How the IRS Operates

Guide 1 of 7 Tax Guides

Robert G. Nath, Tax Attorney

Concentrating in IRS and State Tax Controversy Matters

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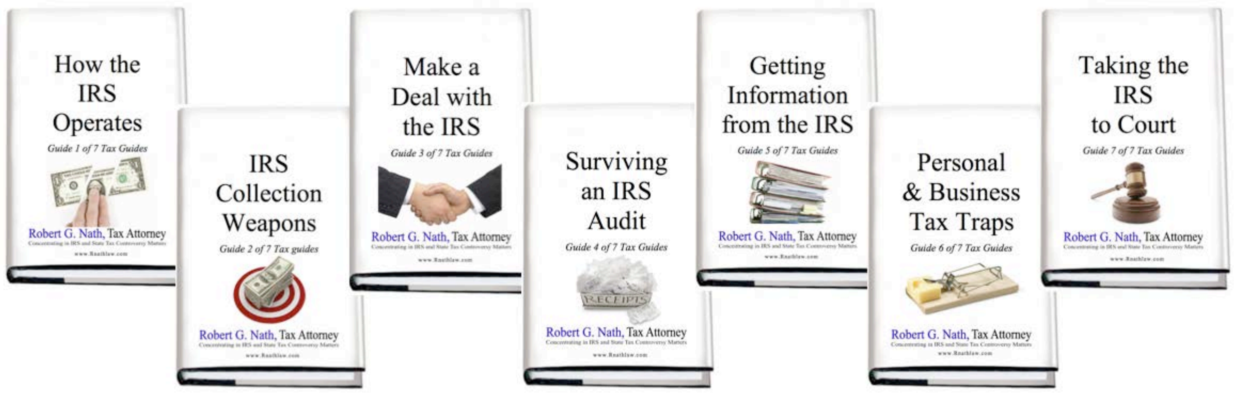

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Written by

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Most of us realize, at least in a general way, that the IRS has extraordinary powers to collect the taxes people owe. Those who face the agency with an audit or collection problem naturally have a more focused sense of these powers. The agency's full arsenal suggests a range of powers people would not ordinarily think should be given to our government, at least not all at once.

But the agency's powers have all been granted by your legislature and mine, the Congress, and the courts have consistently upheld these powers as legal and constitutional – in fact, necessary. While the IRS usually exercises most of its authority with great forbearance, sometimes bordering on reluctance, its powers are available and ready in any case. In this chapter you will learn how the IRS is organized, its vast powers, how it learns all about you and the ways in which it comes to send and collect a tax bill.

The IRS' Draconian Powers

As far back as 1935, the Supreme Court of the United States stated that taxes are "the lifeblood of government . . . and their prompt and certain availability an imperious need."

In other words, the IRS means *business*.

<u>In starkest form, the IRS has the power to</u>:

- Invade your business and seize its equipment and other assets;
- Seize your personal bank accounts without court order;
- Make legally-binding tax assessments, and enforce them, without court order;
- Seize other assets, such as your retirement accounts, insurance policies, even your home;

- Seize one hundred percent of a federal agency's payment to your business, if your business owes employment taxes;

- Sell assets to the highest bidder without your consent;

- Send information about you to the states, Congress, the president, the Department of Justice, and other government agencies, without your consent;

- Adjust your tax accounts, shifting payments among tax years, without your prior knowledge or consent;

- Propose new taxes, impose penalties and interest, and make you sue to contest them;

- Sue you for back taxes, foreclose on property, and even set aside transfers and gifts you have made to others;

- Get virtually anyone to talk to Service agents about your taxes and financial affairs, and obtain any documents that bear on those financial affairs (with limited exceptions);

- In cases of fraud and evasion, or where collection is in jeopardy, terminate your tax year and issue an instantaneous assessment. If you show an inclination to flee, the agency can even obtain a civil writ of arrest.

<u>Against all of these powers, you have a limited arsenal of weapons</u>:

- You can't sue the IRS for an injunction to stop it from assessing or collecting taxes;

- You generally can't sue the IRS to stop it from gathering information, or from revealing that information about you to other agents, other government agencies, even to customers, clients, and friends;

- With certain exceptions, you generally can't stop the IRS from seizing your bank accounts or your other assets, or from selling them without your consent and sometimes without your knowledge;

- You can't sue the IRS at all without the consent of Congress, a consent given in only a few (about ten) types of tax cases.

- However, you can request the IRS to hold off collection action for a period of time.

- You can sue the IRS to contest a proposed tax liability without having to pay it.

Once again, every one of these IRS powers, and your corresponding limited legal capacity to fight them, has been ruled constitutional in thousands of cases. Because of this severe mismatch, if the IRS did not exercise its powers with restraint, in all likelihood Congress would swiftly take them away.

The most recent (and best) example of Congressional oversight is the IRS Reform and Restructuring Act of 1998. Among many other things, this law has severely impacted the IRS' authority to collect taxes with multiple levels of review. For example, before the IRS can seize assets, it must afford you a right to a "Collection Due Process Hearing" at which you can present your case for no collection, or collection alternatives, or even some defenses against the underlying tax.

Moreover, under that 1998 reform act and other provisions you have many rights the remainder of this book will review.

Where It All Came From

After the states ratified the Constitution in 1789, Congress created only four cabinet agencies, among them the Department of the Treasury. For most of its life, the Treasury Department simply collected customs duties, administered the sale of public lands, and managed the federal debt, budgets, and other financial matters. Income and employment taxes were not even on the original Treasury's list of chores-there were no such taxes. Indeed, until the mid-1900's, the Internal Revenue Service did not exist.

Congress enacted the first income taxes during the Civil War as a series of special war measures, promptly repealing them when the war ended. On July 1, 1862, Congress created the Bureau of Internal Revenue, the IRS' predecessor. Another income tax lasted only from 1870 to 1872. But twenty years elapsed before the next income tax was enacted, in 1894, and after a series of court battles, the Supreme Court declared that tax unconstitutional.

The modern taxing system began only in 1913 when Congress passed and the states ratified the 16th Amendment to the Constitution. Even then, only the rich and famous paid taxes. Only in 1950 did Congress brought the modern Internal Revenue Service into being.

What a difference these years make! The agency now has close to 100,000 employees serving a national office, four main, very large functional divisions, in offices all around the country, ten service centers, and numerous computer facilities.

This agency orchestrates a tax system that rakes in more than $2.4 trillion every year, processes more than 2 billion pieces of paper, polices more than 250 million tax returns of 13 main varieties, generates 150 million pieces of correspondence, and performs a host of other functions. The agency has more than 27,000 revenue agents and other tax return auditors, 17,000 revenue officers and other tax collectors, and five thousand special agents (who investigate tax crimes), plus many other employees. In 1967, it cost the IRS 45 cents to collect $100 of taxes. In 2012, that cost was 48 cents per $100 of taxes collected.

The IRS Pyramid

The IRS has always been organized in a pyramid. At the top, the National Office consists of the Commissioner of Internal Revenue and a staff. This office bears overall responsibility for the administration of the Internal Revenue Service.

In 1999, the Commissioner undertook a wholesale shake-up of the agency. This includes a total restructuring of the way the IRS is organized. The idea behind this restructuring was to modernize the IRS, guided by five principles:

- Understand and solve problems from the taxpayer's point of view;
- Expect management to be accountable;
- Use balanced measures of performance;
- Foster open, honest communications;
- Insist on total integrity.

To accomplish these goals and modernize the IRS, a new structure replaced the former regional offices with four functional divisions, each with complete responsibility in its own area. These four groups are:

1. Wage and Investment. This serves about 120 million individual taxpayers with wage and investment income.
2. Small business and self-employed taxpayers ("SBSE"). This division deals with about 45 million owners of small businesses, or self-employed individuals.
3. Large and Mid-Size business taxpayers. This division serves businesses with more than $10 million in assets.
4. Tax Exempt and Government Entities. This consists of employee plans, exempt organizations and state and local governments.
5. There are also the additional important IRS offices: Chief Counsel (the legal arm), Appeals (to resolve cases you can't settle with the revenue officer or revenue agent), Taxpayer Advocate Service (to help with "red tape" and hardship issues) and several other offices.

The real work of the Internal Revenue Service is done in field offices: the nationwide offices and seven service centers.

Functions within the Divisions

<u>Each IRS division has three major functions</u>:

1. examination,
2. collection,

3. and criminal investigation.

The Examination Function audits tax returns. It employs revenue agents and tax auditors. The Collection Function, staffed by revenue officer groups, collects the taxes. The Criminal Investigation Function, using special agents, investigates tax crimes. The Office of Taxpayer Advocate is a section that is supposed to take your side when you are choking on IRS red tape. There is also a Taxpayer Service function that attempts to smooth out administrative problems.

In almost every case, these revenue agents, tax auditors, revenue officers, special agents, taxpayer service representatives, and Taxpayer Advocate officers do the real work of collecting taxes, auditing returns, and performing related duties. These are the officers that you will face when you have an audit, collection, criminal, or other tax problem.

You Can't Hide From the IRS

In almost every IRS investigation, of whatever type - audit, collection, or criminal investigation - the agency needs to know more about you, your family, your finances, your business, and your tax return. Agents use three classes of sources: (1) you, (2) public records, and (3) third-party records and sources. They gather what seems like 98 percent of their information voluntarily, simply by asking you questions. For example, a revenue agent might ask, "What is your justification for deducting medical expenses on Schedule A of your tax return?" The revenue officer wants to know, "Where do you keep your bank accounts, stocks, and bonds?" These and other agents often make their requests in a more formal fashion, such as by an Information Document Request or a letter. In most cases, it's wise to volunteer the information, because the IRS can get it anyway. Things usually go easier if you cooperate.

The second main source of information is public records. Years ago, the late, well-known actor Peter Sellers starred in the movie "Being There." Mr. Sellers played the part of Chauncy Gardener, a childlike housekeeper who had spent his entire life keeping one house. Through a series of errors, Chauncy becomes an adviser to the President of the United States. In the course of investigating Chauncy's background, the President discovers to his surprise that Chauncy has absolutely no history-no tax returns, no military history, no purchase and sale of assets-nothing. He had lived his entire life in one house.

There are no Chauncy Gardeners in America. Almost everyone leaves tracks that become public records. It could be buying a home, filing a court case, getting a government check, earning interest on a bank account, or inheriting property. The IRS has access to public records just like anyone else; agents comb through these records all the time.

The third source of information is third parties. These could be banks, brokers, mortgage lenders, or insurance companies. Customers, clients, friends, relatives, neighbors and employees are also sources.

The law gives IRS agents of whatever job description the widest possible authority to "inquire after and concerning" anyone who may be liable to pay an internal revenue tax. To enforce this authority, the IRS has subpoena ("summons") power. In upholding that power, the Supreme Court has said many times, "The [IRS] may inquire where the law is [being] violated, or merely because he wants assurance that it is not."

The IRS' version of this administrative subpoena is called a summons, used when someone does not voluntarily testify or supply data. The agency resorts to this summons power thousands of times a year. In almost every case, it gets the information, records, and testimony. In fact, you and the third parties the agency summons can be held in civil contempt of court for refusing to obey a summons. Technically, it's also a crime to disobey a summons, though this crime is rarely prosecuted.

The Service's summons power is far-reaching. It extends to any "books, records, papers, or other data which may be relevant" to your tax liability or its collection. Congress chose that language deliberately- it is all-encompassing. It means the IRS can get any corporate record, deed, bank account, or accountants' records, some lawyers' records (where the attorney-client privilege does not apply), and almost anything with a number on it.

Tip: Many people have heard of the new "accountant's privilege," part of the 1998 Tax Reform Act. Don't rely on this. While it may apply in some cases, tax facts are generally not privileged, and if you are about to confess a true tax crime, your CPA will rush you off to a lawyer anyway.

In thousands of cases, the IRS has used this summons power to seize all of these types of paper records, notes, telephone records, computer tapes, etc. Very few defenses exist to the IRS summons. If you are the summoned person, you can plead the Fifth Amendment, but that sometimes does more harm than good and is seldom an effective legal defense. You may invoke a few other privileges, such as the attorney-client or doctor-patient privilege, but these are narrow and easily breached. Beyond these defenses, the IRS can legally force you or some third party to produce virtually any record or document, and to testify about it.

The Tax Collection Officers

The IRS uses tax collection officers at three different levels. First, there is the "notice" level. If you file a return that shows a balance due or your return is audited and you owe more tax, you will get a series of up to five notices. Each is of increasing urgency, instructing you in no uncertain terms to pay. The notice cycles vary from as short as a few weeks to as long as twenty-five weeks. It depends on whether you've had past defaults, what type of tax is involved, and other factors. Beginning in 1997, anyone who owes taxes for a back year will also get an annual statement of the amount still due. You will never see the collection officers who issue these notices; they're all done by computer, automatically, and in the millions from various service centers. The IRS collects billions of dollars simply by sending these past-due notices.

If the notice system fails, your case will then be transferred to the Automated Collection System (ACS). Basically it's a computerized, paperless accounts receivable system. All delinquent accounts, whether business or personal, appear on the ACS computer screens. ACS has call sites all around the country. The collection officers in ACS will call you, your employer, friends, third parties, and anyone else they can think of to get full payment of the taxes. They will also negotiate with you for installment agreements. Failing that, they can and will generate notices of levy on your wages, bank accounts, and other assets, and file notices of federal tax lien. Again, the IRS collects billions of dollars this way.

If the ACS fails to collect the tax in full, or if the case is complicated, ACS will send the case "to the field." That means your case goes to a living, breathing revenue officer in one of the districts around the country.

Revenue officers have many duties, but first and foremost their task is to collect the most money they can in the shortest possible time. They are thoroughly trained in collection techniques, including how to locate you and your assets, how to interview you, and when to take strong action. They know how and when to seize assets, when not to, and when to negotiate with you. Still, they are terribly overworked. Depending on the amount owed by the taxpayer, revenue officers may have between forty and one hundred cases to pursue at any time. Their inventory is constantly high. When they close one case, new cases flow to them from the Automated Collection System.

Cases are assigned to revenue officers according to a priority system. If you owe $500 for one year, that will receive low priority. If you owe $100,000 for five years, that might be a high-priority case.

Revenue officers also investigate “nonfilers,” that is, people who have not filed one or more tax returns that are now overdue (past any extension). Guide 2 discusses the nonfiler in more detail. In cases of nonfilers, revenue officers can persuade you to file the delinquent return, make one for you, or refer the case for criminal investigation.

Revenue officers all go out into the field to collect the taxes. They have ample authority to investigate your personal and business affairs. Toward that end, they may ask you to complete financial statements, narrative statements about your business, and other documents. They can investigate your business to decide whether your workers are employees rather than independent contractors, making your business liable for the payroll taxes attributable to these workers. In the case of a business that has defaulted on its payroll taxes, they will investigate whether you are personally liable for a portion of those taxes. (See Guide 2.)

To collect your back taxes, these revenue officers have the authority to seize any property you or your business owns. The process is easy. They simply send a notice of levy, affix a notice of seizure to the property, or haul it away. They also have the authority to sell noncash assets and apply the money to your back taxes.

Tip: The 1998 Tax Reform Act put a big dent in the authority of revenue officers to seize and sell assets. But these new roadblocks, even when you exercise them, will usually serve to slow the IRS down, not to stop it completely.

It's these powers that make the tax collection system so credible. When you make an offer in compromise, request an installment agreement, or seek relief from a tax lien, you are required to deal with revenue officers and offer examiners (who are sometimes former revenue officers). When you have not filed a tax return, revenue officers can recommend that you be prosecuted, or, if not, they can file a return for you, and then file a notice of tax lien to "protect the revenue."

The Tax Auditors

Internal Revenue Agents and Tax Auditors of the examination function audit income and other tax returns of businesses and individuals. Like revenue officers, these agents have the summons power. They can also propose more taxes, penalties, and interest. You are usually stuck with their figures unless you can persuade a higher office in the IRS or a court to change them. And in all of these dealings, the burden of proof is usually on you.

The Criminal Investigators

Special agents of the criminal investigation function investigate eleven main types of tax crimes, and related offenses (about thirty tax and nontax crimes in all). Tax evasion, false statement, and failure to file a return are the most common. Special agents, too, have the summons power. They never hesitate to use it when they meet resistance. Special agents conduct raids, seize records and monies, trace assets, and arrest people who try to interfere with any other agent of the IRS.

The Office of the Taxpayer Advocate

The Office of Taxpayer Advocate has branches all around the country to help when you run into a bureaucratic brick wall. They are like ombudsmen, slashing through the red tape, taking your side in cases of extreme hardship, and performing many other useful, protaxpayer functions. Guide 3 discusses what they do and how they may be able to help.

These are the people you will usually meet when you have an IRS problem. They know their jobs; they know their power and authority. To contend on an equal footing with them, you also need to know your rights and powers and use them wisely.

How the IRS Assesses a Tax

The end result of an audit is a tax bill. The beginning of a collection case is also a tax bill. Since most confrontations with the IRS are about money, that tax bill assumes critical importance. Understanding that tax bill is the first step to dealing effectively with it. Sometimes these bills seem to strike out of the blue. Other times you'll see them coming but be unable to duck. The amounts can be a total surprise, and many people have difficulty comprehending these bills.

The Plain Vanilla Bill

By far the most common type of bill is the one you get if you don't pay the tax due with your return (called a "balance due" return). When you send your return to one of the seven regional service centers, someone opens the envelope, unfolds the return, and scans it manually or by machine into a computer. The agent enters your name, other identifying data, and key income and deduction items. Electronically filed returns are "entered" automatically.

Tip: The 1998 tax reform act strongly encouraged the IRS to get people to file electronically. In fact, electronic filing is a true blessing if done right. It greatly reduces errors, speeds your refund, and in general, makes it less likely that the IRS will bother you on small mistakes. Electronic filing is catching on more and more.

The agent punches the numbers into a huge data bank called the "master file." Everyone has an "account" in the master file. More than 140 million accounts track individuals; 40 million accounts track businesses in the "business master file." The master file contains a running balance of all your transactions, plus and minus, year by year. Master file records go back a minimum of ten years. So, when you send in a return, your own individual master file account will record the transaction as "return filed and liability assessed." The IRS codes this and other transactions with a three-digit number, such as "150" for filing a return or “670" for a later payment. The Service has about four hundred different transaction codes in all.

Then the computer enters the amount you pay with the return and a code, "payment with return." It will already have noted how much withholding is credited to your account. If you have paid everything, the balance in that year's "module" will be zero. If you have overpaid, the computer generates a refund check. An underpayment generates a notice of tax due. All of this is automatic. It could not be done any other way, because the IRS keeps track of more than two hundred million tax returns. The Service is constantly changing the number and frequency of these notices. Legislation in 1997 and 1998 also requires the IRS to send additional notices of tax due, and to change the notices to be clear, plain, and non-technical.

If you owe a balance, you'll normally get up to five notices over as many as twenty-five weeks (sometimes fewer). The first will be a Request for Tax Payment. The second, third, and fourth are more insistent. The fifth, sent by certified mail, is a Final Notice of Intent to Levy. That legally required notice means the IRS can start seizing your assets thirty days later. And the agency means business. When the thirty days have run out, the next thing you know, your bank account has been seized or your wages levied.

Tip: It's therefore crucial to check the accuracy of these payment-due notices as soon as you get them. If they're wrong, call and write to the IRS to make the corrections or to notify the system of an error. The form itself contains clear, well-written instructions. Don't wait for that last notice.

If there’s an error, call the toll-free number to alert the agent and his or her computer that you believe the bill is incorrect, so the IRS won't seize your property. Your follow-up evidence normally completes the correction process. Always make note of the person(s) to whom you spoke, and when. IRS agents are required to state their name and ID number.

This balance due notice is the most basic type of bill. There are some permutations. If you have a credit or refund on file from a previous year, the IRS will absorb that first, then bill you for the rest or generate a refund. Another variation occurs when a business loses money. The law allows the business to carry that loss back several tax years. That "net operating loss" is a valuable tax asset.

Paying even the basic, plain vanilla tax bill can be complex. What if you have moved, as millions of people do every year? There's no way the IRS can keep track of every move. Besides, it is up to you to tell the Service where you have moved.

Tip: Use Form 8822, which the IRS now routinely sends with balance due notices. If you file a tax return from a new residence, the IRS computers log in your new address. But they do not routinely or quickly check back to prior years. There are many slips. You are always better off being proactive: use the official form to notify the IRS of a move. If you don't, calls, notices, and levies may go unanswered, and you will be hard-pressed to undo them. The IRS has complied with the law by notifying you (at the last address it knows) before seizing assets-even if you never receive the notices.

These balance due notices also show accrued interest and penalties. The first may tell you how the penalties and interest are calculated, but after that, other notices just tack "accruals" onto the last balance.

Tip: You can learn the breakdown of tax, penalty, and interest by asking for a transcript of your account from any IRS office or calling the nationwide toll-free number, 1-800-829-1040.

Remember also the magic of daily compounding. Interest on your tax bill is compounded daily on everything: the tax, the penalties, and the interest. You are in fact paying interest on interest; it's all perfectly legal. Daily compounding raises the effective IRS interest rate by more than 1 percent. If you throw in the typical penalties, you're often paying an effective "interest" rate of more than 20 percent.

Everyone knows that the IRS receives billions of documents every year. Its computers now match your Forms W-2 to your income tax return. The computers also match dozens of other type of reports. These might include Forms 1099 for interest, dividends, and miscellaneous income, and many others. The IRS even matches information from state governments.

If there is a mismatch between one of those forms and your return, the IRS will send you a notice. Even scarier is the case where the IRS finds you have received income, but it does not detect a filed return. That makes you a "nonfiler," discussed in chapter 7. This "matching" bill works the same as any other. Either you pay it, or the IRS will assess it and attempt to collect.

The Audit Bill

The second most common type of bill is the one you get following an IRS audit. If you and the agent agree on the audit results, you sign an agreement form and the agency sends you a bill four to six weeks later. These are relatively straightforward, at least if you have understood the audit itself. The bill will usually recite the tax, penalties, and accrued interest to some date near the expected date of payment. Interestingly, these audit-related bills sometimes do not find their way to the master file.

Applying Your Tax Payments – The "Voluntary Payment" Rule

Many times you will get a bill that seems to have no rational connection to what you think you owe. (The only consistent feature is that the bill exceeds what you think you owe.) This can happen because the IRS has applied your payments to some other tax bill or to interest and penalty first, before applying it to taxes as you intended. Like any other creditor, the IRS applies payments in its own best interest. The IRS manual tells the technicians to apply the money to the oldest liability, first to tax, then penalties, and last interest.

To avoid this problem, you may "designate" your payment, a simple procedure to tell the IRS where you want the money applied. The agency must honor your request as long as the payment is voluntary, hence the name "voluntary payment" rule. In this context, "voluntary" means (1) you are paying outside bankruptcy, and (2) the IRS has not levied the money you are paying.

Tip: Designating a payment is straightforward. In the memo portion of the check, write (for example) "Apply to tax year 2009, tax only, Form 1040, SSN: (for example) 123-45-6789," or any other instructions on how you want the money applied. It also helps to send a cover letter with the same instructions. Just be sure your designation is crystal clear and as simple as possible.

Designating your payments can often save you big bucks. Let's say you owe taxes for 2000 and 2004. You intend to file bankruptcy in 2005 to discharge the taxes from 2000 (see chapter 13, "The Bankruptcy Alternative"). You send in the payment, instructing the IRS to apply it to 2004, the tax for which is not dischargeable if you file bankruptcy in 2005. Undesignated, your payment would have been applied to the 2000 tax, leaving the full liability for 2004 unpaid even after you discharge 2000's remaining taxes in bankruptcy.

A variation of the voluntary payment rule is the designation on Form 1040 itself. People who overpay their taxes during the year can check a box to apply the resulting refund to the next year's taxes. But if you owe a back tax, the IRS' computers will offset your overpayment against any other tax you owe regardless of the voluntary payment rule. So far, the courts have sustained the IRS on this issue.

Nonfiler Assessments

IRS studies estimate that between five million and ten million people have not filed one or more tax returns. (Chapter 7 discusses the nonfiler.) That's an astounding number for a system that supposedly depends on voluntary compliance, but it rings true in actual experience. While nonfilers come in from the cold all the time, each year's filing deadline creates new ones or extends the delinquency of others. It is not unusual to see three to six years of nonfiling; ten to fifteen years is not unknown.

When the IRS catches a nonfiler, it can (1) prosecute, (2) assess and collect, or (3) both prosecute and assess and collect. Mostly, the agency just wants people to file and pay, so usually it won't prosecute. Instead, the agent opens a case file for you for each year of nonfiling. Then, if you don't file quickly on your own, the agent makes a Substitute for Return rather than a true return. She starts with a blank Form 1040 or 1040A for the year involved. She fills in your name, address, and Social Security number, then opens an account in the Individual Master File for that tax year. The agent then "audits" the blank return. Gross income will consist of anything the agent can find that you received. Usually the income figures come from bank accounts, W-2 and Forms 1099, or any other source of income.

How about deductions? The IRS will give you one exemption-yourself-that's all. It will also give you a standard deduction, but nothing for itemized deductions, even if it knows you have some.

In other words, the IRS makes all assumptions against you and in its favor, and then generates a proposed tax bill from the result. You have the right to contest that bill, but you must go to court to do so (or request "audit reconsideration" - see Chapter 8 and below). If you don't-and most people don't-the computer generates the tax assessment and the IRS comes after you to collect.

Despite the apparent arbitrariness of such a bill, you can still fight it. To do so, file true returns, request reconsideration of your bill, and make arrangements to pay the true tax. You'll not be excused from penalties unless you show reasonable cause (see chapters 5 and 18), but at least your tax bill will be lower than the one the agent generated.

The Unknown "Assessment from Hell"

Sometimes, the IRS sends a bill no mortal can decipher. The dates are wrong, the amounts are wrong. It gives little clue as to what the IRS is really upset about. For these bills, rare as they are, you must take action right away. Spend no time thinking about it or questioning whether you might have owed some tax in a past life; analyzing the "Tax Bill from Hell" should not be an out-of-body experience. Immediately call the nationwide toll-free number (1-800-829-1040), identify yourself, and ask what the bill is all about. Get as much information as you can. If you can figure out why the IRS sent the bill, you can deal with it. But if you can't, take the next step. Call the Office of Taxpayer Advocate. They're on your side in cases like this; they help willingly.

The goal with this or any other tax bill is to determine whether you in fact owe all of the tax, penalties, and interest for which you have billed. If you don't owe, you'll need to assemble any evidence you have and send it to the IRS for reconsideration. If you do, the IRS will force you to make arrangements to pay it.

How Long Can They Chase You?

The basic rule is: the Service can audit you for three years, and collect for ten. Of course, if you don't file a return, there is no statute of limitations. (See Chapter 8 for further discussion of the audit statutes of limitations.

The normal collection statute is ten years from the date the IRS "assesses" the tax, that is, sends your bill. Note the big difference between assessment and collection. Let's say the IRS assesses more tax on the deadline - three years after you file your return. The collection period starts then and lasts ten years from that date. So you may be living with this IRS problem for thirteen years.

It can be even longer if the period of limitations for assessment or collection is extended. For instance, if you file an offer in compromise, the statute of limitations on collection is extended for the time the offer is pending, plus 30 days. So you may decide not to file an offer if you are already close to the deadline. The ten-year collection statute is also suspended anytime you or your assets are in the custody of a court, plus six months. This concept includes bankruptcy or receivership. So filing for bankruptcy stops the tax collection period until the bankruptcy is over, plus six months. That's the trade-off the law exacts for keeping the IRS at bay under the bankruptcy laws. You also extend the collection period when you file an emergency Application for a Taxpayer Assistance Order (Form 911). (See chapter 14.) The extension is the price you pay for quick intervention to avoid a harsh collection result. If you contest an IRS levy or and IRS lien, as allowed under the 1998 Tax Reform Act, again the statute of limitations on collections is suspended.

If you stay outside the United States for a continuous period of six months, that action also suspends the collection period. It starts running again when you return to the United States. Many times taxpayers extend the collection period by written agreement, called a waiver (Form 900). The Service asks for this waiver for many installment agreements that would otherwise last past the ten-year deadline. Finally, the government can also take legal action to extend the ten-year period by suing you in federal district court to reduce the tax assessment to a judgment (Chapter 16). If the government wins, the tax lien is extended for more years, depending on your state's law governing such judgments.

Final Tips

- Always respect the IRS' powers, but don't be overawed by them. Understand the audit and collection process.
- Question every bill that does not seem right, and request back-up and detailed calculations.
- Meet all deadlines, for more information, or advise the IRS that you cannot.
- Seek help from a professional or the Office of Taxpayer Advocate in an emergency situation.

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Why You Have Problems with the IRS

The IRS "Menus" for Audits and Collection…
You do have Defenses – Some of Them Even Work…
Do You Need a Tax Professional?...
The Care and Feeding of Your Tax Pro

Tax Problems Big and Small

Americans have always had a love-hate relationship with taxes. We hate paying them, but in general love having the federal government around. That doesn't mean we eagerly pay for the details of government, but Americans certainly love having one.

But the affair is not direct and personal. The link between what you pay and what you get for your tax money is indirect and diffuse. You pay into a large pot (the federal budget) but you get little immediate satisfaction. It's not like buying a suit, paying for advice, or going to a restaurant. If you do those things and don't like the results, you can complain, maybe get a refund, or pick a different restaurant. With taxes, it's different. Don't like the defense budget? Too bad, as many war protestors found out when they excluded some tax payments during the Vietnam War. Outraged over $900 hammers the government could buy for $3 off the shelf? Write your Congressperson, but you can't stop paying taxes.

So, on the philosophical level, people have problems with the IRS because taxes are ultimately coercive, not consensual, and because they can't clearly see the direct benefit for the hard-earned dollars they pay. The built-in resentment against paying taxes means nobody pays them joyfully or willingly. You simply don't control your tax dollar in any meaningful way.

On a more practical level, <u>this clash of interests makes for problems with the IRS over two general issues</u>:

1. Do you owe them money?

2. If you owe it, can you pay it all?

For the vast majority of us, the answer to both of these is yes. You owe the money by filing a correct tax return. You pay the taxes through the withholding system or estimated tax payments. Your problems with the IRS arise when either of these questions is answered "No."

<u>And the problems persist because</u>:

1. The IRS generally interprets the tax laws in its own favor, therefore resulting in more taxes on audit.

2. The IRS collects taxes in its own favor, resulting in coercion and, on rare occasions, oppressive tactics. The IRS always has the iron fist inside the velvet glove.

3. The tax rules – both substantive and procedural – are sadistically complex. And, they change just about every year. The current tax code is over 3,000 pages long. And, we're not talking about "large type" versions either.

   <u>Fun Fact</u>: Try this exercise. Find a copy of the code or go to irs.gov to locate one. Then pick any section, at random, and start reading it out loud. To anyone but a tax professional, it's likely to sound like a foreign language.

4. Record keeping for return preparation and audits is a nightmare, and people are distracted from good record keeping by everyday events in their normal lives.

5. People are often sloppy about record keeping; this important task is simply not that important in their daily lives for many things, especially for taxes. Yet, the law holds us all accountable, and requires us to keep certain records, sometimes for many years beyond what you would consider appropriate.

All of these themes result in problems big and small for many Americans. Others who never cross the IRS' gun sights get headaches nonetheless because of the effort involved in staying out of range. To paraphrase Winston Churchill's famous comment about democracy, our tax system is the very worst type ever invented – except for every other form of taxation.

Menu Choices Big and Small

Our tax system has been described as both coercive and cooperative at the same time: coercive because the IRS can throw you in jail for tax evasion and seize assets without your consent; cooperative because if even a small percentage (estimated around 10 to 20) refuse to cooperate openly, the system would quickly some crashing down. The United States Supreme Court, recognizing this feature, has stated, "There is coercion to be sure, but basically the government depends on the voluntary acts of citizens."

For all of these reasons, a large number but relatively small percentage of Americans has problems with the IRS, and the rest of us simply try to keep a low profile.

Despite the problems, Americans do have choices, even within this ultimately coercive tax system of audit and collection. Picture yourself going out to eat. The waiter brings a menu; you select an appetizer, main course, and later a dessert. The waiter may regretfully say, "Sorry. That

menu choice is not available. Please choose another." With any luck, the choices are to your liking and you leave satisfied.
Dealing with the Examination or Collection functions of the Internal Revenue Service is something like dining out (though nowhere near as tasteful or satisfying). Still, it's often a pleasant surprise to discover how wide an array of choices the law and IRS procedures allow to manage your back tax bill. The choices became even more varied with the enactment of the 1998 Tax Reform Act, a law that contains several taxpayer-friendly provisions.

It's simply not the case that you must always pay in full, and immediately, or go to debtor's prison. The tax audit and collection "menu" has powerful choices that apply to almost every tax debt, business or personal. You can choose one "course," then another, or a combination. You can start with one, then switch to another.

Sadly, many people resign themselves to no menu at all; they believe that whatever the IRS says, goes. It's just not so. Knowing the full range of choices, and how and when to make them, can give you true power in an otherwise one-sided contest.

Of course, the IRS also has a menu of choices it wants to impose on you. Like you, agents of the IRS can make one or more choices, or select them in combination.

Naturally, your selections may be radically different from the choices the IRS makes. The key to survival is to understand your options, choose wisely, understand the IRS' priorities and prepare to deal with them. True enough, the IRS has great power to back up the choices on its menu, but with some exceptions the Service restrains the use of its own power.

Your Audit “Menu”

Let’s see what’s on the menu today where the IRS examines (“audits”) your tax return.

1. <u>Contest the audit right away</u>. You don’t have a choice on whether you’re audited, only the tactics to use when you are. You can cave in to the agent’s proposed new taxes, or fight the audit at that level. You’d be surprised how often agents will make favorable adjustments or decisions, though clearly they usually side with their employer.

2. <u>Fight, then appeal</u>. After you’ve contested the audit, not all is lost. You have a number of procedural rights within the IRS. First and foremost, you can appeal. Chapter 10 discussed this in detail. In theory, the Office of Appeals is a neutral IRS office whose job description reads: “Settle this case if you can.” In most cases, that’s exactly what happens.

3. <u>Go to court</u>. You don’t have to give up even if you “lose” at appeals. You can fight the IRS in court even without paying the tax. Chapter 15 explains this option. You can also pay the tax and fight in a different court (Chapter 16). In both of these courts, the judges are even more “neutral” than the IRS Appeals Officers. They call ‘em as they see ‘em. To the extent taxpayers lose in these courts, it’s often a function of the bias in the law itself

against taxpayers and in favor of the IRS, or a failure of proof on the taxpayer, who almost always has the burden.

You can also mix and match your audit menu choices. You can tell the IRS you want to go directly to court from the audit level. You can settle some issues and take the rest to court. You can give up some, trade others, and so forth. This flexibility within the audit system gives you plenty of opportunity to make your case. But in the end, when you've made your choices, you may end up with a tax bill that has to be addressed. That's where your "collection menu" comes in to play.

Your Collection "Menu"

The collection menu has even more choices.

1. Pay in full within thirty days. Some people who owe a back tax debt can quickly pay in full: sell a stock, or bond, or borrow money. Sometimes they may have to take the painful step of liquidating a retirement account they've been nurturing for many years. When the IRS catches them, they may reason, "OK, you got me; it's worth any price to get you off my back." The stimulus of a single call or letter is often enough to spur the writing of a check. Other times, people may need to sell something quickly to pay in full. The IRS motivates millions to pay billions simply by asking.

2. Pay in full-over time. If you can't pay in full right away, the installment agreement comes in handy (see chapter 12). True enough, the accrued interest and penalties make for financial torture, but at least you'll be able to see the end. While installment agreements can last an extremely long time, the IRS normally looks for full payment in 36 months, or 60 months at most. If you stay within those time limits, you'll have room to negotiate the details.

3. Pay part now, pay part over time. You liquidate some assets, but still can't pay the tax in full. So the Service lets you sell the stock or bond, cash in a retirement account, or borrow $5,000 from a rich and very nice uncle, then pay the rest by installments. This combination may or may not be your best choice to get the IRS off your back, or it may be that the IRS forces it on you, but it's on the menu as an available option.

   Sometimes, if you need the time to pay, you can force the IRS to accept this menu choice. The most important way is through a bankruptcy such as a Chapter 11 or Chapter 13 reorganization. (These names derive from chapters of the Bankruptcy Code.) In these types of bankruptcies, you are essentially asking the bankruptcy court to approve a long-term installment agreement, sometimes up to five years. The IRS will often agree to your plan, or have little realistic choice but to go along. Still, bankruptcy should never be lightly chosen. It ruins your credit and has other negative effects as well. Chapter 13 of this book details the how and why of tax bankruptcies.

4. Pay in part, write off the rest. Does the IRS actually write off a debt? Yes, through the offer in compromise program. Chapter 11 explains this option. Convincing the Service to

accept an offer can be difficult, especially if you try to "do it yourself" without professional help. But if you succeed, you normally end up paying only a fraction of what you owe. The national average is about thirteen cents on the dollar for accepted offers. This means the IRS gives up nearly 90 percent of claims it compromises (on the average). Why not choose this menu option right away? Usually, it's because the IRS thinks you can pay more than you will offer, or you can pay in full now or over time. Its job is to try to collect to the max-quickly! Still, consider whether you may be eligible for an offer in compromise. Still, in fiscal 2009, only 11,000 offers were accepted out of 52,000 filed.

5. Pay nothing. The expression, "You can't get blood out of a turnip," applies in the world of IRS collections, too. In fact, the IRS classifies so many taxpayer delinquencies as "currently not collectible" it even has a form and a verb (Form 53, and "Let's 53 this case"). The IRS shelves these accounts for six months, a year, or more. The Service can revisit your account, but often it does not. Whether "currently not collectible" status is desirable is another story. The federal tax lien stays in place. Interest and some penalties continue to pile up. The tax debt can last for up to ten years, sometimes longer. You are also subject to periodic reviews to see whether you are still as poor as before.

6. Reduce the amount you owe, then deal with the rest from the other menu choices. Sometimes you can actually reduce how much tax you owe. The clearest example is the tax audit. The IRS proposes more taxes in an amount approximating the national debt, but you contest that proposal within the IRS and in court. Another example is "audit reconsideration." (See chapter 8.) You ask the IRS to reconsider an unfavorable audit result either because it is wrong or because the agency failed to consider some evidence. A third type of case involves people who have failed to file federal income tax returns, so-called nonfilers for whom the IRS is authorized to make substitute returns and assessments. These taxpayers can request audit reconsideration if they file true original returns.

   You may also challenge the IRS's computations. True enough, the assessment is usually correct; but not always. Has the IRS correctly computed penalties and interest? Has it applied all of your payments? Has it applied them to the right tax periods? You are entitled to an accounting from the IRS simply by requesting it. Any agent can pull your transcripts to check these items. If you don't understand some of the entries, ask. And, if the agent can't explain an entry that you believe is incorrect, that alone may be grounds for asking for further research to be done or for postponing the payment of the tax until the discrepancy is resolved.

   Finally, you can resort to bankruptcy to reduce your taxes. It's a widespread and tragic myth that you can never eliminate taxes in bankruptcy. In fact, you can. Income taxes are potentially dischargeable in bankruptcy, depending on fulfilling a number of rules. Employment taxes, while not generally dischargeable, can sometimes be negotiated downward once a bankruptcy is filed. Still, filing for bankruptcy is a major step that should never be taken lightly. A host of nontax considerations must be considered as well.

More than one million people file for bankruptcy each year. The IRS is involved in fully one-third of these cases. These statistics give some idea of how popular bankruptcy is, but no one knows how many people are unaware of their right to reduce or eliminate taxes through bankruptcy.

7. Call the boss. You can appeal any collection agent's decision at least one or two levels. Call the agent and state, "I would like to speak to your supervisor [usually called the “group manager”]. Please give me his (or her) name, title, and telephone number." If two levels of appeal do not work, sometimes you can launch a flanking attack by appealing to the Office of the Taxpayer Advocate. Chapter 14 discusses this topic in detail.

8. Sue. Usually a last resort, suing the government over taxes, can reduce your taxes or delay the day of reckoning. It can be downright thrilling if you win, and ecstatic if you also win attorneys' fees. Chapters 15 and 16 discuss the types of lawsuits available to contest taxes, when they are permitted, and the chances of success.

The IRS' "Menu"

Those are your choices. Now let's see what's on the IRS' menu.

1. Pay all-now! First and foremost, the Service wants you to pay in full, right now, on the spot and immediately! In fact, most people can and do pay. Were that not so, the shortfall of revenue would collapse the government like a punctured tire. The IRS is hugely successful in persuading many taxpayers to pay in full, "voluntarily," even if they owe one or more years of back taxes.

2. Pay in full now, involuntarily. Next on the IRS menu is the iron fist inside the velvet glove. The agency has vast and potent enforcement powers by which its agents can seize and sell assets. Few of your assets can elude its grasp. The IRS wants people to pay voluntarily, but does not hesitate to use its enforcement powers in many cases.

3. Pay in full - soon. The Service can and will give you extensions of time to pay, within reason (its reason). As a rule of thumb, three to four months is about as long as the IRS will give you to pay in full without making some other arrangement like an installment agreement. Installment agreements of up to three years are common. Often they last even longer.

4. Pay part now, the rest later. Here's a cute combination the Service sometimes uses. It asks you to pay as much as you can now, such as by selling assets, borrowing against them, or borrowing from friends and relatives. Then it asks you to pay the rest over time by an installment agreement.

5. Pay all later: installment agreement. This one is on your menu, too, but it's way down on the list for the feds. (It may be high or low on your list.) The Service disfavors installment agreements; most of them default. However, a workable one that is paid in full yields the IRS a "profit"-the penalties. Installment agreements stretch out payment to the government and prolong the taxpayer's pain-neither a result the IRS normally enjoys.

Moreover, at one time 80 percent of installment agreement payers defaulted before final payment. Why? People lose their jobs, expenses increase, or the installment amount was set too high to begin with. Still, the IRS grants several million per year; these agreements raise billions of dollars despite the high failure rate.

6. Pay part now, write off the rest: offer in compromise. Officially, the IRS encourages agents to explore offers in compromise, especially if the taxpayer brings up the subject. Officially, the offer is a useful collection tool, that is, an acceptable way for a revenue officer to resolve a case. But in the real world, the wind is shifting against offers. It is hard to persuade the IRS to accept one; the acceptance rate is declining – one out of five in fiscal 2009. When the IRS considers an offer, it's often because there is little alternative.

7. Pay nothing now or later: "currently not collectible" accounts. The Service recognizes reality: some people simply cannot now (and maybe never will) pay their past due tax bills. The IRS will not write off the bill, at least not until the statute of limitations on collection expires (normally ten years). Instead, it will shelve the case as "currently not collectible." The IRS may revisit the case in the future.

8. Sue the taxpayer. The IRS usually views lawsuits to collect taxes as a last resort. Still, it does not hesitate to use this option in many cases. Chapter 23 explains when and how.

Dueling Menus

Your goal is to select menu choices that are best for you and make them digestible to the IRS. This can often be done with a minimum of hassle and pain. Other times a struggle is inevitable. This and other guides available on this site can help you decide on the best way to convince the IRS that your choices of appetizer, entree, and dessert are acceptable.

Rules of the Restaurant

1. Read IRS Publication 594, "Understanding the Collection Process." It's a terrific publication, well-written and evenhanded. It provides an excellent summary of your rights in the collection process. Those rights include the opportunity to reconsider your tax bill, to make an offer, to propose an installment agreement, to engage a representative, and to receive fair and courteous treatment.

2. Deal with your audit or tax bill; meet any deadline. Much as you may want to forget about your audit or bill, the IRS will not. The faster you respond and the more businesslike you are, the better the outcome usually will be.

3. Insist on courtesy and confidentiality. You have a right to fair, professional, and courteous treatment. If you don't get it, call the agent’s boss. Extend the same courtesy to the agents with whom you deal.

4. Use the Problem Resolution Program. If you run into major roadblocks or snafus, often the Office of Taxpayer Advocate can help. The IRS website, irs.gov, contains a list of Taxpayer Advocate numbers and addresses. Also consult chapter 14.

5. Understand your tax bill. The IRS usually calculates your tax balance correctly. But sometimes it makes mistakes. Ask to see the agency's calculations, but don't use this as an excuse not to pay or otherwise address the back tax bill.

6. Put it in writing! Document any significant statements, decisions, or evidence in writing. Send it to the IRS address listed on your tax bill or collection notice. Without fail, keep a copy of whatever you send.

Helping You Get Through It All

Do You Need a Tax Lawyer (Or Other Tax Professional) to Help You Survive All of This?

There's an old expression, "He who acts as his own lawyer has a fool for a client." This motto holds doubly true in tax matters. The tax laws, regulations, and the IRS' internal procedures abound with detail after thorny detail and deadline after hidden deadline. Every day, people "go it alone" miss these deadlines, requirements, and rules, and thereby unwittingly sabotage their own cases. They don’t realize they are committing legal suicide, and when they do, it's often too late for a tax professional to step in and rescue the situation. You don't always need a tax professional; many taxpayers in fact handle their own matters successfully. But your chances of getting the best result are greatly increased if you either know what you're doing or you hire someone who does.

Do You Need a Tax Professional at All?

1. Criminal investigations. In some types of IRS matters, the answer is unmistakably, unequivocally "yes." The best example is the criminal investigation. The moment you find out you are the subject of a criminal investigation, STOP! Call a tax lawyer who concentrates in criminal tax matters. Though this seems like common sense, the IRS counts on taxpayers not to do this. When its criminal investigators, the special agents, come knocking at your door, they want one thing: interview you or, sometimes, seize your records under a search warrant. They already have evidence that you have committed a tax crime; they now want you to confess the essential facts under questioning. Consenting is equivalent to signing your own guilty plea. Feeling intimidated, many taxpayers cave, often spending two to ten hours with a special agent cataloging their crimes (though often they don't think of it as a confession).

   After such an interview, a lawyer's role may be reduced to arguing about how much jail time you should get, not whether you should go to jail at all.

   You have an absolute right to seek legal advice when the special agents come calling, or any other agents for that matter. They understand this right and will not press the point if you insist on getting legal advice. No one can imprison you for seeking legal advice; but the IRS can and will prosecute after you consent to an interview in which you "make their day."

Caution: You may not always know that a criminal investigation is under way. The first sign might be special agents who come knocking at the door. They identify themselves as "special agents of the Criminal Investigation Division" of the Internal Revenue Service, often flashing a gold badge like Sergeant Joe Friday on Dragnet.

So, no matter how busy you are, stop what you are doing and immediately call a lawyer. Not just any lawyer, but a criminal defense attorney experienced in defending IRS investigations.

2. Bankruptcy. Filing for bankruptcy should be done with the assistance of an attorney, preferably one knowledgeable about the tax aspects of bankruptcy. Many attorneys are well versed in the bankruptcy laws and the practices of their local bankruptcy courts, but often they lack deep experience in tax matters, including bankruptcy tax matters. Since that's the reason you're going to them-to get relief from or manage your tax problem-you need a bankruptcy lawyer who knows the rules governing how taxes are treated in bankruptcy. Chapter 13 reviews some of these rules.

3. Civil suits. If the government sues you or you want to sue the government, consult a lawyer experienced in tax litigation. This would be true whether you are contesting a statutory Notice of Deficiency in the United States Tax Court (see chapter 15) or your case proceeds in a federal district court (see chapter 16). It's not absolutely essential that this lawyer be versed in tax matters and procedures, but it certainly helps. Many fine litigators feel uncomfortable handling tax cases. Besides, if you make the right phone calls, you can usually find a tax litigator. The Department of Justice and the Internal Revenue Service graduate dozens of such litigators each year into private practice.

4. Other Civil Matters. Aside from these cases, it's not always obvious that you need a tax professional, or even what type of tax professional. To decide, think about some tax-related tasks and questions. Tax professionals are asked to provide a multitude of services.

   Among these are the following:

   1. Prepare tax return. The most common service accountants, enrolled agents, and some tax lawyers offer. Surprisingly, you need no college degree, nor do you have to pass any test, to be a paid return preparer. The only requirements are that you prepare the return, sign it (as preparer), and be paid for it. Millions of people prepare their own returns each year; other millions rely on paid preparers. If you are a procrastinator (and who isn't, from time to time?), you're unsure of your work, or you just don't have the time, find a qualified, well-trained tax preparer. Starting in 2011, all paid preparers will have to

register with the IRS, and the Service is designing rules on continuing professional education for this purpose.

2. Tax advice on a pending transaction. Thinking about selling a business? Selling a house and reinvesting the proceeds? Collecting disability payments or damages from lawsuits? Divorcing and dividing the assets? The tax impact of these and hundreds of other questions may not be completely clear. You may need competent professional to sort out the tax implications.

3. Getting information from the IRS. You may need a copy of your tax return from a past year. Or, you may need a transcript of your account. A tax professional can help you cut through the red tape.

4. Other disputes. You may get into a fight with the IRS over someone else's taxes. It could be an employee, a customer, lender, creditor, or client. Lien priority contests between the IRS and builders, merchants, banks and financiers are extremely common. A professional's help is often critical in such a case.

5. IRS audit. Do you need a tax professional to help you survive an audit? The answer depends on the type of audit, the amount involved, and other factors. Consider engaging a tax professional for a full-scale field audit or an IRS research audit (formerly, Taxpayer Compliance Measurement Program), as contrasted with a simple correspondence or office audit that you might handle by yourself.

6. Error on past return. How should you handle a mistake on a prior return, such as overstating a deduction or failing to report income? Do nothing? Amend your returns?

   The list of issues and questions where a tax professional's help may come in handy could go on and on. These are only some of the most common.

Should You Then Handle the Matter Yourself?

To decide, consider a few more questions:

1. How comfortable do you feel handling this matter by yourself? The range of answers varies from "completely at ease" to "scared to death." Even if you think you know what you are doing, arcane rules can trip you. Some are so obscure few people know they exist. So check with an expert, even if only to verify your own judgment as to whether you can handle the matter. People who are nervous about their tax issues, whether from fear of the IRS or insecurity about their own knowledge of the tax laws, often exercise clouded judgment, a fatal error in the tax business.

2. Is your regular tax representative qualified to handle your matter? If you have an accountant, enrolled agent, or tax attorney already on board, is she qualified and comfortable with representing you on this matter? Not all tax professionals can handle every type of tax case. Lawyers may feel uncomfortable preparing returns. Accountants may decline to handle a complex audit where evidence is hard to assemble. You'll usually know your representative's comfort level from the start, and if not, it's certainly fair to ask. Tax professionals have an informal referral network, so if yours does not feel up to the task, she usually has people to call for help. Sometimes the help may be a simple "Let me run this one by you." Other times the professional may recommend transferring your case. But you, the client, should never hesitate to pick up the phone and call your own tax professional to ask if she can handle your particular case.

Who Are the Tax Professionals?

There are five main types of tax professionals and, beyond these, others who can represent you before the Internal Revenue Service under some circumstances.

1. Tax attorneys. These are lawyers who have made tax their specialty. All are graduates of law schools, and all have taken and passed the bar exam of at least one state. This law license alone entitles them to practice before the Internal Revenue Service in tax matters. Many such tax attorneys are former IRS or Justice Department (Tax Division) attorneys.

2. Certified public accountants. CPAs have studied accounting in school and have passed a rigorous CPA examination given by each state's society of CPAs. Certified public accountants are trained in all aspects of financial and tax accounting, as well as in tax return preparation. They often represent their clients before the Internal Revenue Service.

3. Noncertified accountants. Like CPAs, noncertified accountants have long and rigorous training in all aspects of accounting and tax return preparation. For one reason or another, they have not taken (or passed) all parts of the CPA exam.

4. Enrolled agents. Enrolled agents have passed a tough IRS examination on all aspects of tax law and tax administration, qualifying them to practice before the Internal Revenue Service. You don't have to be a lawyer or an accountant to take the Enrolled Agent examination, though many enrolled agents in fact have an accounting or legal background or degree.

5. Enrolled actuaries. Like enrolled agents, enrolled actuaries have passed an IRS examination. Their field of expertise is limited to actuarial matters, the mathematical computations underlying retirement plans, pension plans, and deferred compensation plans. It also encompasses estates and trusts and other topics where sophisticated mathematics (actuarial calculations) must be made and defended.

6. Paid Preparers. Starting in 2011, all paid preparers will be required to register with the IRS as a condition of being permitted to prepare a federal tax return.

Most tax professionals, whatever their expertise, will be called upon to perform one or more of the following tasks.

1. Tax audits and tax collection. The professional will need to meet with you or at least confer by phone, analyze your case, and perform any necessary legal research. She must gather the facts and advise you of your rights and choices under the law, IRS regulations, the Internal Revenue Manual, and the vast array of unwritten IRS procedures that permeate the tax audit and collection culture. Sometimes she may call a revenue agent or revenue officer one or more times, write to him to argue your position in the audit, or defend you in collection actions. She will need to document your position legally and factually.

2. Protest. The tax professional who files a "protest" (see chapter 10) needs to meet with you, analyze the facts and the law, develop any more facts required to prove your case, and file a formal document known as a Protest. He may follow this protest with more research, fact gathering, and finally a meeting with an appeals officer at which he argues your case. Then, he may follow this meeting with more work. Finally, he will counsel you on whether to accept a proposed settlement or litigate the matter.

3. Litigation. A tax litigator is usually (but not always) engaged when all else fails and a case must be tried in court. A tax litigator has many tasks, the most important being meeting with you, the client, and your CPA or other tax professional; interviewing you and gathering facts; performing legal research; interviewing witnesses; and preparing for trial. The tax litigator must respond to the IRS' requests for pretrial discovery, including depositions, and prepare to try the case. She will also need to discuss settlement with you and the IRS and, depending upon the outcome of the case, file or defend an appeal.

Finding a Tax Professional

The best way to locate a competent tax professional is by recommendation. Ask around. If you have a regular family or business lawyer, ask her. Inquire of the accountant or an enrolled agent who regularly does your work whether he feels comfortable representing you, or whether you need representation in the first place. If he is not comfortable, maybe he can recommend another. Sometimes it takes two, three, or more calls before you find the right person to handle your case. Ask other lawyers where they would go with a tax problem, including their own.

Some tax professionals advertise in accounting journals, legal periodicals, sometimes the newspaper, the yellow pages, and over the airwaves and now the Internet. Some tax representatives will even seek you out, such as by checking public records at county courthouses for filed notices of federal tax lien or IRS or state court judgments for taxes. Then they send advertisements or canvassing letters suggesting that you might need their services. Bar associations also maintain lawyer referral services and lists. Some tax advocacy groups also maintain lists of recommended professionals.

Regardless of how you come upon a tax professional, the critical issue is whether she can handle the matter at a cost that you can bear. Moreover, in most cases, your tax representative cannot guarantee the outcome. After all, you are dealing with the IRS or a court, which have wide discretion whether to grant you relief.

Choosing an Ethical Professional

All tax professionals are subject to a strict code of ethics and practice. The formal name is Circular 230, which the IRS publishes. Among other things, this code requires tax professionals to be truthful with the IRS, not to misrepresent the facts, and to be prompt in meeting deadlines. Circular 230 also requires practitioners to submit records or information to the IRS promptly upon request and not to interfere or attempt to interfere with the IRS' efforts to gather information.

Practitioners must also exercise "due diligence" in preparing papers for the IRS and in ensuring that whatever they say or write to the IRS is correct. Finally, practitioners must not engage in any "incompetent or disreputable" conduct. And, of course, lawyers, accountants, enrolled agents, and all others must avoid conflicts of interest among their clients.

Lawyers, accountants, and enrolled agents are also subject to other codes of ethics, including those of state bar associations, ethical codes of state CPA societies, and their own, hopefully well developed sense of right and wrong. None of these codes requires tax professionals to take positions against your interest. In fact, most specifically require the tax professional to represent your interests “zealously,” but within the bounds of the law.

The IRS, state bar associations, and state CPA societies receive many ethical complaints every year. Most are not well founded, but some are pursued to the ultimate sanctions such as fines or suspensions from practice. Always be alert to any unethical practice that a tax professional may suggest. Never hesitate to ask, "Is what you're suggesting within the bounds of your ethical codes?" If you get an equivocal answer, it's time to look elsewhere.

Choosing a Tax Professional

Search in stages. First, once you have someone in mind, give her a call. Explain your problem in as much detail as you can, and answer any questions the tax professional asks. Lawyers and (beginning in 1998) CPAs have a communications privilege with prospective clients. So be candid. But also be aware that this privilege is narrow and easily breached.

For instance, you may tell her you own and operate Joe's Bar and Grill, which is delinquent in paying six quarters of payroll taxes. The IRS is knocking at the door, asking questions, threatening seizure. Or, you may be under IRS audit and be completely lost as to what the issues are and how you should handle the audit.

<u>At the very least, ask the following questions</u>, either by phone or when you first meet the representative:

1. <u>Do you need more facts</u> to understand exactly what my problem is? A good tax professional will spot the issues, check deadlines and statutes of limitation, ask a dozen

other questions you hadn't thought to ask, and spot dangers of which you may be only vaguely aware. For example, suppose you've been paying the IRS on a monthly installment agreement for close to two years. You may not realize that you could be eligible for abatement of some of the penalties, but the statute of limitations on claiming a refund of those penalties may expire after two years. Another example: You operate Alice's Restaurant. You receive an IRS levy for wages payable to John, your employee. So far, John has begged you not to pay, and you've gone along with this. The IRS has sent you a "final demand." The tax professional should realize and advise you that you can be liable for not only paying John's wages to the IRS, but also a 50 percent penalty.

Remember: There can be a big difference between answering your specific tax question and solving your overall tax problem. Hire the professional who will solve your problem.

2. Knowledge of related legal issues. The tax professional must know much more than taxes. The best tax professionals know the Internal Revenue Code at a bare minimum. They are also knowledgeable in commercial transactions, financing, loans, real estate, divorce, and bankruptcy, among other legal areas. The IRS' rights and yours often implicate these areas of the law. For instance, your tax professional can't suggest you file for bankruptcy unless she knows whether bankruptcy will discharge the taxes or enable you to propose a viable plan of reorganization.

3. Experience. No tax professional should take offense if you ask about his experience. For example, does he only represent people in court? Handle only audits? Collection matters? How long has the professional been in practice? Ask what percentage of the professional's time is devoted to dealing with the IRS. Find out whether he knows the agents in the local office, and how long he's been dealing with them. Don't be afraid to ask whether he enjoys a good reputation with them. You can be sure that every professional who has had a case or two in the local IRS office has some reputation. You need to know whether it's good or bad.

4. Ask the basic game plan the professional has in mind for your situation. Be prepared with the facts when you interview the professional. Above all, gather the paperwork-yours and the IRS'. The professional will be able to save hours simply by reviewing the papers. With some exceptions, a thorough tax professional usually can explore your goals and how she plans to achieve them even if there are detours along the way. For instance, if you come in with a tax audit problem, you should be advised of the possible outcomes at each stage: the revenue agent's level, an appeal within the IRS, and possibly tax court. If you come in owing $100,000 in taxes, the professional may guide you on what you can expect at each stage, and what the best and worst outcomes might be.

   All possible outcomes may not be knowable at the first meeting. Inevitably, new legal and factual questions arise, but the goals can usually be spelled out. In short, at the end of this meeting, expect to know at least generally where you are going and how you are to get there. In many cases you may come out with a realistic, step-by-step game plan, including the strengths and weaknesses of your matter.

5. Ask yourself <u>whether you have understood</u> what the professional is talking about, in general and in many of the details. If not, question whether that professional is the right one for you. The tax law can be frighteningly complex, but it's not Sanskrit. A good tax professional can explain it to anyone. Albert Einstein once explained the theory of relativity to nonscientists in a short book entitled "Relativity." Therefore, a tax professional should be able to explain your IRS rights and options. Above all, the tax professional will become your legal confidant and your moral confessor. You need to enjoy complete comfort with the relationship.

The Cost! Oy, the Cost!

Most tax professionals charge by the hour; some charge a contingency fee, some a flat fee. (Criminal cases cannot ethically be charged on a contingent fee basis.) While hourly rates are important, it's actually more important to know how much the engagement as a whole will cost, from start to finish, and at each stage. After all, what does it matter if the attorney's hourly rate is $400 if she can solve the problem for a total cost you can handle.

Ask yourself whether you are getting value for your money. Is the expected recovery worth the cost? Remember that tax professionals usually cannot guarantee the outcome of an IRS fight, so you may be faced with spending without the assurance of a good result, only probabilities.

Among types of tax professionals, fees vary widely. Lawyers often charge between $100 and $1,000 per hour, depending upon experience, their firm's practices, their location, and other factors. A lawyer who charges a high hourly rate is not necessarily "too expensive." Maybe that lawyer can accomplish in two hours what another, lower-priced lawyer could not accomplish in ten. So, avoid sticker shock at a lawyer's hourly rate. The cost for the overall engagement may be reasonable given the quality of the result. Accountants and enrolled agents often charge lower hourly rates than do attorneys, but, again, the range can vary considerably. There's no hard-and-fast rule, but accountants and enrolled agents' fees often are between $50 and $300 per hour, sometimes higher. These fee structures may sound high, but even if you are going to handle the matter yourself, you may need just a little guidance or hand-holding, not very expensive even at high hourly rates. It's all a cost-benefit analysis: What are you spending and what can you expect to get in return?

With these principles as your guide, choosing a tax professional becomes easier. Above all, don't delay. The absolute worst course is to stick your head in the sand. Fighting the IRS properly takes time. Moreover, you will surely pass a number of deadlines, whether known to you or not, if you delay.

Relating to the Professional

An astounding level of trust is taken for granted whenever you hire a tax professional to help with an IRS problem. Often it's a person you don't know, or whom you have just met. Sometimes you <u>never</u> meet them. Sometimes the professional comes recommended by someone you trust; other times not. You are about to hand this person <u>your</u> money and much responsibility for your financial life. Always remember that the trust factor is there for *your* benefit. In some ways the tax professional involved in a difficult collection or audit matter is like a father confessor. You can and should tell that person anything and everything that might conceivably bear on your tax problem; let the professional sort out the relevant from the irrelevant. The professional needs to know you, your personality, your tolerance for controversy and difficulty, and many other things before he or she can guide you successfully through the IRS maze. Relate to him or her as a human being as well. After all, they've heard many stories. You may think yours is unique, and perhaps it is. But your lawyer, accountant, or enrolled agent has heard similar ones. The professional you hire is and should be a friend as well as an adviser. Viewing them in this way can almost always be to your benefit. You'll give them more of yourself and get more in return by way of a good result.

Helpful Hints

1. Your problems with the IRS always involve two ultimate questions: Do you owe and can you pay?

2. The tax system gives you ample room for good choices in handling any audit or collection matter.

3. Know those choices and act on them wisely.

4. Find out early if you need professional tax help.

5. If so, choose carefully - then follow your professional's advice and guidance.

About the Author

Robert Nath is nationally recognized as an authority on tax matters. He holds degrees from Yale, the University of Pennsylvania, and Georgetown University. After clerking for a federal judge, Mr. Nath litigated tax cases for 8 years with the Tax Division, U.S. Department of Justice. Since 1984, he has been in private practice advising taxpayers, accountants, and attorneys on tax procedure and controversy matters, as well as representing them before the IRS and in court in tax collection, audit and tax litigation matters.

Mr. Nath is the author of numerous publications, including:

- "The Unofficial Guide to Dealing with the IRS" (Macmillan),
- "Personal & Business Tax Traps Guide,"
- "Getting Information from the IRS Guide,"
- "How the IRS Operates Guide,"
- "IRS Collection Weapons Guide,"
- "Surviving an IRS Audit Guide,"
- "Make a Deal with the IRS Guide,"
- "Taking the IRS to Court Guide."

Mr. Nath's views have been noted in New York Times, the Washington Post, The Wall Street Journal, the Los Angeles Times, Business Week, Money, Kiplinger's Personal Finance and other national business periodicals on tax procedure topics, appeared on radio and television programs, edited professional journals and his articles have appeared in law reviews and other legal periodicals.

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