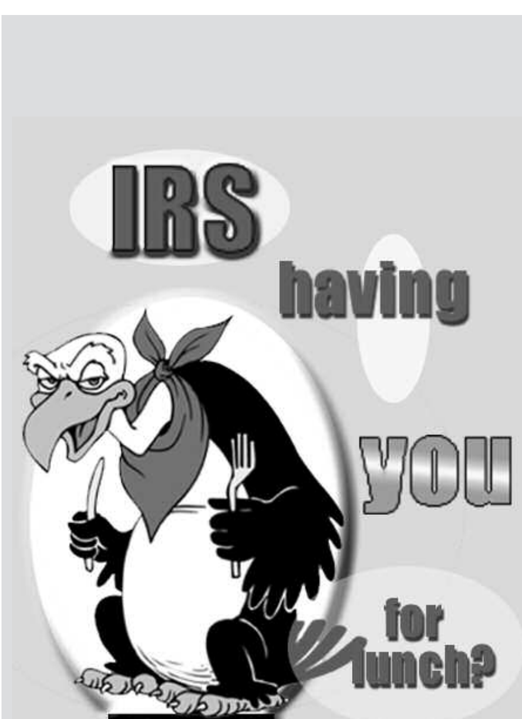
CUTTING A DEAL WITH THE IRS GROWS INCREASINGLY TAXING

Negotiating with the IRS has never been easy and has now gotten even tougher. As the IRS increasingly focuses on collecting more taxes, allowing taxpayers to write off their liability has become an increasing harder row to hoe and makes questionable pitches promising that you will pay only pennies on the dollar. Only those taxpayers with a legitimate and severe hardship still have a shot at winning a reprieve through the offer-in-compromise program. In addition, taxpayers wishing to submit an offer must include a 20% up front payment.

Scott Kauffman, PLC
18881 Von Karman Avenue
Suite 1225
Irvine, CA 92612
Ph: 949-474-1820
Fx: 949-474-1823
besttaxadvocate@email.com
www.besttaxadvocate.com



SENATE HEARING FOCUSES ON FRAUD IN TAX PREPARATION

On April 12, 2007, the Senate Finance Committee (SFC) held its annual hearing on the tax filing season and the challenges taxpayers face. In his opening remarks, SFC Chairman Max Baucus, D-Mont., said that the government needs to do all it can to give "confidence to taxpayers" so that voluntary compliance will not be "shaken." Echoing the chairman's remarks, ranking member Charles E. Grassley, R-Iowa, said that "Congress needs to do more to ensure that those preparing returns possess the competence and ethical standards necessary to maintain the integrity of our tax system." Over 62 percent of all individual income tax returns were prepared by paid preparers in 2006, according to Grassley. In visits to 19 paid tax return preparation companies, the Government Accountability Office (GAO) found that not one preparer could properly prepare a tax return, according to GAO Director, Tax Issues, James White. He testified that preparers were not reporting business income, failing to claim all deductions or failing to itemize deductions entirely.

BUSINESS OR HOBBY LOSS?

The IRS is increasing its efforts to stop taxpayers from deducting losses on activities that are not businesses. Research is showing the IRS that taxpayer errors are costing the Government billions of dollars each year in unpaid taxes. The problem is it's not all that easy to distinguish a business start up from a hobby. Figuring out whether you are running a business or a hobby can be tricky. Factors to be considered: Time and effort and knowledge to carry on the activity for profit. Have you made a profit in the past? Taxpayers should keep close attention to record keeping.

Scott Kauffman, A Professional Law Corp.
18881 Von Karman Ave., Suite 1225
Irvine, California 92612

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Volume VI, Issue 19
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Inside This Issue...


"Always be nice to the little people. They could serve on your jury one day."

JUSTICE DEPARTMENT GOES AFTER JACKSON HEWITT

The Department of Justice has filed suit against five Jackson Hewitt franchise operations for fraudulent tax return preparation. The five franchises prepared over 105,000 returns last year and operated more than 125 Jackson Hewitt tax preparation stores in the Chicago, Atlanta, Detroit, and Raleigh-Durham areas. The government estimates that it has lost $70 million in tax revenue. Jackson Hewitt is the second largest tax return preparer in the United States. The suits name 24 individuals, including Farrukh Sohail of Atlanta, who it is alleged to own part of all of the five franchise corporations. The lawsuits accuse Sohail and the other defendants of having "created and fostered a business environment ... in which fraudulent tax return preparation is encouraged and flourishes."

HOW TO AVOID AN AUDIT

The IRS is cranking up its efforts to catch tax dodgers and cheats, but as usual will end up crushing innocents along the way. Pressured by a Congress which is looking for ways to avoid raising taxes, the IRS is boosting audits of high-income earners, which rose 18% in 2006 from 2005. The IRS recently updated its top-secret computerized scoring systems that helps it target returns ripe for audit. Trouble is most widespread among taxpayers who do not receive 1099s or W2s or who deal in large amounts of cash. Another warning sign is claiming large deductions relative to income. This year the IRS will be scrutinizing deductions for charitable deductions of non-cash items. To avoid trouble, don't guess on market values. Instead use a tax preparing professional who have access to built-in estimating tools. Keep complete records of donations, including lists and photos of whatever you give or get a professional appraisal. Another easy way to attract attention is to deduct hefty losses each year from what you consider to be a business, but the IRS sees as a hobby.

TAX MAN POISED TO GAIN MORE CLOUT

Congress, facing a tight budget, is looking for additional revenue, and lawmakers are focusing on narrowing the tax gap, collecting money taxpayers owe but don't pay. Getting people to pay more of the taxes they owe is politically preferable to raising taxes. Congress is set to arm the IRS with new tools to track underreported income. The primary focus will be requiring business middlemen, such as credit card processors to provide more data. In addition, some legislators want to ramp up the IRS budget and are concerned that it has stopped some inquiries prematurely because it is short on staff. Lawmakers are also exploring ways to provide the IRS with more information about income people earn selling goods at auctions, including those occurring online. Another ideas would require stock brokers to report the initial purchase price of stocks sold. But businesses are already pushing back against the new enforcement campaign, criticizing some ideas as too onerous.

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IT OUT

FIVE AUDIT RED FLAGS

Think you know how the IRS picks its audit victims? You may want to reconsider that notion. Even most accountants say they don't know how to crack the IRS' audit formula. But with the tax agency auditing 1.2 million individuals last year and the IRS ramping up its enforcement spending in recent years, experts say it might be worth taking a look at your return to make sure you aren't making yourself a target for the tax man.

Overkill on charitable contributions. While giving to your favorite non-profit can be rewarding both personally and for the tax break, giving to charity could attract the attention of the IRS, especially if the donation is disproportionate to your annual income. And you might even want to think long and hard before you start inflating the value of that 1982 Dodge Diplomat you donated this summer or the Paul Cezanne painting you gave to charity. Many individuals will overvalue those items and think that the IRS won't notice.

Too many deductions for the self-employed. For those Americans that are self-employed or run a small business, the IRS is really watching you. While filing a Schedule C alone may not be a red flag, the IRS is wary of these taxpayers since they contributed about $68 billion to the $345 billion tax gap as of 2001. The tax man knows there is a temptation by self-employed taxpayers to blur the distinction between personal and business expenses, such as a mileage deduction on your car or calling that room in the basement of your home your office. But don't think you're fooling anyone with that trick. In fact, the IRS will probably size up your expenses relative to your business to make sure your return is honest. Those are areas that the IRS tends to be more concerned about being abused so they are more likely to be audited.

Above-average deductions. The IRS is also closely looking at unusually high deductions. If you earned $100,000 from your day job, but gambled in the real estate market this year and claimed a $40,000 loss, you might become audit material. The IRS computer definitely generates a much greater amount of audits based on categories where incomes and losses are offsetting each other. At the same time, the tax man will weigh the deductions and expenses on your return against other taxpayers in your income bracket. While you might not be able to do anything about that $20,000 medical bill or the inheritance you received from a departed relative last year, if your deductions or expenses tend to be higher than normal that could raise a red flag.

Making six figures. It may not be promising news for those individuals on the higher end of the tax strata, but believe it or not, if you make over $100,000 a year, that could draw some attention to your tax return. During the fiscal year 2005, audits of taxpayers taking home over $100,000 annually reached 221,000, double the number in 2001. And if that's not enough to convince you, in November, IRS Commissioner Mark Everson said in a statement that the coverage of this category "still too low". According to tax experts, those individuals are lucrative targets for the IRS.

Careless omissions. Keep your return as neat and slim as possible. That means filing electronically instead of handwriting your return and avoid attaching any unnecessary forms to your tax return. If there is a need for additional info they'll ask for it. You're trying to avoid someone putting hands on your return.

FORMER IRS DIRECTOR PLEADS GUILTY TO $1.3 MILLION TAX FRAUD

A former Internal Revenue Service (IRS) district director, has pled guilty to conspiring to defraud the United States through his involvement in a tax fraud scheme promoted by the Topeka, Kansas-based "Renaissance, The Tax People, Inc.,". During a hearing before U.S. District Judge Carlos Murguia in Kansas City, Kan., Jesse Ayala Cota admitted defrauding the U.S. Treasury of more than $1.3million and to earning more than $300,000 from his participation in the scheme. Cota, 65, of Vista, Calif., admitted in his plea agreement that from 1997 though April 2002, the conspirators, through Renaissance, operated a scheme to defraud the government and individuals by marketing a program designed to sell illegal tax deductions through false and misleading representations. His co-conspirators, Todd Eugene Strand and Daniel Joel Gleason, previously pleaded guilty to the same fraudulent scheme. Additionally, Cota admitted that during his participation in the conspiracy, those involved prepared or had others prepare false federal income tax returns resulting in a tax loss of approximately $1.3 million. Cota faces a potential maximum sentence of five years in prison followed by up to three years of supervised release, a $250,000 fine, and liability for the costs of prosecution. U.S. District Judge Carlos Murguia scheduled sentencing for January 2008.

"It was semantic difference. The goverment called it 'fraud'; we said it was a misplaced decimal point."

PRESSURE MOUNTS TO CRACK DOWN ON NONFILERS

The IRS is facing increased pressure from Congress to do a better job of nabbing those who should be filing returns but aren't. Under legislation proposed by President Bush, an individual who fails to file tax returns in any three years within a five consecutive year period could be facing 5 years imprisonment. The Treasury Department estimates nonfilers cost the Government about $25 Billion a year.

WHISTLEBLOWER LAW AN EARLY SUCCESS

The IRS recently received tips from informants hoping to cash in on a law offering sharply higher rewards in cases involving large amounts of tax cheating. Since enactment in 2006, the IRS has received about 20 reward claims, some involving hundreds of millions of dollars. Some reward claims have come from people who are knowledgeable insiders with substantial documentation. Rewards range from 15% to 30% of the amount collected. The law applies to someone with information involving a business or an individual whose annual gross income exceeds $200,000 and the amount in dispute exceeds $2,000,000.