

Research Shows Fighting IRS Is Often Worth It

*As Tax Agency Increases Audits,
Appeals Division Frequently Gives
Taxpayers at Least Some Relief*

By TOM HERMAN

SO YOU'VE FILED your tax return. Now comes the nail-biting time, as you pray that the Internal Revenue Service's plans to increase the number of audits this year won't include you.

But even if you are audited and are hit with additional taxes and penalties, a new government report shows your chances of getting those charges reduced—or even eliminated—may be better than you think. In the first in-depth study of its kind, the U.S. Government Accountability Office estimated that taxpayers who took their case to the IRS's appeals division won at least some relief in about 41% of the cases.

The IRS receives some 135 million individual income-tax returns a year and has been auditing a growing number of these, cracking down especially on high-income individuals and those who use tax shelters, that is, transactions the agency believes have no real purpose other than dodging taxes. Last year, the IRS audited about 1.2 million returns, up some 20% from 2004. It plans even more audits this year.

IRS audits come in many different forms: Some are handled entirely by mail, such as when the IRS asks for more documentation to support an item on your return. In other cases, the audit may take place in your home, office, your tax adviser's office or at an IRS office. If you disagree with the outcome, you can ask the appeals office to review your case.

Many people assume it isn't worth the time, trouble and expense to challenge the IRS unless the amount of money at issue is large. But the GAO's report, released last month, confirms the belief of many lawyers and accountants who say taxpayers shouldn't automatically surrender if they feel they have a strong case, or believe an auditor made a mistake. The GAO estimates that 41% of the 102,623 cases closed for 2004 "were not fully sustained" by the IRS appeals division.

Unlike other IRS staffers, appeals officers are authorized to settle cases based on the "hazards of litigation"—which means they can offer to settle based on their judgment of what could happen if the case goes to court.

For example, a client of Alan Straus, a lawyer and certified public accountant in New York, donated a painting to a museum. The client's appraiser came up with a "very different" value than the IRS's art advisory panel thought was correct. The outcome: The IRS appeals office "split the difference with us," Mr. Straus says—saving his client several thousand dollars.

In a separate case, another client of Mr. Straus—a woman under psychiatric care—was hit with hefty penalties by the IRS for not having filed two years of returns. The outcome: The IRS appeals office agreed to waive the penalties in view of her medical problems, but she had to pay the taxes due plus interest.

Appeals officers typically are "very seasoned" and "more savvy" about tax law than auditors and collection staffers, says Charles Rettig, a lawyer

Battling Back

If the IRS audits you and says you owe money, consider taking these steps:

- You can appeal the decision to the IRS's **appeals division** (see IRS Publications 5 and 556 at www.irs.gov).
- Another option is to go to court—the **U.S. Tax Court, federal district court or the Court of Federal Claims**.

at Hochman, Salkin, Rettig, Toscher & Perez in Beverly Hills, Calif. "There's an old line: 'The deals are made in appeals.'"

If you get an audit letter now, it will probably pertain to a tax return you filed in years past, not the 2005 return that you probably filed earlier this year. Appealing an unfavorable outcome could take roughly a year. If you're not satisfied with the outcome, you can slug it out with the IRS in court, either in the U.S. Tax Court, federal district court or the U.S. Court of Federal Claims. Most people who go to court choose the Tax Court because they aren't required to pay the contested tax up front.

The appeals division, with about 1,900 employees, closes more than 100,000 cases a year. Most involve individuals, although some involve corporations, says David Robison, who headed the appeals unit until recently when he left to join the law firm Skadden, Arps, Slate, Meagher & Flom as senior adviser for tax-resolution strategies. It hears a wide variety of cases involving such issues as challenges to IRS audits and "enforcement" actions. The appeals office typically resolves about 80% to 85% of all the cases it receives each year, Mr. Robison says.

The appeals unit has to deal with some of the toughest types of cases. Among them are "innocent spouse" cases, such as when ex-spouses argue they shouldn't have to pay taxes caused by their former spouse's errors or omissions on a joint return. There are also numerous cases involving an "offer in compromise," in which a taxpayer in financial distress has asked the IRS to accept less than the full amount owed. Many other cases involve "collection" issues, such as where the IRS has slapped a lien on someone's property.

Some lawyers contend that the appeals division's independence has eroded

in recent years, that appeals officers often are tougher than they once were, reflecting the IRS's overall enforcement crackdown. "They are being harder, no question about it," says Richard Shaw, a lawyer at Higgs, Fletcher & Mack in San Diego and a former head of the American Bar Association tax section. Moreover, says Alan Straus, "the level of proof and documentation that you need to supply to be successful has increased over the past few years."

IRS appeals-division officials strongly defend their independence and say they're trying to resolve as many cases as possible in a fair manner without giving away the store. "Independence is central" to the appeals division's mission and effectiveness, says Sarah Hall Ingram, an IRS lawyer who took over as chief of appeals this month. The Treasury Inspector General for Tax Administration, in a report last year, concluded the overall independence of the appeals office "appears to be sufficient."

In its report, the GAO urged the IRS to step up efforts to analyze feedback data from the appeals office in order to identify problems and assess whether additional action, such as new IRS guidance or additional training, are needed to improve the consistency of decisions. The IRS agreed.

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"SURVIVOR" WINNER Richard Hatch gets a stiff prison sentence for tax evasion.

Hatch, who won the "Survivor" television series in 2000, was sentenced by a federal judge to four years and three months in prison, according to the Jus-

tice Department. He was found guilty by a jury early this year. The government said he failed to report to the IRS about \$1.4 million from the "Survivor" victory and other sources. The judge increased Hatch's sentence for "obstruction of justice," the Justice Department said.

"Our nation's federal tax system is not a reality show to be outwitted," said Eileen J. O'Connor, assistant attorney general of the Justice Department's Tax Division. "It is a reality, period."

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CALIFORNIA HAD MORE MILLIONAIRES than any other state in 2001.

IRS researchers say that in 2001, the latest year for which they have data, there were about 3.5 million U.S. millionaires—those with net worth of \$1 million or more. A recent article in the IRS Statistics of Income Bulletin says California ranked first with 572,000 millionaires. New York ranked second with 317,000, followed by Florida and Illinois.

The article is by Barry Johnson and Brian Raub of the IRS.

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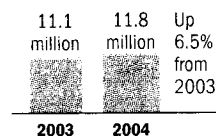
BRIEFS: Under the tax bill to be signed today by President Bush, about four million people will be hit by the alternative minimum tax for this year, about the same number as last year, a Treasury spokesman says. If Congress had done nothing, the number of AMT victims would have soared to more than 22 million. ... Still haven't got your federal income-tax refund? Try the IRS Web site (www.irs.gov), and type "Where's My Refund" in the search box.

Email me at taxreport@wsj.com.

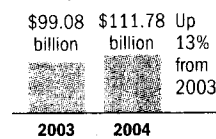
Tax Facts

◆ **MORE PEOPLE** are paying federal income tax on their Social Security benefits.

Number of returns with taxable Social Security benefits



Dollar Amount of taxable Social Security benefits



Source: IRS Statistics of Income Bulletin, preliminary data