

**IRS Solutions**  
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A Tax Pro's Best Friend

## Representing Your Clients at a 1040 Audit

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### Upcoming Webinars

<p><b>What's New! What's Cool!</b></p> <p>Tuesday, July 9, 2024 10 AM PST or 1 PM EST</p>	<p><b>Form 433: Income &amp; Expenses</b></p> <p>Thursday, July 25, 2024 10 AM PST or 1 PM EST</p>
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### Meet the Team

David, Suzanne & Cindy

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### Victor Alden



Victor Alden, worked as a Revenue Agent for the IRS small business and self-employed division for 6 years. As a former Revenue Agent, Mr. Alden conducted many audits on small businesses and individuals. Mr. Alden also conducted audits on tax preparers to ensure compliance with IRS standards. Mr. Alden has unique institutional knowledge of the IRS. He understands the complexity of your IRS tax problems and will work hard to resolve your tax disputes with the IRS.

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### CPE Policy



- Per NASBA regulations, you MUST register for the webinar and answer three of the four polling questions
- Be on the webinar for at least 50 minutes
- Those who qualify for credit will be emailed their CPE certificates following the webinar

IRS Solutions® is registered with the National Association of State Boards of Accountancy (NASBA) as a sponsor for continuing professional education on the National Registry of CPE Sponsors. State boards of accountancy have final authority on the acceptance of individual courses for CPE credit. Complaints regarding registered sponsors may be submitted to the National Registry of CPE Sponsors through its website: www.learningmarket.org.

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**Today's webinar will cover:** **IRS Solutions**  
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- Audits – the how's and the why's
- Various audit types
- The dreaded audit letter – Now what?

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**Polling Question #1** **IRS Solutions**  
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**What is an audit?** **IRS Solutions**  
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A tax audit is an examination by the IRS or state tax agency to determine whether you reported accurately your income, expenses, deductions and credits. It begins with a letter, notice, or phone call. You may also be asked for a list of records you are required to produce and a request for an in-person appointment. This can be a very emotional, intrusive and invasive exercise, and to avoid worsening the economic consequences, you should handle an audit with due care.

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### What is an audit?



That "nice" engaging IRS agent sitting across the table from you, or on the other end of the telephone, will be asking you very innocent sounding questions. They generally ask about 54 interview questions. How you answer them will dictate in which direction the audit will proceed. The IRS uses these questions to build their case against you. They want you to self-incriminate yourself. Always remember, the IRS's job is to assess (bill you) and collect taxes from you. Period.

Did you know that nearly half of the referrals to the IRS's criminal investigation division (CID) come from that "nice" person handling your examination?

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### 2023 yikes



- In FY 2023, the IRS closed 582,944 tax return audits, resulting in \$31.9 billion in recommended additional tax.
- Average assessment = \$54,722

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### Examination with Assessments



Type and size of return	Taxable return examination closures resulting in refunds (1)			Amount of recommended refunds		
	Total	Field (2)	Correspondence	Total	Field (2)	Correspondence
	(1)	(2)	(3)	(4)	(5)	(6)
<b>United States, total</b>	<b>582,944</b>	<b>132,687</b>	<b>450,357</b>	<b>31,905,844</b>	<b>24,144,779</b>	<b>7,761,064</b>
<b>Taxable returns:</b>						
Individual income tax returns, total	518,607	81,041	437,566	10,970,070	3,570,283	7,399,787
Size of total positive income (3)	74,151	10,733	63,418	5,624,362	1,304,709	4,319,654
No total positive income	204,130	8,373	195,757	1,307,639	201,078	1,106,561
\$1 under \$25,000	85,856	10,006	75,850	542,862	174,929	367,933
\$25,000 under \$50,000	39,427	10,091	29,336	263,813	127,816	135,998
\$50,000 under \$75,000	25,671	7,300	18,371	175,992	92,223	83,769
\$75,000 under \$100,000	44,892	14,232	30,660	390,236	243,849	146,387
\$100,000 under \$200,000	21,612	6,998	14,614	308,927	192,074	116,853
\$200,000 under \$500,000	8,589	3,244	5,345	198,524	153,796	44,728
\$500,000 under \$1,000,000	7,967	4,651	3,316	410,461	336,376	74,085
\$1,000,000 under \$5,000,000	1,646	1,278	368	212,562	184,612	27,950
\$5,000,000 under \$10,000,000	3,353	2,743	610	1,529,752	553,915	975,837
\$10,000,000 or more	1,413	1,392	21	4,941	4,909	32
International returns (4)						
Returns with earned income tax credit (5)	229,645	1,073	228,572	1,256,342	6,792	1,249,550

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### Participants in abusive tax shelters



Some returns are selected based on information obtained by the IRS through efforts to identify promoters and participants of abusive tax avoidance transactions.

A prohibited tax shelter transaction is a transaction that the IRS deems to be it transaction which may be used for improper purposes in order to artificially reduce tax liability.

- Conservative easements
- Captive insurance

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### DIF Scores



Discriminate Function (DIF) is a mathematical technique used to classify income tax returns as to Examination potential.

Under this concept, formulas are developed based on available data and are programmed into the computer to classify returns by assigning weights to certain basic return characteristics. These weights are added together to obtain a composite score for each return processed. This score is used to rank the returns in numerical sequence (highest to lowest). The higher the score, the higher the probability of significant tax change. The highest scored returns are made available to Examination upon request.

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### Third party reporting



- Your return may also be selected for examination on the basis of information received from third-party documentation, such as Forms 1099 and W-2, that does not match the information reported on your return. Or, your return may be selected to address both the questionable treatment of an item and to study the behavior of similar taxpayers (a market segment) in handling a tax issue.
  - Note: Routine omissions will just trigger a CP-2000 notice, or similar notice. Those can usually be handled with one written response. More later.
- Third-Party Reports – Turned in by former friends, spouses, lovers, or current neighbors, employers, co-workers, etc.
- Form 3949a is an Information Referral form - <http://www.irs.gov/pub/irs-pdf/f3949a.pdf>
- Form 211 provides for a reward. <http://www.irs.gov/pub/irs-pdf/f211.pdf>
- More common Third-Party sources – Facebook, newspaper stories, radio or TV news or reports featuring your client.

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### The Lifestyle Audit



- The client's standard of living and other related factors could also trigger a tax audit. Auditors use public records and statistical data to trace spending and changes in wealth to prove that you have unreported income. Some of these records include tax returns for all open years, credit reports, property tax records, business license applications, sales tax records, motor vehicle records, 1099 information, currency transaction reports and SEC filings.
- In 1998, Congress limited the use of these outside evidence-gathering techniques because it was believed that the IRS was abusing them. At that time, Congress did not want the IRS to use financial status or "economic reality" techniques unless the tax agency had a reasonable indication that there was a likelihood of unreported income. The statute (law) that resulted did not define "reasonable indication."

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### Random & Special Projects



- National Research Program (NRP)**
- TCMP - Taxpayer Compliance Measurement Program (TCMP)**  
This audit is the most intrusive by its very nature, as it thoroughly examines tax returns line by line. So, for instance, if the client claimed a child as a dependent, you will need to provide the birth certificate to prove that the child is your client's and proof that the child was actually living with the client in the tax year being audited. It continues on from there, through **every line on the income tax return**.
- Random** - Selecting a return for audit does not always suggest that an error has been made. The IRS uses a variety of variables and methods to randomly select individual tax returns for audit.

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**Random & Special Projects** 

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- **Random** Selecting a return for audit does not always suggest that an error has been made. The IRS uses a variety of variables and methods to randomly select individual tax returns for audit.
- **IRS Special Projects** The IRS annually identifies The Dirty Dozen – 12 of the most blatant tax scams. They use this list to identify income tax returns they will audit.

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**Audit Process** 

- Letter to be sent
- Interview (Be aware of trick questions (and they are all trick questions))
- Closing Conference
  
- Negotiate
- Manager meeting
- Appeals
- Tax Court

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**Kind of Audits** 

- Correspondence
- Office Audit – Held in the office by Office Exam (simple issues)
- Field Audit – Best if held a representatives office instead of client's business

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**Red Flags** IRS Solutions SOFTWARE

- Large charitable donations
- Home office deductions
- Large business expenses
- Round numbers
- High income
  
- Related examinations
- Accountant criminal

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**Polling Question #3** IRS Solutions SOFTWARE



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**Best Practice** IRS Solutions SOFTWARE

- Interview your client in depth before accepting the audit engagement.
- Schedule the appointment far enough in advance to prepare properly.
- Gather all the information the client has – and that IRS has.
- Prepare solid, clear work papers – and give the examiners a copy for their files.
- Know what deductions you will lose, or what extra income has cropped up.
- Have replacement deductions ready.
- Advise your client of projected audit results – especially if they are going to have a substantial balance due – due to their own omissions or record-keeping. (Have them sign it.)
- Have a strategy prepared to fight the audit, if you expect to lose, once you've meet the examiner.
- What amount is your client going to allow you to sign off on?

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**Defense – Business Income** IRS Solutions SOFTWARE

ALWAYS

- Be prepared
- Have a great attitude
- Be organized
- Go through questions with your clients (cash transactions, where did monies come from)
- Prepare your proof of income worksheet, receipts, bills, cancelled checks, legal papers, loan agreements...
- Have everything laid out on a spreadsheet.
- Try to limit the scope of the audit.

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**Auto Mileage Audit** IRS Solutions SOFTWARE

Attached you will find copies of:

- Various auto repair receipts
- Route stops

**Mileage extrapolation from Auto repair receipts**

Date of receipt	Mileage
4/9/2016	36,527
6/4/2016	43,273
8/31/2016	53,573
9/24/2016	56,472
5.5 months	19,945
month	3,626
	43,512 miles for year

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**Audit Techniques Guides** IRS Solutions SOFTWARE

Audit Techniques Guides (ATGs) help IRS examiners during audits by providing insight into issues and accounting methods unique to specific industries. While ATGs are designed to provide guidance for IRS employees, they're also useful to small business owners and tax professionals who prepare returns.

- <https://www.irs.gov/businesses/small-businesses-self-employed/audit-techniques-guides-atgs>

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**Hobby Loss** 

- Make sure you can show a profit motive, if not:
  - Business plan showing when a profit is expected
  - Demonstrate business like operation of business

Judge Posner of the Seventh Circuit

- Manner in which the taxpayer carries on the activity. The fact that the taxpayer carries on the activity in a businesslike manner and maintains complete and accurate books and records may indicate that the activity is engaged in for profit.

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**Assessment Statute of Limitations (ASED)** 

Generally, the IRS has 3 years to initiate an audit of your taxes under 26 U.S.C. § 6501. This also means that an IRS audit can look back at 3 years of your tax filings.

- Amended return does not restart the SOL
- Fraudulent returns do not have an ASED

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**30-Day Letter** 

Within a few weeks after your closing conference with the examiner and/or supervisor, you will receive a package with:

- A letter, known as a 30-day letter, or a Notice of Proposed Income Tax Deficiency notifying you of your right to appeal the proposed changes within 30 days.
  - A copy of the examination report explaining the examiner's proposed changes,
  - An agreement or waiver form, and
  - A copy of Publication 5.

You generally have 30 days from the date of the 30-day letter to tell the IRS whether you will accept or appeal the proposed changes. The letter will explain what steps you should take, depending on which action you choose. Be sure to follow the instructions carefully.

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**90-Day Letter – Statutory Notice of Deficiency** 

If you do not respond to the 30-day letter, or if you later do not reach an agreement with an Appeals Officer, the IRS will send you a 90-day letter, which is also known as a notice of deficiency.

You will have 90 days (150 days if it is addressed to you outside the United States) from the date of this notice to file a petition with the Tax Court.

The notice will show the 90th (and 150th) day by which you must file your petition with the Tax Court.

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**Audit Reconsideration – When to Request** 

- You have new information to show the IRS about the audit of your income or expenses
- You disagree with the tax the IRS says you owe
- You never appeared for the audit appointment or sent the IRS the information
- You moved and never got the audit report.

- There is no special Form
- Documentation must accompany the request
- Send documentation to the last office that sent correspondence
- An audit reconsideration request can be made at any time after an exam assessment has been made and the tax remains unpaid

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**Audit Reconsideration – SFR** 

- A Substitute for Return (SFR) is a return prepared by the IRS to assist the taxpayer who forgot to file. This does not require an amended return or an audit reconsideration. You need to file a new return. Exam will review this.

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**After the Audit** IRS Solutions SOFTWARE

- Closing letter stating this engagement is complete
- Set client up for monitoring
- Balance due?
  - New engagement letter
  - New invoice
- Ask for referrals and reviews

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**Polling Question #4** IRS Solutions SOFTWARE



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**Thank You!**

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