PacificCPE

COURSE

34451A

IRS Operations, Filing, and Compliance Basics

Understanding how the IRS works—and what it does with your clients' information—is essential for any tax professional. This course covers IRS return processing, how tax data can become public, and what the Freedom of Information Act means for taxpayers. It also addresses filing requirements, handling IRS questions about unfiled returns, foreign financial account reporting, and tax shelter disclosures. Whether you're helping a first-time filer or a complex client, this foundation in IRS operations and filing compliance will sharpen your practice.

CREDIT HOURS 2 | FIELD OF STUDY TAXES | EXAM QUESTIONS 10

Start Course ↓

Final Exam Copy ↓

LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Recall which entity has the final word on interpreting the U.S. tax code.
- Recall the best methods for minimizing the chances of an audit when filing a federal tax return.

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Chapter 1: INSIDE THE IRS: WHAT YOU NEED TO KNOW ABOUT IRS OPERATIONS

Chapter Objective

After completing this chapter, you should be able to:

- Recall which entity has the final word on interpreting the U.S. tax code.

Let's take a look at the Internal Revenue Service (IRS). The IRS's stated mission is to "Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all."

A chart of the main IRS divisions appears below. Here is a description of the divisions and offices you're most likely to encounter.

National. The IRS is a branch of the U.S. Treasury Department, with headquarters in Washington, D.C., and is ruled by a commissioner appointed by the president. The national IRS office sets tone and policy, while procedures—especially audits and collections—are left to the regional and local offices.

The IRS is divided into four operating divisions, but only two concern most of us: the Wage and Investment Division and the Small Business/Self-Employed Division.

IRS campuses. IRS campuses (formerly called "service centers") annually process over 262 million tax filings, including over 160 million individual income tax returns. IRS campuses collect over $5.3 trillion in tax payments each year. Regional campuses are located in Austin, Kansas City, and Ogden. They mail out tax notices, collection notices, or bills; tax return problem notices; and tax forms. Contacts with the IRS campuses are usually by postal mail or fax, or occasionally by telephone.

Automated Collection System, or ACS. This program communicates with taxpayers who owe the IRS. It is a computerized collection system staffed by personnel working by phone and mail. You might talk to an ACS person, but you'll never meet one.

Local offices. Local IRS offices sit in major cities with suboffices in smaller cities. You can bet one is near you.

Each local office is divided into several departments, four of which you might encounter: examination, collection, criminal investigation, and Taxpayer Advocate Service. Let's look at these departments in more detail:

- **Examination** personnel perform audits, or examinations in IRS-speak. The people who audit tax returns are either tax auditors if they work inside the local IRS office or revenue agents if they come to your home or business, which is called the “field.” The term “auditors” in this course refers to both.
- **Collection** personnel collect tax dollars from people who haven’t voluntarily and timely paid. Local IRS collectors are called “revenue officers.” If your case goes to collection, you or your representative will meet with a collector face to face. The IRS campuses and Automated Collection System are also part of the collection apparatus, but they don’t employ revenue officers.
- **Criminal Investigation** is the police force of the IRS, and its employees are called “special agents.” If you ever meet an IRS criminal investigator, it means that you or someone you know is under investigation for a tax crime.
- **Taxpayer Advocate Service** has the IRS troubleshooters to call on when you can’t get tax problems solved through normal IRS channels. These officers are found at IRS campuses and local IRS offices. Taxpayer advocates hold powers to cut through red tape and get things done quickly.

The total number of IRS permanent and seasonal employees at all levels is approximately 79,000. Auditors make up 25%, collectors 15%, and criminal investigators 3%. The other 57% make policy, run the computers, answer taxpayer inquiries, and God only knows what else. The IRS has been downsized by 22% since 2011. Increased reliance on electronic data processing enables the IRS to continue to function.

The following example shows how the various divisions work.

Example

1. On April 15, Arnold and Aimee Tyson file their income tax return by mail with their IRS campus.
2. The information on their return is transmitted to the National Computer Center for analysis and given a potential audit score.

If the score is high enough (it is), the return is screened at the IRS campus. If the return is then deemed to have a high enough audit potential (it does), it is sent to their local office.

3. At the local office, the Tyson's return is scrutinized again and selected for examination (audit). An IRS agent calls the Tysons or sends them an examination notice.
4. The Tysons make an appointment with a tax auditor at the local IRS office. (Or alternatively, a revenue agent comes to the Tyson's business to conduct the audit.)
5. The auditor looks at the Tyson's records and suspects fraud.

He refers their file to Criminal Investigation for handling by an IRS special agent. The audit is temporarily suspended. A criminal investigation is very rare.

6. The special agent concludes that the Tysons made many errors, but they were not serious enough to be criminal acts. He sends the file back to the auditor.
7. The auditor concludes the audit and sends the Tysons an examination report.

The report states that they owe the IRS additional taxes, interest, and penalties. The Tysons disagree with the report.

8. The Tysons file an appeal, or protest, of their audit.
9. The appeal is heard at the nearest IRS Independent Office of Appeals.

The appeals officer upholds the auditor, and the Tysons file a petition in Tax Court. Tax Court is independent of the IRS. The Tysons win a partial victory in Tax Court.

10. After their Tax Court hearing, the Tysons still owe the IRS.

Taxes, interest, and penalties are formally entered, or assessed, in the Tyson's IRS computer records.

11. The Tysons receive their first series of computerized collection notices from their IRS campus. They don't pay or make only a partial payment.
12. The IRS campus eventually gives up. Next, collection notices and telephone calls come from an IRS call center.

13. The Tysons still don’t pay. The IRS call center sends the file to a revenue officer at the local office.
14. They try to work out a payment plan, but the collector is unreasonable and threatens to take their wages and property. The Tysons seek help from the Taxpayer Advocate Service.
15. With the help of a taxpayer advocate, they arrange a monthly installment plan. Assuming the Tysons make the payments on time, the case will be closed.

Tax Return Processing

From January to May, regional campuses operate around the clock, processing income tax returns, extension requests, and tax payments. Many temporary workers are hired, trained on the job, and paid little more than the minimum wage. IRS officials admit that these seasonal employees sometimes make processing mistakes.

The IRS strongly encourages all taxpayers to file electronically since it makes processing much easier for the agency. 94% of all individual tax returns are filed electronically. For the 6% of returns filed on paper, machines must open tax return envelopes and remove tax returns and checks. Until recently, human transcribers had to review the paper returns and enter the key tax return data into a computer by hand. However, the IRS now has digital scanning technology to speed up the processing of paper returns.

During the COVID-19 pandemic, the IRS had a backlog of millions of paperfiled returns it was unable to process because many of its offices were closed and/or staff were working at home. (IRS employees can’t take returns home.) The backlog has been greatly reduced, but not eliminated.

Tax return data is sent to computer centers in Detroit, Martinsburg (West Virginia), or Memphis, where each return is computer scored for its “audit potential.” About 10% of all individual (nonbusiness) income tax returns are selected for further review. These files are sent back to the regional campuses. There, IRS classifiers (human beings) weed out most of the 10% scored for audit, based on their opinions of the most problematic tax returns. So, roughly 0.5% to 1% of all individual tax returns filed are selected for further taxpayer contact.

IRS INEFFICIENCY

If you’ve never dealt with a bureaucracy, the IRS will give you a lesson in how one operates. The IRS machinery moves slowly and often breaks down. Internally, the IRS is very specialized, which can create problems right at the outset. Often, your first

challenge is to locate the right department and person to talk to. Because most IRS employees don't know or care how the IRS operates outside of their own small area, IRS personnel often don't know where to direct you. Here are the major challenges you'll encounter in dealing with the IRS.

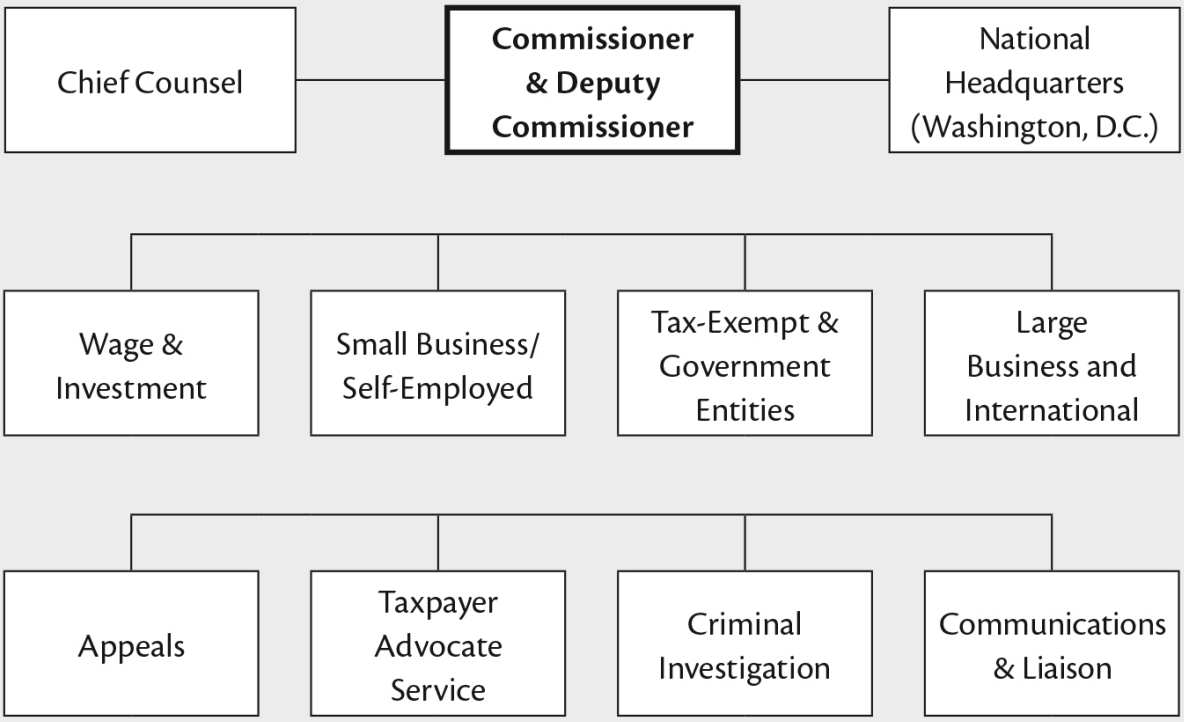
Bureaucracy. Civil servants in the IRS bureaucracy are not usually self-starters. For many, the IRS provides an escape from the long hours and competitive pressures of the private business world. Others are gaining work experience or biding their time until a better job comes along. All this results in a paint- by-the-numbers approach which can drive any taxpayer nuts. In contrast, you are highly motivated in your IRS dealings—it's your pocketbook at stake. What's important is that you hang in there. Success with the IRS is possible, especially if you are armed with the information and strategies suggested in this course.

Computers. The IRS loves its computers and would replace all its people with machines if possible. Sometimes your file gets lost in the computer—usually through human error. Often this is good—for example, if you want to delay dealing with the IRS. In many cases, however, it's better to get your file out of the computer and into human hands. Every individual taxpayer's IRS file is electronically stored by tax year or period and is computer accessed by Social Security number (SSN), not by name. Returns filed by a business with employees are accessed by the business's employer identification number (EIN).

The ultimate computerization goal of the IRS is totally paperless tax returns—a goal it is near to reaching as 94% of all individual tax returns are now filed electronically. The IRS reasons that if all your income, deductions, exemptions, and credits were electronically reported, a paper tax return would be unnecessary. Information returns, such as W-2 and 1099 forms filed by employers, banks, and the like, on paper and electronically, already make it possible for the IRS to prepare tax returns for nonfilers. And electronic tax filing allows tax refunds to be processed quickly without a paper filing.

IRS ORGANIZATIONAL CHART (SHORT VERSION)

The IRS structure is far more complicated than the chart below indicates. Only the top-level divisions you are most likely to encounter are included. The IRS publishes its own chart showing the entire organizational scheme, but you'll probably be more confused than educated if you try to read it.



Complexity. Americans have the dubious honor of having the most complex income tax laws in the world. The IRS was created to see that we follow the rules. But nobody, including the IRS, understands all of them. It's no wonder—given that the tax code is full of contradictions and hopelessly unclear provisions. Blame Congress. It's far easier to pass a tax law than to administer it or to teach a taxpayer or tax professional how to apply it. Each major tax revision produces unworkable tax provisions that are revised or repealed in the next term of Congress.

Caution!

Filing tax returns isn't voluntary. Contrary to what the tax resister, protestor, and Constitutionalist folks might say, income tax filing is not, and has never been, voluntary. Don't get us wrong. We would love to not file or pay income taxes—but in decades of doing tax work, we haven't discovered how to do this legally. The only person who can legally skip filing is the one without much, if any, income to report. Many of the tax scamsters are in prison or are destined for that fate. Common sense tells you that government services aren't free.

COMMUNICATING WITH THE IRS

If you need to communicate with the IRS, try the telephone first. A specific IRS number should be on the notice that's causing you concern. If not, call 800-829-1040, the IRS's toll-free number. Until recently, the IRS didn't use email to communicate with taxpayers, but this is starting to change. Taxpayers can now respond to some types of IRS notices electronically. Such notices contain a link and unique access code to use.

If calling doesn't work and emailing isn't an option, write a letter. However, be warned: Letters, which the IRS refers to as "white mail," aren't the best way to communicate with the IRS. The IRS gets millions of letters every year from earnest, well-meaning taxpayers with legitimate IRS concerns (in addition to letters from cranks). IRS employees are trained to respond to IRS forms, not letters. In addition, due to processing delays that the COVID-19 pandemic caused, the IRS has had a substantial backlog of unprocessed letters and other mailings.

Tip

Before contacting the IRS, find out if there is an IRS form for your problem. The IRS has a form for just about everything. For example, you can request a payment plan on Form 9465, Installment Agreement Request. The clerk who opens the mail will route the form to the proper department right away, but might leave a letter with the same request to languish in a pile. To find out if the IRS has a form for your concern, check the IRS website at www.irs.gov. Alternatively, you can call the IRS at 800-829-1040, or ask a tax adviser.

Getting Your Tax Data From the IRS

Can't find an old tax return or don't know the balance on an unpaid tax bill or whether the IRS has assessed a penalty? Here are three ways to get your tax data from the IRS: