EXAMINING HIGH NET WORTH TAXPAYERS IN THE U.S.

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INTRODUCTION

In September 2021, U.S. Representative Alexandria Ocasio-Cortez (Dem. New York) famously made a fashion statement at the Met Gala Ball when she wore a dress with the message "tax the rich" emblazoned on the back. Beginning in 2023, the Internal Revenue Service ("I.R.S.") and the Department of Justice ("D.O.J.") took up the call with programs of enhanced I.R.S. examinations of high-net-worth individuals, large partnerships, and large corporations, and D.O.J. prosecutions of persons accused of criminal tax offenses.

This article explores the key components of these initiatives, their implications for compliance, and the strategies that tax professionals should employ while navigating the evolving landscape of tax enforcement.

I.R.S. INITIATIVES

IR-2023-166 (Sep. 8, 2023) – High Net Worth[1]

In the fall of 2023, the I.R.S. announced an initiative to focus its tax compliance efforts, including examination and collections activities, on high-net-worth individuals. This initiative focused on taxpayers with income of more than $1 million and tax debt in excess of $250,000. The I.R.S. ensured that while H.N.W.I.'s would be subject to additional scrutiny, taxpayers who earned less than $400,000 per year would not be subject to an increased chance of examination.

IR-2024-09 (Jan. 12, 2024) – Large Partnerships[2]

This initiative didn't just focus on high-net-worth individuals, it also focused on large partnerships. The original initiative focused on examining the largest and most complex partnerships, which traditionally have more than $10 million in assets. These large partnerships include hedge funds, real estate investment partnerships, publicly traded partnerships, and large law firms. Other areas of focus include corporate compliance, transfer pricing initiatives, and self-employment tax initiatives for partnerships.

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1 "IRS Announces Sweeping Effort to Restore Fairness to Tax System with Inflation Reduction Act Funding; New Compliance Efforts Focused on Increasing Scrutiny on High-Income, Partnerships, Corporations and Promoters Abusing Tax Rules on the Books." Internal Revenue Service, September 8, 2023.

2 "IRS Ramps up New Initiatives Using Inflation Reduction ACT Funding to Ensure Complex Partnerships, Large Corporations Pay Taxes Owed, Continues to Close Millionaire Tax Debt Cases." Internal Revenue Service, January 2, 2024..

IR-2024-56 (Feb. 29, 2024) – Reach Out[3]

Earlier this year, the I.R.S. took a big step by reaching out to over 125,000 high-net-worth taxpayers who had not filed income tax returns since 2017. Of these returns, 25,000 were sent out to taxpayers with $1 million or more in income and the additional 100,000 were sent to taxpayers whose income was between $400,000 and $1 million. The I.R.S. sent taxpayers a Notice CP59, sending approximately 20,000 to 40,000 Notices per week for several weeks. The Notice CP59 instructed taxpayers with delinquencies to either immediately file the delinquent returns, or if the return was previously filed or the taxpayer did not have a filing obligation, to file Form 15103 (Form 1040 Return Delinquency).

IR-2024-130 (May 2, 2024) – Focus on Wealthy[4]

The I.R.S.'s focus on high-net-worth individuals began heating up in May of this year, when the I.R.S. announced that it was going to increase audits of the wealthiest taxpayers, including large corporations and large partnerships:

- Setting its eyes on 2026, the I.R.S. plans on tripling the audit rate for large corporations, defined as those with more than $250 million in assets, going from 8.8% of large corporation (the 2019 audit rate) to 22.6%.
- Large partnerships, those with assets over $10 million, will see their audit rate increase from 0.1% (the 2019 rate) to 1.0% (the proposed 2026 rate).
- The I.R.S. also proposed a 50% increased audit rate of high-net-worth individuals, defined as individuals having positive income over $10 million, thereby taking the audit rate from 11% (2019 rate) to 16.5% (proposed 2026 rate).

IR-2024-233 (Sep. 6, 2024) – Initial Results[5]

Although the initiative is in its infancy, it has already been quite successful. Of the 125,000 notices sent to high-net-worth taxpayers, more than 21,000 of these taxpayers have filed their returns. These 21,000 returns have led to more than $172 million in additional tax revenue. Similarly, the I.R.S.'s ramped up collection efforts for high-net-worth individuals has led to over $1.1 billion in recovered tax liabilities. The I.R.S. pursued more than 1,600 high-net-worth individuals—those who earned more than $1 million per year and who had at least $250,000 in tax debt—and was able to obtain some form of payment from nearly 80% of these taxpayers.

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3 "IRS Launches New Effort Aimed at High-Income Non-Filers; 125,000 Cases Focused on High Earners, Including Millionaires, Who Failed to File Tax Returns with Financial Activity Topping $100 Billion." Internal Revenue Service, February 29, 2024.

4 "IRS Releases Strategic Operating Plan Update Outlining Future Priorities; Transformation Momentum Accelerating Following Long List of Successes for Taxpayers." Internal Revenue Service, May 2, 2024.

5 "U.S. Department of the Treasury, IRS Announce $1.3 Billion Recovered from High-Income, High-Wealth Individuals under Inflation Reduction Act Initiatives." Internal Revenue Service, September 6, 2024.

IR-2024-284 (Oct. 29, 2024) – New Task Force[6]

As part of this initiative, the I.R.S. formed a new office, which focuses on Passthroughs, Trusts, and Estates. Recently, the I.R.S. selected Jeffrey Erickson, formerly of Ernst & Young, as the first Associate Chief Counsel for its newly formed Passthroughs, Trusts, and Estates Office. This office will focus exclusively on passthrough entities, including partnerships and S-corporations, and trusts and estates, ensuring that these entities are, become, and remain compliant.

IR-2024-46 (Feb. 21, 2024) – Adjacent Issues[7]

In addition to increased examinations of individuals and entities, the I.R.S. began examining issues adjacent to high-net-worth individuals, which is expected to open the door to other issues involving high-net-worth taxpayers. To illustrate, the I.R.S. began examining the personal use of business aircraft. More specifically, whether business aircraft are used for more than just business activities. These activities presumably impact high-net-worth individuals only, and, therefore, any adjustments in tax would be in line with the current initiative.

IR-2024-166 (Jun. 17, 2024) – Abusive Partnerships[8]

Another high-net-worth adjacent issue involves "abusive" partnership transactions involving "basis shifting." Basis shifting involves related-parties stripping basis from a non-tax generating asset to a tax-generating asset.

According to an I.R.S. Field Service Advice issued contemporaneously,[9] these transactions may employ several steps over a period of years and use highly sophisticated planning to ensure that little or no tax is paid while large amounts of tax basis is "stripped" from certain assets and shifted to other assets to generate tax benefits for the individual partners. These partnerships and the people engaging in these transactions may be high-net-worth individuals.

ARE I.R.S. INITIATIVES WORKING AS PLANNED?

The I.R.S.'s new initiatives reflect new funding for the I.R.S. arising from the Inflation Reduction Act ("I.R.A."). Enacted in 2022, the I.R.A. provided the I.R.S. with nearly $80 billion in additional funds, to be doled out through 2031.[10] Although this amount was reduced by more than $20 billion, it still provided much needed funds to the I.R.S. Most of the available funds have been earmarked for enforcement, including examination and collection. These funds made it possible for the I.R.S. to focus on

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6 "IRS Hires New Associate Chief Counsel to Focus on Partnerships and Other Passthrough Entities." Internal Revenue Service, October 29, 2024.

7 "IRS Begins Audits of Corporate Jet Usage; Part of Larger Effort to Ensure High-Income Groups Don't Fly under the Radar on Tax Responsibilities." Internal Revenue Service, February 21, 2024.

8 "IRS Announces New Steps to Combat Abusive Use of Partnerships; Agency's Focus Intensifies as New Guidance Closes Loopholes Worth Tens of Billions." Internal Revenue Service, June 17, 2024.

9 "New IRS, Treasury Guidance Focuses on 'Basis Shifting' Transactions Used by Partnerships." Internal Revenue Service, June 17, 2024.

10 "How Did the Inflation Reduction Act of 2022 Affect the IRS's Budget?" Tax Policy Center, January 2024.

enforcement by hiring additional personnel and acquiring additional technology to assist agents in enforcement.[11]

We briefly discussed the I.R.S.'s initiatives and their successes, but the question is how are these initiatives really fairing? The initiatives are bringing in taxpayer dollars and seem to be having an impact on the bottom line. Collecting $1.3 billion of additional tax during the initial stages of these initiatives is quite an accomplishment. However, it has not been entirely smooth sailing.

". . . the I.R.S. has not yet succeeded in creating a methodology to target high-net-worth individuals while also excluding taxpayers making less than $400,000 per year."

Although the I.R.S. is not supposed to focus on taxpayers with incomes below $400,000, which was not just an I.R.S. policy but rather a Treasury directive, the Treasury Inspector General for Tax Administration ("T.I.G.T.A.") has found that the I.R.S. has made limited progress in developing a methodology to comply with this directive. In other words, the I.R.S. has not yet succeeded in creating a methodology to target high-net-worth individuals while also excluding taxpayers making less than $400,000 per year.[12]

This is significant because the Treasury's directive instructed that the I.R.A. funds were not to be used for examination of anyone making under $400,000 per year, which does not discriminate between married and unmarried households. Another potential setback involved the I.R.S.'s goal to audit 8% of high-net-worth individuals, which is defined as those who make more than $10 million per year. T.I.G.T.A. found that the I.R.S. began auditing these high-net-worth individuals but then turned away from focusing solely on those making $10 million or more per year,[13] and began focusing more on other high-net-worth individuals, because the no-change rate for the truly high-net-worth taxpayers was quite high. Therefore, although there is usually a larger monetary benefit when auditing taxpayers with more than $10 million per year in income – examining individuals making over $10 million per year yields four times more dollars assessed per return and two times more dollars assessed per man hour than other examined returns – the return rate was insufficient to continue to justify the focus on these taxpayers.

OTHER I.R.S. INITIATIVES

Although the focus has been on the I.R.S.'s recent initiatives, other initiatives appear on the "Dirty Dozen" list of tax scams[14] that include, or normally include, high-net-worth taxpayers. For instance, the I.R.S. has gone after syndicated conservation

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11 Office, U.S. Government Accountability. "Artificial Intelligence May Help IRS Close the Tax Gap." U.S. GAO, June 6, 2024.

12 "The IRS Has Made Limited Progress Developing the Methodology to Comply with the Treasury Directive to Not Increase the Audit Rate for Taxpayers with Incomes below $400,000 Due to Planning and Implementation Challenges." U.S. Treasury Inspector General for Tax Administration, August 26, 2024.

13 "The IRS Ceased Compliance with the $10 Million Taxpayer Treasury Directive in Favor of an Overall Focus on High-Income Taxpayer Noncompliance." U.S. Treasury Inspector General for Tax Administration, June 20, 2024.

14 "Dirty Dozen." Internal Revenue Service. Accessed December 2, 2024.

easements,[15] micro-captive insurance arrangements,[16] alleged misuse of the Maltese-U.S. tax treaty,[17] digital assets (coins and tokens, etc.), and improperly using charitable remainder annuity trusts ("C.R.A.T.'s").[18] These arrangements primarily are marketed to high-net-worth taxpayers. Put another way, only those with means use these tax-avoidance strategies. The I.R.S. has focused on many of these issues for years, and recently final regulations were issued deeming syndicated conservation easement transactions as listed transactions, requiring disclosure. The I.R.S.'s new funding and personnel have assisted in all-around enforcement, including items that have made it to the Dirty Dozen list.

These are not an exhaustive list of the I.R.S.'s recent enforcement strategies and focal points, but they are the most prevalent. The I.R.S. will continue to use its I.R.A. funding to ramp up enforcement and to examine high-net-worth taxpayers.

D.O.J. CRIMINAL PROSECUTION

Every year, the D.O.J. prosecutes all manner of tax crimes. Not all of these crimes involve high-net-worth individuals, but they often deal with large tax losses. D.O.J. prosecutions serve as a deterrent for taxpayers who might consider crossing the line separating aggressive tax planning from criminal activity. At the end of the day, taxpayers tend to reconsider their actions when freedom is on the line. To wit, if the penalty for tax evasion is merely financial, taxpayers may view the risk as a cost of doing business, but when freedom is at stake, they may think differently.

There have been several recent indictments that involve either high-net-worth individuals or significant tax loss. The following examples illustrate:

- A Washington, D.C. accountant who despite earning more than $7.7 million over the better part of a decade did not file income tax returns, and falsified documents to obtain a mortgage.[19]

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15 A syndicated conservation easement is essentially a scheme by which investors acquire an interest in a partnership that owns the land and claim a charitable contribution deduction when a portion of the land is donated as a conservation easement to a charitable organization.

16 Micro-captive insurance companies are an indirect form of self-funded insurance and alleged by the I.R.S. to be less than legitimate insurance arrangement principally because of a lack of risk-shifting. Promoters tout that investment income of a micro-captive insurance company can use incurred but not reported losses to shield investment income of the company.

17 The Maltese pension plan scheme allegedly involves taxpayers putting appreciated assets in a Maltese pension plan and then claiming treaty benefits to avoid gain on the assets based on the broad wording of the pension article of the Malta-U.S. Income Tax Treaty, Article 17 (Pensions, Social Security, Annuities, Alimony, And Child Support.)

18 "Dirty Dozen: High-Income Filers Vulnerable to Illegal Tax Schemes; Face Risk from Improper Art Donation Deductions, Charitable Remainder Annuity Trusts, Monetized Installment Sales." Internal Revenue Service, April 10, 2024.

19 D.O.J. Press Release No. 24-1201 (Sep. 25, 2024).

- A Texas couple who obtained more than $23 million in false refund claims, including reporting false interest income and income tax withholdings for several trusts and estates.[20]
- A film producer who concealed income and assets offshore, including the sale of his company for approximately $25 million, resulting in $5 million in tax loss.[21]
- A Colorado dentist who purchased a tax shelter and used it to conceal over $3.5 million in income over several years, resulting in over $1 million in tax loss.[22]
- A chiropractor who filed false tax returns and impeded I.R.S. collection efforts of the $2.4 million tax liability he initially self-reported.[23]
- A doctor and her husband who defrauded the health care system and filed false tax returns, resulting in receipt of over $10 million in fraudulently obtained funds.[24]
- A former defense contractor who, along with his wife, evaded taxes on more than $350 million in income.[25]
- A Washington business owner who earned $4.8 million from real estate that was not reported on his income tax returns.[26]
- A Florida woman who filed $2 million in false refund claims, receiving approximately $500,000.[27]
- A New Jersey man who owed more than $2 million in tax, but impeded collection efforts, and who hid other real estate assets from the I.R.S.[28]
- Another New Jersey man, a tax preparer, who received $40 million in refunds from 1,600 false income tax returns, which improperly claimed Covid-19 employment-related tax credits.[29]
- A Los Angeles attorney who owed more than $1.7 million in tax, who impeded collection efforts.[30]

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20 D.O.J. Press Release No. 24-1180 (Sep. 19, 2024).

21 D.O.J. Press Release No. 24-1144 (Sep. 13, 2024).

22 D.O.J. Press Release No. 24-1056 (Aug. 26, 2024).

23 D.O.J. Press Release No. 24-955 (July 31, 2024).

24 D.O.J. Press Release No. 24-911 (July 22, 2024).

25 D.O.J. Press Release No. 24-558 (July 3, 2024).

26 D.O.J. Press Release No. 24-506 (April 24, 2024).

27 D.O.J. Press Release No. 24-441 (April 12, 2024).

28 D.O.J. Press Release No. 24-403 (April 5, 2024).

29 D.O.J. Press Release No. 24-395 (April 3, 2024).

30 D.O.J. Press Release No. 24-337 (March 22, 2024).

- A Florida man who hid more than $20 million in assets in two dozen secret Swiss accounts.[31]
- A Texas man whose returns did not reflect $4 million in Bitcoin sales, resulting in significant gain.[32]
- A Minnesota man who evaded tax on nearly $5 million of income.[33]

While these are not exhaustive, they represent that the D.O.J. is prosecuting taxpayers with significant means and whose tax schemes include millions of dollars in lost tax revenue.

In addition to criminal prosecutions, the D.O.J. also has initiatives that are focused on potentially high-net-worth individuals, including the offshore compliance initiative and the recent voluntary disclosure initiative. Earlier this year, the D.O.J. released an internal memorandum regarding a pilot program where the D.O.J. offers a non-prosecution agreement to an individual for original information related to a corporate bad actor.[34] The non-prosecution agreement comes with the requirement that the individual repay all previously-recieved ill-gotten gain or proceeds.[35]

This pilot program looks for

- violations by financial institutions, including their insiders or agents,
- violations related to the integrity of financial markets,
- violations related to foreign corruption and bribery,
- violations related to health care fraud,
- violations related to fraud against the U.S. in the context of government contracts, and
- violations related to the payment of bribes and kickbacks.[36]

The reporting party must provide truthful, complete, and original information, and must agree to fully cooperate.[37]

Another such initiative is the whistleblower initiative, which provides an award for corporate whistleblowers.[38] Once again, the information provided must be original and truthful, and it must lead to successful forfeiture of $1 million or more in net proceeds. The whistleblower may be entitled to an award up to a certain amount ($55 million), which is discretionary and based upon the proceeds collected by the

31 D.O.J. Press Release No. 24-332 (March 21, 2024).

32 D.O.J. Press Release No. 24-150 (February 7, 2024).

33 D.O.J. Press Release No. 24-88 (January 25, 2024).

34 "The Criminal Division's Pilot Program on Voluntary Self-Disclosures for Individuals." U.S. Department of Justice, April 15, 2024.

35 *Id.*

36 *Id.*

37 *Id.*

38 *Id.*

D.O.J.[39] Thus, in order to go after some potentially high-net-worth bad actors, the D.O.J. has provided immunity and an award for original information.

While the D.O.J. is not solely focused on tax-related aspect of high-net-worth individuals, it has provided significant incentives and deterrents that impact high-net-worth individuals who are either not paying their correct share of tax, are impeding tax collections, or who have engaged in some form of scheme to defraud the government.

PATH FORWARD IF COMPLIANCE IS UNCERTAIN

Although these initiatives may have acted as a catalyst, the pragmatic tax professional should have already been reaching out to high-net-worth clients to discuss compliance expo areas in filed tax returns. Even if this was not standard practice, the initiatives offered tax advisers a reason to reach out to clients. However, reaching out to clients is just the beginning. The tricky part is determining whether clients are compliant and, if not, identifying the best path forward, including whether to correct prior noncompliance.

Initial Action Steps

The inquiry begins with the taxpayers' compliance. Unfortunately, not all taxpayers are 100% knowledgeable or truthful about all compliance issues. In these situations, it is important to take certain actions. The first action occurs after the client executes a valid Form 2848 (Power of Attorney and Declaration of Representative) that is filed with the Centralized Authorization File unit. It is to obtain the I.R.S. transcripts of account. These transcripts of account, which can be obtained from the I.R.S. directly or through a third-party provider, such as Tax Help Software, will often show whether a return was filed, when it was filed, and if there has been any I.R.S. action, such as whether an examination has been initiated by the I.R.S., even if the client has not yet been contacted. In addition to the account transcripts, it is also important to obtain both the income tax return and wage and income transcripts. Having both of these will determine whether the income reported on the income tax return, if there was a return, was correct, and if no return was filed then these transcripts will be a good starting point for reporting the taxpayer's income. Transcripts of account should almost, if not always, be the first step in any representation.

Next, the tax adviser should file a Freedom of Information Act ("F.O.I.A.") request. While the information will not be as readily available as I.R.S. transcripts, the information obtained from the F.O.I.A. request is often necessary. In these situations, the tax practitioner can request, *inter alia*, information regarding the filing of information returns, whether there has been any activity regarding the taxpayer's account with the I.R.S., and whether there has been any correspondence sent or received by the I.R.S. Often a significant period of time passes before the F.O.I.A. response is received from the I.R.S. Technically, the I.R.S. has 20 working day to respond but often the F.O.I.A. office will send a letter requesting additional time to respond, depending on the volume and complexity of the request. It is not uncommon for the I.R.S. to require several months to respond to the F.O.I.A. request. While it is always a good practice to get transcripts and submit the F.O.I.A. request, it is of crucial importance in cases of high-net-worth clients whose compliance record is uncertain.

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[39] *Id.*

Choice of Program

Once the extent of any noncompliance is determined, fashioning a path forward is the next step. Stated simply, does the taxpayer focus on correcting past noncompliance or does he or she correct moving forward. Ethically, tax advisers are not obligated to inform taxpayers to correct prior noncompliance. Their obligation is to inform taxpayers of the noncompliance and the consequences of not correcting their noncompliance.[40] Whether to correct is a judgment call and depends on the client. Regardless, if the taxpayer does decide that correcting prior noncompliance is the correct option, several options should be considered.

Quiet Disclosure

The first potential option is commonly known as a "quiet disclosure." A quiet disclosure includes filing the delinquent returns absent participation in an I.R.S. program. In a quiet disclosure, the client will submit the returns and essentially hope that they are accepted without incident. Quiet disclosures offer no protection against penalties, including (i) failure-to-file and failure-to-pay penalties and (ii) penalties associated with delinquent international information returns, if applicable. Because there are no protections associated with submitting a quiet disclosure, it is often considered the riskiest of the options.

"Ethically, tax advisers are not obligated to inform taxpayers to correct prior noncompliance. Their obligation is to inform taxpayers of the noncompliance and the consequences of not correcting their noncompliance."

Streamlined Procedures

While quiet disclosure does not focus on the reason for the compliance shortfall, taxpayers whose failure to file was non-willful may want to consider the streamlined offshore procedures. There are two streamlined offshore procedures, being the domestic procedure and the foreign procedure. Whether a taxpayer is eligible for one procedure or the other depends on a multitude of factors, but the initial focus is on where the taxpayer resides (or has resided in the past three years). These streamlined procedures traditionally deal with unreported foreign income and assets. While foreign participants in the foreign procedure are not subject to a penalty, participants in the domestic procedure face a 5% penalty on unreported foreign assets. Streamlined submissions may provide more protection than a quiet disclosure, but that protection comes with strict eligibility criteria and its own domestic penalty structure.

Voluntary Disclosure

The final way taxpayers can correct noncompliance is through the voluntary disclosure practice ("V.D.P."). This is for taxpayers who have not reported income or foreign assets and whose failure to file or report was willful.[41] The V.D.P. offers the highest level of protection, where there will be a non-prosecution recommendation and a closing agreement, giving finality to the tax periods at issue. The cost of finality, however, can be steep. Taxpayers in the V.D.P. are liable for a 75% fraud penalty for the year with the highest tax liability and a 50% penalty for the highest account balance, if there is a foreign account involved. Although the penalties are stiff, this program offers real and definitive protection. At this point, the V.D.P. is best reserved for taxpayers who have either engaged in fraud or criminal activity.

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40 I.R.S. Circular 230 §10.21.

41 The V.D.P. requires a Form 14457 to be completed (both parts I and II), and the Form, as of recently, specifically requests that the taxpayer check a box indicating that the failure was willful.

Discovery by the I.R.S.

The programs described above are all essentially focused on pre-I.R.S. interaction.[42] Once the I.R.S. reaches out to the taxpayer, the taxpayer has limited options. For instance, once the taxpayer is sent a Notice CP59, which is the notice issued to high-net-worth taxpayers informing them that they have outstanding tax returns that cannot be filed, the taxpayer may: file income tax returns, not file returns and accept the substitute for returns filed by the I.R.S., or submit a Form 15103 (Form 1040 Return Delinquency) challenging either the failure to file the return or the requirement to file a return. The general view of advisers having a tax controversy focus in its practice is that it is better to resolve delinquent income tax returns before the I.R.S. contacts the taxpayer.

Examination Initiatives

In addition to the failure to file initiatives, examination initiatives are available. These examinations are not dissimilar from traditional examinations, where an I.R.S. agent begins the examination by sending an information document request ("I.D.R.") and the I.R.S. and the taxpayer's representative discuss and resolve the issues.

From experience, two significant differences appear to exist between the new high-net-worth examinations and traditional examinations. First, the I.D.R.'s issued in the high-net-worth examinations seem to be significantly broader than traditional I.D.R.'s. The I.D.R.'s request broad information on multiple issues and may request information on numerous entities. Moreover, the I.D.R.'s often do not have a focus but rather ask for numerous potentially unrelated items. While calling these I.D.R.'s a fishing expedition may be extreme, they appear to be broader than normal and often require voluminous responses or clarifications of the documents and information being requested. The end result is that the initial I.D.R.'s will be broad, while follow-up I.D.R.'s will be more focused until the I.R.S. makes a determination. Dealing with the process can be time consuming and frustrating.

The other noticeable difference between traditional and high-net-worth examinations is the presence of attorneys from the I.R.S. Office of Chief Counsel. It appears that Chief Counsel attorneys are more involved at the onset of these high-net-worth examinations. In a typical I.R.S. examination, an I.D.R. will be sent and there will be a response by the taxpayer, or a series of I.D.R.'s will be sent and responded to by the taxpayer. Ultimately, there are discussions between the examiner and the taxpayer's representative regarding the issues. In comparison, with the high-net-worth examinations, Chief Counsel is involved from early on, so initial conferences will include an I.R.S. attorney, who will respond to or discuss I.D.R. responses directly with the taxpayer's representative. While unexpected, it is often reassuring to discuss issues directly with an I.R.S. attorney so that the issues can be resolved earlier in the process. Nonetheless, examinations can drag on when the I.D.R.'s are too broad, or the issues have not yet been determined by the I.R.S.

These differences do not necessarily change the manner or course of representation. It may behoove the taxpayer's representative to have a call early on with the I.R.S. examiner or attorney to discuss the nature of the examination. Even if there

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[42] While there is some debate as to what constitutes prior contact by the I.R.S. or rather what prior contact disqualifies taxpayers from utilizing a program, that discussion is beyond the scope of this article.

is no way to limit the scope of the I.D.R. in a particular examination, it is a good practice to discuss the potential issues as early as possible in order to determine the relevancy of the I.D.R. requests.

As always, make sure to observe the normal formalities of practice. If your I.D.R. response is voluminous, make sure that the response is Bates stamped. Always keep a full and complete copy of the response for your records. Respond as completely but narrowly as possible, neither the client nor the I.R.S. want documents exchanged that are not relevant to the inquiry or were not specifically requested. And, when responding, always be sure to protect and assert any privileges that may apply. When in doubt, feel free to overuse privilege, the privilege can always be waived later but once waived then the privileged information is out there.

The final important point of representing high-net-worth taxpayers during examination is to ensure that these clients are kept informed, and their expectations managed. High-net-worth individuals like to be kept in the loop and heard.

CONCLUSION

The I.R.S. has invested considerably in examination related resources to identify noncompliant taxpayers and collect taxes due in order to reduce the tax gap. One of their top priorities has been making sure that high-net-worth taxpayers report all income and pay the proper amount of tax that is due. For those noncompliant taxpayers wishing to come forward, various procedures are available to come into compliance. Some procedures have no cost other than the cost of compliance. Others have significant costs in terms of tax and civil penalties. Those taxpayers who believe they are invisible may face criminal prosecution.