

Examination

Hello, I Am Your CP2000 Notice!

By *Larry Jones*

CP2000! This is a term we are hearing more often. When calling the Practitioner Priority Line, the first question the IRS asks is, “Are you calling about a CP2000?” Even though taxpayers are timely responding to CP2000 notices, the IRS is not timely processing the responses. The IRS is supposed to work a taxpayer’s response to the CP2000 notice within 30 days. As a result of the IRS failing to do this, 90-day letters are being issued forcing taxpayers to either default on the notice and have an assessment made, or file suit in the U.S. Tax Court.¹

CP2000 notices are generated by the Automated Underreporter Program (AUR) within the IRS. The program was first implemented in 1994. This program analyzes and processes returns with potential underreported income, payments, credits and deductions. When all tax returns for the current year are processed, the returns are computer matched to the corresponding information return documents such as Form W-2, Form 1099-DIV, Form 1099-INT, Form 1098, *etc.*

This computerized matching process generates underreporter cases. A comparison is made between (1) information reported to the IRS by taxpayers on their individual income tax returns; and (2) payer data reported to the IRS on information returns. When potential discrepancies are found, the returns are selected for further analysis. The AUR program is separated into three phases²:

1. Case Analysis (may also be referred to as Screening or “Pre”)
2. Response, includes both CP2501 and CP2000 (also referred to as “Post”)
3. Statutory Notice, legally required final notice (abbreviated as “Stat”)



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Case Analysis

The Case Analysis phase is the initial screening of a case. A technical determination is made regarding the following:

- Does a notice need to be generated?
- Does a case need to be referred and/or re-searched?
- Can a case be closed without further action?
- Should a case be transferred to another function?

In the Case Analysis phase, tax examiners perform an in-depth review of the case, comparing the taxpayer's tax return and the associated payer information trying to locate the potentially under-reported, omitted or overdeducted amounts. If all identified discrepancies can be accounted for, the case is closed without contacting the taxpayer. If the discrepancy cannot be satisfactorily resolved during this review, a notice is issued.

There are basically two types of notices that can be sent in an underreporter case:

1. A CP2501 Initial Contact Letter is an inquiry letter sent to a taxpayer to obtain information regarding apparent underreported or omitted income and/or overclaimed deductions. This notice does not propose an increase in tax liability, but requires the taxpayer to submit an explanation (including supporting documentation) of the issues raised. In most cases the IRS will assume that W-2s and Forms 1099 they have received are correct. If the information provided by a taxpayer in response to this notice substantiates the issues, the case is supposed to be closed and the taxpayer notified. If it is not resolved, then a CP2000 notice is issued. This notice should not be ignored by the taxpayer.
2. A CP2000 Notice Proposing Adjustment to Income, Payments, or Credits proposes a change to tax liability based on apparent underreported or omitted income and/or overclaimed deductions. In the notice there is a detailed explanation of the income and/or deduction types and amounts in question, along with the proposed recomputation of tax including applicable penalties and interest.

Response & Statutory Notice


The Response phase may result in several different actions being taken by the IRS:

- Closure by refile of the case
- Assessment
- Miscellaneous referral

- Research (Unit Suspense)
- Transfer to another area (e.g., Examination or Criminal Investigation)
- Additional correspondence to resolve the issue

In reviewing the CP2000 Frequently Asked Questions (FAQs) on the IRS Web site,³ the IRS states that the CP2000 notice is "proposed changes to your income tax return." This is not a proposal the taxpayer can reject. While there may be certain procedures in place for the IRS to resolve the matter when a taxpayer responds, that is not happening. In many cases, all disputed responses appear to be ignored and a statutory notice of deficiency is issued⁴ which gives the taxpayer the right to file suit in the United States Tax Court.

The first page of the CP2000 Notice looks like this:


Internal Revenue Service
United States Department of the Treasury

CP 2000 Sample Contents Page 1

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You Must Return the Response Form by {response date}.

1. Why are you getting this notice?

The income and payment information (e.g., income tax withheld, wages miscellaneous income, interest, etc.) that we have on file does not match entries on your {tax year} {form #}. If this information is correct, you will owe {\$ amount}.

The proposed changes to your tax are listed below.

Summary of Proposed Changes	
{tax year} Tax Increase	{\$ amount}
Payment Increase	{\$ amount}
Penalties - may not include all applicable penalties	{\$ amount}
Interest - if paid by {due date}	{\$ amount}
Proposed Balance Due	{\$ amount}

2. What steps should you take?

Following these steps can help you understand this notice.

1. Review your {tax year} tax return.
2. Compare your return to the information in the *Explanation Section* - page 5.
3. Decide if the information in the *Explanation Section* is correct.
4. Check the answers to Frequently Asked Questions - page 2.
5. Complete and return the *Response Form* in the enclosed envelope - page 3.
6. Complete and return the *Installment Agreement Request* (enclosed) if you need to set up a payment plan.
7. Review your rights in *The Examination Process Booklet* (enclosed).

3. What happens if you don't respond by {due date} ?

We will send you a final notice, followed by a bill. During this time, interest will increase and certain penalties may apply.

The first line of the CP2000 Notice gives the taxpayer a date by which to respond to the notice. The notice informs the taxpayer of the proposed changes to income, payments, credits or deduc-

tions; and the amount due to the IRS or refund due to the taxpayer. It is normally a five- to six-page letter, but could include more pages depending on the changes proposed.

Other bold phrases in the notice are as follows:

- Frequently Asked Questions
- Response Form. The taxpayer has several options:
 - In Step A, the taxpayer can agree with all changes, not agree with some changes, or not agree with any of the changes.
 - In Step B, the taxpayer can select a payment option.
 - In Step C, the taxpayer is asked to verify the taxpayer's contact information.
- Explanation Section. This section explains the changes being proposed.

If the taxpayer cannot respond within the time set by the IRS, the IRS will generally allow an extension 30 days beyond the response date shown on the notice. Of course that assumes there is someone to communicate with to approve the extension. Practitioners should note the IRS has recently taken the position that a Power of Attorney must be on file for the act of requesting additional response time for your client.

What is and what is not an IRS audit? Most practitioners and taxpayers would consider any type of review of a tax return to be an audit. However, this is not the case. The analysis of a return by AUR does not constitute an audit. An audit is a more comprehensive action, which is generally done in person on returns selected using examination criteria. While correspondence audits from the IRS are considered audits, the underreporter program, or what is sometimes referred to as the information return matching program, is not considered an audit. An underreporter case is an analysis of issues identified through the computer matching process, and a notice is generated only for those amounts not readily identified as reported. Thus, a taxpayer may receive adjustments to a tax return as the result of the matching program and still be audited in the future. In simple terms, an IRS audit is a verification by the IRS of the correctness of a taxpayer's income tax return.

So what does all of this mean? If a taxpayer receives a CP2000 notice and agrees to the additional assessment, or receives a 90-day letter and does not file suit in the U.S. Tax Court, the IRS will make the assessment and send the taxpayer a

bill for the taxes owed. However, payment of the deficiency does not keep the IRS from auditing the taxpayer for the same year in the future. If the taxpayer is concerned about an audit in the future, the taxpayer should file a timely petition with the U.S. Tax Court, in which case the IRS cannot issue a subsequent notice of deficiency for the year for which the CP2000 was issued.⁵ Even if the taxpayer does not desire to contest the deficiency, a petition should be filed with the Tax Court in order to draw the tax year to a close. After filing the petition, the taxpayer can call the IRS attorney assigned to the case and agree to concede. At that time, a Decision document will be prepared and entered by the Tax Court. This Decision document is binding on the taxpayer and the IRS, and will preclude an audit for the same year.

In the recent case of *N.M. Cowie*,⁶ the Tax Court listed a number of facts and contacts by the taxpayers with the IRS over a period of almost two years concerning CP2501 and CP2000 notices that were received by the taxpayers. After receiving a statutory notice of deficiency and filing suit in the Tax Court, the IRS conceded the case. The taxpayers were seeking legal fees, but the court found that the taxpayers did not furnish all of the required information to the IRS. It appears that there was some dispute as to when the IRS received the information. The interesting thing about this case is the lengthy time period during which the IRS corresponded with the taxpayers, and nothing happened.

Nothing in the CP2000 notice gives the taxpayer the right to appeal the issuance of the CP2000 notice. In an AUR case,⁷ when the taxpayer disagrees with the issuance of a CP2000 notice and requests a face-to-face meeting, the AUR unit is instructed to contact the local Appeals office to make the necessary arrangements. Practitioners report that this rarely, if ever, happens.

When the taxpayer receives a CP2501 or CP2000 notice, an immediate response should be made to the IRS. If the taxpayer agrees with the notice, the taxpayer can sign the notice and return it to the IRS. If the taxpayer does not receive a response from the IRS, there should be follow-up phone calls to the unit issuing the notice, to the Taxpayer Advocate, and to the taxpayer's local Appeals Office. As a last resort, if a notice of deficiency is issued, the filing of a Tax Court petition will resolve the issue and protect the taxpayer from a future audit.

ENDNOTES

- ¹ This article deals with a CP2000 Notice when the taxpayer disagrees with the proposed changes by the IRS.
- ² IRM 4.19.2.1 (09-01-2003).
- ³ See www.irs.gov/individuals/article/0,,id=136857,00.html.
- ⁴ IRM 4.19.2.1.5 (09-01-2003).
- ⁵ See Larry Jones, *Have You Been Audited?* J. TAX PRACTICE & PROCEDURE, Dec. 2003–Jan. 2004, at 5.
- ⁶ *N.M. Cowie*, 93 TCM 1182, Dec. 56,920(M), TC Memo 2007-108.
- ⁷ IMRS 07-0000370—Face-to-Face Meetings for Automated Underreporter Cases.

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