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*Presentation:  
Representing Your Clients During  
IRS Civil Examinations*



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## Background

Former Trial Attorney, DOJ Tax Division, Washington, DC

Founder & CEO – MCM Law LLC (d/b/a STLTaxLawyer.com)

J.D., St. Louis University, Criminal Skills Concentration

B.S., Accountancy, University of Illinois at Urbana-Champaign



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# Topics

- Audit Basics
- Pitfalls to Avoid
- Privilege Considerations
- Anticipating Challenge to Audit Determinations
- Avoiding/Detecting Possible Involvement by IRS CID



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# Audit Basics

- Types of Income Tax Examinations/Audits
  - Automated Underreporter (AUR) Program
    - Example: Missing income from 1099s, W-2s, etc.
  - Correspondence Audits
    - Generally narrow in scope
  - **Office or Field Examinations**
    - Typically handled by Tax Compliance Officers or Revenue Agents
    - Potentially broad scope



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# Audit Basics

- IRS Audit Toolbox
  - Information Document Requests (“IDRs”)
  - Interviews (oral and written)
  - Summonses (for records and/or testimony)



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# Audit Basics

- Preparing for Office/Field Audit
  - Review return(s) at issue
    - Gather records to support every item on the return (avoid surprises)
    - Review what information the client provided to the return’s preparer
    - Meet with client(s) to review any items requested (and those anticipated)
    - If any documentation is missing, see what you can reconstruct (*i.e.* mileage log)
  - Contact TCO or Revenue Agent to schedule initial meeting
    - First impressions matter – try to build rapport and trust (in-person preferred)
    - Show willingness to cooperate; recognize the agent has a job to do
    - Narrow the scope of issues



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## Audit Basics

- Responding to Audit

- Create a record - organization is key
  - Keep record of whatever you provide in response (*i.e.* Bates stamping)
  - Preserve your ability to win at next level (*i.e.* Appeals, Tax Court)
- Do the agent's work for him or her (when possible)
  - For example, if the taxpayer is self-employed the agent will likely want to perform a bank deposit review/analysis; prepare the bank deposit analysis yourself and proactively explain any non-income deposits, etc. ("Best defense is a good offense.")
- Rather than let the agent interview your client, ask for written interview questions that you can complete with the taxpayer and respond in writing



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## Audit Basics

- Goal – Agreed Resolution

- Try to reach agreement on as many issues as possible
- Don't expect to win on every issue – minimize the damage
- Don't get bogged down on areas of disagreement – move on
- Try to mitigate penalty exposure



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# Audit Basics

- Potential penalties

- Accuracy-related penalties - I.R.C. § 6662 (equal to 20% of the underpayment)
  - I.R.C. § 6662(b)(1) - Understatement due to negligence or disregard of the rules or regulations
    - Includes failure to keep adequate books and records
  - I.R.C. § 6662(b)(2) – Substantial understatement
    - For individuals, “substantial” means the greater of \$5,000 or ten percent of the tax that must be show on the return
- Civil fraud penalty - I.R.C. § 6663 (75% of the understatement)
  - Civil fraud penalties will be asserted when there is clear and convincing evidence that some part of the underpayment of tax was due to fraud



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# Audit Basics

- Avoid Penalties

- If you can show the taxpayer had **reasonable cause** for the underpayment and acted in ***good faith***
  - Could include reliance on a tax professional for advice
  - Takes into account all of the pertinent facts and circumstances



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## Pitfalls to Avoid

- Don't miss deadlines
  - If you need more time, ask for it, but don't delay unnecessarily
  - Agents also have heavy caseloads and understand scheduling demands
  - Progress is everything; you can always supplement with additional info
- Don't lie to or mislead the agent
  - If you're not sure about something, say so
- Don't make your clients' problems your own
  - Sometimes taxpayers make bad decisions that have consequences



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## Privilege Considerations

- Be careful not to waive any privilege by disclosing otherwise privileged documents and communications
  - Attorney-client privilege - common law right
    - Cover communications (oral and written)
  - Tax practitioner privilege (26 U.S.C. 7525)
    - "With respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a taxpayer and any federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney."
    - IMPORTANT: Limited to "noncriminal tax matters"



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## 5<sup>th</sup> Amendment Considerations

- “Anything you say can and will be used against you.”
- A taxpayer may invoke the Fifth and refuse to answer questions, even in a civil setting, but must have a “real and appreciable fear” of self-incrimination
  - Example: Taxpayer did not report hundreds of thousands of \$ in income; admitting this during an audit could result in criminal exposure
- Generally does not apply to producing documents
- Practice Tip: When responding to a request for testimony (oral or written), consider whether the taxpayer has criminal exposure
  - Invoking the Fifth, however, can lead to a negative inference in civil case



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## Challenging Audit Determination

- 30-Day Letter
  - Includes report of proposed adjustments to the tax return(s)
    - Form 4549 - “Statement of Income Tax Examination Changes”
  - Before the IRS issues what’s referred to the “30-Day Letter,” ask to have a conference with the agent’s manager to discuss disputed issues
  - As the letter suggests, you have 30 days to file a written protest/appeal
  - Appeal is handled by the IRS Office of Appeals after the agent’s manager reviews the protest



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# Challenging Audit Determination

- 90-Day Letter – Statutory Notice of Deficiency
  - “Ticket to Tax Court”
  - Also includes report of proposed adjustments to the tax return(s)
  - Tax Court petition must be filed within 90 days (no exceptions!)
    - Mailbox rule (must be postmarked on or before the 90<sup>th</sup> day)
    - Letter states the deadline but always double check the calculation
  - After 90 days pass, the IRS will assess the additional tax, penalties, etc.



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# Tax Court

- National forum for resolving disputes between taxpayers & the IRS
- 19 presidentially-appointed judges
  - Judges with expertise in the tax laws
  - Judges are based in DC, but travel the country to conduct trials in various designated cities
- Decisions may be appealed to U.S. Circuit Courts of Appeals
- Small tax case procedures for cases involving < \$50K (not appealable)



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## Other Ways to Challenge Assessment

- What if the taxpayer misses the Tax Court petition deadline?
  - Audit Reconsideration Process
  - Refund Suit – Federal District Court or US Court of Federal Claims
    - Cons: Must full-pay the liability before seeking refund; expansive discovery; could expose the taxpayer to other issues (cases handled by DOJ Tax Division attorneys)
    - Pros: File in home district court; right to a jury trial (unsympathetic to the IRS); judge may not be a tax expert (could be a negative)



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## Relevant Criminal Statutes

- Potential Federal Criminal Charges
  - Tax Evasion (26 U.S.C. § 7202) & Filing False Tax Returns (26 U.S.C. § 7206)
    - Failure to report income; claiming false deductions/credits
  - Willful Failure to File (26 U.S.C. § 7203)
  - Corrupt Interference with Administration of Internal Revenue Laws (26 U.S.C. § 7212)
  - Conspiracy to Defraud the U.S. (18 U.S.C. § 371)
  - Making False Statements (18 U.S.C. § 1001)



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# Criminal Tax

- Key Players:

- IRS Criminal Investigation Division (CID)
  - Administrative investigation or
  - Grand jury investigation
- Local US Attorney's Office
- DOJ Criminal Tax
  - Must authorize almost all criminal tax charges



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# Criminal Red Flags



- Inability to substantiate expenses
- Taxpayer admits to not reporting substantial income and/or falsifying deductions
- Participation in an illegal tax shelter/scheme
- History of issues with the IRS (non filing, etc.)
- Engaging in efforts to evade collection (placing assets in the hands of an alter ego nominee)
- Civil agent stops communicating with you
- Agents come in pairs...



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Questions?



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