officer should take steps to secure a copy so an analysis can be made to determine what year the carryback originated and the amount of the carryback allowed.
- (4) Prepare Form 2285, *Restricted Interest Worksheet*, when tentative allowances and other carryback claims are involved. See IRM 8.17.6.4, *Preparation of Form 2285*, for additional information.
- (5) Further discussions of tentative allowances (Form 1045/1139) and other carryback claims (Form 1040X/1120X) are found at IRM 8.17.4.14, *Tentative Allowances and Other Carryback Claims In Notice of Deficiency Statement*.

8.17.5.4.1  
(09-24-2013)

### Settlement Computations with Tentative Allowances and Carryback Claims

- (1) In non-docketed cases, the Appeals Officer determines whether the carryback shown in the tentative allowance or claim for credit or refund is allowed in the settlement computation. (See IRM 8.4.1.12.1 and IRM 8.4.1.12.2 for procedures for docketed case computations with tentative allowances and carryback claims.)
- (2) When the carryback is provisionally allowed in non-docketed cases, include a statement similar to the following in the blank space at the bottom of Form



3610 or the tax computation form (Form 5278, Form 4549, etc.) The information can also be provided on an attachment:

“The net operating loss deduction or other loss or credit carryback reflected herein which gave rise to the tentative allowance (*or claim for credit or refund*) of \$ \_\_\_\_\_ is provisionally allowed and is subject to change upon examination of the returns of the loss year or unused credit year.”

- (3) When the carryback is not allowed, a recapture of the previously allowed tentative allowance or claim for credit or refund is needed. Follow the steps below:
  - a. Do not decrease taxable income or alternative minimum taxable income by the net operating loss and/or capital loss carrybacks from the year giving rise to the tentative allowance or claim for credit or refund.
  - b. Do not decrease tax liability by the credit carrybacks.
  - c. Include the decrease in tax attributable to the tentative allowance (TC 295) or claim for credit or refund (TC 291 or TC 299) in the amount shown as “Tax per return or as previously adjusted” on Form 5278, Form 4549, etc.
  - d. By including the TC 295 from the tentative allowance or TC 291/299 from the claim for credit or refund in the “Tax per return or as previously adjusted” amount, a recapture is automatically created in the bottom line deficiency or overassessment amount on the settlement computation.

8.17.5.5  
(09-24-2013)  
**Partnership Adjustments  
in Settlement  
Computations**

- (1) See Exhibit 8.17.5-1 for an example of how Form 4605-A is used to show the adjustment to partnership ordinary income, long-term capital gains and losses, and contributions. Similar schedules might be necessary for such items as partnership IRC 1231 gains and losses, general business credit, etc. Form 886-S, *Partners’ Share of Income, Deduction and Credits*, and Form 886-Z, *TEFRA Partners’ Shares of Income*, are designed for use in distributing partnership income, deductions and credits.
- (2) Reconcile the “886-type” forms to the Schedule K-1’s. Make certain the percentage of profit column equals 100%. These forms serve as corrected Schedule K-1’s and are used by Campuses to make the investors’ calculations. Therefore, include all flow-through information shown on the Schedule K-1 on the “886-type” forms whether adjusted or not.
- (3) An alternative is to prepare the “886-type” form listing the adjusted issues only, and provide a statement at the bottom indicating all other issues remain the same as shown on the Schedule K-1 as filed.

8.17.5.6  
(09-24-2013)  
**S Corporation  
Adjustments (Form  
1120-S)**

- (1) S Corporation adjustments to income (adjustments to Form 1120-S , *U.S. Income Tax Return for an S Corporation*) are patterned along the lines of partnership adjustments. If the TCS receives a request for computations for the Form 1120-S , use Form 4605 or Form 4605-A for these computations. Also use distribution schedule Form 886-X.

**Note:** It is not usually necessary to prepare Form 886-X if there is only one shareholder.

## 8.17 Settlement Computations and Statutory Notices of Deficiency

- (2) However, if the TCS has the Form 1120-S administrative file and is also preparing the computations for all the shareholders, it is not usually necessary to prepare Form 4605, Form 4605-A or Form 886-X.
- (3) If the TCS receives a request for Form 1040 computations and there are S Corporation adjustments, the S Corporation adjustments are generally just included on the tax computation form along with any other adjustments being made to the Form 1040. Form 4605, Form 4605-A and Form 886-X do not need to be prepared.

### 8.17.5.7 (07-15-2011) TEFRA Partnerships and S Corporations

- (1) The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) and the Subchapter S Revision Act of 1982 established unified procedures for examining certain partnerships and S corporations. As a result of this act, a separate set of procedures was established addressing the preparation of settlement computations for TEFRA partnerships and S Corporations.

**Note:** TEFRA procedures do not apply to S corporations for tax years beginning after December 31, 1996.

- (2) The Appeals Officer or Counsel Attorney should indicate whether the case is TEFRA.
- (3) See IRM 8.19, *Appeals Pass-through Entity Handbook*, for additional information.

### 8.17.5.8 (11-02-2007) Fiduciary Adjustment

- (1) Form 886-W, Distribution of Beneficiaries' Share of Income and Credit, is a distribution schedule of beneficiaries' shares of income, credits, etc. Use either Form 4605-A or pattern a schedule to fit the needs of the case, when adjusting fiduciary income.

### 8.17.5.9 (09-24-2013) Net Worth Method

- (1) The net worth method of proving taxable income is based upon the theory that increases or decreases in a taxpayer's net worth during a taxable period, adjusted for nontaxable expenditures and nontaxable income, must result from taxable income.
- (2) IRM 4.10.4.6.7, *Net Worth Method*, provides detailed information about the net worth method. A formula for computing income using the net worth method can be found at IRM 4.10.4.6.7.3, *Formula for the Net Worth Method*. An example of the net worth method can be found at IRM 9.5.9-1, *Net Worth Statement*.

### 8.17.5.10 (07-15-2011) Source and Application of Funds Method

- (1) The source and application of funds method is a variation of the net worth method and is simply the comparison of all known expenditures with all known receipts. Excess of expenditures, when reported adjusted gross income or net income is included among the sources, represents understated income.
- (2) In this method enter only increases and decreases in assets and liabilities along with other non-deductible and non-taxable receipts.
- (3) IRM 4.10.4.6.3, *Source and Application of Funds Method*, provides a detailed explanation of this method. See IRM 4.10.4-10, **Source and Application of Funds Method: Example of Computation for Cash and Accrual Based Taxpayer**, for an example.

- 8.17.5.11  
(07-15-2011)  
**Bank Deposits and Cash Expenditures Method**
- (1) This method is based upon the assumption that outlays disclosed on the return were actually made; however, only two types of expenditures, check or cash, paid for these outlays. If cash paid them, then the source of that cash must be due to receipts if not accounted for from other funds.
  - (2) IRM 4.10.4.6.4, *Bank Deposits and Cash Expenditures Method*, provides a detailed explanation of this method. The basic formula for computing the understatement of taxable income is outlined in IRM 4.10.4.6.4.6. See IRM 4.10.4-9, *The Bank Deposits and Cash Expenditures Method: Example of Computation of Gross Receipts*, for an example.
- 8.17.5.12  
(11-02-2007)  
**Capital Gains and Losses**
- (1) Devise a schedule to fit the needs of the issue or adjustment. For example, a schedule appropriate for installment sales under IRC 453(b) is totally inapplicable to a timber transaction under IRC 631. The tax return format of capital gains and losses, Schedule D, is an excellent guide for applying the law in effect for a given year.
- 8.17.5.13  
(09-24-2013)  
**Depreciation**
- (1) The computation of the adjusted depreciation may be shown under the explanations of adjustment, or on a schedule or exhibit such as Form 1914. However, there are situations in which a depreciation computation might not be needed. Some examples would be:
    - a. Appeals or Counsel is sustaining the Compliance adjustment.
    - b. Depreciation claimed is disallowed in full.
    - c. Depreciation for one or more items is disallowed.
    - d. Depreciation computation is provided by the taxpayer.
  - (2) If the AO or Counsel wants a depreciation computation included in the settlement computation prepared by the TCS, they must provide the TCS with the information necessary for the TCS to prepare the computation of the depreciation adjustment or provide the TCS with the depreciation computation. Otherwise the TCS may just include the depreciation adjustment amount shown in the work request in the settlement computation without including a depreciation computation schedule.
- Note:** The AO or Counsel may determine that it is not necessary for TCS to prepare a computation of the adjusted depreciation for cases where the AO or Counsel has already shared a depreciation computation with the taxpayer.
- (3) Excel Form 1914 spreadsheets available:
    - a. An Excel Form 1914 spreadsheet is available through a link on the Appeals TCS web site.
    - b. An Excel Form 1914 spreadsheet that can be used to compute a variety of different types of depreciation is available on the RGS web site.
- 8.17.5.14  
(09-24-2013)  
**Net Operating Losses**
- (1) IRC 172 provides that net operating losses may be carried back to prior years and forward to future years as deductions.
  - (2) If needed, explain adjustments to a net operating loss deduction in the settlement computation. Examples of when a computation may not be needed include:

## 8.17 Settlement Computations and Statutory Notices of Deficiency

- a. No change is made in the settlement computation to the amount of the adjustment to the net operating loss deduction shown in the examination report or notice of deficiency.
- b. A net operating loss deduction is disallowed in full.
- c. The net operating loss computation is very simple (such as a corporate return where the amount of negative taxable income is the amount of the net operating loss).
- d. The net operating loss amount is a settled figure provided by the AO or Counsel and not computed by the TCS.

**Note:** A computation may still be needed to show the amount of the net operating loss carryover.

- (3) In order for the TCS to compute the net operating loss, the AO or Counsel must provide the information needed. Generally the complete returns including all schedules and attachments are necessary for the year of the loss and the carryback/carryforward years.
- (4) See IRM 4.11.11, *Net Operating Loss References*, for a list of net operating loss references and resources.

### 8.17.5.14.1 (07-15-2011) Regular Tax Net Operating Loss

- (1) Individuals
  - a. Form 3621, *Net Operating Loss Computation*, may be used to determine a net operating loss for the taxable year. This form is available on the Appeals Technical Support Sharepoint site. Be careful when using Form 3621 if capital gains and losses are claimed on an individual income tax return, or allowed in the settlement computation, because it does not always compute the correct amount of net operating loss for individuals. Instead, it is preferable to use Schedule A of Form 1045, *Application for Tentative Refund*, which does correctly compute the amount of the net operating loss when capital gains and losses are allowable.
  - b. Form 3621-A, *Computation of Net Operating Loss Deduction for Intervening Years Modifications*, may be used to compute the net operating loss deduction allowable when a net operating loss is carried to another year. It also computes the remaining amount of net operating loss available to carry to other years. This form is available on the Appeals Technical Support Sharepoint site. Schedule B of Form 1045, *Application for Tentative Refund*, may be used instead of Form 3621-A.
  - c. Schedules A and B of Form 1045 are available in Excel spreadsheets on the RGS web site. The file is labeled "Individual NOL - Room for 5 years carryback".
  - d. Schedules A and B of Form 1045 are also available in a fillable Adobe Acrobat form on the Electronic Publishing Catalog web site.
- (2) Corporations
  - a. Form 3621 and Form 3621-A may be used to determine net operating losses and net operating loss deductions for corporate taxpayers.
  - b. Excel spreadsheets for computing corporate net operating losses and net operating loss deductions worksheets are available on the RGS web site.
  - c. Forms for SRLY computations are also found on the Appeals Technical Support Sharepoint site.

8.17.5.14.2  
(09-24-2013)

**Alternative Minimum Tax  
Net Operating Loss**

- (1) The alternative minimum tax net operating loss is the regular tax net operating loss modified by the adjustments required under IRC 56 and IRC 58, and tax preference items under IRC 57.
- (2) Use of the alternative minimum tax net operating loss deduction is generally limited to 90% of alternative minimum taxable income in the carryover or carryback years. There are exceptions to this 90% limitation as noted below.
  - a. For net operating loss (NOL) deductions attributable to NOL carrybacks arising in taxable years ending in 2001 and 2002, as well as NOL carryforwards to those taxable years, IRC 56(d)(1)(A), as amended by P.L. 107-147, IRC 102(c), allows the NOL to offset 100% of a taxpayer's alternative minimum taxable income.
  - b. Other exceptions may apply. When preparing computations, it is best to check the instructions for Form 6251 or Form 4626 to determine the applicable rules.
- (3) If a regular tax net operating loss is computed, consider whether or not an alternative tax net operating loss computation is applicable. When there is no alternative minimum tax Form 6251 or Form 4626 in the taxpayer's return, and the settlement results in a regular tax net operating loss, a computation of the alternative minimum tax net operating loss may be needed.
- (4) Individual taxpayers - Schedule A Form 1045 Excel spreadsheets can also be used to compute the alternative minimum tax net operating loss. These Excel spreadsheets are available on the RGS web site in a file labeled "Individual NOL - Room for 5 years carryback".
- (5) The SRLY Excel spreadsheets located on the Appeals Technical Support Sharepoint site can also be used for SRLY alternative minimum tax net operating loss computations.

8.17.5.15  
(11-02-2007)

**Charitable Contributions**

- (1) Sometimes complicated computations of limitations on contributions and contributions carryovers are needed.
- (2) Schedules patterned along the line of schedules in the return may be used whenever appropriate for individuals and for corporations. See Exhibit 8.17.5-2 (Computation of Corporation Contribution Deduction and Carryovers) for details.
- (3) A charitable contributions limitation worksheet for Form 1040 is found on the RGS web site.

8.17.5.16  
(11-02-2007)

**Claim of Right**

- (1) Certain computations are common to both corporate and individual taxpayers. See Exhibit 8.17.5-3 for an example of a computation of tax when the taxpayer restores an amount held under claim of right (IRC 1341). Special computations may be necessary for income tax paid to a foreign country or U.S. possession ( IRC 27 and IRC 901).

8.17.5.17  
(07-15-2011)

**Life Insurance Company  
Cases**

- (1) A life insurance company files their return on a Form 1120-L. There are special tax rules for life insurance companies and special limitations on losses when a life company files a consolidated return with a non-life company. The rules that govern the taxation of life insurance companies are located in IRC sections 801 through 818. Some of the general provisions that apply to all insurance companies are contained in IRC sections 841 through 848.

## 8.17 Settlement Computations and Statutory Notices of Deficiency

- (2) Worksheets to use when computing life insurance company taxable income are available on the Appeals Technical Support Sharepoint site.
- (3) Most of the tax forms and instructions are available at the Electronic Publishing Catalog web site.

### 8.17.5.18

(07-15-2011)

#### Refundable Credit (Prepayment Credit) Adjustments)

- (1) Refundable credits are different from non-refundable credits:
  - a. A non-refundable credit is a statutory credit offset against, and limited to, the amount of the tax liability for the tax year.
  - b. A refundable credit can reduce tax liability below zero. If these credits exceed the total tax liability, the excess is refunded.
  - c. "Refundable credits" are also called "Prepayment credits".
- (2) See the following IRM sections for additional information about refundable credits:
  - IRM 21.6.3 - Individual Income Tax Returns
  - IRM 21.7.4 - Business Tax Returns.
- (3) The following IRM sections discuss the procedures to follow for refundable credit adjustments made to income tax returns:
  - a. See IRM 8.17.5.18.1 for procedures for refundable credit adjustments **not** included in the definition of a statutory deficiency per IRC 6211.
  - b. See IRM 8.17.5.18.2 for procedures for refundable credit adjustments **included** in the definition of a statutory deficiency per IRC 6211.

**Note:** Adjustments to the credits listed in IRC 6211(b)(4) are included in the definition of a statutory deficiency.

### 8.17.5.18.1

(09-24-2013)

#### Adjustments to Refundable Credits Not Included in the Statutory Deficiency

- (1) Adjustments to the following refundable credits are **not** included in the definition of a statutory deficiency:
  - a. Withholding
  - b. Estimated Tax Payments
  - c. Excess Social Security, Medicare, and RRTA (Railroad Retirement Tax Act) Tax Credits
  - d. Notice to Shareholders of Undistributed Long Term Capital Gains (Regulated Investment Company Credit - See Form 2439)
  - e. Telephone Excise Tax Refund (TETR) - Form 8913 (2006 years only)
  - f. Health Coverage Tax Credit (For deficiencies determined **before** 12/30/2007.

**Note:** Adjustments to health coverage tax credit included in deficiencies determined **after** 12/29/2007 **are** included in the definition of a statutory deficiency. See IRM 8.17.5.18.2 for procedures.
- (2) Click on the "Procedures and Resources" link on the TCS web site, and then see the "Refundable Credits" folder for information about refundable credits not included in the statutory deficiency, including Credit Reference Numbers (CRN's).



- (3) Form 5278 or Form 4549/Form 4549-A is used to show adjustments to these credits.
    - a. The tax computation forms 5278, 4549, 4549-A, etc. have a line after the deficiency for adjustments to prepayment credits.
    - b. Enter adjustments to the refundable credits listed in paragraph (1) on this line. (Line 22 of Form 5278 and Line 15 of Form 4549 or Form 4549-A.)
  - (4) Also, enter adjustments to these refundable credits on the Form 5403 Worksheet, or on the RGS Form 5403 or Form 5344 attached to the Form 5403 Worksheet:
    - a. If the RGS Form 5403 or Form 5344 shows the correct amount of adjustments to these refundable credits, attach either the RGS Form 5403 or the RGS Form 5344 to the Form 5403 Worksheet. This is the preferred method if RGS is used for the tax computations.
    - b. Or, enter the refundable credit adjustment on the Form 5403 Worksheet.
- Note:** The Form 5403 Worksheet has a line to indicate that the RGS Form 5403 or Form 5344 is attached. This line should be marked in the appropriate tax year column by the TCS or AO when an RGS Form 5403 or RGS Form 5344 is attached to the Form 5403 Worksheet, to alert APS of the attachment.
- (5) Form 3610 is not required when there are adjustments to refundable credits.
  - (6) However, **if** Form 3610 is prepared and there *are* adjustments to refundable credits not included in the statutory deficiency, Form 3610 should be modified as discussed below. The format shown in either paragraph (4)(a) or (4)(b) can be used:
    - a. The details pertaining to the refundable credit adjustment can be shown at the bottom of Form 3610. The information can also be shown on an attachment to Form 3610. See suggested wording, below. (It is recommended that the type of refundable credit adjustment be identified, as shown below.) See Exhibit 8.17.5-4 for an example.

Statutory Deficiency		\$50,000
Refundable credit adjustment:		
Correct refundable credit (withholding)	5,000	
Credit claimed on return	<u>4,000</u>	
Increase (Decrease)		<u>1,000</u>
Net Underpayment (Net Overpayment)		\$49,000
		=====

- b. Or, the tax heading on Form 3610 may be modified to read as shown below. Exhibit 8.17.5-5 for an example of this format.

## 8.17 Settlement Computations and Statutory Notices of Deficiency

Statutory Deficiency/ (Overassessment)	Increase/(Decrease) in Refundable Credit	Net Underpayment (Net Overpayment)
\$50,000	\$1,000	\$49,000

**Note:** Both formats in paragraphs (a) and (b) can be used on Form 3610.

8.17.5.18.2  
(09-24-2013)

### Adjustments to Refundable Credits Included in the Statutory Deficiency

- (1) Adjustments to the following refundable credits listed in IRC 6211(b)(4) are **included** in the definition of a statutory deficiency for income tax cases:

Code Section	Refundable Credit	Form
IRC 24(d)	Additional Child Tax Credit	Form 8812
IRC 25A, Subsection (i)(6)	American Opportunity Tax Credit. (Modification of Hope Scholarship Credit. Referred to as a Refundable Education Credit on the 2009 Form 1040.)	Form 8863
IRC 32	Earned Income Credit	
IRC 34	Credit for Federal Tax Paid on Fuels (Fuel Tax Credit)	Form 4136
IRC 35	Health Coverage Tax Credit (For deficiencies determined after 12/29/2007)	Form 8885
IRC 36	First Time Homebuyer Credit	Form 5405
IRC 36A	Making Work Pay and Government Retiree Credits	Schedule M of Form 1040
IRC 36C	Adoption Credit	Form 8839
IRC 53(e)	Credit for Prior Year Minimum Tax (Individuals, Estates & Trusts) Refundable credit beginning in tax year 2007.	Form 8801
Form 168(k)(4)	Election to accelerate AMT & research credits (Corporations)	Form 8827 or Form 3800
Form 6428	Recovery Rebate Credit	

**Note:** Click on the “Procedures and Resources” link on the TCS web site, and then see the “Refundable Credits” folder for information about IRC 6211(b)(4) refundable credits, including Credit Reference Numbers (CRN’s).



- (2) Form 5278 or Form 4549/4549-A is used to show adjustments to these credits. (The adjustment to the credits is shown on Line 20 of Form 5278 and Line 13 of Form 4549 or Form 4549-A.)
- (3) Also, enter adjustments to these refundable credits on the Form 5403 Worksheet, or on the RGS Form 5403 or Form 5344 attached to the Form 5403 Worksheet:
  - a. If the RGS Form 5403 or Form 5344 shows the correct amount of adjustments to these refundable credits, attach either the RGS Form 5403 or RGS Form 5344 to the Form 5403 Worksheet. This is the preferred method if RGS is used for the tax computations.
  - b. Or, enter the refundable credit adjustment on the Form 5403 Worksheet.
 

**Note:** The Form 5403 Worksheet has a line to indicate that the RGS Form 5403 or Form 5344 is attached. This line should be marked in the appropriate tax year column by the TCS or AO when the RGS Form 5403 or RGS Form 5344 is attached to the Form 5403 Worksheet, to alert APS of the attachment.
  - c. The Form 5403 Worksheet and the RGS Form 5403 or Form 5344 will show three asterisks (\*\*\*) instead of the Credit Reference Number (CRN) for the Recovery Rebate Credit (RRC) and fuel tax credit. The TCS or AO does not need to enter the CRN for the Recovery Rebate Credit (RRC) and the fuel tax credit on the Form 5403 Worksheet or on the RGS Form 5403 or Form 5344. APS will determine the appropriate CRN for the RRC and fuel tax credit and enter on the Form 5403 prepared to close the case.
- (4) Form 3610 is **not** required when there are adjustments to refundable credits.
- (5) If Form 3610 is prepared and there are adjustments to the refundable credits included in the statutory deficiency, then:
  - a. No special format for these refundable credits is required on Form 3610. It is acceptable to just enter the amount of the statutory deficiency on the Form 3610. (The statutory deficiency is shown on line 21 of Form 5278 or line 14 of Form 4549 and Form 4549-A.)

8.17.5.19  
(07-15-2011)  
**Pre-Refund Cases  
(Frozen Refund Cases)**

- (1) Pre-refund cases (also called frozen refund cases) are those selected for examination prior to scheduling refunds claimed on returns. The IRS identifies issues that may indicate a taxpayer is not truly entitled to the refund amount claimed. The entire refund is generally held pending assurance of entitlement. The refund is released when the taxpayer provides information indicating he/she is entitled to the refund. To determine the status of refunds, however, secure a transcript of account before a case is closed. (See IRM 8.17.3, *Preparing a Statement of Account*.)
- (2) Examples of pre-refund examinations include earned income credit cases, CID initiated freeze codes, and unallowable tax holds.
- (3) The general procedure for settlement computations for frozen refund cases is the same as other individual income tax cases except that special language is needed either on Form 3610 or on the tax computation form. See discussion in paragraphs (4) and (5).

## 8.17 Settlement Computations and Statutory Notices of Deficiency

- (4) If Form 3610 is prepared, either of the formats discussed in paragraphs (a) or (b) can be used:

- a. Modify the bottom of the Form 3610 as follows:

Statutory deficiency	\$15,000
Less: Overpayment claimed (not refunded)	<u>1,000</u>
Net Underpayment (Net Overpayment)	\$14,000
	=====

- b. In the alternative, modify the heading on Form 3610 to read:

Statutory Deficiency	Overpayment Claimed (Not Refunded)	Net Underpayment (Net Overpayment)
\$15,000	\$1,000	\$14,000

**Note:** Both formats in paragraphs (a) and (b) can also be shown on the Form 3610.

- (5) The Form 3610 formats discussed in paragraph (4) are not needed if language is included on the tax computation schedule instead:

- a. The Form 3610 format discussed in paragraph (4)(a) can be shown on the tax computation schedule (Form 5278, Form 4549, etc).
- b. If the frozen refund is shown on the "Adjustments to Prepayment Credits" line of the tax computation form, the format shown in paragraph (4)(a) is not required. Instead, a footnote can be added to the tax computation form with an explanation that the amount is a claimed overpayment that was not refunded. The following is a suggested format for the footnote:

"Claimed overpayment not refunded."

### 8.17.5.20 (11-02-2007) Settlement Computations When Converting Separate to Joint for Non-docketed Case

- (1) IRC 6013 provides for filing joint returns. This subsection discusses the procedures for converting separate returns to joint returns in non-docketed cases.

### 8.17.5.20.1 (07-15-2011) Both Taxpayers Filed Separate Returns

- (1) In non-docketed cases, if both taxpayer-husband and taxpayer-wife have filed separate returns which are to be converted to a joint return, address the settlement computations to the joint taxpayers.
- (2) The starting point for adjustments can be either the last examination report issued for the taxpayer-husband or the taxpayer-husband's return. Make the appropriate adjustments to include the taxpayer-wife's income, deductions, credits, etc. to arrive at the joint taxable income and the joint total corrected

tax liability. Reduce the joint total corrected tax liability by the tax per return of the taxpayer-husband to compute the joint statutory deficiency/ (overassessment).

- (3) Adjust the joint statutory deficiency/(overassessment) on Form 3610 by the taxpayer-wife's unrefunded prepayment credit adjustments to compute the net underpayment/net overpayment.
  - a. All tax and penalty amounts assessed on the taxpayer-wife's account will be reduced to zero since joint filing status is being allowed. See IRM 8.20.7.21.4.1, *Separate to Joint Return When Both Primary and Secondary TP Filed*, for additional information.
  - b. Prepayment credits that had been applied to pay assessed tax and penalty amounts on the taxpayer-wife's account are the "taxpayer-wife's unrefunded prepayment credit adjustments."
  - c. Include the taxpayer-wife's unrefunded prepayment credit adjustments on Form 3610 as payments to be applied to the joint account, since they will be transferred from the taxpayer-wife's account to the joint account.
  - d. Use the refundable credit adjustment setup to prepare Form 3610. See IRM 8.17.5.18.1.
- (4) Modifications of these procedures may be necessary due to the unique facts and circumstances of the particular case.

8.17.5.20.2  
(11-02-2007)

**Only One Taxpayer Files  
a Return**

- (1) Non-docketed cases — SSN of filing spouse used as primary number.
  - a. If only one taxpayer has filed a return, that taxpayer's SSN may be used as the primary number on the joint return and in the settlement computation.
  - b. The starting point for adjustments is either the filing spouse's return or the last examination report issued to the filing spouse. Make the appropriate adjustments to include the non-filing spouse's income, deductions, credits, etc. to compute the joint taxable income and the joint total corrected tax liability. Reduce the joint total corrected tax liability by the tax per return of the filing spouse to arrive at the statutory deficiency (overassessment).
  - c. Adjust the joint statutory deficiency/(overassessment) on Form 3610 by the prepayment credits of the non-filing spouse to compute the net underpayment/net overpayment. Use the refundable credit adjustment setup shown in IRM 8.17.5.18.1.
- (2) Non-docketed cases — SSN of non-filing spouse used as primary number.
  - a. If only one taxpayer has filed a return, the non-filing spouse's SSN may be used as the primary number on the joint return and the settlement computations. This will usually occur when the taxpayer-husband is the non-filer and the taxpayer-wife is the filing spouse.
  - b. The starting point for computations is zero (\$0.00) since the primary taxpayer did not file a return. Make the appropriate adjustments to include both spouse's income, deductions, credits, etc. to compute the joint taxable income and the joint total corrected tax liability. Tax per return is zero (\$0.00).
  - c. Adjust the joint statutory deficiency on Form 3610 for taxpayer-husband's prepayment credits and taxpayer-wife's unrefunded prepayment credits.

## 8.17 Settlement Computations and Statutory Notices of Deficiency

Use the refundable credit adjustment setup shown at IRM 8.17.5.18.1 as a guide for preparing Form 3610.

- d. For information on the disposition of the taxpayer-wife's account on Master File, see "Separate to Joint Return When Only One Spouse Filed" in IRM 8.20.7.21.4.2.

- (3) Modifications of these procedures may be necessary due to the unique facts and circumstances of the particular case.

### 8.17.5.21 (09-24-2013) **Cases Involving Termination Assessment under IRC 6851 (Termination of Taxable Period)**

- (1) When collection of income tax is in jeopardy, the Area or Field Operations Director terminates a taxpayer's taxable period, and has an assessment made for tax and penalty determined to be due, under the conditions found in Policy Statement P-4-89 and the procedures in IRM 4.15, *Jeopardy/Termination Assessments*.
- (2) At the end of the usual annual accounting period, the taxpayer is responsible for filing a return for his or her annual accounting period.
- (3) Upon filing the full year return, the Area or Field Operations Director's office determines the correct liability and, where appropriate, issues a preliminary notice or notice of deficiency. The statutory deficiency is the difference between the liability determined and the liability entered on the full-year return. If the taxpayer does not file a full-year return, follow the "substitute for return" procedures. The statutory deficiency is not reduced by the assessment under IRC 6851. The taxpayer may protest the notice to Appeals. In some cases, it is possible for Appeals to receive the case prior to issuance of the notice of deficiency. In these cases, Appeals issues the notice of deficiency.
- (4) In preparing settlement computations, use the format similar to jeopardy assessment cases, except change "jeopardy assessment" to "termination assessment under IRC 6851."
- (5) See IRC 7429(a) and IRM 8.7.1.6.4, *Termination Assessments*, for additional information.
- (6) If a termination assessment case is docketed, a statement of account is required. See IRM 8.17.3, *Preparing a Statement of Account*.

### 8.17.5.22 (09-24-2013) **Jeopardy Assessments in Settlement Computations**

- (1) Jeopardy assessments of income, estate and gift taxes are covered in IRC 6861, and jeopardy assessments on all other taxes are covered in IRC 6862.
- (2) Generally settlement computations for cases involving jeopardy assessments follow the pattern of a regular settlement computation, except for the changes noted below.
  - a. Face Sheet - Revise columns on Form 3610 to show the following information:

Deficiency (Overassessment) before considering Jeopardy Assessment			Deficiency (Overassessment) after considering Jeopardy Assessment	
Year	Tax	Penalty	Tax	Penalty

- b. If Form 3610 is not prepared, the above information can be provided on the tax computation form (Form 5278, Form 4549, etc.).
- c. Computation of Tax on Form 5278, Form 4549, etc: Determine correct tax liability and statutory deficiency before considering jeopardy assessment. When determining tax liability per return or as previously adjusted, do not consider jeopardy assessments.
- d. It is helpful to APS if the above computation on Form 5278 (or Form 4549, etc.) is followed by a computation of deficiency or overassessment after considering jeopardy assessment similar to the following:

	<u>Tax</u>	<u>Penalty</u> <u>IRC 6663(a)</u>
Deficiency (Overassessment) before considering jeopardy assessment	\$25,000	\$5,000
Jeopardy Assessment	(5,000)	(500)
Deficiency (Overassessment) after considering jeopardy assessment	=====	=====

- (3) If a jeopardy assessment case is docketed, a statement of account is required. See IRM 8.17.3, *Preparing a Statement of Account*.

8.17.5.23  
(11-02-2007)  
**Bankruptcy and  
Receivership Cases**

- (1) Appeals procedures are covered in IRM 8.7.6, *Appeals Bankruptcy Cases*.
- (2) If a settlement computation is needed in a case where an assessment was made under bankruptcy/receivership proceedings, follow the format of jeopardy assessment cases.

8.17.5.24  
(09-24-2013)  
**Barred Overpayments  
and Deficiencies**

- (1) If it is determined an overpayment or deficiency in a case is barred by statute, special annotations are made to Form 3610 or the tax computation form (Form 5278, Form 4549, etc.). The information can also be shown on an attachment.
- (2) The same procedures apply to barred overpayments and barred deficiencies whether the case is non-docketed or docketed.
- (3) If the total overpayment or deficiency is barred, asterisk (\*) the amount and add a footnote to Form 3610, the tax computation form, or an attachment. The following is an example of the footnote for a barred overpayment case:  
"Overpayment barred by statute of limitations."
- (4) If only part of the overpayment or deficiency is barred, asterisk (\*) the total amount and add a short summary of the barred amount to the bottom of the Form 3610, the tax computation form, or an attachment. The following is an example of the summary for a barred overpayment case:

## 8.17 Settlement Computations and Statutory Notices of Deficiency

Overpayment	6,000
Overpayment barred by statute of limitations	<u>1,000</u>
Overpayment allowable	5,000
	=====

8.17.5.25  
(09-24-2013)

### Refund Litigation Cases

- (1) It is the responsibility of Appeals to provide tax recomputation assistance for settlements and judgments in Department of Justice (DOJ) refund litigation cases when it is requested by Counsel. All requests for TCS assistance on DOJ cases must come from a Counsel attorney to a TCS manager for assignment. The DOJ cannot send a request for TCS assignment directly to the TCS manager but must go through a Counsel attorney.
- (2) Since refunds involve payment of interest by the Government, these recomputations must be furnished without undue delay.
- (3) The tax computation form (Form 5278, Form 4549, etc.) will be prepared taking into consideration prior assessments of tax and penalties. (Be sure to attach penalty schedules if applicable.) Show the tax, penalty and interest adjustments on Form 3610 by periods to enable the Campus to properly handle the overpayments and process the refunds.

**Note:** Only include adjustments to deficiency interest on Form 3610.

- (4) Form 3610 is required for refund litigation cases. Other forms needed to prepare recomputations are the same as those used for regular settlement computations - Form 5278 , Form 4549 , penalty schedules, etc.
- (5) If the TCS is preparing tax computations for a DOJ refund litigation case and needs assistance/support with interest computations due to complexity, the TCS will:
  - a. Complete the APS Complex Interest Team (CIT) Referral Form. (The APS CIT Referral Form can be found on the APS web site.)
  - b. Send the CIT Referral form to the APS CIT mailbox at the following address using encrypted e-mail:
 

\*AP Complex Interest
  - c. Attach any required forms to the CIT Referral Form such as Sequa worksheet, Form 2285, etc.
- (6) See Exhibit 8.17.5-6 for an example of a suggested format for a settlement computation prepared for a refund litigation case.

**Note:** If the penalty and interest schedules included in the settlement computation show the amounts to be abated, then the Schedule 2 shown in the exhibit is not necessary.

## Exhibit 8.17.5-1 (07-15-2011)

## Settlement Computation for Partnership on Form 4605-A

<b>Form 4605-A</b>	<b>Department of the Treasury - Internal Revenue Service Examination Changes - Partnerships, Fiduciaries, S Corporations and Interest Charge Domestic International Sales Corporation (Unagreed and Excepted Agreed)</b>		
Name of Taxpayer XYZ Partnership		EIN:	Form No.
1. Adjustments to ordinary, distributable net, or taxable income.	Period End: 12/31/04	Period End: 12/31/05	Period End:
a. Gross receipts	112,000	129,000	
b. Other deductions	54,000	38,000	
c.			
d.			
e.			
2. Total adjustments to ordinary, distributable net, or taxable income.	166,000	167,000	
3. Ordinary, distributable net, or taxable income as reported.	250,000	(475,000)	
4. Corrected ordinary, distributable net, or taxable income.	416,000	(308,000)	
5. Other adjustments.			
a. Long Term Capital Gain			
(1) Adjustment	12,000	12,000	
(2) As reported	25,000	0.00	
(3) Corrected	37,000	12,000	
b. Contributions			
(1) Adjustment	3,400	4,700	
(2) As reported	5,288	34,700	
(3) Corrected	1,888	30,000	
Remarks			
Examiner's Signature		Area Office	Date

# 8.17 Settlement Computations and Statutory Notices of Deficiency

Exhibit 8.17.5-1 (Cont. 1) (07-15-2011)  
Settlement Computation for Partnership on Form 4605-A

Form 4605-A	Department of the Treasury - Internal Revenue Service Examination Changes - Partnerships, Fiduciaries, S Corporations and Interest Charge Domestic International Sales Corporation (Unagreed and Excepted Agreed)
Form 4605-A (Rev. 12-2010)	



**Exhibit 8.17.5-2 (11-02-2007)**

**Format — Computation of Corporation Contribution Deduction and Carryovers**

SCHEDULE	
Name:	Taxable Year Ended
1. Taxable income previously determined.	
2. Add (Subtract) Net adjustments (other than contributions) per this statement	
3. Add:	
(a) Contributions previously allowed	
(b) Dividends received deduction	
(c) Partially tax exempt interest	
(d) Dividends paid deduction. IRC 247	
(e) Net operating loss carryback	
4. Taxable income for computing limitation on contribution deduction	
5. 10% of line 4	
6. Contributions for current year	
7. Excess of line 5 over line 6	
8. Contribution carryover from prior years	
9. Contributions carryover allowable in taxable year (smaller of line 7 or 8)	
10. Line 6 plus line 9	
11. Allowable contributions (smaller of line 5 or 10)	
12. Unused contributions for taxable year (line 6 minus line 5)	
13. Contributions carryovers from prior years not used in taxable years (line 8 minus line 9)	
14. Total of lines 12 and 13	
15. Unused contributions carryover not allowable as carryover to next year	
16. Contributions carryover to next year (line 14 minus line 15)	

## 8.17 Settlement Computations and Statutory Notices of Deficiency

### Exhibit 8.17.5-3 (11-02-2007)

#### Settlement Computation with Claim of Right Computation

SETTLEMENT COMPUTATION WITH CLAIM OF RIGHT COMPUTATION			
Computation of Overassessment for Tax Year Ended 12/31/1996 due To Application of IRC Section 1341 on Income Reported in 1994			
Tax shown on 1994 return			246,500
Taxable income shown on 1994 return			725,000
Add:	Adjustments to taxable income shown in notice of deficiency dated 01/27/1997	50,000	
Deduct:	Adjustments to taxable income shown in the settlement computation.	<u>35,000</u>	<u>15,000</u>
Taxable income as adjusted			740,000
Income tax liability on \$740,000 shown in settlement computation for 1994			251,600
Taxable income for 1994 as adjusted		740,000	
Less:	Exclusion of amount restored	<u>50,000</u>	
Taxable income for 1994 by applying Reg. Section 1.1341-1(b)(1)(ii)		690,000	
Tax on \$690,000			234,600
Decrease in tax for 1994 by applying Reg. Section 1.1341-1(b)(1)(ii)			<u>(17,000)</u>
Tax liability for 1996			7,500
Tax liability for 1996 return			<u>500</u>
Statutory Deficiency for 1996			7,000
Decrease in tax for 1994 under IRC Section 1341 *			<u>(17,000)</u>
Net Tax (Overassessment)			(10,000)
* The decrease in tax for 1994 is treated as a refundable credit adjustment, as if it had been paid on the last day prescribed for payment of the 1996 tax.			

## Exhibit 8.17.5-4 (03-07-2014)

## Form 3610 with Adjustment to both EIC and Withholding Credits

<b>Form 3610</b>	<b>Department of the Treasury - Internal Revenue Service</b>				<b>Symbols:</b> <b>XX:XX</b>
<b>AUDIT STATEMENT</b>					
Name of Taxpayer John and Mary Doe			SSN/EIN:	Date Prepared:	
Kind of Tax Income			Docket Number:		
DEFICIENCY (OVERASSESSMENT) (Increase or decrease in Tax and Penalties)					
Tax Year Ended	Statutory Deficiency				
12/31/2008	1,273				
Interest for (year) will be computed under _____ of the Internal Revenue Code.					
The deficiency shown above for (year) does not take into account a payment of \$_____ made on (date).					
Statutory deficiency					1,273
Refundable credit adjustment:					
Correct refundable credit (withholding)				1,495	
Credit claimed on return				<u>868</u>	
Increase in refundable credit					<u>627</u>
Net Underpayment					646
					=====
Form 3610					

**Note to TCS or AO :** In this example there is a \$60 decrease to earned income credit (EIC) included in the statutory deficiency amount of \$1,273. Form 3610 is not required for a case with adjustments to refundable credits that are included in the statutory deficiency such as EIC since adjustments to those credits are shown on Form 5278 and on the Form 5403 Worksheet. However, if a Form 3610 is prepared, there is no special format required for adjustments to refundable credits that are included in the statutory deficiency such as EIC. A special format is required for the withholding credit adjustment when Form 3610 is prepared, as shown above.

## 8.17 Settlement Computations and Statutory Notices of Deficiency

**Exhibit 8.17.5-5 (09-24-2013)**

**Alternative Format for Form 3610 with Adjustment to Both EIC and Withholding Credits**

<b>Form 3610</b>	<b>Department of the Treasury - Internal Revenue Service</b>			<b>Symbols:</b> <b>XX:XX</b>
<b>AUDIT STATEMENT</b>				
Name of Taxpayer John and Mary Doe			SSN/EIN:	Date Prepared:
Kind of Tax Income			Docket Number:	
DEFICIENCY (OVERASSESSMENT) (Increase or decrease in Tax and Penalties)				
Tax Year Ended	Statutory Deficiency	Increase in Refundable Credit	Net Underpayment	
12/31/2008	1,273	627	646	
<p>Interest for <u>(year)</u> will be computed under _____ of the Internal Revenue Code.</p> <p>The deficiency shown above for <u>(year)</u> does not take into account a payment of \$_____ made on <u>(date)</u>.</p>				
Form 3610				



# 8.17 Settlement Computations and Statutory Notices of Deficiency

## Exhibit 8.17.5-6 (Cont. 1) (09-24-2013)

### Refund Litigation Case Settlement Computation

Form <b>5278</b> (Rev. June 2004)		Department of the Treasury - Internal Revenue Service <b>Statement - Income Tax Changes</b>		Schedule <b>1</b>	
1. Name(s) of taxpayer(s) <b>John Q. Tax and Mary Tax</b>			2. <input type="checkbox"/> Notice of Deficiency <input type="checkbox"/> Other (specify) <input checked="" type="checkbox"/> Settlement computation		
3. Taxpayer Identification Number <b>XXX-XX-XXXX</b>		4. Form number <b>1040</b>		5. Docket number <b>XX-XXXXX</b>	
				6. Office symbols <b>XX-XX-XX-XX</b>	
7. Adjustment to income			Tax years ended		
			1994 <input type="checkbox"/>		
a. Schedule E Expenses			(3,200.00)		
b.					
c.					
d.					
e.					
f.					
g.					
h.					
8. Total adjustments			(3,200.00)		
9. Taxable income as shown in:			44,700.00		
<input type="checkbox"/> Preliminary letter dated _____					
<input type="checkbox"/> Notice of deficiency dated _____					
<input checked="" type="checkbox"/> Return as filed					
10. Taxable income as revised			41,500.00		
11. Tax			6,414.00		
Tax method			Tax Table		
Filing status			Joint <input type="checkbox"/>		
12. Alternative tax, if applicable					
13. Alternative minimum tax (Starting tax year 2000)					
14. Corrected tax liability - (lesser of line 11 or 12 plus line 13)			6,414.00		
15. Less credits					
a.					
b.					
c.					
16. Balance - (line 14 less total of lines 15a - 15c)			6,414.00		
17. Plus other taxes					
a.					
b.					
c.					
18. Total corrected tax liability - (line 16 plus lines 17a - 17c)			6,414.00		
19. Total tax shown on return or as previously adjusted			7,583.00		
20. Adjustments: increase (decrease) to:					
a. Earned income credit					
b. Additional child tax credit					
c. Fuel credits / other					
21. Deficiency - Increase in tax (overassessment - decrease in tax) (line 18 less line 19 adjusted by lines 20a - 20c)			(1,169.00)		
22. Adjustments to prepayment credits - Increase (decrease)					
23. Balance due or (Overpayment) excluding interest and penalties			(1,169.00)		
24. Penalties and/or Additions To Tax (listed below)					
Section 6662 (a) See Schedule 2			(234.00)		
Tax per original return			3,109.00		
Assessment of notice of deficiency			4,474.00		
Tax as previously adjusted			<u>7,583.00</u>		

Form 5278 (Rev. June 2004)

**Exhibit 8.17.5-6 (Cont. 2) (09-24-2013)**  
**Refund Litigation Case Settlement Computation**

***Explanation of Adjustments (Schedule 2) for Refund Litigation Case***

John Q. Tax and Mary Tax	Schedule 2
Explanation of Adjustments	
<b>Penalty Computation - IRC Section 6662(a)</b>	
Revised tax liability	6,414.00
Less : tax per return	<u>3,109.00</u>
Amount subject to penalty	3,305.00
Rate	<u>0.20</u>
IRC Section 6662(a) penalty per settlement	661.00
IRC Section 6662(a) penalty previously assessed	<u>895.00</u>
Decrease in penalty - assessed penalty to be abated	(234.00)
	=====
<b>Assessed interest to be abated</b>	
Interest assessed on deficiency in tax and penalty	1,844.00
Total interest due per settlement	<u>1,362.00</u>
Assessed interest to be abated	(482.00)
	=====





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**C**

<b>Claim of Right .....</b>	<b>30</b>
<b>Contribution Carryovers .....</b>	<b>29</b>
<b>Contribution Deduction .....</b>	<b>29</b>

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**R**

<b>Refund Litigation .....</b>	<b>33</b>
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