IRS Rules of Engagement: Under Promise and Over Perform

In practicing before the IRS regarding collection matters, penalty abatements and examinations, I have found certain rules of engagement helpful. This is the fifth in the series on such rules of engagement, with the previous four editions appearing in this magazine.

11. Carefully read and fully understand all IRS communications.
The title of this "rule" seems to say it all. However, I am astounded by the number of taxpayers and practitioners who misread IRS communications. The first thing to look for in any IRS communications is whether there is a deadline to take action (i.e. appeal the denial of a request for penalty abatement). Even if I do not have time to carefully read the entire communication at first, I quickly peruse it to be certain that no deadlines will be missed. From time-to-time, the IRS will request documentation within a short period of time and failure to do so will create havoc for the client. For example, offer in compromise specialists will often request additional information within 10 to 14 days. If you don't provide the requested information by the due date, the IRS will return the case to you without a decision. This is worse than a rejection in some respects, because you cannot appeal the decision to return the case. If you realize at the outset that there is a short time line, you can then take action to meet the deadline or speak to someone, including a manager, to request additional time to gather the information.

It is also key to know how to respond. For example, if the proper response is an appeal, to what address do I send the appeal? Most of the time, the communication will provide that information. If it does not, you should call the telephone number on the notice (or the practitioner hot line, 866-860-4259) to determine the proper address (usually, the inside address within the communication). We will often fax our appeal as well as mail it via Certified Mail, to ensure timely receipt.

Many IRS letters can be confusing. For example, some letters state that the IRS has made a decision, but if you provide additional information within 30 days, they will reconsider. Yet, I have often seen that same letter include language advising the taxpayer that he/she had 30 days to appeal the decision (most often in offers in compromise). A taxpayer may send in the additional information, but not ask for an appeal. Thus, if the information does not change the mind of the IRS, the taxpayer has lost the right to go to Appeals!

Many of you are familiar with IRS letter 1058, wherein the IRS advises the taxpayer of a potential levy and his/her right to a Collection Due Process Hearing. After a case has remained dormant for awhile, the IRS may file what is often referred to as a "refresher letter," letter 3174. Essentially, this again advises the client of the potential for levies as well as other enforcement action if full payment is not timely made. However, there is no formal Appeals mechanism. In my opinion, a response is necessary to ensure that levy or lien action is not imminent. The appropriate response is to follow the process which would lead to a CAP Appeal (form 9423), the first step of which is to communicate with the source who sent the letter 3174.

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IRS Representation Advisor

E. Martin Davidoff, CPA, Esq.

IRS communications often provide explanations on changes in tax, interest and/or penalties. Yet, such communications are often not complete. So, in order for you to "fully understand" a communication, you may need to use a variety of tools to request such documentation to enable you to fully understand the notice. Such tools are E-Services or the Practitioner Hot Line to secure account transcripts or Freedom of Information requests to secure other documents (i.e. SFR, AUR or examination assessments).

The bottom line is to read the IRS communication from cover to cover, making sure that you fully understand how the document impacts the taxpayer and, if you disagree with that impact, how and when to reply to the communication.

12. Know your case's status! Set ticklers and follow-up.
When dealing with IRS controversy matters, you, the practitioner, should take control and fully understand the procedural context of the case. Is the case in Appeals? Has the tax been assessed? Can an innocent spouse claim be timely filed? Can the taxpayer take advantage of a Collection Due Process Hearing or the equivalency hearing? Is your case nearing the expiration of the Statute of Limitations on IRS collections? Once you understand the procedural context, then set forth a plan of action and execute that plan.

Never just wait for the IRS to contact you. You should set ticklers and time lines for anticipated contacts. Depending upon your situation and your strategy, you may wish to push the case to a conclusion aggressively. If your hope is that the IRS will be quiet and go away, that should be a strategic decision, not as a result of indecision. At our office, after we have made contact with the IRS, we "tickler" a follow-up to check the status of the case. When the "tickler" pops up, we then decide whether contact with the IRS is appropriate and, if so, we decide upon the best manner of contacting the IRS.

For example, at the time we submit an offer in compromise package on behalf of a client to the IRS, we also set a tickler of 30 days to make certain that the case has been received and assigned. If we have heard nothing in that time frame, we call the OIC unit to

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Save Thousands of Dollars By Running Examination Results Through Tax Software

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which the case was sent (usually Holtsville, NY for us). After the call, we evaluate the discussion and set a new tickler.

Another example, would be securing an installment agreement. We monitor the case to ensure that the IRS is not placing levies or liens on the case while the request for an installment agreement is pending. Also, many clients wish to have some finality to their situation as quickly as possible. So, we will set ticklers and make contacts to keep the case moving along. After each conversation with the IRS we inquire on the best time to make contact again and use that information as one point of reference in setting the next tickler.

13. Confirm all examination computations through tax software.

In the past year, I have saved two clients thousands of dollars by merely running the tax examination results through our tax software. I had a 'hunch' on each matter that there were some errors in the initial return preparation or in the computations by the IRS. So, I ran the original return and the adjustments (as a 1040-X) through my tax software. I found that there were computational errors as a result of passive loss computations, the AMT, depreciation and net operating loss carryovers. (It should be noted that the original returns were not prepared by our firm.) The results were so significant that I have made it a rule to check the computations on all examinations. We also check the more complicated interest and penalty computations using a program by TValue entitled TaxInterest.

The first step is to make certain that we ensure that there were no errors in the original return. Through that process, you can discover and evaluate errors in the return, the correction of which will benefit your client. The complexity of the passive loss rules, the AMT and the combination of the two provide a significant opportunity for tax savings. Then we add the agreed-to changes in income to arrive at a revised tax liability.

The IRS will usually not have a problem correcting errors such as those described above. The settlements we reach with them are usually related to under-reported income or disallowed deductions. The ultimate tax is merely a computation. The IRS software for examinations does not have the sophistication of the IRS tax processing computers or our software. Accordingly, it is not unusual for the IRS to fail to pick-up a passive loss carryover, for example, which gets freed up with the disallowance of current year deductions on rental real estate.

More rules of engagement to come next issue.

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