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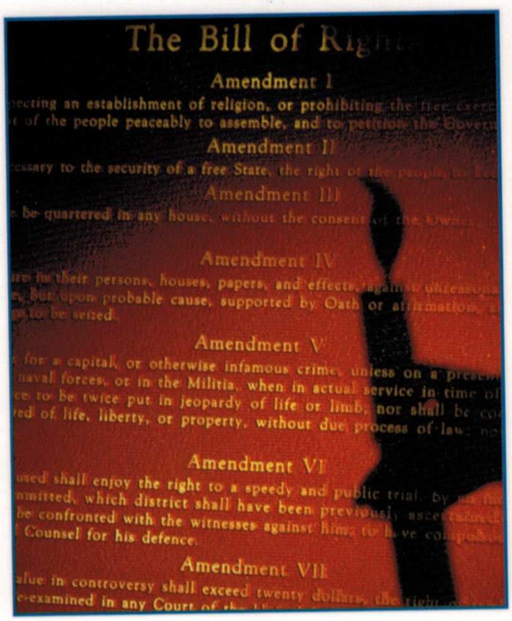
THE COMPLETE IDIOT'S GUIDE® TO

Your Civil Liberties

- **The legal lowdown** on inalienable rights guaranteed by the Constitution but threatened by national security measures
- **Expert information** on legal actions authorities may enforce in your home, car, and office
- **Essential facts** on personal information that is accessible and easily obtained



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Trademarks

Chapter 23

Taxing Matters: Internal Revenue Service

In This Chapter

- Byzantine bylaws for taxes
- The privilege of paying taxes
- Haves vs. Have-nots
- Due process is overdue

Our federal tax system harms civil liberties much more than many people realize. Not only is the code excessively complex and difficult to understand, the IRS often abuses the rights of citizens when it enforces the code. Tax matters play themselves out in a legal arena quite different than those that address civil or criminal matters. In many respects, our tax system is unfair and denies you constitutional rights you've come to expect. In fact, the IRS would have you believe that the Bill of Rights doesn't apply to them at all.

With so much power in the hands of the IRS, it's important to know how to not become a victim. New laws were recently enacted to address the flagrant abuses of the IRS. We will discuss how those laws affect you and how you can avoid a tax-auditing nightmare.

"Ignorance of the Law Is No Excuse"

How many times have you heard this one? It is the responsibility of every citizen to know the nation's laws and comply with them. The old maxim applies to the tax code just as equally as it applies to anything else. However, the complexity of the code and the constant amendments to our tax laws make compliance, for many taxpayers, unusually difficult.

The Law of the Land

In the 1926 case of *Bowers v. Kerbaugh-Empire*, the Supreme Court noted that a statute that is "so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application, violates that first essential of due process of law." Sure sounds like they're talking about the tax code!

The federal tax rules and regulations span over 45,000 pages and offer over 700 different forms (be sure to choose the right ones!). To add insult to injury, many rules frequently change. For instance, pension tax laws have changed substantially nearly every year since the early 1980s, leaving employers baffled over how to comply. And did you know there were over 440 amendments to the tax rules in the 2001 tax cut law alone?

When the tax system consists of more than 45,000 pages of law and regulation, compliance is no easy matter. Most taxpayers make every reasonable effort to appropriately comply with the law. However, their efforts are often defeated because they do not understand what the law requires. Oddly, a tax professional may prove to be no help either. The tax laws are now so complex that even many tax professionals are often ignorant of all the nuances of the code.

Each year from 1987 to 1991, *Money* magazine conducted a study of the competence of various tax professionals. Editors of the magazine created a hypothetical family financial profile and presented those facts to 50 different tax professionals in the private sector. The instructions were simple: Compute the tax liability of the hypothetical family based upon the facts provided and any applicable tax laws. Guess what? In every survey ever sent out, 50 different tax professionals came up with 50 different answers. Even more astounding is the fact that not one tax professional came up with the right answer!

Taking Liberties

In 1993, the IRS overcharged taxpayers five billion dollars in penalty assessments.

Don't think the IRS knows the answers either. According to the report of the General Accounting Office (GAO), nearly half of all IRS audits are erroneous, and about 40 percent of the penalty revenues collected each year were wrongfully assessed. Additionally, the GAO report reveals that each year the IRS telephone taxpayer assistance hotline provides approximately 8.5 million Americans with the wrong answers to basic questions about the tax laws.

Is the Tax System "Voluntary"?

Hardly. If it were, few people would pay taxes. The income tax currently supplies more than half of the federal government's revenue. How will the government support itself without an income tax? In the early part of our nation's history, the federal government relied solely on tariffs and excise taxes, but this revenue wasn't enough to support the activities of a growing and more powerful government. This shortfall led Congress to ratify of the Sixteenth Amendment to the Constitution, which empowered Congress to levy an income tax. The government needs these taxes to pay for the costs of goods and services that we can't provide well on our own—things like the military, postal system, highways, etc.

The Law of the Land

"Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among several states, and without regard to any census or enumeration."

—Sixteenth Amendment, U.S. Constitution.

It's wrong to think that Uncle Sam can open his pocketbook and allow you to keep yours closed, but this doesn't stop thousands of scam artists around the country from claiming that the payment of income taxes actually is voluntary. Those claims are false! The requirement to pay a personal income tax is set forth in section 1 of the Internal Revenue Code. To support their claim, tax protestors point to the Form 1040 instruction booklet, which refers to the filing of a tax return as voluntary. It reads: "You are among the millions of Americans who comply with the tax law voluntarily."

> What do they really mean by "voluntarily"? That only means that an IRS agent won't show up at your door on April 15 and decide what you owe. The word voluntary refers to our system of permitting taxpayers to assess their own tax liability and file the appropriate returns, rather than have the IRS determine the tax for them. Paying your taxes, however, is not voluntary, and we've got some case law to prove it. For instance, the 1989 case *United States* v. *Schiff* puts it this bluntly: "The payment of income taxes is not voluntary." In other words: A taxpayer's legal obligation to comply with tax laws is as voluntary as a driver's legal obligation to stop at a red light. Although in both cases enforcement depends on the 'voluntary' actions of individuals, compliance with the law is not optional and all violators are on notice that noncompliance will be punished.
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> —*Department of Correction* v. *Duncan Keizer*, et al., OATH No. 1481-98 (N.Y. Nov. 30, 1998).

To ensure compliance with the voluntary part, IRS computers examine your financial information. Employers and financial institutions also report your income. So if you didn't file, or did file but underreported your income, the computer will catch it, and you can expect the IRS to "voluntarily" get in touch with *you.* Failure to file your return and pay taxes owed could subject you to fines and imprisonment. In short, if you voluntarily fail to file your tax return, you may also be volunteering for an orange jump suit with free room and board at Uncle Sam's penitentiary.

Statutes of Liberties

Good news for Form 1040 filers: Your compliance is strictly voluntary! Bad news: Failure to comply may result in fines and imprisonment.

Is the Tax System Fair?

That depends on whom you ask (and how much in taxes that person you ask is paying). In many ways, our tax system is unfair. Taxpayers within the same salary bracket are treated unequally by the many exemptions, credits, and deductions provided in the tax code. For example, homeowners receive preferential treatment in our tax system by way of itemized deductions for mortgage interest and property taxes. Renters could easily pay thousands more per year because of these intricacies. Also, there are more than 50 tax provisions that provide differing benefits depending on whether you're married, divorced, or single. In essence, the tax code is used by Congress to encourage or discourage a particular lifestyle.

Looking for Liberty

Chief Justice John Marshall once said, "The power to tax involves the power to destroy."

Additionally, our due process rights are ignored in many respects by the federal income tax regime. The IRS is granted broad authority to obtain private confidential records without court intervention or supervision. Without a warrant, the IRS can obtain your personal records from banks, credit agencies, and other financial institutions. In fact, the IRS regularly conducts Fourth Amendment-style searches and seizures, without the necessity of a warrant or probable cause.

During 2001, for example, the IRS arbitrarily decided to target taxpayers who use credit cards issued overseas, demanding that credit card companies reveal confidential records. The IRS had no reason to suspect illegal activity on the part of any such taxpayers, nor was there actual proof that these cardholders were tax evaders. But this didn't stop the IRS from conducting a fishing expedition into the private financial affairs of American citizens. The IRS received millions of private financial records from MasterCard and American Express that involve cardholder accounts in 30 countries. The broad authority to obtain private records without court supervision has been aptly referred to by the Supreme Court as the "power of inquisition."

Guilty Until Proven Innocent

Generally, in our legal system of justice, you are presumed innocent until proven guilty. This rule applies whether you're being sued in a civil matter or charged by the state in a criminal case; the plaintiff or prosecutor carries the burden of proving that you are at fault. However, there is an exception to the general rule: the IRS.

In the vast majority of cases, the IRS does not have to prove that the taxpayer is guilty. Rather, it is the taxpayer who must prove that the IRS has made an error. So, if you receive a notice of deficiency from the IRS, chances are, unless you can afford to bring them to court, you're stuck paying the taxes. That's the oddity of it: A taxpayer must bring the IRS to court to prove the IRS is wrong. It's like being the victim of a car accident and having the at-fault driver receive unfettered discretion to wipe out your bank accounts, seize your assets, and snatch your paycheck to pay for injuries and damages unless, and until, you drag him into court and persuade a judge that you're the innocent party.

> **Statutes of Liberties**
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> If the IRS sends you a "Notice of Deficiency," you have 90 days from the date on that notice to file a petition with the tax court. If you miss the 90-day cutoff, you are required to pay the tax. Although, you may sue for a refund, your option to sue before payment is gone.

Although you have the option to sue the IRS to prove your innocence, your court options aren't too impressive either. Your choices are to litigate in either the U.S. Tax Court, U.S. District Court, or U.S. Court of Federal Claims. If you select the U.S. Tax Court, you lose the right to a jury trial. Since the tax court is an administrative court, not an Article III court, no jury trial is required. To obtain a jury trial, you must file suit in a U.S. District Court. But before that can happen, all taxes, penalties, and interest that the IRS claims you owe must be paid in full. The last option—the U.S. Court of Federal Claims—is the least favored of the three: You must pay the taxes in full, *and* you have no right to a jury trial.

The burden of litigation, especially the time and expense, often overwhelm the average taxpayer. To relieve the expense burden, you may be awarded costs and attorney's fees if you prevail and the court finds that the IRS's position was not substantially justified.

Without Judge or Jury

As you can see, the "guilty until proven innocent" concept is quite clear. The collection methods available to the IRS are equally unfair. Not only can the IRS automatically stamp the word "guilty" on your forehead, they can collect their money in the smoothest and swiftest way possible.

Let's illustrate this by example. Your neighbor Bob complained for years about your barking dog in the backyard. He finally sues you for nuisance and the judge sides in Bob's favor, awarding him damages in the amount of 1,000 dollars. You were found guilty and are now liable for the dollar amount of this judgment. Now let's assume you refuse to pay Bob. Bob must go through a burdensome route to collect on his judgment, including filing additional paperwork with the court and paying a filing fee to pursue either wage garnishment, bank levy, or property liens. Not so for the IRS! The taxman doesn't need court intervention for collection.

Legal Dictionary

Tax lien—A legal claim to charges that are due to the IRS. A lien allows your property to be attached and sold if necessary to satisfy the delinquent tax.

If a tax bill goes unpaid, the matter is referred to collection personnel for action. A *tax lien* may be promptly filed against you if the IRS feels it needs to protect its interest. A tax lien may be filed in any county in which you own real estate. The IRS has the option to foreclose upon the property or wait until you sell it, in which case the IRS will collect any money that results from that sale. A tax lien may also be placed on personal property, such as autos, boats, or campers.

The IRS may also serve a legal notice to your bank, demanding that they surrender any assets in your accounts, including cash, stocks, bonds, and retirement savings. In some cases, one or more of your accounts may qualify for an exemption from this levy. Otherwise, the bank will remit the full balance in your account to the IRS, up to the amount requested in the notice of levy. Thus, any checks submitted to your account for collection thereafter may bounce.

Taking Liberties

"The art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing."

—Jean-Baptiste Colbert, the Seventeenth-century financier of Louis XIV

In addition, the IRS may garnish your wages. The wage garnishment is the most powerful tool used to collect back taxes owed. Once a wage garnishment is filed, the employer is required to remit to the IRS a large percentage of each paycheck. This can be very embarrassing since the employer is now aware of your tax problems. Another downside is that, in most instances, it leaves you with insufficient income to pay your bills.

The individual under the gun from the IRS has one good option: to attempt to reach an offer in compromise. An offer in compromise is an effective way to resolve a tax debt and stop the collection activities described above. An *offer in compromise* is a contract between you and the IRS that allows you to pay a reduced amount in full settlement of the tax debt. However, the IRS will only agree to an offer in compromise if there is doubt as to the actual tax liability or if you are financially unable to pay the full amount of the debt. A current statement of your financial affairs signed under penalty of perjury must be furnished before a compromise agreement will be considered. You can be assured that the IRS will verify your financial information by reviewing prior years' tax returns, and by reviewing bank, courthouse, and state motor vehicle records.

The program benefits the IRS by providing more revenue than it would otherwise receive and by encouraging future compliance by taxpayers. Be aware that if you default on the terms of the compromise agreement, the original tax liability can be revived, which sets you back to square one.

Legal Dictionary

Offer in compromise—An agreement to pay an amount that is less than the full tax liability due.

New Protections

In 1998, Congress passed the Internal Revenue Service Restructuring and Reform Act. This new law extends taxpayer rights by shifting the burden of proof to the IRS if certain conditions are met.

Under the new laws, the IRS must now prove its point on any factual issue, provided that the taxpayer, among other things, (1) introduces credible evidence, (2) complies with substantiation requirements, (3) maintains adequate records, and (4) cooperates with the IRS. Thus far, reports show that the new laws have made few changes within the IRS. Before the burden of proof shifts, someone must determine whether you've fully "cooperated" or "complied." Who do you think will make that decision? (I'll give you a clue: It's not *you*.)

Although the new laws provide little strength in reversing the "guilty until proven innocent" standard, there are a number of protective measures in the statute that restrict the IRS's previously unrestricted right of collection. Of particular note:

- The IRS must provide 30 days notice before levying a taxpayer's property.
- Your principal residence cannot be levied without court approval.

Statutes of Liberties

The IRS must now comply with the Fair Debt Collection Practices Act. The FDCPA regulates the activities of debt collectors. In general, the IRS cannot harass, oppress, or abuse any person in connection with the collection of taxes.

- The IRS cannot seize your residence to satisfy a liability of 5,000 dollars or less.
- The IRS is subject to the Fair Debt Collection Practices Act.

In an effort to make the IRS more taxpayer-friendly, they also reduced the agency's ability to go after affluent tax cheats. Our kinder, friendlier IRS now picks on the working poor. At the behest of Congress, the IRS has diverted its army of enforcement agents from chasing down wealthy tax cheats to catching lower-income tax evaders.

Odds have improved significantly for those in the upper-income brackets. Among taxpayers with incomes above 100,000 dollars, the chances of being audited after 1998 are slim to none. In fact, the General Accounting Office reports that audits for the affluent group dropped more than 30 percent after the 1998 reforms, but taxpayers grossing less than 100,000 dollars are 25 percent more likely to be audited. In fact, over half of all 2001 audits targeted people claiming the earned income tax credit, a benefit claimed by low-income taxpayers. This is an oddity considering the affluent group is more likely to have income that is easier to hide. Our most affluent Americans cheat the tax system out of billions of dollars each year. In the last decade, three of America's top 10 wealthiest persons reneged on their tax liabilities.

> **Taking Liberties**
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> Following the 1998 Reform Act, the IRS reduced its full-time staff by more than 30 percent. Auditing the wealthy often takes a long time, and usually requires use of a corpus of lawyers, accountants, and consultants. The opposite scenario exists for the poor, who cannot afford to pay for top-notch legal representation.

Since a quarter of our congressional members are themselves millionaires, some will argue that they are biased to enforcing the code against their fellow compadres. Remember how hard President George H. W. Bush worked to get approval for the estate tax repeal, a tax generally collected from only the wealthiest two percent of the population? Public confidence is undermined in a tax system where not all citizens pay their fair share for government services; where the wealthy are the only one's who won't get caught and punished.

The IRS admits there is a problem and has requested Congress to give the IRS more resources to enforce the law equally for the rich and the poor. These are areas that our elected politicians must work to resolve. If they don't, next time around, you can exercise your right not to check their name on the ballot form.

How Can You Avoid an IRS Audit?

In the end, every tax matter boils down to this one question. No letter from the government is more unappreciated than 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 necessary to give the tax system its credibility (after all, a tax system's effectiveness is undermined if there were no ability to enforce and collect). So just how can you avoid an audit? To start, honesty and accuracy is of utmost importance. If you have two kids, but claim 12 dependents, you're really asking for it. If you added incorrectly or claimed a larger deduction than the law allows, the IRS computer will catch it. However, sometimes honesty and accuracy is not enough. For this reason, it is important to know how the process works in order to understand how to avoid an audit.

Statutes of Liberties

Federal law places a timeline on the IRS's ability to audit your returns. Generally, the limitations period is three years from the date you filed your return. If, however, you failed to report more than 25 percent of your income on the tax return, the limitation period extends to six years. If you filed a fraudulent return, or failed to file a return at all, no limitation period applies.

Most tax returns are selected for audit by a computer-generated program that uses a mathematical formula to compare your deductions to other similarly situated taxpayers. The formula considers income, deductions, family size, and profession to select returns that have a high probability of being inaccurate. For instance, a family of six living in Bel Air would rarely have an income of 35,000 dollars or less; and a taxpayer with a 40,000 dollars salary would rarely have 25,000 dollars in charitable contributions. If anything looks unusual, you may want to include receipts with your return to ward off an audit.

The IRS pays particular attention to returns filed by taxpayers in specific professions. For instance, if your salary consists of mostly tip-income, you will be a prime target for an audit. It may be useful to keep a daily journal of your tips to ward off any future claim of underreporting. Also, being self-employed will increase your chances of being audited. The IRS is aware of the myriad of improper business deductions claimed by self-employed taxpayers, so be prepared to prove your expenditures as deductible expenses.

Even if you don't practice in one of these targeted professions and you have followed all the appropriate precautions, you can still be selected for an audit by random. The IRS computer selects a small number of returns for audit on a random basis—a process often called the "audit lottery." This is one lottery you don't want to win. However, if you're honest and accurate in your reporting, and maintain good records to prove your financial information, then you should fair fine with the IRS.

The Least You Need to Know

- If you fail to file a tax return and pay taxes owed you may be fined and/or imprisoned.
- To overturn a final decision of the IRS, you must file suit in the U.S. Tax Court, U.S. District Court, or U.S. Court of Federal Claims.
- If you are financially unable to pay a tax assessment, you may be able to lessen the burden with an "offer in compromise."
- Honesty, accuracy, and maintaining good records are the keys to avoiding an IRS auditing nightmare.