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## Meet the Trainer



Keep More Commissions with Tax Breaks

# Lesson 7: IRS Audits

## Overview

**Fear:** IRS wants you to be afraid. It selects returns for audit for a variety of reasons including the creation of fear.

**Jail:** During the heart of the tax season, IRS releases prison stories about those taxpayers who have tried to cheat on their tax returns. The release of information is timed so that while you are putting together the information for your tax return, you are reading about people who are going to prison.

## IRS Personnel with Whom You Deal

**Taxpayer service representatives:** When you call the IRS information service to get a question answered, you talk to a taxpayer service representative. A taxpayer service representative is someone with a two-year associate degree - two years of college in any field, with no requirement for any accounting or tax courses. These are the people who answer your tax questions. The reps do get some training. Three days of classroom training are required for reps who assist persons wishing to file Form 1040A. There's also a 20-day basic training course for the people who answer the phones. After the basic training, an individual is IRS qualified to answer phone-in questions.





## Chances of an IRS Audit



<b>Income Level</b>	<i>In 2014</i>	<i>In 2015</i>
Individual Return Non-Business		
No Earned Income Credit		
Under \$200,000	0.4	0.3
Under \$200K Schedule E Form 2108	1.0	0.7
\$200,000 - \$1,000,000	2.5	1.8
Individual Return Business (not Farm)		
No Earned Income Credit		
Under \$25,000	1.0	0.9
\$25,000 - \$100,000	2.3	2.4
\$100,000 - \$200,000	3.0	2.5
\$200,000 - \$1,000,000	2.7	2.0
\$1,000,000 and above	10.8	9.6
Partnership Return	0.4	0.5
S Corporation Return*	0.4	0.4
Corporation Return (Based on Assets)		
Under \$250,000	0.8	0.8
\$250,000 - \$1,000,000	1.3	1.2
\$1,000,000 - \$5,000,000	1.4	1.1
\$5,000,000 - \$10,000,000	2.0	1.5
\$10,000,000 - \$50,000,000	15.8	5.8
\$50,000,000 - \$100,000,000	7.0	11.3
\$100,000,000 - \$250,000,000	15.5	14.2
\$250,000,000 - \$500,000,000	19.4	14.0
\$500,000,000 - \$1,000,000,000	22.5	17.0

Point being, your chances are slim.

*Pursuant to "Internal Revenue Service Data Book; Table 9. Examination Coverage."*

**\*Note:** IRS announced it will be increasing audits for S Corporations.



**Call the IRS at your own peril:** The IRS does not stand behind its answers. If it answers your question incorrectly, you're stuck and must pay the proper tax.

**Take names:** When IRS gives you an incorrect answer and you reasonably rely on it, you can avoid penalties if you have the name of the IRS person who gave you the bad information.

**Tax auditors:** Your tax return will be examined either by a tax auditor or a revenue agent. If you are going to an IRS office to present your information, you will in all likelihood be visiting a tax auditor. To qualify, a tax auditor must have a four-year college degree - in anything. Tax auditors generally start at half of what the big accounting firms pay.

**No thinking allowed:** The office auditor is generally not required to interpret guidelines or engage in research. The issues in contention are clearly defined by a classifier before the returns are assigned to individual examiners. Any expansion beyond that must be approved by the group manager.

If you call IRS, get and write down:

1. Name
2. Badge #
3. Date of call
4. Time of call
5. What was the question you asked them
6. What was the answer they gave you

When you have this information to prove to IRS, IRS will waive penalties.

**Revenue agents:** Revenue agents must have a four-year college degree and a minimum of 24 semester hours of accounting. Experience can be substituted for the 24 hours of accounting. IRS does not recruit all "A" students. Many of the revenue agents squeak through college with "C" averages. The "A" students are snapped up by the big accounting firms.

**Like the Army:** Revenue agents are expected to be and usually are good soldiers. That's important. For the IRS system to work, revenue agents must believe that it is their IRS, right or wrong. They learn tax law the way IRS teaches it and wants them to see it. Revenue agents go through extensive training at IRS to learn the way IRS wants things done. They handle complex returns which require full use of their accounting skills. Unlike the tax auditor, the revenue agent sets the entire scope of the examination. Revenue agents are also underpaid in comparison to their contemporaries at the big accounting firms.



## Ten Ways To Reduce Your Chances Of An IRS Audit

### 1. **Mail your return by Certified Mail Return Receipt**

**Requested:** If the IRS Regional Service Center fails to receive your tax return, you automatically increase your chances of being audited. To make sure you're not taking unnecessary chances, send your tax return by Certified Mail Return Receipt Requested, overnight delivery,<sup>1</sup> or I like "E-Filing" which prints a receipt and processes your refund quicker.

### 2. **Send changes of address to the IRS:** File Form 8822 "Change of Legal Address" whenever you move. This will ensure that you will get any refund. In addition, any notices that IRS sends you can be at the last known address. If you move, you may be liable to the IRS without knowledge since you didn't tell them of the move.

### 3. **Make sure your tax return is neat:** Your tax return does not have to be typed, but it must be neat and easy to read. Legible tax returns create an impression of attention to detail.



4. **File all elections:** There are certain tax breaks and options that require the filing of an election. Sometimes the filing can be done by merely picking a method of reporting. It's generally better to attach separate statements for all elections made in a tax return. This further supports attention to detail and shows an understanding of tax law.
5. **Report all income:** The IRS has implemented various unreported income audit programs. Make sure your tax return: first, reports all income earned by you, and second, identifies the income by source. If you receive a Form 1099 for consulting services, report the income on a supporting schedule and include the taxpayer ID number from the 1099. Since the IRS already has the information from the 1099, you will reduce your chances of audit selection by enabling IRS to match the 1099 with your tax return.
6. **Have your return prepared by a competent tax preparer:** The signature of a certified public accountant, tax attorney, or enrolled agent will help minimize your chances of an audit examination.



7. **Break income and expenses into small segments:** Income reported to the IRS on a 1099 should be separated from other income. The separation will help IRS determine that you have indeed reported all income earned. Also, break down expenses as far as possible to explain to the IRS examiners exactly what was involved in the expenses. If, for example, you had promotional expenses of \$10,000 and that's all that appeared in your tax return, your chances of audit would be significant. However, should your promotion be broken down between travel, advertising, and entertainment expenses, you may reduce the chances of audit.
8. **Keep records of expert advice:** If you relied on the advice of your accountant or lawyer, keep records as to the nature and date of the advice. There are cases that have waived penalties for a good faith reliance on an independent expert.<sup>2</sup>
9. **Sign your tax return:** Failing to sign a tax return is one of the biggest "Red Flags" for an audit.
10. **Double check your Social Security number:** This is another big mistake that taxpayers make. Always double check your Social Security number on your tax return.





## Fifteen Steps For The Audit

- 1. *Get ready when preparing your tax return:*** The time to get ready for an IRS audit is while you are preparing your tax return. That's the only time you have all your tax information in front of you. Reference your support to the return so that you can find it later, if you should need it. Questionable items, if any, should be supported by tax memorandums or other information from your tax advisor.
- 2. *Don't panic:*** An audit notice does not indicate that anything is wrong with your return. It's simply a request by the IRS to find out if your tax return was properly prepared and to determine the proper amount of tax – no more, no less. Generally, you will be notified of the audit by mail, although you could be telephoned. If you are notified by mail, you'll be asked to telephone the examiner.
- 3. *Limit scope of audit:*** In an IRS office audit, the IRS tells you what is being examined and sets the scope of the audit. Try to get the examining auditor to agree to that scope before the examination begins. The reason for limiting the scope is simple: If an issue is not raised on audit, it is not often allowed as a question at the appeals level.



4. **Burden of proof is on you:** Tax law requires you to prove that your deductions are valid and that you have paid the proper amount of tax. The IRS need prove nothing. When going through your records and getting ready for the audit, make sure you keep in mind that the burden of proof is on you. None of that "innocent until proven guilty" business.
5. **Dress normally:** Do not make a special trip to Goodwill Industries to buy clothes for your audit. Dress and act normally during the entire audit. Do not plead poverty or stupidity. Excuses don't work.
6. **Be on time:** IRS examiners are graded on efficiency. If you are late for your appointment and cause the auditor to be inefficient, you start the audit in an antagonistic environment. Moreover, you have given the auditor extra time to scrutinize your records before the audit begins. Frequently, office auditors will have only 15 to 20 minutes to look over your return before you arrive. If you are late, you've expanded that time and irritated the tax auditor. Best bet: Be early.



7. ***Bring organized information:*** Make sure you are prepared to answer questions and deliver documents to the auditor. If you receive notification from the IRS about the documents you need for the audit, make sure those are organized so that you cannot only answer the questions, but also deliver the supporting documents quickly. This helps the examiner complete the audit more efficiently, get a better grade from his or her superiors, and bring the whole unpleasant task to a quick conclusion.
  
8. ***Don't volunteer information:*** Never say, "I've always done it that way." Don't elaborate; answer only questions asked. Be concise, and if the question does not appear to be relevant, ask why it is being asked. Bring only the documents requested in the IRS's invitation letter and do not volunteer any information concerning those documents during the audit process. When asked specific questions, answer them, but do not elaborate. In addition, be careful what you say to a revenue agent. This information can be used in a criminal trial.<sup>3</sup>



9. ***Don't dangle ends:*** Do not leave or expose dangling ends for the auditor to find. If it is easy for the auditor to find something wrong, the immediate conclusion is that there must be lots of other things wrong in your return.
  
10. ***Ask for tax law references:*** If you think you are right, ask the auditor or agent for the legal references. Don't accept vague statements or interpretations of the law. Make your tax advisor the goat by saying: My accountant told me this deduction was proper, can you give me something that shows he's wrong?
  
11. ***Don't give in:*** The IRS Audit Manual states, "Hasty agreement to adjustments and undue concern about immediate closing of the case may indicate a more thorough examination is needed." If you appear to be a soft touch, the IRS will look for larger contributions from you.



**12. Never be alone with a Special Agent:** Special Agents are not special. Their job is to investigate criminal actions. If you ever have two agents see you, ask whether either of them is a special agent. If one is, terminate the meeting and seek out a good tax lawyer.

*There is no privilege protecting your communications with your accountant.<sup>4</sup> Accordingly, never hire an accountant to represent you with a special agent. Hire a lawyer who in turn can hire an accountant.*

**13. Don't tamper with the evidence:** No backdating of documents or intimidating of witnesses should ever occur. More people get indicted for these items than the original offense since it is easier to prove. To be safe, don't contact any witnesses for the government, let your lawyer do it.

**14. Never ever die:** IRS audits approximately 68% of all final returns.

**15. Be careful of the Rat Fee:** IRS pays a 10% commission for people to rat on you. If you want to make a living in reporting tax cheats, get publication 733 (cash rewards for turning in tax cheats).

