

Podcast: Got Mail? What to Do When the IRS Contacts You

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Receiving a letter from the IRS is like seeing the flashing lights of a police patrol car in your rear view mirror. As tempting as it might be, trashing the letter is like trying to outrun the patrol car. Not all correspondence from the IRS is bad news, but good or bad, you need to understand how you should respond when contacted by the IRS.

Douglas Charnas: I'm Douglas Charnas, Member in McGlinchey's Washington DC office. I practice tax law. I'm joined by my partner, Jim Sturdivant, from our Birmingham office, who focuses on white collar investigations and proceedings, and also has an LLM in tax. Jim represents and defends corporate and individual clients in criminal and white collar matters.

Jim, sometimes you hear tax lawyers say, "pay me now or pay me more later." It's a kissing cousin to the adage, penny wise, pound foolish. No one likes paying taxes or their tax professional. But when the IRS comes knocking, not involving your tax professional early on could mean more taxes and more professional fees later.

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Jim Sturdivant: That is an unfortunate truth. Playing at home alone with taxes is risky business. To its credit, the IRS endeavors to make its communications to tax payers clear. It also assists tax payers in understanding their tax situation when the taxpayer is able to reach someone at the IRS. Even so, taxes do not lend themselves to ease of understanding and getting through to someone at the IRS can be a challenge. I recently read that in 2021, the IRS received over 281 million calls, but it only answered 32 million of those calls.

Douglas Charnas: I recently received an IRS tax tip in which it listed the reasons why a taxpayer might receive a letter or notice from the IRS. These included: the taxpayer has a balance due; the taxpayer is due a larger or smaller refund; the IRS has a question about the taxpayer's tax return; the IRS needs to verify the taxpayer's identity; the IRS needs additional information; and the IRS changed the taxpayer's tax return.

Jim Sturdivant: Well, and these reasons show that a letter from the IRS may appear to raise a simple matter that can be resolved quickly, and this might be the case. But it also may raise a much more serious matter. Responding without advice of a tax professional can cause problems that could have been avoided.

Why a taxpayer might receive a letter or notice from the IRS... these included: the taxpayer has a balance due; the taxpayer is due a larger or smaller refund; the IRS has a question about the taxpayer's tax return; the IRS needs to verify the taxpayer's identity; the IRS needs additional information; and the IRS changed the taxpayer's tax return.

Douglas Charnas: Jim, I thought we might spend a few minutes discussing the types of IRS examinations and the types of correspondence the IRS sends taxpayers. I understand that there are three general types of examinations.

First, there are **correspondence examinations**. These are conducted by mail because the information needed to resolve the tax issue can easily be furnished by the taxpayer through the mail.

Second, there are **office interview examinations**. These are conducted at an IRS office because the IRS determines that the issue cannot be resolved through the mail.

Third, there are **field examinations**. These are more involved and are conducted at the taxpayer's business or home because that is where the books and records are usually kept.

Jim Sturdivant: Doug, you're correct on the three basic types of examinations.

Douglas Charnas: And I'm assuming that the most common type is the correspondence examination.

Jim Sturdivant: That's true. The IRS uses an automated system referred to as the Automated Underreporter, or AUR, function. It compares the information reported by third parties to the information recorded on your return to identify potential discrepancies. When a potential discrepancy is identified, a tax examiner further reviews the return, comparing the information reported to the IRS by employers, banks, businesses, and other payers on information returns, such as Forms W-2 and 1099, to the income reported on your tax return. If a discrepancy exists, a Notice CP2000 is issued. The CP2000 is not a bill. Rather it is a proposal to adjust your income up or down. It may result in additional tax owed or a refund.

Douglas Charnas: Is this notice an IRS examination, or what is often referred to as an audit? Or is this a less formal notification?

Jim Sturdivant: The CP2000 notice is not an examination. You usually are expected to respond within 30 days. It is not uncommon for a Form 1099 to get lost in the mail or misplaced when you receive it. So the income does not get reported. If this is the case, you likely owe the additional tax and sorting this out with the IRS can usually be handled through the mail. This is probably the most common example of a correspondence examination, or audit.

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Douglas Charnas: You know, Jim, this happened to me. I never received a Form 1099 from one bank, and I did not realize I was missing it when I filed my return. I received a CP2000 notice and worked it out with the IRS. I did not have to pay a penalty, but I did have to pay the additional tax and interest. I should note that the CP2000 is just one of several types of notices that the IRS sends taxpayers.

Correspondence examinations are not always so simple. I represented one taxpayer who fraudulently received a Form W-2 from a company where he never worked, and another taxpayer who reported all the income on Forms 1099 he received, but in both cases, the IRS proposed additional tax. The taxpayers tried to work it out with the IRS, but were unsuccessful. In both cases, I was able to sort it out with the IRS, but it took months of back and forth with the IRS.

Jim Sturdivant: Unfortunately, many tax issues that should be easy to resolve end up requiring a tax professional.

Douglas Charnas: Jim, you said that a Notice CP2000 is not a notice that I'm being examined by the IRS. How do I know if the IRS is going to examine my return?

Jim Sturdivant: The most obvious letter the IRS sends to inform you that you are under examination is a Letter 2205-A. The first paragraph of this letter generally says, "Your federal return for the period shown above was selected for examination."

Douglas Charnas: Well, my experience is that it's never good when the government selects you for something. It reminds me of a letter I received from the Selective Service at the beginning of 1973, informing me that I had been selected.

Jim Sturdivant: Yes, being selected can have its downside. The examination letter generally instructs you to call the revenue agent or tax compliance officer. The letter may include Form 4564, which is an Information Document Request, or IDR, or it may follow later. The IDR will request information such as the taxpayer's books and records, bank statements, Forms W-2, and 1099, etc., and ask for answers to questions.

Douglas Charnas: Jim, quick question. What is the difference between a Revenue Agent and a Tax Compliance Officer?

Jim Sturdivant: Revenue Agents generally are accountants and more advanced and sophisticated than Tax Compliance Officers. They handle the more complicated cases. If your case is assigned to a Revenue Agent, it signals that the IRS sees your case as one more complicated than one it would assign to a Tax Compliance Officer. Probably not a good sign.

Douglas Charnas: I know that responding to IDRs can be a daunting task. I do not want to say that the IRS tries to trick taxpayers with its questions, but the reason the IRS is asking a particular question may not be obvious.

The best way to respond to an IDR is to prepare a draft of your responses and then have your tax professional review your responses. The tax professional can explain the reason for the questions and help you answer them in a way that is least harmful to your case... Some information requested may be subject to attorney-client privilege. It is important that this privilege be asserted when it applies.

Jim Sturdivant: Without an understanding of the tax law, you may answer a question in a way you think is favorable to you, but actually hurts you. The best way to respond to an IDR is to prepare a draft of your responses and then have your tax professional review your responses. The tax professional can explain the reason for the questions and help you answer them in a way that is least harmful to your case. Sometimes there is no good answer, but you want to avoid answering in a way that is more harmful than it needs to be.

Your tax professional can also ensure that the answer fully responds to the IRS request. While it is common for the IRS to send follow up IDRs, you want to minimize the times the IRS comes back to you for additional information or questions.

And I should also note that some information requested may be subject to attorney-client privilege. It is important that this privilege be asserted when it applies.

Douglas Charnas: Jim, this is all good information. What I want to get to now is the more serious stuff in an area of the law where you have lots of experience. When a client asks me about taking an aggressive tax position, my first question is whether taking that position could land the taxpayer in prison. Committing civil fraud results in severe financial penalties, but committing criminal fraud can mean up to five years in prison.

You have worked criminal cases from both sides, first as a federal prosecutor and now as a highly respected white collar criminal defense attorney. Of all the federal enforcement agencies, the one that generally strikes more fear than any other is the IRS Criminal Investigation Division, or CID. CID, working with the Department of Justice, often gets convictions when other enforcement agencies cannot. We are all familiar with who took down Al Capone. According to CID, its conviction rate is about 90 percent.

Jim Sturdivant: A CID investigation is a serious matter. Most of the time, a taxpayer does not know that a CID investigation is underway.

Douglas Charnas: Well, how does CID select a taxpayer for an investigation?

Jim Sturdivant: CID looks for matters it finds to have criminal fraud prosecution potential, or that it deems warrant further inquiry. Some of the sources CID uses to select cases are: fraud referrals from other divisions within IRS; undercover sting operations; informants, such as ex-spouses, former employees, neighbors, and business competitors; whistleblowers; other Federal or State government agencies, such as FBI, DEA, HHS, and ATF; or, finally, other financial institutions.

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Douglas Charnas: Do CID special agents ever just show up unannounced at someone's house or workplace asking to talk?

Jim Sturdivant: Yes. Special agents usually travel in pairs and they often try to contact a taxpayer when he or she is unprepared to answer questions and possibly scared into telling them everything.

Douglas Charnas: If two individuals show up at my house or place of business and identify themselves as being with the IRS, what should I do?

Jim Sturdivant: First, if they do not identify themselves as Special Agents, ask them if they are, in fact, Special Agents. If you notice them carrying a handgun, they are Special Agents. Special Agents are the only IRS agents who carry guns.

Second, ask them to show you identification and their business card.

Third, if they have come to your house, **don't invite them in**. Be polite, but firm.

Fourth, tell them that you will have your attorney contact them.

Under no circumstances, and this is very important, **do not engage them in conversation**. Immediately call your attorney and not your accountant.

Douglas Charnas: Why not call the accountant? He or she likely prepared the tax return.

Jim Sturdivant: The Internal Revenue Code does provide some level of a confidentiality privilege between your accountant and you, but it does not extend to criminal tax matters. You do not want to say something to your accountant that is not protected by the attorney-client privilege.

Douglas Charnas: Jim, why is it so important not to talk to the Special Agents?

The Internal Revenue Code does provide some level of a confidentiality privilege between your accountant and you, but it does not extend to criminal tax matters. You do not want to say something to your accountant that is not protected by the attorney-client privilege.

Jim Sturdivant: What most people do not know is that when Special Agents show up unannounced, it is after they have done an extensive amount of investigation. They often already know the answers to the questions they want to ask you, and they want to see if you're going to lie to them.

You often see reports of high profile individuals being convicted of lying to the prosecution or impeding an investigation. They are often not convicted for the crime for which they are being investigated, but for something they did during the investigation.

Douglas Charnas: Why is this the case?

Jim Sturdivant: Well, a criminal tax violation requires the government to prove that the taxpayer intentionally committed fraud. Proving an intention to commit fraud can be difficult. But proving that a taxpayer lied to a federal agent or acted in a way to impede the investigation is usually easier to prove. When defending a taxpayer, it is easier for me to demonstrate that the taxpayer did not intend to commit fraud than to defend a lie by the taxpayer when the government has convincing evidence of the lie.

Douglas Charnas: When I turn on the TV, there is always some Law & Order episode on. I often see the detectives lying to the suspect. Can Special Agents lie to a taxpayer when they are questioning him or her?

Jim Sturdivant: Yes. And that's another reason why taxpayer should never talk to a Special Agent. Government attorneys cannot lie to a taxpayer, but Special Agents can. Taxpayers often do not know that Special Agents will lie to get the taxpayer to admit something harmful to the taxpayer.

Douglas Charnas: Well, it seems so unfair that the government agents can lie, but you cannot lie to them. Could the Special Agents arrest me at my home or place of work?

Jim Sturdivant: It could happen, but it would be extremely unusual.

Douglas Charnas: Well that's comforting. If CID concludes after its investigation that the evidence is strong enough to convict me of criminal tax fraud, what happens next?

Jim Sturdivant: CID will refer the matter to the Department of Justice. Generally, it is the Tax Division within the Department of Justice itself that will prosecute you, but it might be the local United States attorney in some cases. And it also depends on whether other criminal acts were involved or other non-tax Code crimes.

Being contacted by the IRS can be relatively benign or very serious. It is not always easy to tell. You should seek the help of a tax professional at the outset, and this can help minimize problems down the road.

Douglas Charnas: Wow. After listening to you, I'll take the flashing lights of a patrol car over CID agents any day. You've given me a lot of good information, but my big takeaway is that if I see two Special Agents approaching, I'm calling you, even if they're just going to ask me for directions to the closest Dunkin Donuts.

Jim Sturdivant: Yeah, well being contacted by the IRS can be relatively benign or very serious. It is not always easy to tell. You should seek the help of a tax professional at the outset, and this can help minimize problems down the road. If you are contacted by CID Special Agents, two fundamental rules: one, do not engage them in conversation; two, immediately contact an attorney with experience handling tax investigations. Someone without experience with government investigations can do irreparable harm to their case trying to handle matters on their own. It is not time to play at home alone with the IRS.

Douglas Charnas: Thank you, Jim. And thank you listeners for spending time today with members of the McGlinchey team.

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