

## TAX PREPARERS COME UNDER FIRE

A report by the Government Accountability Office highlights persistent problems of tax preparers cheating on clients' returns. The report detailed undercover visits by government investigators to 19 outlets of several commercial tax preparation chains, which were not identified. Staffers posed as taxpayers and asked the firms to prepare – but not file – returns under two scenarios. In 10 of the 19 cases, preparers failed to report side income that had been supplied by the taxpayer. Some preparers also missed key tax-saving opportunities. In addition, the IRS has allowed some preparers to continue to practice even though they have been convicted of crimes, suspended by state officials, or failed to pay their own taxes. Some 22,500 licensed tax preparers haven't complied with their own individual tax obligations.

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the innocent-spouse issue is one of the 21 most-serious problems encountered by taxpayers. Of the nearly 50,000 claims received by the IRS in 2005, only 21% were allowed in full and 8% were partially allowed, according to the report. An additional 29% were rejected in full, and the rest were screened out as "non-qualifying" for various reasons.

When you file jointly, both you and your spouse are responsible for any taxes, interest or penalties on those returns, with relatively few exceptions -- even if you later get divorced. That means the IRS typically can collect all the tax owed from either person. That is true even if you signed a divorce decree saying the other spouse will be responsible for any taxes due on previously filed joint returns, the IRS says -- and even if all of the income was earned by the other person.

That is why tax advisers routinely advise clients never, ever sign a joint return if the client suspects his or her spouse didn't play by the rules. While you may honestly believe you are innocent, proving it requires jumping over several hurdles. To qualify for innocent-spouse relief, you have to demonstrate, among other things, that you didn't know -- and had no reason to know -- there was an understatement of tax. Proving you had no reason to know can be especially tough, especially if you are well educated. There are two other possible escape hatches, but they can also be difficult to get through. The relief rules are "sometimes overly narrow, complex, costly for the IRS to administer and burdensome for taxpayers," the Taxpayer Advocate's report says. Furthermore, even if someone is declared an innocent spouse and not liable for the other spouse's tax, the IRS still may be able to collect the other spouse's tax liability from the "innocent" person in community-property states such as California, the report says.

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# IRS Tax Advocate



A Legal Newsletter

"Read About Taxpayers with IRS Problems & Learn  
Helpful Tips on How To End Them."

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Learn How to Avoid

# IRS

problems and solve  
them if you find  
yourself with one!

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### DUKING IT OUT WITH THE IRS

Talk about a taxpayer's nightmare. The IRS has stepped up its attempts to rake in more taxes, and it's not being bashful about auditing more taxpayers and clamping down with levies and seizures when it thinks you need to cough up more money. The IRS is zeroing in on individuals making over \$100,000. Last year more than 219,000 people in that group were hit with an audit, up 32% from the previous year. Driving the crackdown are not only concerns about federal budget deficits but also evidence of cheating and other forms of tax dodging. The IRS says millions of people who should be filing returns, do not, and it estimates the government is losing \$290 billion a year. It is especially concerned about the self-employed, and it is also attacking what it calls abusive tax shelters. Some tax shelter battles already have resulted in huge inflows of revenue. Last year 1,200 people accepted settlements in a shelter known as Son of Boss producing revenue of \$ 4 billion. (One piece of advise is to never sign a joint return if you believe your spouse is breaking the law because once you sign you're generally on the hook if something goes wrong unless you can show you're an "innocent spouse", which includes showing you didn't know and had no reason to know of the tax shenanigans. Instead file a separate return even if you must pay more in tax.)

With the IRS intensifying its crackdown, a growing numbers of citizens could soon be facing a tough decision: Fight back or write a check. Whatever the case, if you receive an IRS letter challenging something on the return and asking for information, the dumbest thing you can do is ignore it and hope it goes away. It won't. Once you respond and the IRS will not back down, ask to speak to the agent's supervisor. If that doesn't work, consider:

**Appeals.** This is an IRS unit where issues may be resolved by correspondence, telephone, or in person. There's a special procedure for small cases (less than \$25,000 per tax period). You may represent yourself or use an attorney. Appeals receives 100,000 cases a year and resolves about 80% of them.

**Tax Court.** If you cannot resolve your issues with the auditor or in Appeals, you may go to court. Most people choose the U.S. Tax Court since you don't have to pay the contested tax up front in order



**IRS TAX AUDITOR COULD NOT EXCLUDE SOCIAL SECURITY PAYMENTS**

An IRS tax auditor and his wife could not exclude Social Security disability payments from their gross income. Although the wife had applied for workers' compensation benefits after she was injured on the job, the Social Security payments were not received under a statute in the nature of a workers' compensation act because eligibility for the payments was not limited to individuals who had been injured in the course of employment. The taxpayers also were not entitled to a loss deduction with respect to an uncollectible damage award for personal injuries the wife sustained outside of her job. The loss was not incurred in a trade or business, in a transaction entered into for profit, or as a result of a fire, storm, theft, or other casualty. Makes you wonder that if an IRS auditor couldn't get his own return right, just think of what he does to yours on audit.

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 Look back at newsletter issues, articles I've written, and general advice at my website\*  
[www.besttaxadvocate.com](http://www.besttaxadvocate.com)

to have your case heard. If you go in by yourself, be prepared and NEVER interrupt the judge.

**When You Can't Pay.** If you admit you owe the tax, but are having major financial woes, you have a few choices. You can request the IRS to let you pay on an installment plan. Or for people in particularly dire financial straits who can't pay what they owe, they can submit an offer-in-compromise. If accepted, they will pay pennies on the dollar, but it is exceptionally difficult to be accepted since the taxpayer must prove extreme hardship. The IRS received over 100,000 offers in 2004 and accepted about 20%. Asking for a compromise should be considered only after all of your payment options have been exhausted. Before you build up your hopes for a compromise, remember that the offer program has been heavily criticized for taking too long and rejecting too many offers. The IRS will tell you much of the blame lies with the large number of blatantly unacceptable offers, many of them submitted by enrolled agents working on behalf of taxpayers that slow up the process. These firms charge excessive fees to people who have no hope of meeting the program's requirements. So do plenty of homework before forking over money to anyone promising it will be a breeze to get the IRS to buckle. Also, even if you do not submit an offer, the IRS may be willing to remove the penalties if you can document reasonable cause for the action giving rise to the penalties.

**Taxpayer Advocate Service.** This is a good place to go if you've already tried regular IRS channels, but you feel that you're stuck in the bureaucracy. It can be especially helpful if you are facing a financial hardship because of some action the IRS has taken or may be about to take. Even though it may seem counterintuitive to seek relief from the IRS itself, the TAS unit has drawn widespread praise from tax professionals for its independence and willingness to help taxpayers.

**One Last Warning.** Don't even consider challenging the IRS if you plan to argue that taxes are voluntary or that wages really aren't income. Courts have consistently rejected these and other arguments, and those that have tried have been hit with fines as much as \$25,000, but there is a small but highly vocal number of people who have been trying it.

**IRS REVIEWS EXTENSION DENIALS**

The IRS mistakenly told more than 45,000 taxpayers they weren't entitled to an income tax filing extension for 2005. An IRS spokesman blamed the blooper on mistakes in putting the proper date stamp on the extension forms filed by regular mail at the IRS's Fresno campus, which serves 15 Western states.

**SPITZER BRINGS FRAUD SUIT AGAINST H&R BLOCK**

New York Attorney General Elliot Spitzer is alleging H&R Block steered approximately 500,000 customers into IRA accounts that were "virtually guaranteed" to lose money, with 85 percent of the accounts doing just that.

Customers who opened an Express IRA account were often burdened by unadvertised account fees, making it difficult to grow their savings, said Spitzer, who is currently seeking the Democratic nomination for governor of New York.

"(H&R Block) has been advertising itself quite consistently as being in your corner," said Spitzer at a press conference. "I think it is fair to say they are not in your corner -- they've been putting their clients in the corner instead."

H&R Block rebuffed Spitzer's attacks, defending the IRA product which has been in existence since 2001. "Make no mistake -- we believe in the Express IRA product and are proud of the opportunities it presents for our client," H&R Block Chairman and CEO Mark A. Ernst said in a prepared statement.

H&R Block noted that Express IRA account holders have accumulated over \$360 million and over \$50 million in tax benefits and that the interest rates paid on Express IRA accounts remain competitive.



The IRS is reviewing all of the denied extensions to determine how many were turned down erroneously.

**IRS MAKES IT TOUGHER FOR SPOUSES TO CLAIM INNOCENCE**

It is getting harder to prove your innocence when you sign a joint tax return with your spouse that later turns out to be wrong or fraudulent -- due to a combination of tougher IRS enforcement, a string of recent court cases and ambiguous laws. Most married couples file jointly, a strategy that typically saves taxes. But as thousands of taxpayers have discovered in recent years, signing a joint return can turn into a long-running nightmare when a spouse has neglected to report taxable income or committed some other offense. In an "innocent spouse" defense, one spouse argues that he or she didn't know, and didn't have any reason to know, about any wrongdoing -- and shouldn't be responsible for paying the taxes due. Lea Fastow, the wife of former Enron Corp. Chief Financial Officer Andrew Fastow, declined to mount that defense -- though her husband later implied she could have. She pleaded guilty in 2004 to filing a false joint tax return and subsequently spent a year in federal prison. In emotional courtroom testimony, Mr. Fastow choked up and wiped tears from his eyes, saying he had misled his wife about the source of some of the couple's money from an Enron-related deal. "I find it hard to believe myself that she is guilty. I did mislead her," Mr. Fastow said.

The Internal Revenue Service's get-tough attitude is part of the agency's renewed emphasis on tax-law enforcement, which comes amid growing congressional concern about big budget deficits and unpaid taxes. Officials repeatedly emphasize their determination to eliminate what they consider to be abusive tax shelters, or transactions with no real purpose other than dodging taxes.

Congress changed the innocent-spouse law in 1998 after protests from many victims, mainly women, who felt they were getting stuck with tax bills they didn't rightfully owe. The changes broadened the circumstances under which one can qualify for relief. Critics now say these protections, in the face of stepped-up IRS enforcement, are too weak to do the job Congress intended.

A recent report to Congress by the National Taxpayer Advocate, an IRS unit designed to help taxpayers resolve problems with the agency, warned that

**Tax Facts**

◆ **MOST MARRIED COUPLES** file their federal income-tax returns jointly, instead of separately.

Tax returns filed, in millions

|            | 2002 | 2003 |
|------------|------|------|
| Jointly    | 51.3 | 51.5 |
| Separately | 2.3  | 2.5  |

Source: Internal Revenue Service