

*Excerpt from eBook*

# IRS Tax Audits and Collections

Accuracy Related Penalty

Omission of Over 25% of Income

FBAR Civil Penalties: Reasonable Cause Exception

Collection After Assessment

IRS: Jeopardy Assessment

Offer in Compromise

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# THE WOLFE LAW GROUP

Gary S. Wolfe has over 34 years of experience, specializing in IRS Tax Audits and International Tax Matters including: International Tax Planning/Tax Compliance, and International Asset Protection.

As of July 2016, Gary Wolfe has internationally published 15 books and 28 articles. Gary has received 14 international tax awards from five different Global expert societies in LONDON/UK including being voted one of the 100 leading world's law firms with votes from over 150,000 voters in over 160 countries with the following award: Global 100 (2016) (KMH Media Group) - CA/US International Tax Planning Law Firm of the Year.

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## **Chapter 30 - Accuracy Related Penalty**

The two penalties primarily applicable to underpayments of tax are the accuracy-related penalty (Code Sec. 6662) and the fraud penalty (Code Sec. 6663).

The accuracy-related penalty consolidates all of the penalties relating to the accuracy of tax returns. It is equal to 20% of the portion of the underpayment of tax (i.e. greater of \$5,000 or 10% of the tax) that is attributable to one or more of the following: (1) negligence or disregard of rules or regulations, (2) substantial understatement of income tax, (3) substantial valuation misstatement, and (4) substantial overstatements of pension liabilities (Code Sec. 6662(a) and (b))., or 40% of the tax underpayment from an undisclosed foreign financial account understatement.

The accuracy-related penalty is entirely separate from the failure to file penalty and will be imposed if no return, other than a return prepared by the IRS when a person fails to make a required return, is filed (Code Sec. 6664 (b)). In addition, the accuracy-related penalty will not apply to any portion of a tax underpayment on which the fraud penalty is imposed.

Also, no penalty is imposed with respect to any portion of any underpayment if the taxpayer shows that there was reasonable cause for the underpayment and that the taxpayer acted in good faith (Code Sec. 6664(c)).

## **Chapter 31 - Omission of Over 25% of Income**

If the taxpayer omits from gross income (total receipts, without reduction for cost) an amount in excess of 25% of the amount of gross income stated in the return, a six-year limitation period on assessment applies.

An item will not be considered as omitted from gross income if information sufficient to apprise the IRS of the nature and amount of such item is disclosed in the return or in any schedule or statement attached to the return (Code Sec. 6501(e); Reg. §301.6501(e)-1(a)).

## **Chapter 32 - FBAR Civil Penalties: Reasonable Cause Exception**

A failure to file a FBAR has civil and criminal penalties (which are in addition to any income tax penalties if the income is not reported). The IRS must assess the civil penalties within 6 years of the FBAR violation (31 USC 5321(b)(1)).

For a willful failure to file, the civil penalty increases from \$10,000 (non-willful failure to file) to the greater of \$100,000 or 50% of the account balance in the foreign account for the tax year.

The civil penalties for non-willful failure to file may be waived by the IRS if the Taxpayer can show reasonable cause. If the Taxpayer has a reasonable cause exception, the FBAR should be filed with an explanation (i.e., the reasonable cause, with an express request for waiver of penalties).

The waiver of civil penalties for a reasonable cause exception may include among other factors:

All the income from the foreign account was included on the US Taxpayer's return.

The Taxpayer was unaware of the requirement to file (for example, lack of understanding of what constitutes a financial interest).

Once the Taxpayer became aware of the filing requirements, he filed all delinquent reports (up to 6 years).

## **Chapter 33 - Collection After Assessment**

After assessment of tax made within the statutory period of limitation, the tax may be collected by levy or a proceeding in court commenced within 10 years after the assessment or within any period for collection agreed upon in writing between the IRS and the taxpayer before the expiration of the 10-year period. The period agreed upon by the parties may be extended by later written agreements so long as they are made prior to the expiration of the period previously agreed upon. The IRS has to notify taxpayers of their right to refuse an extension each time one is requested (Code Sec. 6501(c)(4)). If a timely court proceeding has commenced for the collection of the tax, then the period during which the tax may be collected is extended until the liability for tax (or a judgment against the taxpayer) is satisfied or becomes unenforceable.

Generally effective after 1999, the 10-year limitations period on collections may not be extended if there has not been a levy on any of the taxpayer's property. If the taxpayer entered into an installment agreement with the IRS, however, the 10-year limitations period may be extended for the period that the limitations period was extended under the original terms of the installment agreement plus 90 days. If, in any request made on or before December 31, 1999, a taxpayer agreed to extend the 10-year period of limitations on collections, the extension will expire on the latest of:

the last day of the original 10-year limitations period,

December 31, 2002, or

in the case of an extension in connection with an installment agreement, the 90th day after the extension.

Interest accrues on a deficiency from the date the tax was due (determined without regard to extensions) until the date payment is received at the rate specified (Reg. §301.6601-1(a)(1)). Interest may be assessed and collected during the period in which the related tax may be collected (Code Sec. 6601(g)).

## **Chapter 34 - IRS: Jeopardy Assessment**

Under a jeopardy assessment, Taxpayers who have unreported income may be subject to immediate IRS seizure of assets. If the IRS determines that tax collection is at risk, the IRS may immediately seize taxpayer assets without prior notice.

The IRS must have made a determination that a deficiency existed and that tax collection would be jeopardized if the IRS were to follow normal assessment and collection procedures. (IRC § 6861(a)).

In the event of a jeopardy assessment, the IRS is permitted to send a notice and demand for payment immediately. (IRC § 6861(a)).

Normally, the IRS assertion of an income tax deficiency is made after the taxpayer's year closes and the tax return is filed. However, if the IRS determines that a Taxpayer (who received significant income) may prejudice tax collection (e.g., leave the country, place assets beyond IRS reach) the IRS may issue a jeopardy assessment (levy on Taxpayer's property without prior notice (IRC § 6861(a)).

IRS jeopardy assessment requirements:

1. The Taxpayer's year is completed;
2. The due date of the tax return (with extensions) has passed;
3. Either:
  - Taxpayer did not file tax return or;
  - Tax liability on the filed return is understated, and;
  - Tax collection is jeopardized.

Treas. Reg. Sections 301.6861 – 1(a)

IRS general levy requirements (IRC § 6330, 6331) do not apply if the IRS finds that tax collection is in jeopardy.

Under IRC § 6330(f), the IRS is entitled to levy on taxpayer's property, without prior notice to Taxpayer.

To justify a jeopardy levy, the IRS must be able to show:

1. The Taxpayer is (or appears to be) designing to quickly depart from the U.S.;
2. The Taxpayer is (or appears to be) designing to quickly place their assets beyond the reach of the IRS by:
  - a. Removing assets from the U.S.;



- b. Concealing assets;
- c. Dissipating assets;
- d. Transferring assets to third parties; or

3. The Taxpayer is in danger of becoming insolvent (bankruptcy or receivership, alone is not sufficient evidence to establish financial insolvency for jeopardy purposes).

The IRS procedures for a jeopardy levy, (as stated in the Internal Revenue Manual):

1. IRS chief counsel must personally give prior written approval to a jeopardy levy (IRC § 7429(a));
2. Thereafter, the IRS must provide Taxpayer with a written statement, within five days, of the information upon which the IRS relied in making its jeopardy levy (IRC § 7429(a)(1)(B));
3. IRM 5.11, Notice of Levy Handbook section 3.5(5) instructs the IRS to try to give Taxpayer notice in person, or certified mail (last known address);

IRS notice should include:

- a. Reason for jeopardy levy;
- b. Taxpayer's rights to administrative and judicial review (IRC § 7429);
- c. Notice of Taxpayer's rights to administrative and judicial review within a reasonable period of time (under IRC § 6330).

The jeopardy assessment may be made either:

Before or after a notice of tax deficiency is issued, and;

Also, either before or after a Tax Court petition is filed (IRC § 6861(a), Treas. Reg. Section 301.6861 – 1(a).

IRS notice and demand for payment gives the Taxpayer ten days to pay the tax in full or post a bond to stay collection (Treas. Reg. Section 301.6861 – 1(d).

If tax collection is determined to be in jeopardy, the IRS may immediately levy on Taxpayer's assets (without 30 day notice of intent to levy) (IRC § 6331(d)(3)), subject to IRS chief counsel personally approving the levy in writing (IRC § 7429(a)(1)(A)).

The IRS must send a formal notice of deficiency within 60 days after making the jeopardy assessment (IRC § 6861(b)). Upon receipt of notice of deficiency, the Taxpayer may file a Tax Court petition for redetermination of the deficiency amount (IRC § 6213(a)).

Under IRC § 6213(a), the Tax Court petition stops additional IRS assessments until the Tax Court decision is finalized. However, upon receipt of the notice of deficiency, payment (of the tax assessed), or a bond is required, within ten days, to stay collection (IRC § 6863(a)).

Under a jeopardy assessment, any amount collected by the IRS, in excess of the amount determined by the Tax Court, (as the final assessment), is refunded (IRC § 6861(f)).

## Chapter 35 - Offer in Compromise

The IRS may compromise the tax liability in most civil or criminal cases before referral to the Department of Justice for prosecution or defense. The Attorney General or a delegate may compromise any case after the referral. However, the IRS may not compromise certain criminal liabilities arising under internal revenue laws relating to narcotics, opium, or marijuana. Interest and penalties, as well as tax, may be compromised (Code Sec. 7122; Reg. § 301.7122-1).

Offers-in-compromise are submitted on Form 656 accompanied by a financial statement on Form 433-A for an individual or Form 433-B for businesses (if based on inability to pay) (Reg. § 601.203(b)). A taxpayer who faces severe or unusual economic hardship may also apply for an offer-in-compromise by submitting Form 656. If the IRS accepts an offer-in-compromise, the payment is allocated among tax, penalties, and interest as stated in the collateral agreement with the IRS.

If no allocation is specified in the agreement and the amounts paid exceed the total tax and penalties owed, the payments will be applied to tax, penalties, and interest in that order, beginning with the earliest year. If the IRS agrees to an amount that does not exceed the combined tax and penalties, and there is no agreement regarding allocation of the payment, no amount will be allocated to interest.

A \$150 user fee is required for many offers-in-compromise (Reg. § 300.3). Taxpayers must normally pay the user fee at the time a request to compromise is submitted. No user fee is imposed with respect to offers (1) that are based solely on doubt as to liability or (2) that are made by low-income taxpayers (i.e., taxpayers whose total monthly income falls at or below income levels based on the U.S. Department of Health and Human Services poverty guidelines). If an offer is accepted to promote effective tax administration or is accepted based on doubt as to collectibility and a determination that collecting more than the amount offered would create economic hardship, the fee will be applied to the amount of the offer or, upon the taxpayer's request, refunded to the taxpayer. The fee will not be refunded if an offer is withdrawn, rejected or returned as nonprocessable. The IRS treats offers received by taxpayers in bankruptcy as non-processible, even though two district courts have held that the IRS must consider such offers (*R.H. Macher*, DC Va., 2004-1 USTC ¶150,114 (Nonacq.); *W.K. Holmes*, DC Ga., 2005-1 USTC ¶150,230). However, one district court and one bankruptcy court have held in favor of the IRS on this issue (*1900 M Restaurant Associates, Inc.*, DC D.C., 2005-1 USTC ¶150,116; *W. Uzialko*, BC-DC Pa., 2006-1 USTC ¶150,297).

Detailed IRS procedures for the submission and processing of offers-in-compromise are reflected in Rev. Proc. 2003-71.

Taxpayers are required to make nonrefundable partial payments with the submission of any offer-in-compromise (Code Sec. 7122(c)). Taxpayers who submit a lump-sum offer (any offer that will be paid in five or fewer installments) must include a payment of 20 percent of the amount offered. Taxpayers who submit a periodic payment offer must

include payment of the first proposed installment with the offer and continue making payments under the terms proposed while the offer is being evaluated. Offers that are submitted to the IRS without the required partial payments will be returned to the taxpayer as nonprocessable. However, the IRS is authorized to issue regulations waiving the payment requirement for offers based solely on doubt as to liability or filed by low-income taxpayers. Pending the issuance of regulations, the IRS has announced that it will waive the payment requirement for such offers (Notice 2006-68).

The required partial payments are applied to the taxpayer's unpaid liability and are not refundable. However, taxpayers may specify the liability to which they want their payments applied. Additionally, the user fee (see above) is applied to the taxpayer's outstanding tax liability. Any offer that is not rejected within 24 months of the date it is submitted is deemed to be accepted. However, any period during which the tax liability to be compromised is in dispute in any judicial proceeding is not taken into account in determining the expiration of the 24-month period (Code Sec. 7122 (f)).

The IRS may not levy against property while a taxpayer has a pending offer in compromise or installment agreement (Code Sec. 6331(k)). If the offer in compromise or installment agreement is ultimately rejected, the levy prohibition remains in effect for 30 days after the rejection and during the pendency of any appeal of the rejection, providing the appeal is filed within 30 days of the rejection. No levy may be made while the installment agreement is in effect. If the installment agreement is terminated by the IRS, no levy may be made for 30 days after the termination and during the pendency of any appeal.

