How to participate in call-in CLE

Through ABA Connection programs of the ABA Journal, ABA Center for CLE, and ABA Membership Department

What it is

The article starting on this page is the basis for a live CLE program by telephone conference call at 1 p.m. (EST) Nov. 18, at no additional cost to ABA members. The ABA has requested MCLE credit in states that approve a telephone format.

To participate

Read "Taxman on Your Trail" and on Nov. 18 listen to the 1-hour program from any Touch-Tone phone in the 50 states or D.C.

To register

By telephone: Call the ABA at (800) 285-2221 from 8:30 a.m. to 6:30 p.m. (EST) weekdays, beginning Oct. 26. You will be asked for the membership number from your membership card or *Journal* mailing label. For state MCLE credit, you will need to have your state law license number available. Only one registration can be accepted per caller.

On the Internet: Go to www.abanet.org/cle/connection.html and follow the directions.

Multiple participants in an office who don't need MCLE credit should register under one name and listen by speakerphone to free up connections for other ABA members.

This program
Begins at 1 p.m. (EST) Nov. 18 with more tips on handling an IRS audit for a client or yourself.

Program co-sponsor
Section of Taxation.

New state credits
North Dakota and Utah now approve a telephone format, such as ABA Connection, for MCLE credit.

After registering

You will receive by fax an unpublished, toll-free telephone number to call for the program, a Personal Identification Number to access it, a certificate of attendance and an evaluation form.

On the program date

Call the toll-free number a few minutes before 1 p.m. (EST) Nov. 18, and enter your PIN. After the program, return the evaluation form.

CLE credit

States that accept a telephone format are Ala., Ariz., Ark., Calif., Colo., Fla., Idaho, Iowa, Ky., Mo., Mont., Nev., N.H., N.M., N.C., N.D., Okla., Ore., R.I., Tenn., Texas, Utah, Vt., Va., Wash., W.Va., Wis. and Wyo.

Some limitations

The ABA Connection test project is subject to modification or discontinuation. Each program is limited to 1,000 phone connections. Registrations for future programs are not accepted. Non-ABA members may pay $110 per program, if space is available. Only ABA Connection programs are available at no cost to members. Other ABA-CLE programs may require fees.

Next month from ABA Connection

How to wind up those end-of-case worries.

ABA Connection programs for self-study

This month's program and previous ones are available on audiotape. Some programs also are available through ABA-CLE On Demand, a telephone audio library accessible 24 hours-a-day. For information and costs, call the ABA Service Center at (800) 285-2221.

Taxmen on Your Trail

Even though Congress passed legislation to make IRS probes easier on taxpayers, clients still need a firm legal hand to guide them through the mean streets of audit city.

BY SAMUEL L. BRAUNSTEIN

Like the shadowy figures that stalk the hero in a classic old detective movie, the specter of being subjected to an audit by the Internal Revenue Service can give someone the feeling of being hunted down.

Ask any client—or lawyer, for that matter—who has been through it. No letter from the government, except maybe the one that used to come from the draft board, delivers the punch of the one that starts: "Dear Taxpayer: Your return has been selected for examination. You have 10 days to ..."

It hardly helps to acknowledge that audits are a distasteful but necessary aspect of the enforcement process that helps give the tax system its credibility. As the Russians have come to understand, a tax system's effectiveness depends on its ability to collect those taxes.

The IRS takes that responsibility very seriously. At a congressional hearing earlier this year, IRS Commissioner Charles Rossotti reported that the gap between the government's estimate of what should be paid by the nation's taxpayers every year and the amount actually collected is about $195 billion—more than 10 percent of the new federal budget.

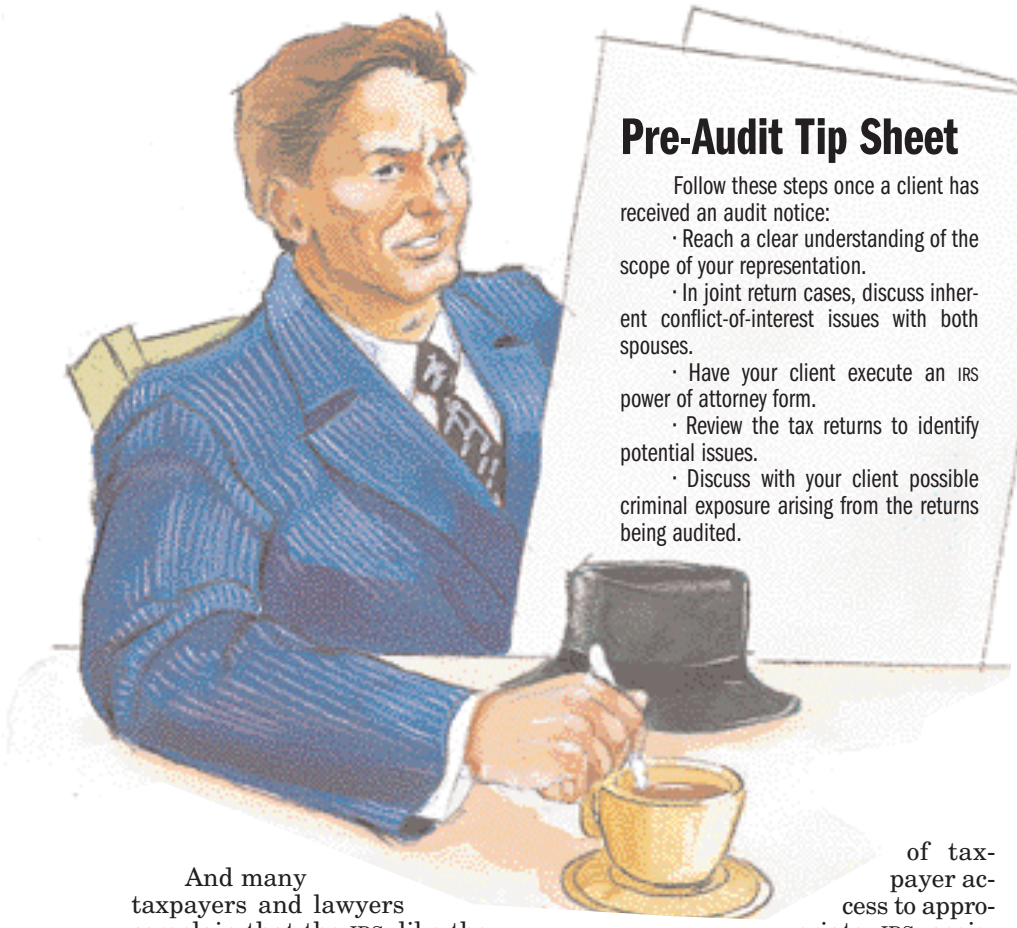
In representing clients—and, from time to time, themselves—lawyers must remember that the underlying reason for the existence of the IRS is, as it has said, to enforce the tax laws in a fair but aggressive manner and to ensure the collection of the maximum amount of tax revenue that it can generate in a "voluntary" system.

The problem is, that mission is unlikely to make the IRS very popular among those taxpayers, despite occasional efforts by the service to be more user-friendly and service-oriented.

Samuel L. Braunstein is a member of Braunstein & Todisco in Fairfield, Conn. In the ABA Section of Taxation, he is vice-chair of the Closely Held Businesses Committee and a member of the Continuing Legal Education Committee.

ILLUSTRATIONS BY JUVENAL MARTINEZ

Reprinted with permission *ABA JOURNAL,* NOVEMBER 1998



Pre-Audit Tip Sheet

Follow these steps once a client has received an audit notice:

· Reach a clear understanding of the scope of your representation.

· In joint return cases, discuss inherent conflict-of-interest issues with both spouses.

· Have your client execute an IRS power of attorney form.

· Review the tax returns to identify potential issues.

· Discuss with your client possible criminal exposure arising from the returns being audited.

And many taxpayers and lawyers complain that the IRS, like the movie detective who blindly breaks the rules in his obsession with tracking down a suspect, often becomes so carried away by its zeal to fulfill the mission of collecting taxes that it loses credibility with taxpayers.

Earlier this year, the IRS lost credibility with Congress, as well, after hearings in which taxpayers and service employees alike testified to a litany of incidents in which the service mishandled cases and mistreated individuals undergoing audits.

The Internal Restructuring Scheme

The result of those hearings was Congress' adoption of the Internal Revenue Service Restructuring and Reform Act of 1998, which President Clinton signed in July. While the act did not receive the fanfare that greeted its predecessor, the Taxpayer Relief Act of 1997, it has targeted a number of aspects of the tax enforcement process that have long rankled taxpayers, lawyers and other tax advisers.

The hearings before the Senate Finance Committee chaired by William V. Roth Jr., R-Del., revealed a number of alleged inequities, including an actual or perceived lack of taxpayer access to appropriate IRS assistance; a lack of confidentiality under IRS rules between taxpayers and tax return preparers who are not attorneys; unavailability of "innocent spouse" relief in many cases even when it would be equitable; inflexibility of the "offers-in-compromise" program; excessive penalties and interest on taxes owed; alleged abusive collection tactics by the IRS; and the burden of proof imposed on taxpayers in most controversies.

The case of *Cockrell v. Commissioner,* 79 AFTR2d 97-1067, became something of a lightning rod for these frustrations when the U.S. Supreme Court refused in March to hear the appeal of a decision by the 2nd U.S. Circuit Court of Appeals at New York City (unpublished, No. 96-4072, June 24, 1997) affirming an IRS determination that Elizabeth Cockrell could be held responsible for the $650,000 tax bill related to business ventures of her husband before they divorced in 1983.

Cockrell became a star witness before the Senate Finance Committee on how divorced people (usually wives) are often pursued by the IRS for the tax debts of their former spouses. And when the Supreme Court refused to hear the case, Roth issued a statement that the Court's decision "shows that we need to take strong congressional action to prevent the IRS from hounding innocent spouses for debts that are not theirs."

Predictably, the 1998 IRS act includes provisions that significantly ease the requirements for obtaining innocent spouse relief from joint and several tax liability, both for spouses who are still married and for those who are divorced or separated.

The act also contains a number of other measures that should make life a little easier for taxpayers:

• The current geographic structure of the IRS, based on regional divisions, will be replaced with units that serve groups of taxpayers with similar interests and needs, such as individual taxpayers who have only wage and investment income; small businesses, including sole proprietors and small corporations; larger corporations; and tax-exempt entities.

• In noncriminal matters before the IRS, the privilege of confidentiality that now exists between taxpayers and their attorneys is being extended to other "federally authorized tax practitioners."

• The act limits the power of the IRS to levy against a taxpayer's

'Tax Tips Live' Is New CLE Offering

Gift, estate and generation-skipping taxes will be the topics on the first Tax Tips Live, a continuing legal education teleconference being offered by the ABA Section of Taxation as a new member benefit.

The 60-minute program will start at 1 p.m. (EST) on Dec. 1.

The $55 registration fee for Tax Section members will be waived for the first 100 section members to register. The registration fee for nonmembers is $110.

For more information or to register, call ABA Member Services at (800) 285-2221.

property while an offer in compromise is pending, and it calls for independent administrative review of decisions by the service to reject such offers.

• The act implements several reductions in the penalty and interest rates that the IRS may impose on underpaid taxes, and it gives the service more flexibility to waive those charges in appropriate cases.

• A number of changes have been made in IRS tax collection practices, including greater restrictions on the service's powers to seize residences and businesses, application of the Fair Debt Collection Practices Act to IRS employees, and higher exemption levels for IRS liens and levies.

• In court proceedings, the burden of proof with respect to factual issues relevant to determining tax liability has been substantially shifted from the taxpayer to the IRS, provided the taxpayer presents credible evidence with respect to such issues and satisfies several other specified conditions.

Do all those changes mean we no longer should fear the audit and tax collection process? Not exactly. The process will continue to be cause for high anxiety, and lawyers must still guide their clients carefully through it. Here are some clues on how to do it.

When the Bad News Arrives

Invariably, when clients call to tell you they "got the letter," they also will ask (in the same breath), "What do they want from me, and why are they auditing my return?" That has to be one of the most unanswerable questions any practitioner ever hears.

But for the attorney, pondering the answer to that question is not as important as following several rules of thumb once the client has been notified of a tax audit:

• There should be a clear delineation of the scope of the engagement, set forth in writing, between you and your client.

While the engagement must conform with the applicable state rules of professional conduct, it also must meet additional requirements specified in U.S. Treasury Department Circular No. 230 (Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries and Appraisers before the Internal Revenue Service).

In particular, circular sections 10.28 (Fees) and 10.29 (Conflicting Interests) should be consulted in defining the nature and extent of the engagement. Under those provisions, practitioners are forbidden to charge unconscionable fees for representing clients in matters before the IRS; contingent fees are sharply limited; and practitioners are forbidden to represent conflicting interests except by express consent of all directly interested parties after full disclosure has been made.

• When the audit involves a joint tax return filed by a married couple, discuss with both spouses the inherent conflict-of-interest issues that may be raised in the normal course of the audit process.

• Before involving your client's accountant or other return preparer, discuss with the client any possible criminal exposure that may exist with regard to the tax returns being audited.

• Your client should execute IRS Form 2848 (Power of Attorney and Declaration of Representative), appointing you to represent him or her in the audit.

• Review the tax returns in question to identify probable tax issues that can be expected to evolve during the audit.

Even with changes implemented by the 1998 act that soften the blow of the innocent spouse rule, a useful step would be to consider ways to avoid the application of the rule altogether.

Due in large part to the successful indoctrination of taxpayers by the IRS over the years, however, even the suggestion that a married couple file their income tax returns as "married filing separate" carries the taint of supposed marital difficulties.

As a result, the decision by married couples to file their tax returns jointly has become as much an instinctive affirmation of their marriage vows as a reasoned tax planning decision.

The problem with such uncompromising but sometimes ill-considered allegiance is found in Internal Revenue Code § 6013(d)(3), which states that, if a joint return is made, "the tax shall be computed on the aggregate income and the liability with respect to the tax shall be joint and several."

The 1998 act requires the IRS to distribute appropriate explanations to taxpayers of the ramifications of filing jointly rather than separately.

Breaking Out of Joint

A discussion between attorney and clients regarding the ramifications of filing a joint return should start with these considerations (and there likely will be others, depending on the circumstances of the particular clients):

• Even with changes under the 1998 act, the defenses available for relief from each party's liability stemming from joint tax returns are still few and difficult to assert successfully.

• When joint returns are filed, one spouse still can be held respon-

The Big Meeting

When the audit begins, remember:

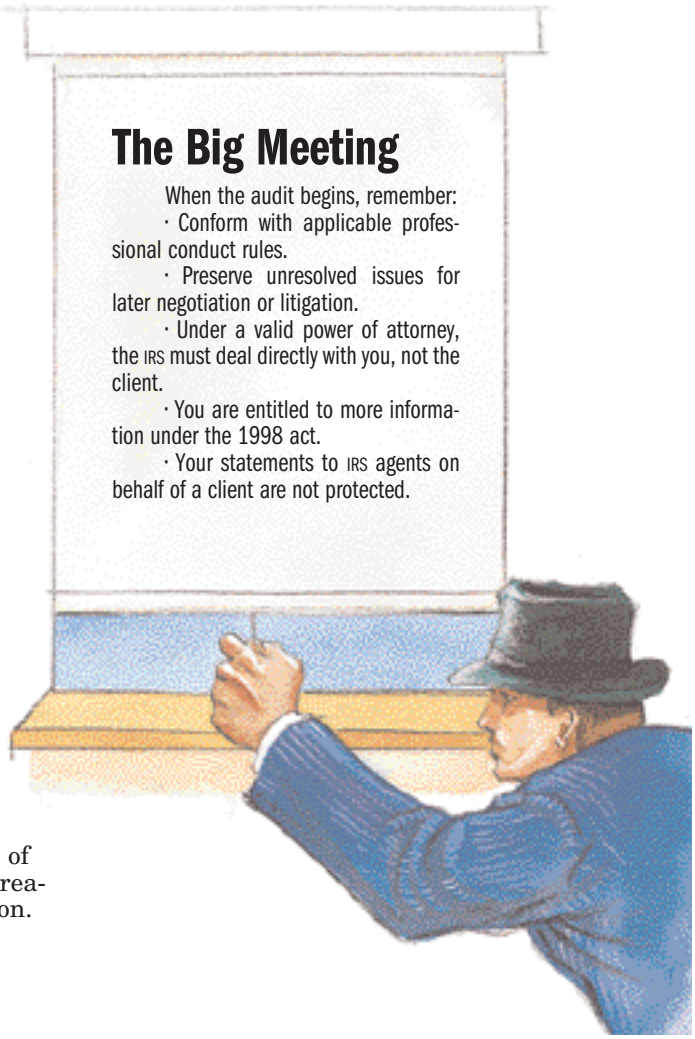
· Conform with applicable professional conduct rules.

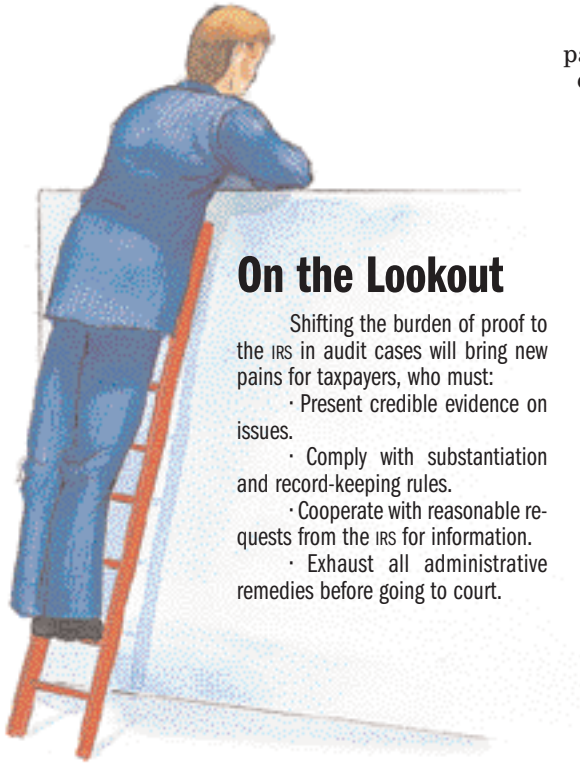
· Preserve unresolved issues for later negotiation or litigation.

· Under a valid power of attorney, the IRS must deal directly with you, not the client.

· You are entitled to more information under the 1998 act.

· Your statements to IRS agents on behalf of a client are not protected.





On the Lookout

Shifting the burden of proof to the IRS in audit cases will bring new pains for taxpayers, who must:

· Present credible evidence on issues.

· Comply with substantiation and record-keeping rules.

· Cooperate with reasonable requests from the IRS for information.

· Exhaust all administrative remedies before going to court.

sible for prior existing tax problems of the other spouse.

• "Aggressive" tax positions of one spouse can still be attributed to both spouses.

• Even when a couple divorces, for tax purposes they remain married for an additional period of some three years due to the statute of limitations regarding audits of returns and matters related to them. And even if there is a normal hold harmless clause in the divorce settlement or decree, the clients must understand that it is not binding on the IRS, which still may seek to collect taxes from the most convenient source.

Watch Who You Talk To

One of the most publicized and controversial provisions in the 1998 IRS Restructuring and Reform Act applies the extended confidentiality privilege that previously existed only for attorneys and their clients to certain nonlawyers, as well.

Specifically, in any noncriminal proceeding before the IRS, a taxpayer is now apparently entitled to the same basic confidentiality protections with respect to tax advice given by a federally authorized tax practitioner as he or she would have if the adviser were a lawyer.

But there are dangers lurking in that rule for unsuspecting taxpayers. Because the extended confidentiality privilege is extremely limited in scope and application, it is likely that many taxpayers will unknowingly disclose unprotected confidences that could end up leading to criminal prosecutions.

Accordingly, if your client discloses any information that may create "real" criminal exposures, it may be necessary for you to take an entirely different approach to your representation than you have in the past.

The new steps you may need to consider include mandating independent representation of one of the spouses in the audit and even, in appropriate circumstances, referring representation to a criminal litigator experienced in tax issues.

That need for flexibility, especially during the audit process, underscores the importance of having the client execute IRS Form 2848 (Power of Attorney).

Of particular interest on the form is the "acts authorized" provision whereby specific additional powers may be granted to the taxpayer's representative.

Some practitioners specifically include, as a matter of course, "the authority to add additional representatives, substitute other representatives or to delegate authority," which allows them to selectively engage (and terminate) their "team" as the audit progresses without having to submit new or revised powers of attorney to the client each time there is a change.

In conjunction with your analysis of the affected tax returns and supporting data in preparation for an audit, you should arrange for a tax specialist—lawyer or otherwise—to help assess the probable tax issues and potential liability exposures unless you already are well-qualified to do so yourself.

In most cases, the natural selection will be the tax return preparer. If it is determined, however, that there may be some type of criminal exposure or, alternatively, a material civil discrepancy stemming from the preparation of the return, the prudent course of action might dictate the engagement of an independent tax practitioner to assist during the audit process.

Face to Face With the Feds

The actual audit may be conducted at an IRS office, your client's premises or your office. Wherever it is held, there are certain considerations you should keep in mind when representing the client:

• Your conduct must conform with your jurisdiction's professional conduct rules, Treasury Circular 230 and all other appropriate rules, statutes and court decisions.

• You should formulate a strategy that will enable you to preserve any issues that cannot be resolved at the initial level of the examination for negotiation or litigation at a subsequent higher level—most likely the federal courts.

• If you have filed a valid power of attorney (IRS Form 2848) with the service, IRS personnel are effectively precluded, except for certain special circumstances, from having direct contact with your client, thereby giving you effective control over the development and presentation of the information presented during the audit and the orderly resolution of issues as they arise.

• The 1998 act requires the Internal Revenue Service to provide—either automatically or on request—several new forms of notice and information that can offer valuable insight into the origin of the audit and what particular items are of primary interest to the examiner, such as omitted income, unreported barter transactions, excessive charitable deductions or excessive losses from rental property.

• Your statements to an IRS agent on behalf of a client are not protected, as they might be in other types of cases. Accordingly, it is particularly important that you not provide information or make any representation to the IRS on behalf of your client unless you have determined to your satisfaction that it is accurate.

The question, "How far do you go?" in cooperating with the examining agent in the audit is not easily answered.

In most adversarial matters, an attorney normally refrains from doing the other side's homework and concentrates efforts on presenting

the case in the light most favorable to the client.

In that regard, however, there may be an unintended consequence resulting from provisions in the 1998 act that shift the burden of proof in tax proceedings to the IRS:

- The taxpayer must present "credible" evidence with respect to an issue.
- The taxpayer must comply with requirements regarding substantiation and recordkeeping.
- The taxpayer must cooperate with "reasonable" requests by the IRS regarding witnesses, information, documents, meetings and interviews (whether in the United States or in foreign countries).
- The taxpayer must exhaust all available administrative remedies, including appeals, within the IRS before pursuing his or her case in court.

The practical consequence of the burden-shifting requirements may actually be to substantially increase the expense to taxpayers of being represented in audits, especially since all administrative remedies must be exhausted prior to litigation without regard to costs.

Moreover, the attorney also will probably be inclined to spend considerably more time—all at a cost to the client—on the audit in order to meet the 1998 act's "full cooperation" requirement and assure that a court will not rule in subsequent litigation that the burden of proof did not shift because the taxpayer failed to meet the requirement. (If such a ruling is issued, the attorney might want to reread certain portions of his or her malpractice insurance policy.)

One additional point to remember in an audit situation: The examining agent is essentially a finder of fact. As such, the agent is limited in his or her authority to make substantive interpretations of the applicable law. It is critical to recognize those limitations and to present and argue the facts at the audit level.

When It Happens to You

Make no mistake about it, the legal profession is a special target for audits by the IRS.

And lawyers may as well not look to Congress to lift the siege, either. Congress in effect gave its blessing to the IRS policy when it included a provision in the Taxpayer Relief Act of 1997 stating that any person engaged in a trade or business who makes a payment in the course of that trade or business to an attorney for legal services must, with few exceptions, file an information return with the IRS and a statement with the attorney.

Information on which segments of the legal profession are most likely to be targeted for IRS audits can be culled from the Market Segment Specialization Program, a project begun by the IRS in 1988 to identify lawyers who did not file federal income tax returns. In that program, the service has determined that certain segments of the legal profession tend to produce more audit adjustments than others:

- Practice areas in which cash payments are common, such as criminal law and immigration law.
- Areas in which lawyers accept interests in property, such as an equity interest in real estate or a business, rather than regular fees.
- Areas in which there are significant accounting/timing issues, such as personal injury, where lawyers often advance client costs.
- Areas in which there is significant activity in client trust accounts, raising the issues of who actually owns the funds in an account and how those funds should be treated for purposes of tax reporting.

Look Out, Solos

Based on its analysis of data gathered in the market segment project, the IRS concluded that solo practitioners and small firms were the best candidates for audit.

In analyzing tax returns filed by lawyers for their audit potential, the IRS has paid particular attention to levels of income reported, sources of income, amounts and sources of withholding credits, and total tax paid.

The data also was analyzed in conjunction with the law schools that attorneys attended and when they graduated for the primary purpose of identifying practitioners with a "propensity to earn substantial income because of graduation from a prestigious law school."

A lawyer who is facing an audit should take the same first step as just about anyone else: Retain expert representation. In doing so, lawyers should be aware that they are likely to be subjected to a more intensive investigation from the IRS than most taxpayers. Moreover, the ramifications of an audit can reach far beyond the tax realm for lawyers. Remember the adage that describes the client of the lawyer who represents himself.

Whether the IRS is justified in its selective treatment of lawyers is a question that will be answered only over time. If it looks hard enough, the government will find bad as well as good lawyers when it comes to reporting and paying taxes—just as it would with any segment of the population.

As lawyers, however, we claim to follow higher standards of professional conduct than the public at large. Perhaps compliance with the nation's income tax laws is not too great a burden for lawyers to carry.

At the same time, of course, it should not be too much to ask the IRS to do the same thing in return. ■

Who's Likely to Get Tapped

These practice traits increase the possibility that a lawyer will be audited by the IRS:

- Clients often pay in cash.
- Interests in property are accepted in lieu of fees.
- Client costs are advanced.
- Heavy use of client trust accounts.