

What Happens Next – Sunday June 6, 2021
Stopping Aging, IRS Audits, and China
Phil Ryan & Tom Durham Panel

Larry Bernstein:

We're doubling the IRS budget. Historically, you spent many years defending taxpayers for various types of tax shelters, re characterization of incomes between capital gains and ordinary rates, and other aggressive tactics that taxpayers have done. You mentioned earlier that a lot of those shelters have been closed. What do you think the IRS is going to go after among individual taxpayers to get some of this \$700 billion in revenues?

Tom Durham:

Well, I have a hard time figuring that out. Phil mentioned that their offshore income was a big issue, around the time I retired five or six years ago. That was a very big issue. There were enforcement amnesty programs against people with offshore income, and through increased cooperation with some foreign countries.

I think that's probably no longer a very viable source, at least for most people who don't want to take those risks. I have a hard time figuring out where the tax gap is going to be on the upper-income people, which I think is sort of what the same thing as Phil was saying. With increased information reporting on 1099s and so on and partnerships, et cetera, I don't think that there's a huge pool of untaxed or unreported income out there. I mean, there is certainly some, but I don't think that there's going to be a huge amount out there. My doubt is one of the things I think Phil also mentioned, is Bitcoin, either some of the crypto currency, possibly that's going to be an area of exploration, but I'm not convinced there's going to be a huge amount.

In the 1980s, 1990s, there was huge amounts of tax shelters and some of those were quite legit and worked, some of them didn't. When those were audited, the ones that didn't work produced additional income. I'm just not sure that there's a lot of low hanging fruit for individuals these days. It's going to be interesting to see how that develops over the next few years,

Larry Bernstein:

Let me bring Phil into the conversation. Phil, you've done tens of thousands of tax returns over the years. Now that there's all this excellent reporting to the IRS, do you see in the returns that room for the IRS to find income?

Phil Ryan:

No. No, I think there's very little. I tried to point out that on the third-party reporting that the IRS has what the financial institutions say you made in interest or dividends. I would want to reconfirm what Tom has said. I think one of the focuses in the future will be virtual currencies.

And that in the Biden plan proposed comprehensive financial reporting so that every financial institution will report to the IRS that for each bank account, what your total deposits were for the year and what your total disbursements were for the year. That would go into effect in 2023, if it passes Congress.

Larry Bernstein:

Did you just say that the IRS is going to get your bank accounts and go through with a fine-tooth comb using some computer, using machine learning or whatnot, and on that basis, they're going to try to audit you? Is that what you're saying?

Phil Ryan:

The proposal, Larry, is not for the 12 monthly statements, but that the IRS would get a number from your bank that would be your total deposits for the year and then your total disbursements for the year. What they're looking at is sole proprietorships, basically that they want to make sure that all the income that goes into the bank account shows up on their Schedule C because that's the tax form a sole proprietor would prepare.

Larry Bernstein:

Let me try to rephrase what you just said, Phil. I think what you're saying is, look, for an individual who gets a W2 and gets a 1099 from his broker and bank, there's nothing to do here. We're just copying the numbers right in the form and there's really very little chance of raising a fraud or raising additional tax revenues. But for those individuals who own and operate their own business and fill out their sole proprietary statements and use that to generate a tax return, that may be more open to under-reporting of income. Those were the sort of numbers you said, where there were 17% of sole proprietors were under-reported. They want to dig into those sole proprietors.

Phil Ryan:

Yeah, Larry, 55%, according to the IRS.

Larry Bernstein:

These sole proprietors are maybe a scope for enforcement. What kind of businesses are those that they'll probably be going after? Are those restaurants, doctors' offices, and law offices? What do you suppose that is?

Phil Ryan:

Any business that would deal in cash. I'll give you an example, marijuana businesses. Marijuana businesses can only deal in cash because under federal law, the banks can't service their business. Restaurants, people, tradesmen that do work that could be paid in cash. But again, we're talking not about material amounts. I mean, we're not talking billions of dollars here.

Tom Durham:

Yeah, I agree with what Phil just said. Most of these Schedule C businesses are not going to be material amounts in reference to the goals that Biden has stated. There are just not hundreds of billions of untaxed income generated from these types of businesses, which is where I'm just not sure where this tax revenue is going to come from.

Larry Bernstein:

As someone who's been audited in the past, the audits can be very annoying and very time-consuming.

Tom Durham:

Yes.

Larry Bernstein:

Your sense is that with greater and greater numbers of audits, how should taxpayers prepare themselves for this onslaught of audits, which may or may not generate any revenue at all, but will definitely be a waste of time? Should we be working on our own recordkeeping? What thought process should we have in terms of interacting directly with the IRS, either through our agents or directly, in terms of trying to minimize the waste of time?

Tom Durham:

It's always good to have your ducks in a row and to have your records prepared well, both so you can do your return and for the future. It's a pain, obviously, but it's a good idea, especially for people who think they may have some issues, to have their records organized well, to make sure they're accessible, in a logical form, because that will speed things up when the audit comes. I think it's of increasing importance to have those prepared and ready.

You know how time consuming this is too, which is another reason why I'm just not convinced that there's going to be that much money resulting from this. The new plans mean that there's going to be thousands of new agents who are going to be less skilled than prior agents and are probably going to take more time to perform an audit, and sometimes there's not going to be that much money at the end of the tunnel. I'm just not sure where all of this is leading.

Larry Bernstein:

There's a lot of thought when the auditor gets there, I imagine he's under a lot of pressure to find something. Even if you find something that may be not true, sometimes it's better just to pay the guy off and just get him out of your hair. To what extent do you think this is going to just be, "Come in, look at whatever you want. You don't understand what you're doing, but fine, do you want a few thousand dollars? Here you go, just get out of my hair. I don't think I owe that money, but so what?" Would that be the more common response to all this?

Tom Durham:

I think that's possible. There may be pressure to do audits more quickly and try to close them out without collections. I'm not sure about that, but I think it's certainly a possibility.

Larry Bernstein:

Phil, what do you think?

Phil Ryan:

In any IRS audit, the agent starts out looking for fraud. Then he gets into income and deductions. There's a point where he has to justify his time. If the agent doesn't see a pot at the end of the rainbow, he's going to try to cut it off either with a no change or, Larry, what you're suggesting is that he questions a \$2,000 expense and your representative says, "Fine, just disallow the \$2,000 deduction and let's move on."

Larry Bernstein:

Do you think that's the future, what we're talking about here? Just a lot of those minor quibbles? And if so, how time consuming would that be for taxpayers?

Phil Ryan:

Well, it is going to be time consuming because the agent, he has an audit program that he's going to go through. Maybe 80% of the audit steps that have nothing to do with their particular taxpayer, but that he'll still go through them and so it'll still be time consuming. I have to go back to something Tom said and something that preparing for this presentation I've concluded. The numbers that people are throwing out in terms of unreported income for higher income people are ludicrous. I mean that they're not there.

Tom Durham:

I mean, I certainly agree with Phil on that. I was a partner in a law firm for many years where we had high incomes, and to the best of my knowledge, partners in this firm were not doing anything fishy. We were all paying the high tax rates and all grumbling about it.

Phil Ryan:

Especially today, with third-party reporting.

Tom Durham:

Yes, yes.

Larry Bernstein:

Why do you think that the Biden administration decided to double the IRS budget? It was not something that was talked during the campaign. Why do they think that this is such an opportunity for generating revenues if both of you guys think that there's nothing there? What got them excited?

Tom Durham:

Well, as Phil has mentioned, there has been a reduction in the high-risk budget over the last 10, 20 years, so it probably needs to come back up. I've been talking to IRS people over the last 20

years and they all felt the cuts in a lot of ways and complained about it, so I think that there is some underfunding. As Phil mentioned, their computer systems are a mess. I once had a trial where the issue was whether certain computers were state-of-the-art or valuable or not. We found an expert witness who testified that this particular computer was the most common computer in the IRS system, and the IRS lawyer stipulated, he said, "Well, I'll stipulate that our computers are worthless." Their computer systems are very, very much behind the curve. They need to be fixed, especially with all of this new reporting requirements. I think it'll make it more efficient. They are aging out. I think there's a number of reasons why it's logical to think that there needs to be an increase in the budget, but I continue to believe, as Phil said, it's just not going to produce that much extra income.

Larry Bernstein:

Well, thank you very much to both of you.