PERSPECTIVE

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When Disputing A Tax Bill, Should You Go Ahead And Pay?

By Robert W. Wood

No one likes paying taxes. After soccer star Cristiano Ronaldo was accused of criminal tax evasion, some sources suggested that his team would pay the $16.5 million in taxes for him. It now appears that Real Madrid will not pay his tax bill. Next, reports said that Ronaldo would pay the taxes to reduce the severity of the charges, and to keep the size of his tax bill and penalties from continuing to grow.

Then, he said he would not pay after all. Paying taxes and even penalties in a criminal tax case is common, often as a way to take at least some of the wind out of the prosecution's sails. But in tax disputes more generally, do you pay, or do you refuse and put it off as long as possible?

Opinions vary, but the optics and dynamics of a criminal case are especially sensitive. Given that this is a criminal case, Ronaldo's advisers are probably telling him to pay.

After all, it can help with the public, and more important, it can help ease the tension of the criminal proceedings.

If the case ever ends in a plea bargain or a conviction, it can certainly help at sentencing. So in a criminal case, most indicators point toward making the payment if you can afford it. Clearly, Ronaldo can afford it.

Moreover, there would be no admission of guilt associated with the payment. It would normally also be possible to make the payment *conditional*. That way, the hefty payment could be recouped if Ronaldo defeats the criminal charges and the additional taxes that came with it. All of this suggests payment is wise, even though paying the bill would not eliminate the pending criminal charges.

Here, prosecutors contend that Ronaldo used an offshore company to hide his income from tax authorities. They allege that Ronaldo filed tax returns that understated his income and his taxes due. They say he defrauded the Spanish government out of 14.7 million euros (about $16.5 million) between 2011 and 2014.

In a regular civil tax case, whether to pay is a tougher call. 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? Interest is one point of debate.

When the IRS (or the California Franchise Tax Board) proposes adjustments to your account, interest on the liability runs from the date the tax return was due. That interest keeps running until 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 is no interest due.

But if you turn out to be wrong in whole or in part, you will owe the taxes (penalties if applicable), plus interest. And interest mounts quickly. Moreover, although you make think that interest is always tax deductible, it is not. Interest on tax deficiencies is not tax deductible (except for corporations).

That makes the interest payments even more painful. The interest compounds daily and runs at the short-term federal rate plus 3 percent. The IRS adjusts the federal short-term rate quarterly based on market rates. Right now, that interest would be accruing at over 4 percent, so it can add up.

Some taxpayers want to stop the bleeding and pay up, but still fight the underlying tax. There is usually a way to do this, but the details certainly matter. Moreover, tactics can clearly come into play.

Who is holding the money is not supposed to impact the resolution of your tax dispute. However, many taxpayers and advisers worry that the IRS (or the FTB) will be more motivated to resolve your case favorably if they *do not* have possession of your money. Get professional advice about your particular dispute and how it might play out if you're in doubt.

To completely stop interest from running, you must pay the entire amount, including all interest that has accrued up to that point, as well as penalties. Otherwise, interest will continue to accrue on any excess tax, penalties and interest that may be assessed. If you win your tax dispute you should be able to get it back, provided that you follow the rules.

If you pay to stop the interest, you must specifically call it a *deposit* and follow IRS procedures. Otherwise, the IRS might think you're agreeing to the tax bill. In the case of the IRS, 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 label it as a *deposit* is very important. For one, it should allow you to withdraw it upon request if you later determine you want or need the money back. However, note that if you do withdraw your deposit, and it later turns out that 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.

If that seems unfair, it may well be. But those are the rules. As you might suspect, in most tax cases people put off paying the amount the IRS says is due until it is clear the IRS has won. People worry about the change in dynamics in the dispute if the IRS has the money.

Besides, people correctly figure that if they can defeat the IRS, the interest will go away too. Yet, there are some cases in which the taxpayer has no choice, and *must* pay in order to dispute the taxes. For example, if you receive an IRS Notice of Deficiency (also called a 90-day letter), you have only 90 days to file in U.S. Tax Court to dispute the taxes.

You don't want to miss that 90-day deadline. If you do, the only way you can keep disputing the taxes is if you pay the bill, and then file a claim for a refund. If the IRS denies or ignores your refund claim, you can sue for a refund in District Court or the Court of Claims.

In taxes, much is about procedure. No matter what, weigh your options and consider the dollars involved as well as the impact on your negotiating posture.

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