

How to survive an IRS audit

Taxpayers have rights, too; knowing what they are and how to prepare can help you minimize the pain and cost of an IRS examination

While anyone is a candidate to be audited, the IRS concentrates on four groups of taxpayers: large corporations, very wealthy individuals, individuals who fail to report income for which another taxpayer has issued a Form 1099, and individuals who fail to report business income using a Schedule C or other appropriate form.

Whether or not you are a member of one of those four groups, you may find some comfort in learning that these days the IRS examine about one in 103 returns, as opposed to one in 20 in the early 1960s. If you make over \$100,000, the rate is one in 22.

Don't let those favorable odds make you complacent, though; taxpayers who are selected for audit can anticipate a far more thorough and aggravating examination than they might have experienced just a few years ago. And the most vulnerable taxpayers are those who can't document the information on their returns by means of receipts, valuations or other types of supporting evidence.

Tips: If you've received an audit notice from the IRS, or if you're afraid you will, here are some tips for you to follow before and during the process:

Plan ahead: Examine your recent tax returns and the supporting evidence. If you can't find records to substantiate a deduction or non-taxable income, get busy. Make your tax file as complete as you can now; you'll rest easier, and it will take some of the worry out of being put through the IRS's wringer.

Find out if you're on the bubble: The IRS occasionally announces that it's going to zero in on certain industries. If your company is a member of a targeted industry, start getting your ducks in a row immediately. Through a trade association related to your industry, or through a CPA firm that works for companies like yours, find out what issues are priorities with the IRS, and begin becoming as bullet-proof as possible in those areas.

Improvise: The IRS loves taxpayers who set up money-losing "businesses" so they can try to deduct the cost of their expensive hobbies (flying, boating, horse ownership, etc.). If you've done that, substantiate hobbies of a dubious business nature by preparing a business plan showing how you hope to make a profit some day if everything goes really well. Better yet, have a business consultant or some other professional do it for you, to give it more credibility.

Play it smart: The IRS doesn't have carte blanche when it comes to examining tax returns. There are times to be nice, and times when you should draw the line.

Be responsive: Unnecessary delays in meeting with the IRS or providing information will only cause you greater expense and a more microscopic examination.

Decline return engagements: Don't let the IRS come after you year after year for the same thing. If two or more recent examinations on a given issue have come up empty, tell them you don't wish to participate this year.

Require notice: Don't let an IRS agent come to your home or office without advance warning. As a matter of law, they don't get to. As a matter of strategy, you may expose yourself by having him or her see your lavish lifestyle, which doesn't square with the small income reported on your return.

Treat IRS examiners with respect: Stay calm, speak carefully and briefly. But don't cave in; the benefits of being nice have their limits.

Don't agree to issues on a piecemeal basis: A favorite tactic of IRS examiners is to get you to agree to the facts regarding Issue A, and then use it against you when you get to Issue B. Don't let them trap you; wait until everything is on the table. Only after you know what all of the issues are, how they relate to each other, and where the examiner is going with each of them do you truly know what you can agree to.

Consider not showing up: Instead of appearing in person, it may be better to send your representative (CPA or tax attorney) to meet with the examiner. On the one hand, he or she knows more than you do (about the process and the limits of IRS authority); and at the same time knows less (about your financial details), and thus can plead ignorance honestly and convincingly. If the IRS really wants you to be there, it has to issue a summons.

Know when it's time to call up reinforcements: If you meet with the examiner personally and get in over your head, call time out and resume the meeting at another time. When you reconvene, have your CPA or tax attorney join you or appear in your place.

Don't go on fishing trips: You don't have to cooperate with IRS "fishing expeditions," although that's hard to define. Generally, the examiner has to have some basis for a request. If you honestly believe there's no foundation for a question or request for documentation, politely tell them no, thank you. Further, don't give the IRS your records to sift through. Make them ask for specific information, and if the first several items they request check out, say that's enough for that category. Beyond that, they're fishing.

Don't be too quick to go over the examiner's head: It may become necessary to ask to meet with an examiner's supervisor, but be careful: He or she is probably more experienced than the examiner, and perhaps shrewder and harder to get along with.

Conclusion: Few taxpayers emerge entirely unscathed from an IRS audit, but following these suggestions can help you cut your losses and move the process toward a speedier resolution. Our advice: Use us or another qualified CPA to represent you, and don't roll the dice. You could lose big-time!

Please contact us for a free consultation about any IRS correspondence that you may receive.