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Tax Summit 2021



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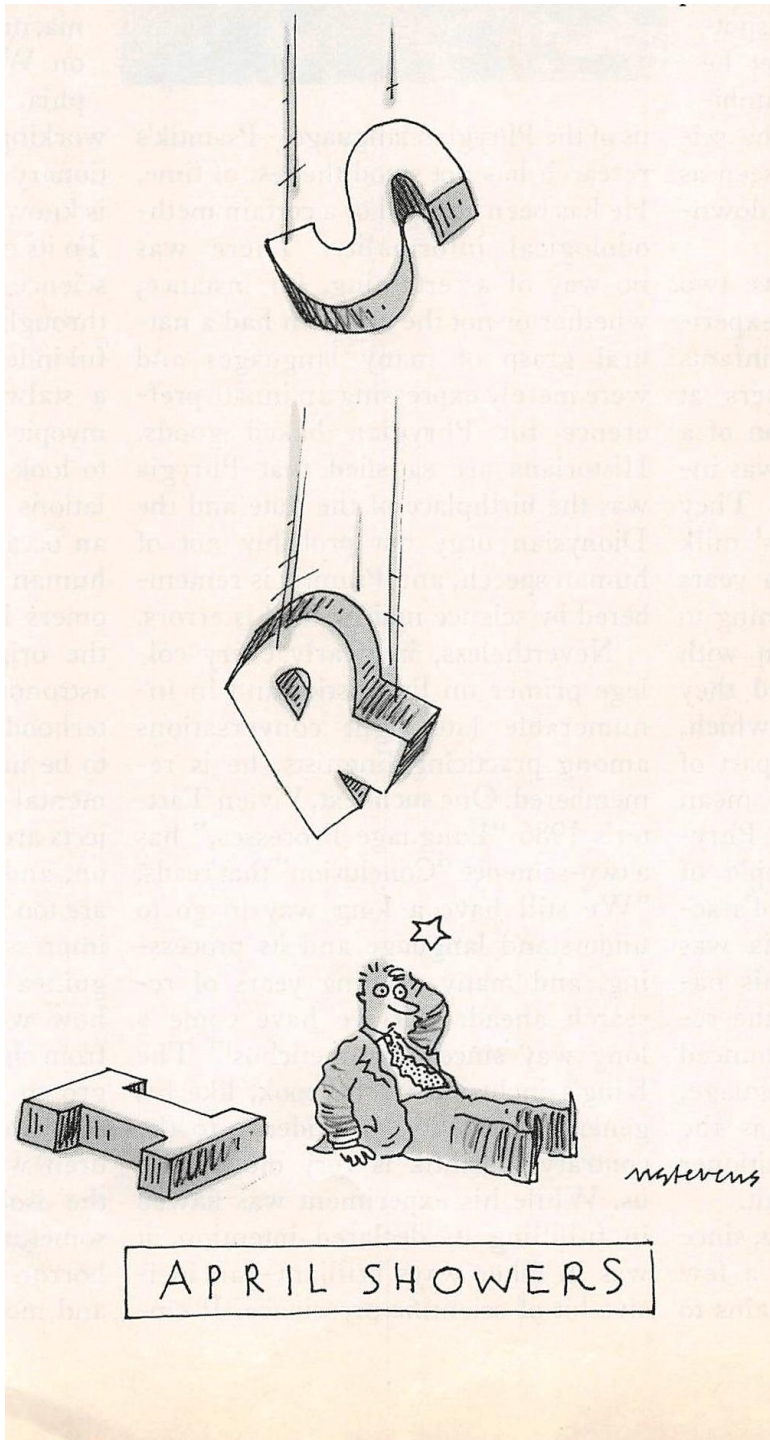
Presenter: Heather C. Liston

**CFP[®], E.A. Vice President & Advisor at
Hargrave Fiduciary Advisors, LLC**



TAX TROUBLE

What Happens When You Owe the IRS . . .or they think you do



Outline

- ▶ What Causes Trouble?
- ▶ What Happens?
 - ▶ Audit
 - ▶ CP 2000 Letter
- ▶ Will it Go Away?
 - ▶ Statutes of Limitations
- ▶ How serious?
 - ▶ Small Mistakes
 - ▶ Big Mistakes
 - ▶ Fraud

Outline Two

- ▶ Common Triggers & Their Solutions
 - ▶ Under-Reporting
 - ▶ Home Office Audit
 - ▶ Basis
 - ▶ RMDs
- ▶ What's the worst that can happen?
 - ▶ Liens, Levies, Garnishments
- ▶ What can you do?
 - ▶ Amended Return
 - ▶ Appeal
 - ▶ Offer in Compromise
 - ▶ Installment Plan
 - ▶ Abandoned Spouse and Innocent Spouse

What Causes Trouble?

Common Triggers

Reasons People Get in Hot Water

- ▶ Math Errors & Typos
- ▶ Starting a New Business
- ▶ Retirement Plan Problems
- ▶ Employment Taxes
- ▶ Basis Misunderstandings
- ▶ Under-Reporting
- ▶ Underpaying
- ▶ Other People's Problems
 - ▶ Spouses, Former Spouses, Business Partners

Math Errors & Typos

- ▶ Anything a computer can catch, it will.
- ▶ Don't go down because of a silly error.
- ▶ Proofread.
- ▶ Have someone else proofread.
- ▶ If you get a notice triggered by this:
 - ▶ Fix it
 - ▶ Apologize
 - ▶ Pay the difference
 - ▶ Don't do it again

New Business

- ▶ Know when you ARE in business
 - ▶ Sole Proprietors
 - ▶ Independent Contractors
 - ▶ 1099 Workers
 - ▶ Partnerships
 - ▶ LLCs & LLPs
 - ▶ S-Corps
- ▶ Act professional. Your business is not a hobby.
- ▶ Know the rules.
- ▶ Keep good records.
- ▶ Fill out Schedule C (most cases).
- ▶ Read the instructions. Follow them.

Retirement Plan Problems

- ▶ RMD failures
- ▶ Over-contributions
- ▶ Employer non-reporting

Under-Reporting and Under-Paying

- ▶ Which is more serious?
- ▶ Under-Reporting
 - ▶ File every year.
 - ▶ Report everything.
- ▶ Underpaying
 - ▶ Problems with IRS withholding calculators
 - ▶ Pay estimated taxes **OR** Have more withheld

What Happens?

Audits and Letters

Audits: From Financial Planning.com

4/10/2018

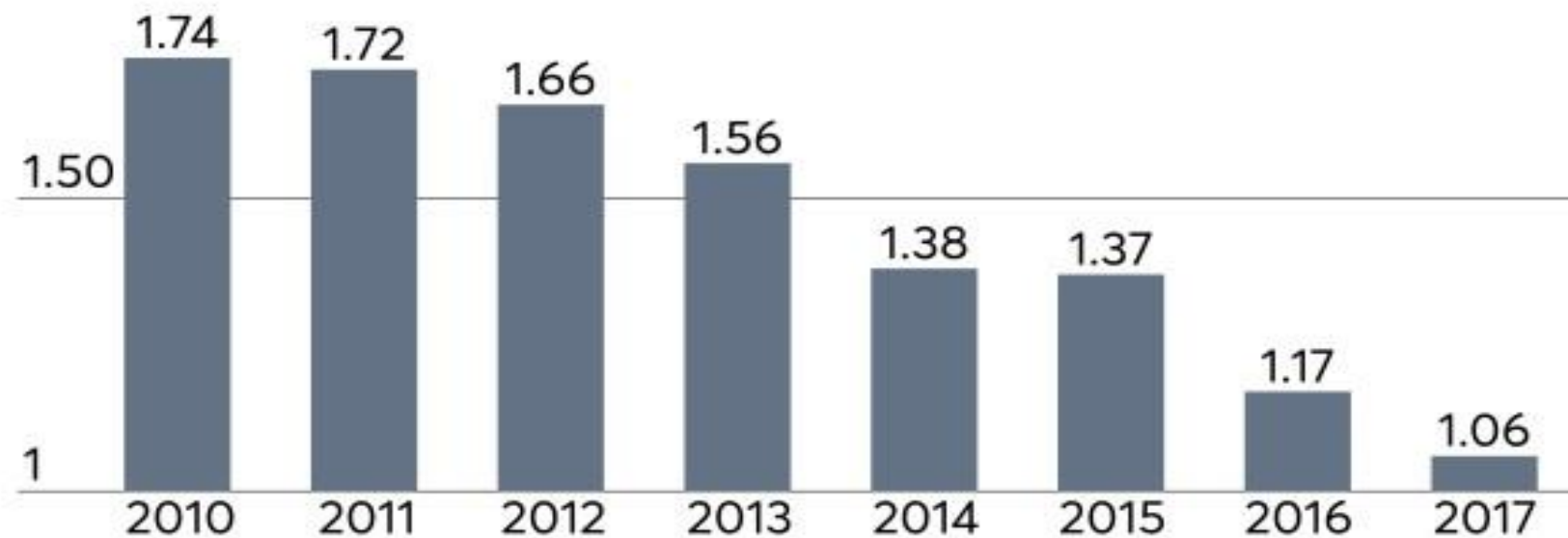
- ▶ The number of tax returns examined by the IRS drops every year, to the point where the agency now audits just 0.5% [.4% in 2019] of all returns — but that still amounts to over a million squirming taxpayers.

Audits

An ongoing decline in scrutiny

Millions of tax returns examined by the IRS

2



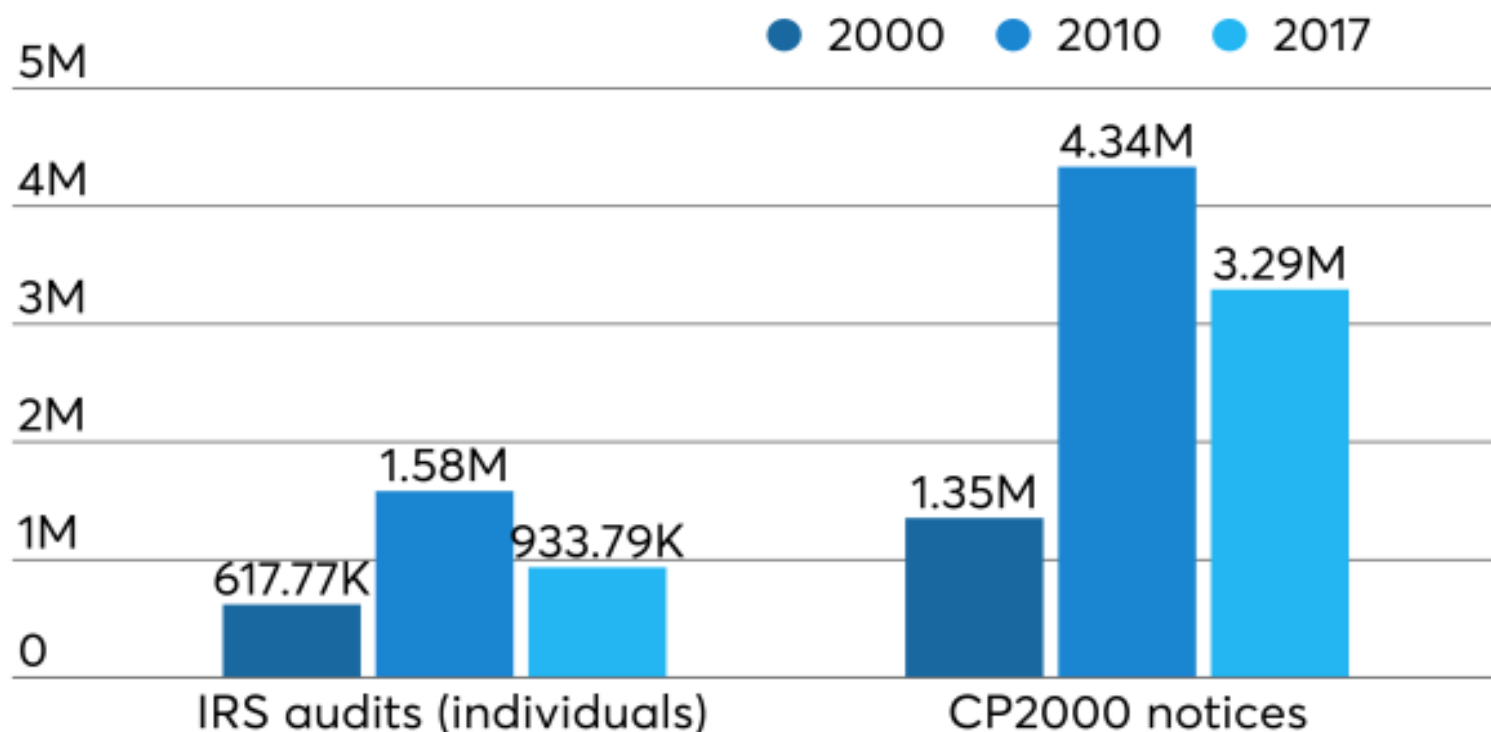
Source: IRS Data Books, 2010-2017

From *Financial Planning Magazine*

January 29, 2019

More matching notices than audits

How the IRS is questioning tax returns



Source: IRS Data Books

How to Avoid Problems

- ▶ Know what information the IRS already has
 - ▶ Anything a computer can check, it will
 - ▶ All your statements: bank accounts, brokerage, stock comp, W-2s, 1099s
 - ▶ Your ex-husband's Social Security number and your babysitter's phone number
- ▶ Check your math!
- ▶ Always **keep** records
 - ▶ Mileage, business expenses, real estate documents
 - ▶ File folders, shoebox, app, spreadsheet . . . Whatever works
 - ▶ Don't throw them away after you file your return

When the IRS Disagrees

- ▶ CP 2000 Letter
 - ▶ The letter may or may not be correct
 - ▶ Ask questions
 - ▶ Check your sources
 - ▶ Follow directions

- ▶ Audit
 - ▶ Organize your records and documentation clearly
 - ▶ Know your position and act with confidence
 - ▶ Ask for help if you want it: EA, CPA, JD

SOME BUTS (that may apply to you)

1. Audit rate is higher for business owners

- ▶ In 2019, between .8% and 1.6% of Schedule C businesses with more than \$25,000 of gross receipts
- ▶ Higher if you make more than \$100,000 from your business
- ▶ OR if it's cash-intensive (hair salons, taxis, bars)
- ▶ OR if you use Schedule C **losses** to offset other income

2. And for Real Estate People

The IRS actively scrutinizes large rental real estate losses, especially those written off by taxpayers claiming to be real estate pros.

It's pulling returns of individuals who claim they are real estate professionals and whose W-2 forms or other non-real estate Schedule C businesses show lots of income.

Agents are checking to see whether these filers worked the necessary hours, especially in cases of landlords whose day jobs are not in the real estate business. - [Kiplinger](#), Jan. 12, 2021

Next But: the non-Audit Audit

More CP-2000 Letters



Department of the Treasury
Internal Revenue Service
5045 E BUTLER AVE
FRESNO CA 93888-0021



011442.815528.177769.21251 2 AB 0.412 1771



AVE
SAN FRANCISCO CA 94112-2245

011442

Notice CP2000
Tax year 2017
Notice date May 28, 2019
Social Security number
AUR control number 50018-0336
To contact us Phone 1-800-829-8310
Fax 1-877-477-0962

Page 1 of 15



55091068220171

We are proposing changes to your 2017 Form 1040 tax return. This is not a bill.

Proposed amount due: \$35,631

We received information from third parties such as employers or financial institutions that doesn't match the information you reported on your tax return. This notice:

- Proposes a change to tax and/or payments and credits (such as federal income tax withheld, earned income credit, etc.) that you originally reported.
- Provides you with an opportunity to agree or disagree with the proposed changes. If our information is correct, you will owe \$35,631 (including interest), which you need to pay by June 27, 2019.

Summary of proposed changes

Tax you owe	\$26,874
Payments	\$0
Substantial tax understatement penalty	\$5,375
Failure-to-file penalty	\$1,171
Interest	\$2,211
Proposed amount due by June 27, 2019	\$35,631

Reminder: This is not a bill. We haven't charged the proposed amount due.

What you need to do immediately

If you need more time to respond to this notice, contact us at 1-800-829-8310. Interest will continue to accrue during this period if the information in this notice is correct.

Review this notice, and compare our changes to the information on your 2017 tax return.

If you agree with the proposed changes

- Complete, sign, and date the Response form on Page 13 (we require both spouses' signatures if you filed married filing jointly), and mail it to us along with your payment of \$35,631 so we receive it by June 27, 2019.
- Do not file an amended return (Form 1040X) if you fully agree with our changes. We'll make the correction when we receive your signed response.

If you don't agree with the proposed changes

- Complete the Response form on Page 13, and send it to us along with a signed statement explaining your disagreement and include any documentation that supports your claim so we receive it by June 27, 2019.
- If you have allowable costs or expenses related to the unreported income that will change our proposal, it may benefit you to include the applicable form or schedule with your response.

Will it Go Away?

Statutes of Limitations

TIMING: Statutes of Limitations

- ▶ 3 years
 - ▶ The IRS has three years from your filing date to audit your return if it suspects good-faith errors.
 - ▶ That is, 3 years from the return due date or the date filed. And 2 years after the tax was paid.
 - ▶ The three-year deadline also applies if you discover a mistake in your return and decide to file an amended return to claim a refund.
- ▶ 3.5, 4, 5 years
 - ▶ Some states have longer periods to look back at errors. Check yours.
 - ▶ California and Arizona: 4 years. Montana: 5 years. Minnesota: 3.5 years.
- ▶ 6 years
 - ▶ The IRS has six years to challenge your return if it thinks you underreported your gross income by 25 percent or more.
- ▶ FOREVER
 - ▶ In the case of fraud, there is no statute of limitations. And they can investigate the whole tax return; not just the part under suspicion of fraud
 - ▶ There is no statute of limitations regarding the timeframe in which they can enforce penalties regarding failure to file your return or the filing of a fraudulent return.

Direct from the IRS

1. Keep records for 3 years if situations (4), (5), and (6) below do not apply to you.
2. Keep records for 3 years from the date you filed your original return or 2 years from the date you paid the tax, whichever is later, if you file a claim for credit or refund after you file your return.
3. Keep records for 7 years if you file a claim for a loss from worthless securities or bad debt deduction.
4. Keep records for 6 years if you do not report income that you should report, and it is more than 25% of the gross income shown on your return.
5. Keep records indefinitely if you do not file a return.
6. Keep records indefinitely if you file a fraudulent return.
7. Keep employment tax records for at least 4 years after the date that the tax becomes due or is paid, whichever is later

So What?

- ▶ So keep your tax records.
- ▶ Keep your entire file of tax stuff for **at least** three years after you file.
- ▶ If you have any doubts or worries, keep it longer
- ▶ And, if possible, scan your old returns and save electronic copies before you throw out the paper copies

Mistake Sizes

Small, Big, Fraud

SMALL

- ▶ Typos, Math Errors
- ▶ Misunderstandings
- ▶ Omissions of income, but less than 25% of your gross income
- ▶ No bad intent

BIG

- ▶ Understatement of income by more than 25% of Gross Income
- ▶ But no bad intent

What is Tax FRAUD?

- ▶ Tax due and owing + fraudulent **intent**
- ▶ Intentional wrongdoing on the part of a taxpayer, with the specific purpose of evading a tax
- ▶ No statute of limitations
- ▶ Criminal penalties possible

Badges of Fraud

- ▶ Omitting Income
- ▶ Claiming False Dependents
- ▶ False statements about material facts during the exam
- ▶ Attempts to hinder or obstruct the exam
- ▶ Ignoring the advice of tax professionals
- ▶ If you do not file on time because of an intent to evade tax

Penalties

- ▶ **Fraud: 75%!**
 - ▶ (of the underpayment related to fraud)

What to *DO*?

First Steps

First Steps

1. Stay calm.
2. Know that it might be them and not you.
3. Read your CP 2000 letter (or other notice). Follow instructions.
4. Talk to the IRS; they're people.
5. Be organized and professional. Act confident and courteous.
6. Documentation is your friend. Find and organize all your paperwork.
7. Ask for help if you need it. (EA, CPA, JD)
8. Work out a payment plan if necessary.
9. Fix it fast.
10. Don't do it again.

Under-Reporting

- ▶ If your letter says you under-reported income, check all the facts.
- ▶ Are they **right**?
 - ▶ If so, pay.
- ▶ Are they **wrong**?
 - ▶ Write a letter. Attach documentation. Explain yourself.
- ▶ If they're right, but you can't afford to pay: **FACE UP TO IT.**
 - ▶ **Do not hide or procrastinate.**
 - ▶ Under-paying can be worked out.

Specific Problems

A few common examples

1. Home Office Deduction

- ▶ Follow the rules!
- ▶ No home office deduction for employees, 2018-2025.
- ▶ Business **owners** only.

Home Office Rules

- ▶ Your records must show:

That you use part of your home **exclusively** and **regularly** for business as either your **principal place of business** or as the place where you **meet or deal with clients or customers** in the normal course of your business

Exceptions to Exclusive Use:

- Inventory Storage
- Daycare

Home Office Audit

- ▶ If you're questioned:
 - ▶ Clean up your space.
 - ▶ Be clear that it's a dedicated office.
 - ▶ Be serious about your business.
 - ▶ No home office deduction for a hobby
 - ▶ And none for an employee
 - ▶ Organize your bills and receipts.
 - ▶ Be very clear about what you spent and why it was relevant.

2. BASIS Misunderstandings

- ▶ Company Stock, esp. RSUs
- ▶ Inherited Stock
- ▶ Personal Residence
- ▶ Rental Real Estate
- ▶ Non-Deductible IRAs

What is Basis?

- ▶ What you've already paid tax on
- ▶ Often, the purchase price
 - ▶ Or purchase price - selling expenses + capital improvements - depreciation

BASIS and the IRS

- ▶ You might be the **ONLY** person who knows the basis in your real estate or your investments
- ▶ If you can't prove it, the IRS defaults to assume \$0
- ▶ You can correct that assumption, IF you have good records

2. BASIS Misunderstandings

- ▶ Company Stock, esp. RSUs
 - ▶ Basis = FMV the date it vested
- ▶ Inherited Stock
 - ▶ Basis = FMV the day the original owner died
- ▶ Personal Residence
 - ▶ Basis = Purchase price + closing costs + major improvements
- ▶ Rental Real Estate
 - ▶ Basis = Purchase price + closing costs + major improvements - accumulated depreciation
- ▶ Non-Deductible IRAs
 - ▶ The amount of after-tax money in your IRA

E-Trade Statement

FORM 1099-B TOTALS SUMMARY

REALIZED GAIN / LOSS SUMMARY

Refer to Proceeds from Broker and Barter Exchange Transactions for detailed information regarding these summary values. The amounts shown below are for informational purposes only.

SHORT-TERM GAINS OR (LOSSES) – REPORT ON FORM 8949, PART I	PROCEEDS	COST BASIS	MARKET DISCOUNT	WASH SALE LOSS DISALLOWED	REALIZED GAIN OR (LOSS)
Box A (basis reported to IRS)	\$123,028.82	\$79,926.14	\$0.00	\$0.00	\$43,102.48
Box A – Ordinary – (basis reported to IRS)	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Box B (basis not reported to IRS)	\$45,272.48	\$0.00	\$0.00	\$0.00	\$45,272.48
Box B – Ordinary – (basis not reported to IRS)	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Total Short-Term	\$168,301.10	\$79,926.14	\$0.00	\$0.00	\$88,374.96
LONG-TERM GAINS OR (LOSSES) – REPORT ON FORM 8949, PART II					
Box D (basis reported to IRS)	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Box D – Ordinary – (basis reported to IRS)	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Box E (basis not reported to IRS)	\$14,372.93	\$0.00	\$0.00	\$0.00	\$14,372.93
Box E – Ordinary – (basis not reported to IRS)	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Total Long-Term	\$14,372.93	\$0.00	\$0.00	\$0.00	\$14,372.93
UNKNOWN TERM – CODE (X) REPORT ON FORM 8949 PART I OR PART II					
Box B or Box E (basis not reported to IRS)	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Box B or Box E – Ordinary – (basis not reported to IRS)	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Total Unknown Term	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00

E-Trade

“Stock Plan Transactions Supplement”

Symbol	Qty.	Date Acquired	Date Sold or Disposed	Total Proceeds	Cost Basis	Adjustment Amount (Ordinary Income)	Adjusted Cost Basis	Adjusted Gain (Loss)	Capital Gain Status	Covered / Non-Covered	Grant Type	Grant Number
	3	06/05/2018	06/06/2018	\$901.54	\$0.00	\$873.39	\$873.39	\$28.15	Short	Non-Covered	RSU	118337
	7	06/05/2018	06/06/2018	\$2,103.61	\$0.00	\$2,037.91	\$2,037.91	\$65.70	Short	Non-Covered	RSU	Q031408
	8	06/05/2018	06/06/2018	\$2,404.12	\$0.00	\$2,329.04	\$2,329.04	\$75.08	Short	Non-Covered	RSU	Q051547
	302	12/20/2018	12/20/2018	\$96,921.23	\$59,361.12	\$37,581.33	\$96,942.45	\$21.22	Short	Covered	ISO	017102
				\$182,674.03	\$79,926.14	\$104,295.08	\$184,221.22	(\$1,547.19)				

Basis Misunderstandings

1. Respond to the IRS immediately.
 1. Acknowledge the issue and ask for more time.
2. Contact your brokerage.
 1. Get the Supplemental Statement
 2. Figure out the correct BASIS of your securities
3. File an amended return: Form 1040X
4. Respond to the IRS letter and attach the amended return.
5. If you still owe something, pay it.

3. Retirement Plan Problems

- ▶ Over-contribution
- ▶ Failure to take RMDs

RMD Rules

- ▶ In 2020: **None!**
- ▶ Used to be: Starting April 1 of the year after you turn 70.5
 - ▶ This still applies to people who turned 70.5 by 12/31/2019
- ▶ **Now** (SECURE Act): April 1 of the year after you turn **72**
 - ▶ And every year after that, by 12/31
- ▶ Inherited IRAs
 - ▶ Old Rule: RMDs every year, starting 12/31 of the year after decease
 - ▶ **New Rule:** No RMDs until year 10. Then 100%.
 - ▶ for account owners who died 1/1/2020 or after

RMDs: What if you miss one?

▶ **50% Penalty!!!**

RMDs: How to Fix the Problem

Form 5329 Department of the Treasury Internal Revenue Service (99)	Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts ▶ Attach to Form 1040, 1040-SR, or 1040-NR. ▶ Go to www.irs.gov/Form5329 for instructions and the latest information.	OMB No. 1545-0074 2020 Attachment Sequence No. 29
Name of individual subject to additional tax. If married filing jointly, see instructions.		Your social security number
Fill in Your Address Only if You Are Filing This Form by Itself and Not With Your Tax Return	Home address (number and street), or P.O. box if mail is not delivered to your home	
	City, town or post office, state, and ZIP code. If you have a foreign address, also complete the spaces below. See instructions.	
	Foreign country name	Foreign province/state/county
		Apt. no.
		If this is an amended return, check here <input type="checkbox"/>
		Foreign postal code
If you only owe the additional 10% tax on early distributions, you may be able to report this tax directly on Schedule 2 (Form 1040), line 6, without filing Form 5329. See the instructions for Schedule 2 (Form 1040), line 6.		
Part I Additional Tax on Early Distributions. Complete this part if you took a taxable distribution (other than a distribution related to a qualified disaster or a coronavirus-related distribution) before you reached age 59½ from a qualified retirement plan (including an IRA) or modified endowment contract (unless you are reporting this tax directly on Schedule 2 (Form 1040)—see above). You may also have to complete this part to indicate that you qualify for an exception to the additional tax on early distributions or for certain Roth IRA distributions. See instructions.		
1	Early distributions included in income. For Roth IRA distributions, see instructions	1
2	Early distributions included on line 1 that are not subject to the additional tax (see instructions). Enter the appropriate exception number from the instructions: _____	2
3	Amount subject to additional tax. Subtract line 2 from line 1	3
4	Additional tax. Enter 10% (0.10) of line 3. Include this amount on Schedule 2 (Form 1040), line 6 Caution: If any part of the amount on line 3 was a distribution from a SIMPLE IRA, you may have to include 25% of that amount on line 4 instead of 10%. See instructions.	4
Part II Additional Tax on Certain Distributions From Education Accounts and ABLÉ Accounts. Complete this part if you included an amount in income, on Schedule 1 (Form 1040), line 8, from a Coverdell education savings account (ESA), a qualified tuition program (QTP), or an ABLÉ account.		
5	Distributions included in income from a Coverdell ESA, a QTP, or an ABLÉ account	5
6	Distributions included on line 5 that are not subject to the additional tax (see instructions)	6
7	Amount subject to additional tax. Subtract line 6 from line 5	7
8	Additional tax. Enter 10% (0.10) of line 7. Include this amount on Schedule 2 (Form 1040), line 6	8
Part III Additional Tax on Excess Contributions to Traditional IRAs. Complete this part if you contributed more to your traditional IRAs for 2020 than is allowable or you had an amount on line 17 of your 2019 Form 5329.		
9	Enter your excess contributions from line 16 of your 2019 Form 5329. See instructions. If zero, go to line 15	9
10	If your traditional IRA contributions for 2020 are less than your maximum	

Form 5329: RMD Part

Part IX Additional Tax on Excess Accumulation in Qualified Retirement Plans (Including IRAs). Complete this part if you did not receive the minimum required distribution from your qualified retirement plan.

52	Minimum required distribution for 2015 (see instructions)	52		
53	Amount actually distributed to you in 2015	53		
54	Subtract line 53 from line 52. If zero or less, enter -0-	54		
55	Additional tax. Enter 50% (.50) of line 54. Include this amount on Form 1040, line 59, or Form 1040NR, line 57	55		

Sign Here Only If You Are Filing This Form by Itself and Not With Your Tax Return	Under penalties of perjury, I declare that I have examined this form, including accompanying attachments, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.
	<div style="display: flex; justify-content: space-between;"> <div style="width: 60%;"> <p>▶ _____ Your signature</p> </div> <div style="width: 35%;"> <p>▶ _____ Date</p> </div> </div>

Paid Preparer Use Only	Print/Type preparer's name	Preparer's signature	Date	Check <input type="checkbox"/> if self-employed	PTIN
	Firm's name ▶				Firm's EIN ▶
	Firm's address ▶				Phone no.

RMD Problems

- ▶ Send in Form 5329 for every year you missed your RMD
- ▶ Write a letter, explaining why
- ▶ Ask for forgiveness
- ▶ Pay the income taxes you owe
- ▶ But not the penalty
- ▶ Sit back and wait
- ▶ 3 Years and you win

What's the Worst that Can Happen?

Garnishments, Levies, and Liens

The Really Bad Stuff: Garnishments, Levies, and Liens

- ▶ An IRS levy permits the legal seizure of your property to satisfy a tax debt.
- ▶ It can garnish wages, take money in your bank or other financial account, seize and sell your vehicle(s), real estate and other personal property.

▶ – IRS.gov

Definitions

- ▶ Levy: a legal seizure of your property to satisfy a tax debt.
- ▶ Lien: a legal claim against property to secure payment of the tax debt.
- ▶ Garnishment: a lien against your wages.

When will the IRS issue a levy or lien?

- ▶ *If you do not pay your taxes (or make arrangements to settle your debt) . . . the IRS may levy any property or right to property you own or have an interest in. . . . the IRS could levy property that is yours, but is held by someone else (such as your [wages](#), [retirement accounts](#), [dividends](#), [bank accounts](#), [licenses](#), [rental income](#), [accounts receivables](#), the cash loan value of your life insurance, or commissions). Or, the IRS could seize and sell property that you hold (such as your car, boat or house). – IRS.gov*
- ▶ Note that you will get a tax bill, a final notice, and at least 30 days' warning

Garnishment Limitations

- ▶ A Judgment Creditor (from a lawsuit) may take 25% of your disposable income
- ▶ Federal Student Loans: up to 15%
- ▶ Child Support or Alimony: 50% to 60%
- ▶ **Taxes:** A formula based on how many dependents you have and what your standard deduction is.
 - ▶ Note: Your employer will give you a form to fill out. If you don't do it in 3 days, the default is MFS - 0

How to Get Rid of a Levy or Lien

- ▶ Contact the IRS immediately
- ▶ Read IRS Publication 1660: Collection Appeal Rights
- ▶ Work with the IRS to enter an Installment Agreement
- ▶ Gradually pay off your debt that way, and stick to it!

Working it Out

- ▶ **Extension of Time to Pay:** 120-day extension is easy to get
 - ▶ If IRS Collection Division has already sent a “notice of intent to levy,” then 60 days
- ▶ **Installment Agreement**
 - ▶ If you owe \$50,000 or less, you may be eligible for a “streamlined agreement”
 - ▶ Pay by direct debit. Get it done in 72 months.
 - ▶ Annual cost for interest, penalties, and set-up fees is about 6%
- ▶ **Hardship Agreement:** IRS has discretion to set terms of your repayment plan
- ▶ **Currently Not Collectible (CNC):** This is temporary, and you must prove that you’re really broke.
- ▶ **Offer in Compromise:** If you have few assets, little monthly income, and little or no prospects for future income, you may request an offer in compromise (OIC); the taxpayer & the IRS to agree to settle the tax liability for less than the full amount owed.

Installment Agreement

- ▶ Try to do this BEFORE the levy, lien, or garnishment happens

Offer in Compromise

- ▶ Be aware this is not easy to arrange
- ▶ You cannot be an open bankruptcy proceeding
- ▶ You must be current with all tax return filings
 - ▶ for at least the last 6 years
- ▶ Visit the OIC Pre-Qualifier tool:
 - ▶ https://irs.treasury.gov/oic_pre_qualifier/
- ▶ Read **Offer in Compromise Booklet, Form 656-B**

What if It's Not Your Fault?

Spouses and Ex-Spouses

Married Tax Returns

- ▶ Most married couples use the **married filing jointly** (“MFJ”) status.
- ▶ That’s almost always the best thing to do. Lots of benefits and credits. Good tax rates.
- ▶ However . . .
 - ▶ under MFJ, both taxpayers are “jointly and severally liable” for the tax liability and any additions to tax, interest, or penalties that arise from that return, even if they divorce later.
- ▶ Each spouse is legally responsible for the whole tax liability on their MFJ return, even if only one spouse earned all the income or claimed improper deductions or tax credits.

About Marriage

- ▶ Note: **Married Filing Separately** status won't solve all your problems, so don't think that's an easy out.
- ▶ Not marrying the person with tax problems or poor judgment **IS** a good idea.
- ▶ But let's assume it's too late for that . . .

Injured and Innocent Spouses

- ▶ You're an "injured" spouse if someone takes money that's rightfully yours.
- ▶ You're "innocent" when your spouse commits some wrongdoing on a joint return, but you had no knowledge of what they were doing.

Injured vs. Innocent

➤ Form 8379: Injured Spouse Allocation

- for MFJ filers only

➤ Form 8857: Request for Innocent Spouse Relief

- Your spouse omitted income or claimed false deductions or credits, and you didn't know or have reason to know of the understatement.
- There is an understatement of tax and you are divorced, separated, or no longer living with your spouse

Injured vs. Innocent

- ▶ **Injured Spouse** relief applies to taxpayers who **are married**.
 - ▶ You are an injured spouse if your share of your tax refund as shown on your joint return was, or is expected to be, applied against your spouse's past-due federal debts (including student loans), state taxes, or child or spousal support payments.
- ▶ In most cases, **Innocent Spouse** relief is limited to taxpayers who are no longer married. They must have filed a **joint return** for the year in question.

Are You an Injured Spouse?

- ▶ You may be an injured spouse if you file a joint tax return and all or part of your portion of the overpayment was, or is expected to be, applied (offset) to your spouse's legally enforceable past-due federal tax, state income tax, state unemployment compensation debts, child or spousal support, or a federal nontax debt, such as a student loan.
- ▶ - IRS instructions for Form 8379

Who is considered an injured spouse?

- ▶ When a joint return is filed and only one spouse owes a past-due amount, the other spouse can be considered an injured spouse. The injured spouse:
 1. **Must not be legally obligated to pay the past-due amount, and**
 2. Must have made and reported tax payments, or claimed a refundable tax credit.
- ▶ **In community property states, the injured spouse must meet only the first condition.**
- ▶ If the taxpayer meets these requirements, Form 8379 can be e-filed with the joint return.
- ▶ If a taxpayer already filed a joint return and the refund was offset, Form 8379 can be filed by itself.

Community Property States

- ▶ Nine community property states: Arizona, California, New Mexico, Texas, Louisiana, Washington, Idaho, Nevada, and Wisconsin.
- ▶ Debts incurred during a marriage are equally owned and owed by both spouses.
- ▶ Assets acquired during the marriage are equally owned by both spouses as well.
- ▶ So the Injured Spouse claim only works if the debt was PRE-marital.

Injured Spouse Case Study

- ▶ Jeff & Ann
 - ▶ Jeff's ex-wife owes back taxes
 - ▶ Ann (his new wife) files Injured Spouse form
 - ▶ Gets her federal refund
 - ▶ But then California takes it!

- ▶ Beware!
 - ▶ States do not always conform to federal tax laws

Innocent Spouse

- ▶ A couple is expecting a refund, and one spouse owes money to the IRS and the other one doesn't.

Innocent Spouse Relief

- ▶ Generally, both you and your spouse are responsible, jointly and individually, for paying any tax, interest, or penalties from your joint return.
- ▶ If you believe **your current or former spouse should be solely responsible** for an erroneous item or an underpayment of tax from your joint tax return, you may be eligible for innocent spouse relief.
- ▶ Innocent spouse relief may also be available if you were a resident of a community property state and did not file a joint federal income tax return and you believe you should not be held responsible for the tax attributable to an item of community income.

- ▶ See IRS Publication 971 and Form 8857

To Qualify for Innocent Spouse Relief

You must meet all of the following conditions to qualify for innocent spouse relief.

1. You filed a **joint** return.
2. There is an **understated tax** on the return that is due to erroneous items of your spouse (or former spouse).
3. You can show that when you signed the joint return **you did not know**, and had no reason to know, that the understated tax existed (or the extent to which the understated tax existed).
4. Taking into account all the facts and circumstances, it would be unfair to hold you liable for the understated tax.

More Innocent Spouse Rules

- ▶ Doesn't work if you've already entered an Offer in Compromise
- ▶ The IRS *will* contact your spouse or former spouse
- ▶ Two year deadline
 - ▶ The Innocent Spouse must bring a claim within two years after collection activity begins.

Spouse Remedies

- ▶ Innocent, Injured, Ignorant, Ill-Advised
 - ▶ Best protection is to think carefully about who you grant spouse status to

SUMMARY

- ▶ Read carefully.
- ▶ Follow directions.
- ▶ Stay organized.
- ▶ Exude calm, cool, competence, confidence, and courtesy.
- ▶ Ask for help if you want to.
- ▶ Work it out.
- ▶ Understand what went wrong to make sure it never happens again.

Heather a **Certified Financial Planner™**
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Thank you!

I wish you all a thriving
business and a low-drama
relationship with the IRS.



She also teaches Income Tax and
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Questions?

ASK IN THE Q&A Box

OR SEND QUESTIONS TO:

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Thank You!
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