SWEET AND SOUR REVENGE

One of the IRS's tools for finding audit targets has historically been the newspaper and, more recently, the Internet. Now the IRS has a fresh web source in CheaterNews.com where the scorned and lied to are already busy naming names and telling tales of woe in messages headlined with alerts like "Satan's Son. More than a few postings have detailed accounts of tax fraud. But the most interesting item on CheaterNews is an advertisement that would seem to guarantee future visitors to the site. The ad offers to help people "find interesting married men and women for safe and anonymous adventures." Stay tuned.

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on other TV shows, most recently the "Battle of the Network Reality Stars" on Bravo.

NICHOLED AND DIMED

An IRS Appeals officer abused his discretion when he determined to proceed with the collection by levy of 48 cents, plus penalties and interest. The taxpayer and his wife had filed a joint return for the tax year at issue and, at the time of filing, paid approximately one-half of the total tax liability. Shortly thereafter, the husband, an intellectual property lawyer, entered into an installment agreement with the IRS that called for him to make two payments totaling $26,696.48 (which included the unpaid tax liability and interest and penalties). The taxpayer made two timely payments of $13,348.00, as required by the installment agreement, rounding down the amount due according to the IRS's conventions. The IRS then tried to collect by levy the 48 cents, plus penalties and interest, a total of $440.00. After a Collection Due Process hearing, the Appeals officer issued a determination sustaining the proposed levy because taxpayers are usually charged a late payment penalty and interest until the amount owed is paid in full.

The Tax Court rejected the IRS's argument that its determination was not an abuse of discretion. Because most of the amount to be collected was penalties and interest, the IRS had the burden of production. In order to satisfy that burden, the IRS had to produce evidence indicating that it was appropriate to impose the penalties and interest. However, the only evidence produced by the IRS indicated that the taxpayer's liability for the year at issue was satisfied. In addition, the taxpayer credibly testified that he made timely payments of the tax, penalties, and interest required by his installment agreement with the IRS. Moreover, the IRS presented no evidence concerning how the disputed amounts were calculated. Finally, the installment agreement entered into by the parties already imposed penalties and interest on the unpaid liability and the IRS failed to show that any amount accrued in excess of the amount already paid.

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Volume VI, Issue 19
Friday, 9:47 AM

Learn How to Avoid

IRS

problems and solve them if you find yourself with one!

Inside This Issue...

"I thought our procedures were well within established accounting principles"

IRS: AUDITS UP 20%

The IRS recently announced that the number of tax-return audits in 2005 increased by over 20% to 1.22 million, the highest number in seven years.

In addition, increased audits led to a 10 %growth in "enforcement revenues," to $47.3 billion. IRS Commissioner Mark W. Everson said the better enforcement stemmed from increased efforts to train employees to comply with the 1998 IRS reform act. Audits of high-income individuals – those with salaries of more than $100,000 -- reached their highest level in 10 years, at 221,000. Everson said he felt that the coverage in this category was still low compared to his goals, with only 1 in 63 high-income individuals being audited. After several years of decline, audits of small corporations more than doubled, to almost 18,000. And audits of corporations with assets of over $10 million increased 14 percent, to nearly 11,000. Everson also noted that audit rates were still below their mid-1990s highs, but had increased dramatically from just a few years ago. The agency also reported that levies and liens had recovered to levels last seen in 1998, and that seizures were up slightly from 2004. The IRS budget for fiscal year 2005 was $10.2 billion, and President Bush has recommended an increase to $10.7 billion for 2006.

THE CHECK'S IN THE BAY

A highway accident on September 11, 2005, caused some 30,000 quarterly estimated tax payments to the IRS to be dumped into San Francisco Bay off the San Mateo Bridge. The IRS said the checks were being transported from a post office to an IRS lock box.

AUDIT RED FLAGS: DO YOU REALLY THINK YOU CAN OUTFOX THE IRS?

The overall number of individual audits is still relatively small, but membership in this club is open to all. Unfortunately, you can never be sure what will trigger an audit. You may not be an outright tax cheat, but your return may contain a couple of those red flags. Here are five to watch out for.

VOCAL TAX FOE PLEADS GUILTY

The last issue of The Tax Advocate discussed the arrest of Nick Jesson of Huntington Beach for federal tax evasion. Mr. Jesson has since entered a plea of guilty, but still faces a state trial on tax charges. A nationally known anti-tax crusader, Mr. Jesson ran unsuccessfully for governor of California in 2002, finishing fourth of seven candidates in the 2002 GOP primary for governor. He was arrested in April at his company, No Time Delay Electronics, in Huntington Beach. An IRS spokesman said that Jesson admitted to filing a false federal tax form in May 2000, contending that his business paid no wages in 1997. He actually paid wages of $177,083 that year to himself and $273,236 to his wife. Jesson also admitted falsely obtaining a business tax refund of $215,454 and converting it to his personal use. He faces a maximum sentence of five years in prison and a fine of $250,000, plus $215,454 in restitution. He remains free until sentencing. Jesson and his wife, Trina Thi Vu, also face a state court trial on six felony charges of failing to pay state taxes on $3 million in income from 1997 to 1999. Court documents in the state case allege that the couple falsely reported their taxable personal income as zero for 1997 through 1999. If convicted on the state charges, Jesson could face up to nine years in prison. His wife could face seven years. Each is free on $250,000 bail in that case. Jesson was involved with We the People Foundation for Constitutional Education, a tax protest group that bought a full-page ad in USA Today in 2001 to declare that the government did not have the authority to collect taxes from paychecks.

Itemized deductions

The IRS is more likely to scrutinize returns with itemized deductions than those that take only the standard deduction. The agency keeps a range of "normal" deductions for each tax bracket based on the average claim taken. So if you are earning $45,000 a year and deduct half of that for mortgage interest -- but the average for your tax bracket is around $5,000 -- the taxman may come calling. $7,000 on business meals? If the average for your tax bracket is only $1,500, watch out. If you can legitimately claim those deductions, by all means take them. But hold on to your receipts.

Hobby losses

If you are holding down a full-time job but are running a side business, you may be targeted for an audit if your pet project posts a loss year after year. Schedule C is used to report income or loss from sole proprietorships, but some businesses are little more than a cover-up for a loss-producing hobby. The Internal Revenue Code does not permit you to deduct hobby losses. The gentleman farmer that doesn't intend to turn a profit, is an example of a hobbyist. Even if that hobby generates a few bucks, it may be in your best interest to stay far, far away from Schedule C because the IRS may not be satisfied with a modest profit.

Schedule C filers are among the highest audit risk group so be prepared to justify your claims (or to consider incorporating). Consider drafting a business plan and enlist expert help, if needed. Also, carefully record your business expenses and keep them separate from your personal expenditures and consider using a separate checkbook. The goal is to present yourself as a professional, not an amateur.

Home office deductions

If your place of business is also your residence, be careful with that home office deduction. The room has to be used exclusively for business purposes. You cannot just have a desk in your living room where you have a television set.

Have a tape measure handy because the IRS limits that deduction to the actual space your office occupies. So if your office takes up 200 square feet in a 1,000 square foot apartment, then only 20 percent (200 divided by 1,000) of your total housing expenses are eligible for that deduction. Your total housing expenses includes any rent or mortgage, insurance, utilities, and maintenance associated with the residence. Beware though, because a home office deduction cannot result in a loss. If your business income totals $6,000, but you have $5,000 in business expenses and $1,500 in home office costs, that last $500 cannot be deducted from your taxes. You can, however, carry that deduction over to the next year provided you have sufficient income.

Casualty losses

The rules regarding casualty losses are very specific. Such losses must exceed any insurance reimbursement by $100. Even then, that first $100 is not deductible. Next, your loss must be attributed to a sudden event such as theft, fire, or hurricane damage. Losses that result from a gradual wearing down of conditions – such as erosion -- do not qualify. And finally, the total loss must exceed 10 % of an individual taxpayer's adjusted gross income (AGI) after any insurance payments have been received. That percent isn't deductible either and you cannot claim the loss until you've been reimbursed by your insurer. For example, if your home was damaged by lightning and your loss, after any insurance payments have been received, totaled $20,000 the first $100 is not deductible. Now if your AGI is $70,000 then the first 10 percent, or $7,000, of the remaining $19,900 isn't deductible either. That leaves you with only a $12,900 casualty loss deduction. Also note that your deduction is limited to the actual cost of the item, not its value.

CELLAR UNDONE

This has little to do with tax law, and I add it only for a bit of levity. A madam in the United Kingdom who amassed millions running a brothel empire has been sentenced to community service and may forfeit her fortune as well. The Manchester Guardian reports that Ann O'Brien of London (née Wambui of Nairobi) was so prosperous that she planned to add a dungeon activity room to her establishment. She was arrested by police posing as paying customers who received nothing in return – a tactic that the judge described as "doing your duty but certainly no more."

IRS TO FOCUS ON S CORPORATIONS

The IRS will be conducting special random audits of about 5,000 S Corporations as part of a wide-ranging program to help combat tax evasion and improve compliance. S Corporations are the single most popular entity and their total assets are huge. In 2002, 3.2 million S Corporations filed returns. The audits will be the first of their kind in 20 years and will focus on the extent to which income, deductions, and credits are properly reported not only by the corporations, but also their owners.

"I thought I was guilty until my lawyer straightened me out"

High income

Not only are your taxes higher, your chances of being audited are 1 in 20 if you earn $100,000 or more. Higher income earners are more likely to be audited because there is more tax money at stake. The IRS is a business, they have employees and they do not have time to let them audit people if they are only going to earn $2 worth of tax. Earning less money really isn't an option, but high earners should be aware that the government is eyeing their returns very carefully. So any temptation to tack on another $1,000 to a charitable deduction shouldn't be indulged.

Luckily, none of that applies to me.

You may not fall into any of those categories, but a few careless errors may cause the IRS to take a second look at your returns. Using tax preparation software could alleviate some of the drudgery and cut down on simple mathematical errors. If your math is off, the IRS will likely re-compute your taxes.

If it is a relatively small thing, like you transpose two numbers, that is less likely to trigger an audit than if you omit a large portion of your income. Also, be sure to sign and date your return once it is completed. This isn't an audit red flag either, but you don't want to lure the IRS into looking over your return for more than is necessary.

SURVIVOR WINNER INDICTED

Richard Hatch, who won $1 million on the first season of the reality show "Survivor," was indicted for failing to pay taxes on his winnings. Prosecutors had charged Hatch with two counts of tax evasion in January, and he agreed to plead guilty. But he backed out of the deal in March, saying he thought CBS was responsible for paying the taxes on his prize. CBS has said Hatch knew he had to pay taxes on the winnings. The new indictment charges Hatch with 10 counts including tax evasion, filing a false tax return, wire fraud, bank fraud and mail fraud. According to the indictment, his 2000 and 2001 tax returns omitted his income from the reality show, $327,000 he was paid to co-host a radio show and $28,000 in rent on a property he owns in Newport. Hatch, 44, also was accused of misusing $36,500 from a nonprofit camp he set up, Horizon Bound. If found guilty on all charges, he could face up to 75 years in prison and several million dollars in fines. Hatch won during the first season of "Survivor" in August 2000. He has since appeared