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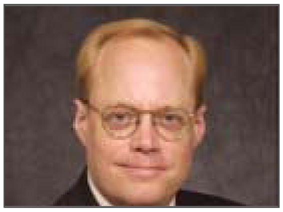

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When Fighting IRS, Should You Pay To Stop Interest?

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When disputing a tax bill, are you better off refusing to pay until you get it resolved or paying to stop interest from running while you disagree? This is a tough question. It comes up in many tax disputes and has no universal answer.

When the IRS proposes adjustments to your account, interest on the liability runs from the date the tax return was due to the date the IRS receives your payment of the ***entire amount*** including taxes, penalties and interest. Of course, if you convince the IRS they are wrong and no tax is due, there's no interest due. But if you turn out to be wrong in whole or in part and owe taxes, interest mounts quickly.

Interest on tax deficiencies is not tax deductible (except for corporations), so that makes interest payments even more painful. The interest compounds daily and runs at the short-term federal rate plus 3%. See IRS Topic 653 IRS Notices and Bills, Penalties and Interest. The IRS adjusts the federal short-term rate quarterly based on market rates.

Some taxpayers want to stop the bleeding and pay up but still fight the underlying tax. Who is holding the money is not supposed to impact your dispute, but some worry the IRS will be more motivated to resolve your case favorably if they don't have possession of your money. Consult your tax adviser about your particular dispute if you're in doubt about the impact in your case.

To completely stop interest from running, you must pay it all, including all interest that has accrued up to that point, as well as penalties. Otherwise interest will continue to build on any excess tax, penalties and interest that may be assessed. If you win your tax dispute you'll get it back.

Deposit? If you pay to stop the interest, you must ***specifically call it a deposit*** and follow IRS procedures or the IRS may think you're agreeing. Make your check payable to "United States Treasury" and send a written statement designating it as a "DEPOSIT." Also include the tax year, type of tax, and why you disagree. The nature and grounds of your disagreement should be specific.

The fact that you call it a DEPOSIT is important. For one, it allows you to withdraw it upon request if you later determine you want or need the money back. But note that if you do withdraw your deposit and it later turns out you owe the tax, the IRS will charge you interest from the ***original*** due date of the tax return as if you never made a deposit. See IRS Revenue Procedure 2005-18.

Getting it Back. If you've made a deposit to stop interest running but later want the money back, there is a separate procedure. Your request must be in writing and will be honored by the IRS unless it determines that the payment of any tax deficiency would be "in jeopardy." That means the IRS can retain your deposit if the IRS expects to have trouble collecting if you lose the dispute.

For more, see:

Dispute Your Tax Bill, But Not IRS Regulations!

Choose Your Ground In Tax Disputes

Received An IRS Notice? 10 Simple Tips

10 Ways To Audit Proof Your Tax Return

Becoming Tax Mr. Clean

Ten Tax Protester Claims To Avoid

IRS Internal Revenue Manual Part 4. Examining Process

IRS Treasury Decision 8959

Code Section 6603 Cash Deposits to Stop the Running of Interest On a Deficiency: Factors to Consider Before Remitting a Deposit

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