

Surviving the IRS Examination

By: Bill Bradley and Joel Slater

Somehow IRS audits do not make the list of top contributing factors to high blood pressure and cardiac stress, though those unlucky enough to be involved may disagree. This article will discuss what to expect from an IRS audit, and how you can utilize the expertise of tax professionals to help you emerge relatively unscathed.

I received a letter stating that I am being audited. They're going to eat me alive!

The first step is to Relax. Stressing out, worrying, or scrambling to gather old documents and records is pointless. The audit process could take months, and you won't know what the auditor wants to see until they ask for it. Sit back, take a nap, and get ready to do a lot of waiting.

The second step is to inform your accountant. At no point should you talk directly with the IRS. Repeat: **DO NOT TALK DIRECTLY TO THE IRS, ESPECIALLY THE AUDITOR.** Nothing you could say to the IRS will help your case, but it may hurt your case. Your accountant knows more about your tax situation than you do. He or she should be by your side at all times during this process. If your accountant is unprepared or unwilling to stand up for you in an audit, you need a new accountant.

Finally, comply with the auditor's requests. Given the IRS administrative summons power, attempts to conceal certain items and records will prove fruitless. Auditors are human beings trying to do their job. Anger, pettiness, and snide remarks will only hurt your case. Let the auditor do their job and take solace in the fact that they will not have the final say in the matter.

The audit is over. I survived, but at what cost?

Upon the conclusion of the audit, the clock starts ticking. Practically every audit will end with the issuance of a Letter 950, otherwise known as a "30-Day Letter," explaining the proposed changes, taxes, interest, and penalties due based on the auditor's report. You will have, you guessed it, 30 days to respond. During this short window you will have your first chance to challenge the audit results.

If the amount owed is substantial, you should seek legal counsel and consider appealing. Your attorney will need to submit a Form 12203 or file a separate written protest depending on the total amount owed. Once the appeal documents are submitted, it's time to sit back and wait again. The appeals process will take anywhere from 6 to 18 months. You will eventually be referred to an appeals officer within the IRS Appeals Division. IRS Appeals is a neutral division of the IRS – they hear both sides of the story. IRS Appeals is very informal. You can make verbal legal arguments, settlement offers, and generally discuss the case freely with the appeals officer. Many cases are settled at the IRS Appeals level, but not all.

IRS Appeals didn't help me at all! Now what?

If you are unable to reach a settlement at appeals, or if you fail to respond to the 30-Day Letter, you will receive a Notice of Deficiency, otherwise known as the "90-Day Letter." This notice is your last chance to challenge a tax assessment before the IRS begins collection procedures. After receiving the 90-Day Letter, you have yet another chance to challenge the audit results.

If you choose to challenge the assessment, you will have your choice of venue. You could file a petition in the United States Tax Court. This is the most common route, as it does not require you to pay the tax and penalties up front. In addition, the Tax Court procedure is streamlined and finely tuned to handle tax cases. This is your quickest route to reaching a settlement or final order. The Tax Court petition must be filed before the expiration of the 90-day period granted in the letter.

Your other option is to pay the tax and penalties and file for a refund in the United States Federal District Court (where you reside) or the United States Court of Federal Claims. This may be your only route if you failed to act before the 90-day deadline. The downside here, of course, is that you have to pay everything assessed in the 90-day letter first and file for a refund.

Is that it?

A decision by the Tax Court or District Court can be appealed to the Federal Appeals Court. Illinois is a part of the 7th Circuit, and so the legal precedent established by the 7th Circuit Court of Appeals will control any appeal. A decision by the 7th Circuit is, for all intents and purposes, final, since the United States Supreme Court will rarely decide tax cases, apparently leaving such matters to the professionals!