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Your IRS income tax audit: know when to say "no"

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Very few people enjoy getting a notice of an Internal Revenue Service audit. IRS Form 4564 - Information Document Request - labeled "Request Number 0001" - may be the first of several requests that will require you and your accountant to gather records for review by the IRS revenue agent. The accompanying statement of "Your Rights as a Taxpayer" is not likely to calm your nerves.

First, your return may have been selected for audit on a random basis, so you should not be concerned. Second, even if your return was selected for a reason, e.g., you are part of an industry the IRS is targeting or

one of your deductions was judged by the IRS's computers this year to be "too big," competent representation will probably minimize both your anguish and the financial problem. Third, the negative image of the IRS portrayed by so-called "tax relief" agencies - the IRS is "the most aggressive" collection agency - has nothing to do with the audit process. The average IRS examiner is a thoughtful, courteous college graduate with five years' of experience. Fourth, if you understand the auditor's goals and job, you will know when you need to "just say 'no.'" And that can make a big difference in the result of your audit.

The IRS agent's goal is to gather facts. The agent will (i) send out one or more IDRs; (ii) try to interview the taxpayer; (iii) subpoena records from the taxpayer and, if necessary, third parties; and (iv) question the taxpayer's representative. Once the agent has the facts, the agent's job is to ascertain the law and apply it to the facts. Then the auditor will articulate a position, usually in a phone conversation with the taxpayer's representative. Once that occurs, the taxpayer and the representative must determine whether the IRS's position has merit and, if so, to what extent. That analysis determines how the taxpayer should proceed.

Assume that the IRS agent's position (a) is wrong; (b) is against the taxpayer; and (c) involves significant dollars. The goal is to get to the IRS Appeals Division because IRS appeals officers are the "best of the best." Most of them are lawyers; most have 20 years' experience; their job is to settle cases; and they have the power to consider the "hazards of litigation." However, there are two different ways to get to the Appeals Division, and the difference is important to the outcome of your case.

If the IRS position is adverse, most taxpayers and representatives reflexively want to try to *persuade* the IRS agent to take a more favorable position. That is not a good idea. It is not the IRS agent's job to *negotiate* with the taxpayer. If your attempt at persuasion includes providing additional facts and arguments to the IRS agent, there will be two bad results. First, the IRS agent will include in the file that will be forwarded to the IRS Appeals Division arguments that will anticipate and counter your additional facts and arguments. Second, you will be unable to provide the IRS Appeals Division new facts and new arguments, without which it is more difficult for the IRS appeals officer to rule in your favor.

Even if your return was selected for a reason ... competent representation will

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probably minimize both your anguish and the financial problem.

When the IRS agent sees the impasse, the agent will make one or both of the following offers. First: "sign this extension of the statute of limitations. Give me another year (or two) and we should be able to get you a better result." Or: "since we have not been able to agree, let's send your file to the IRS Appeals Division. The IRS Appeals Division is separate from the Audit Division, and appeals officers can settle matters based on the hazards of litigation."

As to the first offer - signing an extension - the answer is "no." Under any circumstances. Giving the agent an extension only provides the agent time to supplement the file which is already going to be negative to the taxpayer. Instead, agree that you will promptly provide all requested information so that the agent can complete the audit within the time remaining under the statute of limitations.

As to the second offer, the praise of the IRS Appeals Division is warranted. However, if you go to the Appeals Division *directly* from Audit, and you do not reach a good result, then the "90 Day Letter" (Notice of Deficiency - Letter 531-T) you ultimately receive will be prepared by the appeals officer. If you turn down the IRS agent's offer, then an IRS agent will write the letter. You would you rather have the "Income Tax Discrepancy Adjustments" (IRS Form 4549-A) and "Explanation of Items" (IRS Form 886-A) that accompany the letter written by a five-year IRS agent with a college education, not by an IRS lawyer with 20 years' experience.

Once you receive a "90 Day Letter" written by the IRS agent, you file a petition in the U.S. Tax Court (the U.S. Court of Claims is also a possibility). IRS district counsel will respond within 60 days. Then your file will be sent (automatically) to the IRS Appeals Division. You and your representative will now have the opportunity to present new facts and new arguments to the highly skilled IRS Appeals Officer assigned to your matter. If your case has any strength, you are likely to get an offer that reflects some of that strength. In other words, the IRS Appeals Officer may offer you as little as a 20 percent concession. If your case is truly strong, the IRS Appeals Officer may offer an 80 percent concession - and may concede the case entirely.

So, resist the impulse to persuade, and resist the impulse to accept the offers made by the IRS agent. Be courteous. Be cooperative. And just say "no."

Deserve Victory!

—Winston Churchill



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