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Tax Audit Horror Stories: When the IRS Attacks

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Joan Smith, 52, a Philadelphia-based artist, was preparing to go in for spinal surgery in 2010 when the IRS put a \$10,000 tax lien on her bank account -- which was more money than she had in the bank. It turns out she'd never received an audit memo that had been sent to her old address. She spent the next 11 months digging out from the paperwork avalanche that comes with a full audit.



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It's the headache that we fear each year when we file our tax returns -- that we'll face the massive inconvenience of an audit plus have to fork over thousands of dollars in rejected deductions. As a *Seinfeld* episode famously put it, the audit process can be "the financial equivalent of a full rectal examination."

In fact the experience is rare -- only some 1% of personal tax returns trigger an IRS audit -- but for those few, it can cause emotional and financial turmoil.

A Long Struggle to a Surreal End

In addition to her independent work as an artist, Smith (right) was working for a nonprofit organization, a job that allowed her a tax write-off of a couple thousand dollars annually. That unusual deduction triggered the audit and her failure to respond to the notice led to the lien, which she discovered when her debit card was denied.

Instead of moving ahead directly with her planned surgery, she spent her time hunched over a muddled file drawer of papers, culling through



Excerpt from: http://www.dailyfinance.com/2012/02/28/tax-audit-horror-stories-irs/?icid=maing-grid10%7chtmlws-main-bb%7cdl6%7csec1_Ink3%26pLid%3D139268

receipts dating back to 2003. "It was insane," she said. "It wasn't the time to be digging through old records."

It gets worse: Her computer and its back-up hard drive had been stolen from her studio, which meant her neatly organized digital record of deposits and expenditures was lost.

But after all the sweat, an ironic conclusion: "Probably the most comical part was that the audit found I was *owed* \$587 dollars in 2003," Smith said.

Scars That Don't Go Away

Tax audits can be fairly routine and often fairly painless, but for the rare few, the horrors don't go away.

Freelance writer Joan Barthel (below), now 68, was living in Manhattan with her husband when she endured an audit in 1986. Because their summer house in Connecticut burned down in 1985, her husband claimed a deduction that rang alarm bells with the IRS.

"Two agents came to our apartment in New York and came in like storm troopers, just big bullies," Barthel said. "They said, 'Your calculations were inaccurate and you owe \$14,000.'"

What amazes Barthel most, even after all these years, was the detail that was required of her. "I'm a writer, and the house was filled with books," she said. "They wanted the name and author of every book I lost in the fire. I was in tears. It was just horrible."

"Starting out with those two guys -- they were so gruff and and rough and mean," Barthel said. "They came in assuming I was a criminal and had deliberately tried to cheat the United States government. It was 'guilty until proven innocent.' "

For ordinary people not well-versed in the minutiae of the taxosphere, the audit experience can be intimidating. "As a layperson, you're up against this monolithic organization represented by two guys who are yelling at you," Barthel said. "You're at a disadvantage to say the least."

The IRS was adding interest to her alleged debt throughout the ordeal. Her razed home was a casualty loss and a hefty burden; the audit came as a second punch to the gut.

The Barthels eventually hired a lawyer, who ended up taking on their case pro bono and going with them to tax court.



In response to the "storm trooper" reputation, the IRS publicly tried to clean up its act during the Clinton administration. Yet most of the changes it made had to do with collections, according to Anthony Parent, the founding partner of IRS Medic, a law firm oriented toward those with tax troubles. There was a lot of congressional testimony about revenue officers' abuses, but there was no censuring of abusive auditors, nor were any concrete limitations placed on their powers.

IRS veterans refer to this period as "Rah Rah '98," Parent said -- a mocking cheer that represents the emptiness in the push for audit reform.

"It's just sort of the ebb and flow of Congress lambasting the IRS," Parent said, "while simultaneously demanding it do some pretty God-awful and difficult jobs -- like invading people's personal affairs to see what kind of money they made in any particular year."

Given that the typical auditor today was just a kid during the Clinton administration, Parent says, the public now can still expect "skittish" auditors who "if pushed into a defensive position, will lash out at a taxpayer."

When contacted about its audit policy, the IRS referred *DailyFinance* to its document *Your Rights as a Taxpayer*, which lists among them "a right to professional and courteous treatment by IRS employees."

But for those like the Barthels, policy and reality don't always match. They settled for about \$4,000, far less than the \$14,000 the originally IRS demanded. But the case dragged on so long they had accrued some \$2,000 in interest.

"It was horrible," Joan Barthels said. "I blocked it out, and I've thrown out all the paper."

Will This Ever End?

For those still battling with the IRS, blocking it out is an unavailable luxury.

Paul Hatz of Boston is knee-deep in appealing the results of a five-year-long "nightmare audit" that concluded six months ago.

The auditor, Hatz claims, failed to send out statutory notice of deficiency letters -- thus denying him "the most fundamental taxpayer right, the right to appeal what an auditor says," he said -- and he was slapped with a personal lien for \$110,000 in taxes. The liability, though, wasn't Hatz's, but rather that of the C corporation he ran -- by definition, taxed separately from its proprietors.

"To add insult to injury, this 'tax' was all because the auditor miscategorized money I invested into the

corp as 'income,'" Hatz said. Because of the auditor's error, not only did Hatz lose the \$100,000 investment he made in his corporation, he also got a \$110,000 bill from the IRS for failing to report the amount as income.

"I know this sounds crazy, and I wish I made it all up," Hatz said.

Hatz hired a tax attorney and got a congressman involved. But as a result of the financial burdens of the audit process, Hatz ended up closing his small manufacturing business, where he employed over a dozen people.

Now he collects unemployment and takes care of his child as a stay-at-home dad while he looks for work. He's dropped \$60,000 in CPA and tax attorney costs and has had to declare bankruptcy. He and his spouse keep their finances separate.

For all the trouble and expense Hatz has endured, the actual amount he owes is small by comparison: a measly \$5,000.

The ordeal has left Hatz disillusioned with the idea of personal entrepreneurship.

"I never want to start a business again," he said. "Large corporations with teams of tax attorneys and CPAs can deal with an audit. If you get the wrong auditor and are a small business struggling to make ends meet, you are done--out of business regardless of whether you did anything wrong or not."

Advice From the Experts

There's no sure-fire way to avoid the attentions of the IRS auditors, but there are some tips on how to come out of the audit process relatively unscathed.

Joshua S. Barger, vice president of tax services at Foundation Financial Group in Manhattan, recommends keeping thorough documentation of travel mileage, medical expenses and meals-and-entertainment expenses -- the categories IRS auditors are most persnickety about monitoring.

"Whatever miles you've driven for business purposes, you need to keep proper logs," Barger said. "You need to write down what the odometer is when you start and then you need to write it down when you get home."

Unitemized receipts or credit card statements from a gas station aren't enough to prove you filled your tank -- you might have been buying other items from the adjoining convenience store.

Likewise, medical bills from a doctor's office are insufficient to indicate an expense for the IRS, Barger advises, because they don't prove you actually paid the money, nor do they show what portion of the

bill may have been covered by insurance.

"Entertainment for business purposes" can be one of the most fluffed-up expense categories, Barger said. "People entertain a client and have a couple of cocktails, and try to write it off without saving the receipt," he said. That's a major no-no.

But fudging numbers is not the solution.

"Answer the questions that are put to you as best you can," said Julian Block, the attorney who represented Barthel through her tax audit saga. "Absolutely do not lie when you give an answer. Remember Martha Stewart? If you can't recall the answer, say so."

By the same token, be wary of over-narrating or elaborating.

"Answer only that which is asked of you," Block said. "Do not volunteer what might seem to you innocuous information ... it might turn out to be an additional avenue for inquiry from the IRS. There's no need for you to ingratiate yourself with the IRS auditor: This is not a social contact."