

What To Do If You Get A Letter From The IRS

Recently the Internal Revenue Service has stepped up its attempts to take in more overdue taxes. The Agency is auditing more people and clamping down more frequently with tactics such as levies and asset seizures when it thinks someone owes more money.

IRS officials have particularly focused on individuals making \$100,000 and above. Last year, more than 219,000 people with incomes in that group were hit with an audit, up about 32% from the previous year.

What's behind this initiative? One is certainly concern about federal budget deficit. But there is also much concern about cheating and other forms of tax-evading. For example, the IRS says millions of people who should be filing returns, don't. The Agency estimates that the government is losing about \$290 billion a year to cheating and other forms of noncompliance.

Among the targeted areas:

- Self-employed workers.
- Those with incomes over \$100,000.
- Abusive tax shelters, in other words, those that have transactions the IRS insists have no business purpose other than to avoid taxes. For example, last year, settled more than 1,200 people accepted its offer to settle battles over a shelter known as "Son of Boss." The IRS also said it has collected nearly \$4 billion from that group.
- Family limited partnerships.

What should you do if you come under IRS scrutiny? Push back, or just write a check?

What if you miss a deadline and get charged penalties as a result? IRS may be willing to remove penalties if the taxpayer had a good reason, such as a death in the family or major illness.

If the amounts involved are small, it might be better to just pay up. Tax law is complex, and many taxpayers don't have the time or desire to get involved with what can be a long and expensive struggle. Do a cost-benefit analysis. How much money is at stake, how good are your records, how confident you are of winning, how complex is the issue is, how much will representation cost you?

On the other hand, one taxpayer went to Tax Court to contest an IRS charge that he owed 48 cents in income tax, plus penalties and interest adding up to \$440. The judge ruled that the taxpayer had met his burden of showing the disputed amount was in error, while the IRS had not met its burden of showing it was appropriate to impose penalties.

A more complicated case would be one where a couple that had filed jointly gets divorced, and the IRS comes after one of them for taxes that person feels are owed by the other. Never sign a joint return if you suspect your spouse is breaking the law. Instead, consider filing separately. Because once you sign a return, you're generally liable if

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something goes wrong later, unless you can show you were an "innocent spouse" which can include proving that you didn't know, and had no reason to know, about any tax wrongdoing.

Let's say you get a letter from the IRS. One thing not to do is to ignore an IRS letter challenging something on your return. The IRS will catch up with you, and interest and penalties can add up quickly.

Respond to the letter. Usually you will hear back from the auditor. But if the auditor seems to be ignoring your position, you can write a letter asking to speak to that auditor's supervisor.

If you still are not able to reach some sort of agreement, then other paths include:

Appeals: This is an IRS unit where issues may be resolved by correspondence, phone or in person. Taxpayers who want a face-to-face meeting can get one. There's a special procedure for "small" cases, those in which the total amount for any tax period isn't more than \$25,000. You may represent yourself or use an attorney, certified public accountant or an "enrolled agent". See IRS Publications 5 and 556. IRS appeals office receives about 100,000 cases a year, and roughly 80% are resolved.

IRS Taxpayer Advocate Service: This is a worth trying if you are not getting anywhere. It can be especially useful if you are facing a financial hardship because of some action the IRS has taken or may be about to take. Last year, taxpayer-advocate offices around the nation received roughly 200,000 cases. To contact the office, call 877-777-4778, or go to www.irs.gov/advocate. There is at least one advocate office in each state.

Go To Court: Most people choose the U.S. Tax Court (www.ustaxcourt.gov) since you don't have to pay the contested tax up front in order to have your case heard.

The court hears a wide variety of cases involving such areas as income taxes, estate taxes and gift taxes. But the court can't hear cases involving certain other issues.

Some people prefer going to federal district court or the U.S. Court of Federal Claims (www.uscfc.uscourts.gov) because they think their chances are better there. But these courts generally will hear tax cases only after you've already paid the tax and filed a refund claim with the IRS. IRS Publication 5 has more details.

If you do go to court, remember that your case and, potentially, sensitive financial details become a matter of public record.

What if you lose and can't pay? Or what if you decide not to contest, and can't pay what's assessed?

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You have some choices. You can ask the IRS to let you pay on an installment plan. Or, if you're in such dire financial straits that you can't pay everything you owe, consider asking the agency to compromise.

Getting the agency to agree to a compromise is not easy and might involve a lengthy battle. The IRS received about 106,000 offers in 2004 and accepted about 20%.

In their defense, the IRS gets a large number of blatantly unacceptable offers. Many of these offers come from firms representing the taxpayer that skew the numbers and slow up the process. There are firms out there that charge excessive fees to people who have no hope of meeting the program's requirements. So keep this in mind when anyone indicates that they can muscle your proposal through the IRS compromise program.