



What happens if I haven't filed old returns?

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Healthcare Traveler

If you never got around to filing your taxes during the past few years, you're not alone. In some parts of the United States, over 20 percent of taxpayers did not file a 2003 return. Of course, the lifestyle of healthcare travelers makes tax time particularly challenging—and increases the likelihood of missed or inaccurate filings.

Is no news really good news?

A matter of refunds

If you have not filed an extension, lived overseas, served in the armed forces, or had some other extenuating circumstance, you have only 3 years from the due date of a return to claim a refund. After April 15 of this year, for instance, you can no longer claim a refund for the 2001 tax year. Additionally, any income not reported to IRS (i.e., self-employment income) will not be considered when calculating your Social Security credits.

Millions of dollars in federal and state refunds go unclaimed each year and cannot be granted without a return. While there is no penalty for filing late with the IRS, a few states have late filing penalties, even for refunds.

A matter of refunds

document. If there is an amount due, IRS will issue you an appropriate notice. Another caveat: Substitute returns do not apply any credits or deductions to which you are entitled, so it is always better to file an original return.

Perhaps the most overlooked aspect of unfiled returns is the accumulation of **interest and penalties**. IRS can pursue any amounts due at any time, so there is no "statute of limitations" for collection of tax liabilities. While the interest charges can be quite nominal, there are two types of penalties charged by the agency: **failure to file** and **failure to pay**. The former is much worse than the latter. A failure to file penalty is 4.5 percent per month of the amount due. However, if the return is filed 60 days late, it is an automatic minimum of 100 percent. Penalties for timely filed returns without payment are 0.05 percent a month, increasing to 1 percent per month after a notice is sent.

Failure to file a tax return may also negatively influence other aspects of your life—from **increasing stress** levels beyond those associated with adjusting to new practice environments and constant relocation, to inhibiting **loan and credit applications**, to eliminating **Social Security benefits**. Rarely can you purchase a home without supplying a copy of a tax return and, in some cases, lenders may request copies of returns from the past 3 years. In addition, without a filed tax return, you **do not have evidence of other income**. Tax returns are the primary means of confirming rents, royalties, or capital gains when applying for any credit item. And, if you are considered self-employed, all credits for Social Security retirement and disability will be lost if a return is not filed within 3 years of the due date—which can affect your future retirement income.

Another unwanted side effect of non-filing involves **state taxes**. Almost every state and U.S. territory shares income, wage, and tax information with IRS. It is likely that taxpayers, who owe federal taxes, owe state taxes, as well. State revenue agencies have their own sets of policies and penalties regarding unfiled returns. Keep in mind that as a mobile professional, you leave an easily identifiable trail of income as you relocate, and it is not uncommon to have to settle with five or more states after a series of missed returns.

Weighing your options

Suppose you have not filed and owe money on your taxes. What are your options? The one thing you cannot do is file for

Of the Americans who do not file taxes, most owe the Internal Revenue Service (IRS) money. If you fall in this group, you may believe it's better to ignore the matter, hoping it will go unnoticed. The fact that IRS generally does not address unfiled returns for at least a year and a half makes it even easier to forget.

Side effects of not filing

While you may never hear from IRS—if the amount of income reported by employers, banks, and other entities corresponds appropriately to the amount of tax withheld or paid as estimates—you still need to be cautious. The agency can use this information to prepare a **substitute return** in lieu of receiving an original

Reasons to grant OICs

Debit as liability - Credit exists that the assessed tax is correct.

Debit as to Collectibility - Credit exists that the taxpayer could never pay the full amount of tax owed.

Effective Tax Administration - There is no doubt the tax is correct, and no doubt that the amount owed could be collected, but an exceptional circumstance exists that allows the IRS to consider a taxpayer's OIC, to be eligible for a compromise on this basis. The taxpayer must demonstrate that collection of the tax would cause an economic hardship or would be unduly and inequitable, creating a serious margin of financial stability.

Source: Internal Revenue Service

Reasons to grant OICs

an extension. These waivers grant more time to file, not more time to pay.

Fortunately, few people in this scenario go to jail. IRS prefers to get taxpayers back into the "system" of voluntary tax compliance. A number of different alternatives exist to help meet this objective.

Pay the amount with a credit card, loan, or other funds. This method is considered the best approach, since the accumulated interest and penalties are usually more than the interest charged by banks and credit companies. Any payment problems that would occur in the future on this amount would be a problem with the bank and not IRS.

Installment agreements. This is the most common method for taxpayers who do not have access to sufficient credit to catch up on their tax bills. It is similar to any loan. Interest still accumulates, as well as a late payment penalty of 0.025 percent for each month the installment agreement is in effect. Additionally, there is a \$43 user fee to set up the plan. Any subsequent defaults, late payments, or a failure to file a tax return may jeopardize the agreement, resulting in a demand for full payment.

Offer in compromise (OIC). Considered a formal offer to IRS to settle on all tax debts, interest, and penalties at a possibly reduced amount, this approach is more expensive (it requires a \$150 fee) and is difficult to obtain. There are only three reasons an OIC will be granted by IRS, according to the agency's website, www.irs.gov (see box).

A number of advertised schemes exist to settle your IRS debts "for pennies on the dollar." For someone with a steady stream of income, this is nearly impossible. Only those who have no means to pay or can evidence a severe hardship like a disability can hope for this. As far as the average taxpayer is concerned, the one item that can be easiest to reduce is the penalties, but even then, only with a compelling reason. The OIC can also be paid through an installment agreement, but a default on the installment agreement or another subsequent failure to file will void the offer and the original amount could be demanded. Application for this type of settlement involves some lengthy personal financial statements and approval can drag on for more than a year. It is best to begin voluntary payments prior to an offer to demonstrate willingness to pay.

The first steps

If you are only late in filing the past year's returns, it is generally an easy process to manage; however, if you are dealing with two or more years of unfiled returns, you may want to consider asking a professional to prepare your taxes and to legally represent you before IRS and state taxing authorities.

One practical reason for arranging this type of assistance involves **lost communications**. Travelers collect temporary addresses, and some correspondence from employers and tax authorities—including W-2s, IRS notices, state revenue notices, letters from credit agencies, and other documents requiring a dated response—could easily have been mailed to an incorrect address. A representative can obtain duplicates or transcripts of these documents and assess the status of your tax accounts without committing you to a course of action.

The **ability to present multiple options** is another rationale. A representative can advise you of your alternatives and negotiate settlements with IRS and state authorities. In the course of negotiations, he or she may help you obtain a waiver of penalties and possibly interest.

Three types of professionals can legally represent you before IRS: an attorney, a certified public accountant (CPA), or an enrolled agent (EA). The average attorney does not deal with tax issues, so it's best to look for one specializing in taxation. CPAs, oddly enough, do not always deal with tax matters, as public accounting is often the primary focus of their jobs. Enrolled agents concentrate on addressing tax issues. These professionals are usually former IRS revenue agents or tax advisors who have passed a 2-day, IRS-administered exam, demonstrating their competency in tax law. They cannot, however, argue a case before the tax court. Most EAs have referring attorneys if the matter escalates that far.

Be sure that whomever you choose for representation feels comfortable with interacting with revenue agents. Or consider seeking assistance from IRS directly. Agents can be very helpful, but remember that they work for the government and may not always have your best interests in mind.

Taking responsibility

Whether you suffered from a lack of available space to carry all of the necessary tax documents or some of your W-2s were sent to distant—or former—addresses, if you haven't filed or owe tax for previous years, now is the time to admit the oversight. Continuing to postpone the inevitable can have serious consequences that you should not ignore. After all, no one wants to carry the burden of unfiled taxes—and the fear of an IRS letter arriving in the mailbox. So, take advice of industry experts to heart: "Don't delay, file today." The sooner you accept this mantra, the quicker you can focus your energies on more important activities ...like providing quality care for your patients.

REFERENCE

Internal Revenue Service. (n.d.). *Offer in compromise*. Retrieved January 7, 2005, from <http://www.irs.gov/businesses/small/article/0,,id=104593,00.html>

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