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Audits, Appeals and Payment Options

What IRS publications deal with audits?

Here are the publications that deal with audits (examinations), appeals and payment options:

Pub No.	Title
1	Taxpayer Rights
3498	Examination Process
3498a	Examination Process (By Mail)
556	Examination of Returns, Appeal Rights
5	Your Appeal Rights, Protest
3605	Fast Track Mediation
594	IRS Collection Process
1660	Collection Appeal Rights
971	Innocent Spouse Relief

These are available for download from our KnowledgeBase at **www.watsoncpagroup.com/kb**.

What types of audits could I face?

There are basically two types of audits: correspondence and field. Correspondence audits are simply mailed letters that the IRS sends to taxpayers requesting more information, adjusting tax returns, etc. Of the 1,564,690 examinations performed for fiscal year 2011 (involving 2010 tax returns), 75% were handled by correspondence (mail).

The other audit is in the field, or face to face interview which makes up the remaining 25% of all audits. The interview can take place in a variety of places- your local IRS office, your accountant's office, your home or your place of business. Sorry, Starbuck's and remote desert areas in Nevada are not acceptable audit locations. To keep the audit out of your business office, you must demonstrate that it would be disruptive to your operation.

What are my chances of being audited?

The IRS has recently released their enforcement and service results for fiscal year 2011 in their review of 2010 tax returns. They remain consistent in some areas yet have increased their visibility in other areas. Here we go-

Income	Examinations	Returns Filed	Audit %	Field %	Mail %
Under $200,000	1,389,836	136,387,547	1.02%	23%	77%
Above $200,000	174,854	4,449,952	3.93%	45%	55%
Above $1M	36,422	291,831	12.48%	56%	44%
S Corps (1120S)	18,519	4,444,154	0.42%		
Partnerships (1065)	13,770	3,434,905	0.40%		
Small C Corps	19,697	1,931,008	1.02%		
Large C Corps	10,459	59,291	17.64%		
Tax Exempt Orgs	11,699	858,865	1.36%		

Notes: For income under $200,000 audit percentages remain consistent since 2006. For those $200,000 to $1 million tax returns, audits have increased from 2.57% to 3.93%. And for those $1 million and higher tax returns, audits have increased from 5.25% in 2006 to 12.48% 2011.

What causes or triggers an IRS audit?

There are several reasons why an audit might fall into your lap:

Random: The percentage of random audits is very low, but still exists.

Computer Scoring: All tax returns are scored by the Discriminant Function System (DIF). Basically the IRS establishes a norm, and checks to see if your tax returns fit the norm. The system also rates the potential for adjustments based on historical data and past IRS experience. In other words, if the IRS has a good chance of putting more money in their pocket based on your DIF score, your tax return goes into the "maybe" pile. Your tax return also gets assigned a UDIF score as well which is the potential that you have unreported income.

The variables and formulas used to determine your DIF score is like the NOC list in Mission Impossible. But here are some focus areas according to other tax professionals and media outlets-

- <u>Large Changes in Income</u>: Historical data of your income is maintained by the IRS and the Social Security Administration. If you have a large increase in income, the IRS will further check to see if the increase came from wages, capital gains, small business income, etc. Wages aren't necessarily a concern since taxes are withheld and reported, but other sources of income are.

- <u>Self Employed or Small Business Losses</u>: The IRS despises small business losses, and despises hobbies even more (read our article on Business vs Hobby at **www.watsoncpagroup.com/Hobby.pdf**). Since history has proven that a lot of taxpayers are gaming the system for tax sheltering, self-employment income (and most cases, self-employment losses) is being scrutinized. Remember, the basic premise of a business is the reasonable expectation of earning a profit. If you can't demonstrate that premise your small business losses will be deemed a hobby and disallowed.

- <u>Deductions</u>: If your deductions such as mortgage interest or charitable contributions are outside the average for your income range, you could trigger an IRS audit. Don't be afraid to take the deduction if it is legitimate, but ensure that it is allowed and keep good records. You might be mailing them in.

- Rental Losses: This is a relatively new focus for the IRS since over the past few years several taxpayers are unable to sell their houses. While rental losses are fairly straightforward, it remains an area that the IRS is currently paying attention to. In addition, the IRS is targeting those investors who are claiming a real estate professional status to avoid passive loss limitations. See our article at

  www.watsoncpagroup/REP.pdf.

- Home Office Deduction: Audits based on home offices are not as prominent today as it was in the past since telecommuting including self-employed taxpayers is more common. Having said that, a lot of taxpayers still claim a home office deduction when it is clearly not allowed according to the IRS. Commonly a taxpayer will have another office where they perform substantial administrative or managerial activities, work at home a couple of days out of the week, and then claim a home office deduction.

  See our **What are the rules on a home office deduction?** FAQ on our KnowledgeBase at **www.watsoncpagroup.com/kb**.

- 100% Business Use of a Vehicle: Let's face it, to have a 100% business use of a vehicle that you own personally is rare- commuting and personal miles are nearly impossible to avoid. Regardless, keep detailed mileage records. And if you do have a 100% business use vehicle that is not associated with a business, be prepared to demonstrate your claim and substantiate your mileage deduction.

- Meals, Entertainment and Travel: These expenses have commonly been abused by past taxpayers, and the IRS has historical data showing the averages as compared to income depending on your profession. The IRS also has the average increase in tax liability based on past examinations. Keep very detailed records if you are claiming these deductions- you might be sending these in too.

Information Matching: Most W2s and 1099s are electronically transmitted to the IRS. If your tax return is missing a W2 or 1099, or if the amount you report is different than the amount the IRS has in their database, your tax return will be adjusted or audited.

Related Examination: If your business partner's individual tax return is examined and a particular issue or transaction is discovered, your tax return might be examined as well. This is not limited to business partnerships- any transaction or agreement between you and another taxpayer that causes a taxable event on two different tax returns might flag you if one tax return shows a discrepancy.

Abusive Tax Avoidance Transactions: Certain promoters and participants involved in abusive tax avoidance transactions have found themselves in trouble. From there, the courts and other enforcement agencies have provided lists of names based on credit card data, summons and other testimony to allow the IRS to follow up. So you might simply be guilty by association.

Large Corporations: The IRS examines many large corporate tax returns on an annual basis.

Other: Field IRS offices in conjunction with local agencies identify certain tax returns for examination based on local compliance initiatives, tax return preparers or specific market segments.

What is the period of limitations for an audit?

The statute of limitations starts on the day a tax return was due or the day it was filed, whichever is later. So, if you file your personal tax return on March 1, the period will start April 15. If you file your tax return late, such as October 1, then the statute of limitations starts on October 1.

There are three general look-back periods-

3 Year Period: This is the typical time the IRS has to audit most tax returns. The IRS attempts to notify the taxpayer within 12 to 18 months of the due date or filing date, whichever is later. This is so the audit can be completed within the three-year window. If you do not fall into the other categories below, then the 3-Year Period is the default.

6 Year Period: If you understated your income by 25% of more, the statute of limitations is six years. For example, you file a tax return with $100,000 as income but you forgot a K-1 with $25,000 from an inheritance trust. The IRS can actually audit this tax return up to six years.

Unlimited Period: Don't fall into this category. If you filed a tax return with the intent to commit fraud then the statute of limitation is indefinite. This only applies to fraud, and not negligence. If you make a good faith effort in preparing and filing a tax return yet made a mistake, you have not committed fraud. But if under a routine audit of a previous tax return the auditor discovers fraud, now your whole tax history is open for review. Yuck.

What are some of the types of IRS notices and letters?

There are several notices that are the 'lite' version of a full blown audit or face to face examination. The IRS might send a notice adjusting child tax credit or earned income credit, correcting miscalculations or requesting a missing schedule or form for your tax return.

The IRS has a nice list of various notices and letters at **www.irs.gov/Individuals/Understanding-Your-IRS-Notice-or-Letter**. Here are some of the highlights-

CP2000 Notice of Proposed Adjustment for Underpayment or Overpayment: This is a common notice, and the majority of CP2000s are generated because of what you report on your tax return and what the IRS has in the database (W2s, 1099s, etc.) is different. The CP2000 typically includes a transcript of everything the IRS has associated with your social security number. In our experience, the proposed amount due is simply wrong- at times it is actually in your favor, but commonly an amended tax return will work out better than the IRS's proposed balance due.

A great example is a stock sale which was reported to the IRS. Unfortunately, the cost basis and transaction fees don't get transmitted. So, you could easily sell $10,000 in stocks and the IRS will consider the entire amount as a gain, or taxable income. This situation requires an amended tax return to offset the gain with your costs.

CP2501 Notice, Initial Contact Letter: This IRS notice is the close cousin of the CP2000. It typically does not have a proposed balance due, rather it requests clarification on differences between your tax return and information from other sources. In these cases, the best advice is to order a transcript of your tax return- this will show all the information the IRS has associated with your social security number. Use Form 4506-T, Request for Transcript of Tax Return to get the information.

Letter 2205-A: This IRS letter informs you that your tax return is being examined. The letter will provide the agent's name and contact information, and the areas of your tax return which will be examined. This is a common misconception among taxpayers- only selected sections of your tax return will be audited. However, if the IRS agent smells a rat, they can easily open up the entire tax return for examination.

CP22E Examination Adjustment Notice: This is the follow up letter from the IRS after an audit (either correspondence or field). It usually includes the details or findings from your audit resulting in unpaid balance of tax due. You generally have 30 days to respond to this notice.

Letter 2625C, 2626C: This is a common notice from the IRS and it is also called a 30-day letter since you have 30 days to agree or appeal the findings. It shows a balance due, and provides instructions on which steps you can take (agree, appeal, etc.).

Letter 3219 Notice of Deficiency: This notice informs you that there is an increase in your tax due. This is generated after you appeal or if you do not respond to your 30-day letter. After receiving a notice of deficiency you have 90 days to petition the tax court (or 150 days if you live outside the United States). The appeals process typically has expired once this letter is issued, and while the IRS mentions the Taxpayer Advocate assistance program it also states that they essentially cannot reverse the IRS's determination. Professional tax help is required at this level unless you agree to the changes.

How should I respond to an IRS notice or letter?

Quickly. Do not blow these off or think you can beg for forgiveness after a deadline has passed. The IRS can be compassionate (really!), and will typically extend all deadlines **only if you contact them** and explain your situation.

To the IRS's credit, they provide very detailed list of options and steps to take for each option. Follow the instructions closely. You can always have us look at it for you as well.

Here are some general rules in responding to the IRS-

Be Prompt: As mentioned before, timely responses are essential. While the IRS gives you generally 30 days to respond to initial notices, if you wait to the very last minute to send in your documentation there is a good chance that correspondence will get crossed in the mail. Make this is a priority.

Send 100%: When you mail or fax information to the IRS, ensure that you have completely responded to the entire letter or notice. **Do not** send some information today while you gather up other information later. If you send two partial responses to the IRS, the chances of the same processor getting both pieces of your tax puzzle are very low. Request an extension for your response. Be patient, yet punctual, and send everything required at once. Fax or mail, pick one. If mailing documents, use a certified mail service.

Send Copies: Never ever send originals. The IRS might lose your documentation, and they certainly won't mail it back.

Don't Overshare: Only send what is asked for. Don't overshare with the IRS but at the same time don't send a riddle. If you make the processing agent's job a little bit easier, they might make your life a little bit easier. When they ask for your favorite color, don't respond with pizza.

Fax: When you fax your information, write your name, social security number and tax year on the bottom of each page.

If you've been examined for the same item in the preceding two tax years and both audits resulted in a no change result, you can notify the IRS of this fact and that particular element of your impending audit will be removed.

If you are filing bankruptcy or have already filed for bankruptcy, then you are required to inform the IRS. Things such as collections, liens and levies have new rules once the taxpayer has filed for bankruptcy.

The IRS can also contact other people such as a neighbor, bank, employer or employees.

Can I ignore an IRS notice or claim I never received it?

Good luck. The Tax Court recently ruled that a taxpayer had actually received a tax deficiency notice even though the IRS made a clerical mistake in addressing the notice. In this particular case and several prior cases, the taxpayer never physically touched the envelope. Yet the tax Court ruled he still had constructively received it according to previous case law.

Section 6212(a) of the tax code allows the IRS to send notices by certified or registered mail. Typically the taxpayer has 90 days from the **date the notice was mailed** to file a petition with the Tax Court for redetermination of the deficiency. A taxpayer has 150 days if he or she is living outside the United States.

Sending a notice of deficiency to the last known address is not the only way the IRS can deliver a notice to a taxpayer. The Court has held in the past that sending the notice to the last known address is merely a safe harbor whereby the notice will be considered received by the taxpayer even it if never was. Bummer.

Further, the last known address caveat is not a factor if the taxpayer actually receives the notice through other constructive means. Actual receipt can take several forms such as receiving the envelope and throwing it away, or deliberately refusing delivery from the Postal Service. Also, delivery notifications from the Postal Service (you know, those annoying yellow or salmon colored notes) might be considered constructive receipt even if the taxpayer never physically has the envelope containing the notice. In other words, **attempted delivery is delivery.**

In this particular Tax Court case (Tax Court Memo 2012-278), the court found that the taxpayer did not have problems receiving other mail and since the taxpayer's wife clearly understood the importance of an IRS notice after her own tax audit, the Tax Court ruled that the taxpayer had actually received the notice. Subsequently he did not petition the Tax Court within the statutory 90 day window, and therefore was denied his petition for determination of tax deficiency.

If the 90 day window expires, and in this court case it had, relief is to still available. You can pay the tax, and then you have two years from the payment date to challenge the tax with a refund suit in the US Court of Federal Claims or the US District Court. Sounds like fun- we suggest keeping the IRS updated on your current address, don't ignore notices, and make sure your spouse doesn't toss out the mail.

How does a joint return get handled during an audit?

Either spouse can respond, or both taxpayers can respond jointly. This applies to correspondence audits (mail) and field audits (face to face interview).

How can I prepare for my face to face or interview field audit?

Hopefully your recordkeeping skills are up to snuff. Please visit our KnowledgeBase at **www.watsoncpa.com/kb** on recordkeeping to ensure you are doing a good job for the future. You can also download our article at-

www.watsoncpagroup.com/Recordkeeping.pdf

Back to the audit-

Be Organized: If you appear organized, your credibility will jump right up. Contrary to the theoretical innocent until proven guilty paradigm, an IRS agent has seen so many incredulous deductions and expenses it is hard to blame him or her for being a bit suspicious. Of course the IRS will disagree with that statement, but they are humans first and agents second. And human nature will look upon your perceived sloppiness with friendly contempt. Truthfully if you were an IRS agent you would do the same thing.

Spreadsheets and tally tapes show that you are not afraid to add things up and match the figures to your tax returns.

Bring Copies: Never bring originals. The IRS might lose your documentation right before your eyes, and they certainly won't mail it back if later found.

Don't Overshare: Only bring documents that are needed. Don't overshare with the IRS but at the same time don't bring a jigsaw puzzle with a missing piece. If you make the auditor's job a little bit easier, they might make your life a little bit easier.

Stay On Point: When they ask for your favorite food, don't respond with green. Don't give the agent a reason to go fishing for additional stuff to bother the IRS with. If the question requires a Yes or No answer, answer with a Yes or No. Don't blink.

Be Courteous: IRS agents are people too, and they have chosen tax administration as their profession. Don't be demeaning or obnoxious. Remember that they have wives, husbands, kids and lives outside the exciting world of taxation.

Be Flexible: You might have to decide which issues you want to fight, and which issues you want to let the IRS win. No change audits (where you win everything) are a low percentage, as in rare- knowing this will help during your interview. Be ready to trade some horses, and move on.

Review Your Deductions: Review your expenses, deductions and credits on your tax return to ensure you are not missing anything in your favor. Just because the IRS is looking for issues that increases your taxable income does not mean you can't introduce new evidence that was omitted on your original tax returns. It might require an amended tax return, or it might just be adjusted right there (depends on the situation).

Who can be with me at my IRS audit or conference?

Anyone can be with you at your face to face or interview field audit. They can act as witnesses, give you moral support, etc. What they cannot do is represent you. Typically only attorneys, CPAs and enrolled agents can represent you during IRS proceedings, audits, conferences, etc. This representation requires a Form 2848 Power of Attorney (POA). In these situations you are not required to be present at the examination.

However if you want your accountant to simply be there for the interview, that does not require a POA since either you are still representing yourself pro se or you can give authorization right there for representation.

If you go to an audit and at some point you decide that it's over your head, you can request representation and the IRS must stop the interview. This is just like an episode of Law and Order. Save yourself this grief and hire a tax professional such as the Watson CPA Group to assist you with the IRS.

If you are responding to a summons interview, the proceeding **cannot** be suspended after requesting representation.

You may also make sound recordings of any examination, appeal or collection proceedings provided you tell the IRS in writing 10 days before. Get the app. Bring your iPod.

How much is interest and penalty on taxes owed?

There are three additional assessments the IRS can tack onto the taxes that are due-

Failure to File Penalty: The IRS charges 5% per month for each month after the due date of the tax return up to a maximum of 25%. This includes extensions. So, if you extend your individual tax return and file it in December you could face a 10% of the tax due. Naturally if you are due a tax refund there isn't a failure to file penalty- it is only imposed if you owe.

Failure to Pay Penalty: This is computed at 0.5% per month (or 6% per year) with no limit. Extensions do not eliminate this penalty- for example, you file an extension and eventually submit your tax returns on July 15. You will owe 1.5% (3 months x 0.5%) in failure to pay penalties.

Interest: Interest rates change every quarter and are currently at 4% per year. Just like the failure to pay penalty, interest is charged from the original due date of the tax return based on the balance due. Generally the IRS has to notify you of a discrepancy or issue within 18 months of original filing date to charge interest- this is only if you face an adjustment of your tax return. If you owe taxes on your originally filed tax return, interest will be charged regardless.

If you acted reasonably and in good faith, the IRS might abate your penalties but typically not interest.

What is the appeals process?

If your audit was conducted an IRS field office, you can request a supervisor or manager review right on the spot. Remember, for a supervisor to find in your favor suggests that the initial agent is wrong, or is not interpreting tax law and your facts correctly. Office politics might come into play here. Having said that, if you believe the auditing agent is wrong it doesn't hurt to run it up the flagpole.

After you receive the IRS's determination of your situation, you have 30 days to decide what to do. You can pay the amount requested, you can request **Fast Track Mediation**, you can appeal to the **Office of Appeals**, or you can wait and petition the **Tax Court**, Federal Claims Court or US District Court.

Fast Track Mediation: If you do not agree with any or all of the IRS findings, you can request Fast Track Mediation. You and the IRS will meet with a trained mediator who will help facilitate communication in a neutral setting. Mediation in various legal proceedings is about educating both sides about the issues, and to work towards an agreement. This typically involves some horse-trading where you and IRS give up a few of sticking points so the matter can be resolved. Remember, the IRS thinks they are right. You think you are right.

Most cases not docketed in any court qualify for fast track mediation including examinations (audits), offers in compromise, trust fund recovery penalties (withholdings, payroll stuff) and other collection actions. Generally within a week of submitting the signed agreement to mediate, the mediator will contact you to schedule the meeting.

You may represent yourself at mediation or you may have an attorney, CPA or enrolled agent act as your representative when Form 2848 Power of Attorney (POA) is in effect. You may stop mediation at any time and you still retain all your appeals rights.

You can download the application at **www.watsoncpagroup.com/FTM.pdf**.

There is also a Fast Track Settlement program for small to medium-sized businesses.

Office of Appeals: Within 30 days of the IRS's determination you can have the Office of Appeals review your case. If you want to go directly to court, you must wait the 30 days to receive your Notice of Deficiency.

IRS Publication 3498 describes the appeals process. There are two different processes depending on the taxes due. Under $25,000 is considered a small case, and anything over $25,000 requires a formal appeals process. The statement that is sent to the IRS will depend on the small request versus formal request threshold.

The appeals application for small cases (under $25,000) can be downloaded at-

www.watsonpcagroup.com/Appeals-Small.pdf.

Some of the reasons to consider appealing your case are-

1. you are submitting additional information that could result in a change to the additional amount you owe, or

2. you are identifying a mathematical or processing error that the IRS made.

Appeal must be based in tax law or fact, and cannot be based on moral, religious, political, constitutional, conscientious or similar grounds. Some argue that taxes are illegal given the framework of our constitution- good luck with that.

Appeals must be completed within 3 years after a tax return is due or filed, whichever is later. A written agreement between you and the IRS can extend this statute of limitations (called a "consent"). You have the option to limit the consent to a particular issue or issues, or limit the consent to a particular of time. You also have the option to refuse the extension (which might or might not be a good idea depending on your situation).

The Office of Appeals handles Examination (audit) issues and Collection issues separately.

Court: After you receive a Notice of Deficiency detailing the final answer from the IRS, you have 90 days to petition the Tax Court (or 150 days if you live outside the United States). Usually the Tax Court will not entertain a hearing unless the matter has been considered by the Office of Appeals.

There are two types of cases- an S case and a regular case. An S case has a limit of $50,000 in terms of dispute amount, but it is less formal and has broader rules of evidence. These cases and the subsequent summary opinion are final, and cannot be appealed.

Visit **www.ustaxcourt.gov/taxpayer_info_start.htm** for more information.

Also the Tax Court cannot have jurisdiction over Trust Fund taxes (such as withholding or other payroll type taxes).

If you want to bring your case to the Federal Claims Court or the US District Court (and not the Tax Court), you generally have to pay the tax due, receive denials for your claim for refund from the IRS and the petition the Court. This is contrary to the Tax Court which does not require taxes to be paid in advance.

Interestingly the IRS has the burden of proving certain facts in court if you kept adequate records to show your tax liability, cooperated with the IRS and met certain other conditions. Having said that, many Tax Court summaries and opinions start with the words "*As we have observed in countless opinions, deductions are a matter of legislative grace, and the taxpayer bears the burden of proof to establish entitlement to any claimed deduction.*" Sounds like the Tax Court is really on your side, wink wink.

We can't be completely sarcastic- Rule 142(a)(1) Section 7491 shifts the burden of proof to the IRS with respect to a given factual issue where a taxpayer-

1. introduces credible evidence with respect to that issue
2. meets all applicable substantiation requirements
3. complies with all record-keeping requirements
4. cooperates with any reasonable requests for information

If you do not respond to the Notice of Deficiency within 90 days, you will receive a bill for the amount due and your appeals as they related to the tax liability are usually over. From here you have several options in terms of payment (see **What if I cannot pay my taxes?** below).

Taxpayer Advocate Service is for those people who are having trouble communicating and resolving their tax issues with the IRS, or for those who believe the IRS is creating financial difficulties. There are eligibility requirements- call **877-777-4778** or visit **www.irs.gov/advocate** for more information.

How can I pay my taxes or my notice of deficiency?

There are a handful of ways to pay your taxes, not only for back taxes but for any tax due:

Check or Money Order: This is obvious of course, and the can be mailed or delivered in person. Make checks or money orders payable to United States Treasury, and write your social security number and tax year in the memo area for proper handling. The IRS also suggests writing your phone number on your check or money order. Also, most banks will tell you that using online bill pay is not recommended for paying taxes.

EFTPS: The Electronic Federal Tax Payment System is a free service from the US Department of the Treasury. All federal taxes can be paid using EFTPS. You can make payments via their web site, a voice response system, or special channels designed for tax professionals, payroll services, and financial institutions. Quick, secure, and accurate, EFTPS is available by phone or online 24 hours a day, 7 days a week. You can schedule a business payment up to 120 days in advance or an individual payment up to 365 days in advance.

Please visit the EFTPS website at **www.eftps.gov** to enroll and make your tax payment. Some states also have an online payment option. Please contact us for more details.

Credit Card or Debit Card Payments: There is a third party vendor that several states and other taxing authorities endorse for various types of tax payments including Federal taxes. They are called Official Payments (sounds legit) and their web site is **www.officialpayments.com**. They charge about 2-3% of the payment amount for this service.

What if I cannot pay my taxes?

The IRS is a business- they look at a risk versus reward utility curve. If they can have a guaranteed collection of an amount less than owed, the IRS might consider this a win. In other words, shooting for the proverbial moon from the IRS's perspective might not be in their best interest since the amount might be totally uncollectable.

Having said, there are several options if you cannot pay your taxes, either with a tax return or from a Notice of Deficiency. The IRS advises that if you cannot pay your taxes in full, pay as much as you can and contact their offices to explain your situation. From there, you have the following avenues:

Installment Agreement: Payment plans typically involve a fixed monthly payment along with the usual interest charges. Terms will be based on the amount you owe and your ability to pay. Collection proceedings such as wage garnishment and other levies are halted during your application review, for 30 days after the IRS rejects your application and for the duration of your appeal following a rejection.

There are two types of installment plans-

1. Statutory Installment Agreement- for amounts less than $10,000, current tax laws allow for an automatic payment plan approval. As with all plans and agreements, all your tax returns must be filed.

2. Streamlined Installment Agreements- for amounts up to $50,000, the IRS has created a more simplified process for installment agreements. Terms are generally limited to 72 months (6 years), and for amounts over $25,000 you will need to complete Form 433 which is a financial statement and disclosure.

The IRS has an online application at **www.irs.gov/Individuals/Online-Payment-Agreement-Application**.

You can also download Form 9465-FS at **www.watsoncpagroup.com/Installment.pdf**. We can also electronically file the installment agreement request with your eFiled tax returns.

Lastly you can make an application for installment at your local IRS office. Pack a lunch.

To be eligible for an Installment Agreement you must file all required tax returns, and there is a user fee charged for all approved agreements. If you get rejected for your installment plan, you can request the Office of Appeals to review your application.

Offer in Compromise (OIC): The IRS can accept an amount less than the full balance due. This is similar to a short-sale for a home. However, and this is a big however, Offers in Compromise are only accepted by the IRS when-

1. they agree that your tax debt may not be accurate,

2. you have insufficient assets and income to pay the amount due, or

3. because of your exceptional circumstances, paying the amount due would cause an economic hardship or would be unjust.

There are several companies on television touting their ability to reduce your tax debts. Essentially they are coordinating OICs on your behalf, for a nice fee of course.

The amount of an offer is based on how quickly you can pay the offered amount, and there are two types. A lump sum offer must be paid in six months, and a short-term payment offer is spread out over 24 months. The deferred payment offer where you could make a lump sum payment in the future is gone.

The IRS wants their money, and they want all of it. And they don't mind waiting while you make installment payments- heck, they're earning 4% interest. Where else can the IRS get that kind of return? As stated earlier, however, the IRS is still a business and is willing to accept something less.

There are two applications for an Offer in Compromise-

Form 656-L is used when you doubt the accuracy of your tax debt.

Form 656 is used for all other situations (can't pay, hardship, special circumstances, etc.). You can download this at **www.watsoncpagroup.com/OIC.pdf**.

Request a Delay in Collection: The IRS can also grant a delay in collection where they temporarily halt collection proceedings until your financial situation improves. A 120-day extension is not uncommon especially if you can demonstrate the ability to pay in the future (such as reliance on a future tax refund). Penalties and interest will still accrue on the unpaid balance. The IRS may also place a lien on your assets to protect their interests.

Bankruptcy: Bankruptcy can only alleviate some tax burdens, some of the time. Please see **How does bankruptcy affect my unpaid taxes?** below.

All applications for installment plans, offers in compromise and other collection actions are appealable through the **Office of Appeals** (the appeals office handles both examination appeals and collection appeals).

How does bankruptcy affect my unpaid taxes?

First and foremost, if you are considering bankruptcy and have unpaid taxes, you must contact an attorney specializing in bankruptcies. The rules are complex, and before you rely on the possibility of a fresh start from a tax perspective you need advice from an experienced attorney.

Here are some basics-

1. the tax liability must be three years or older according to the due date of the tax return including extensions

2. tax returns (and not IRS substitutes) had to be filed at least 24 months before bankruptcy filing, and

3. 240 days must pass from the date of the assessment

Not all tax debts can be rolled up and tossed into the bankruptcy arena. Depending on which type of bankruptcy you file (Chapter 7 versus 13) will dictate how your taxes are handled. Notices of Federal Tax Lien survive the bankruptcy even if the underlying dollar amount is discharged. This can create some sticky issues down the road.

You do get an automatic stay (temporary stoppage) on collection proceedings when you file bankruptcy.

IRS hates bankruptcy. Not that this is a negotiation tactic, but the IRS aggressively attempts to negotiate tax debts before they get wrapped up in the bankruptcy drama. There are tax attorneys who specialize in back taxes, tax liens, etc. who argue that negotiating with the IRS is money-ahead compared to bankruptcy- we tend to agree.

Remember, if you are dealing with the IRS and have or are considering bankruptcy, you must inform the IRS.

What can the IRS do if I don't pay my taxes? What is the collection process?

The IRS can do a variety of things during their collections of unpaid taxes.-

Federal Tax Lien: A legal claim against all your current and future property, such as a house, car, wages, bank accounts, etc. The IRS uses this to establish their priority in your assets versus other creditors' claims.

Notice of Federal Tax Lien: This is a searchable public notice to creditors, and will appear during title searches or other credit applications.

Notice of Intent to Levy: Before your property is seized the IRS sends this notice to give you time to arrange for a hearing.

Levy / Seizure: Wages, salary, commissions, bank accounts, Federal payments (up to 15%), house, car or other property can be seized to pay your taxes. The IRS cannot seize unemployment benefits, necessary schoolbooks and clothing, certain amounts of fuel, provisions, furniture, personal effects, and tools used in a trade, business or profession. There are also rules on seizure of primary residences, business assets, annuity and pension benefits, service-connected disability payments, workers' compensation and public assistance payments. The IRS cannot seize property unless there is an expectation that the proceeds will help pay your tax debt.

The IRS has 10 years to collect unpaid taxes.

Collection proceedings are halted during review of Installment Agreement or Offer in Compromise applications, and if you are living outside of the United States for more than 6 months.

If you attempt to dodge or sidestep the actions of the IRS, they can issue a summons to secure financial information for carrying out their collections. Not only can you be legally required to appear in front of the IRS, other third parties can be compelled as well. Everything (banks, investments, property) is tied to your social security number now, and it is pretty easy to track down your stuff and lock it down.

How do I appeal the collections of unpaid taxes?

There are two programs, Collection Due Process and Collection Appeals Program. **IRS Publication 1660 Collection Appeal** Rights details these two options in more detail.

Please call or email us anytime with your questions and concerns. Thank you in advance, and we look forward to working with you!

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