

## Tax Talk Today

March 10, 2009

Show Questions

### Question

It's a very common notion amongst the Taxpayers that a TP having Schedule "C" ( Self employment business) around gross receipts/income around \$ 500,000.00 or more are possible subject to an audit as opposed to business run under a Corporation, LLC, LLP etc.& the practitioner communities advises them accordingly. Is this true?

### Answer

Actually the Internal Revenue Service strives to have a broad coverage of individual and business returns. Returns are selected several different ways such as:

- § Computer Scoring - Sometime refer to as DIF-Discriminate Information Function. The IRS evaluates tax returns based on a set of IRS formulas that compares deductions, credits and exemptions with norms for taxpayers in each income bracket.
- § National Research Project (NRP): The NRP was designed to collect data that is used to measure payment, filing and reporting compliance.
- § Local and National Projects – Noncompliance areas that need focused on
- § Information Matching – for example – 1099 received and matched to the return
- § Related Examinations – We audit a partnership and if adjustments are made, then the related K1s may be pulled for audit

### Question

I am not an enrolled agent but I have studied and prepared tax returns for clients for over 9 years and has represented clients over the telephone by filling out form 2848 "Power of Attorney". However I am not able to represent the clients face to face with the IRS agent. Should there be an exception for long tern professional practitioners who wish to represent their clients.

### Answer

The provisions for tax preparers are spelled out Circular 230 and the following publications:

- Publication 3021 What You Need to Know About...IRS Power of Attorney
- Publication 947 Practice Before the IRS and Power of Attorney
- Publication 4693-A OPR Tri-fold - How to Become an Enrolled Agent

An individual can become an enrolled agent by filing an application (Form 23) with the Office of Professional Regulation. They must pass the Special Enrollment Examination or present evidence of qualifying experience as an IRS employee. A background check including a review of the applicant's tax compliance is also conducted.

#### Question

One of my clients is being audited for 2006-2007; however, the audit is dragging on since November 2007. What can we do to accelerate the final findings without seeming to be pressing?

#### Answer

You can contact the examiner's manager and discuss the progress of at anytime during the case.

#### Question

A client's company is being audited. I provided several detailed lists of expenditures. I have received additional requests for information. It seems like a lot. How much can they ask for?

#### Answer

You can contact the examiner's manager anytime during the audit to discuss your concerns. For your reference, the Internal Revenue Code section 6001 provides in part: Every person liable for any tax imposed by this title ... shall keep records, render such statements, make such returns, and comply with such rules and regulations.... Whenever in the judgment of the Secretary ... he may require any person ... to render such records ... or keep such records ... deemed sufficient to show whether or not such person is liable for tax under this title."

#### Question

When S-corp basis is needed, as part of an individual audit, exactly what does the IRS want? How the basis was computed for the current year, basis detail since existence of the corp, or something in between?

#### Answer

It is a shareholder's responsibility to track stock basis. Shareholder's S corporation stock basis changes each year depending upon the allocations to the shareholder.

S corporation stock basis is unique – it is a moving target each year. Basis goes up and down based upon S corporation flow through allocations of income; loss and deductions; and the distributions a shareholder receives. Stock basis is determined at the end of the year, except when stock is sold or disposed of.

As with any asset, it is important that the taxpayer maintain records to track basis. With an S corporation, it is important to have documentation for all years the taxpayer was a shareholder.

#### Question

I have had a number of letter issues resolved; however, no explanation is sent. Just a check is sent and it is very difficult to determine why or how amounts were determined. Are responses to resolved issues no longer sent out? Both checks were preceded by or followed by a letter stating 'an explanation would be received', but it never was. No address changes etc. were involved here.

#### Answer

I am assuming that these letters were correspondence audits that requested you to forward verification through the mail regarding an issue on your return. If this is the case, there should be a contact number and/or address for you to contact someone to ask for a final report on the issue.

#### Question

What is the proper procedure to use for requesting a refund or an adjustment to tax assessed in situations where a client has not responded timely to a CP2000, tax was assessed based upon the proposed changes, but the proposed changes are incorrect or incomplete given the taxpayer's actual information?

#### Answer

Forward a letter to the address shown on the CP2000.

#### Question

What is the proper procedure to use when amended returns with supporting documentation providing basis on stock sales and a check for a tax amount less than the assessed amount have been provided to audit reconsideration, the checks cashed but the amended returns not processed?

#### Answer

You may contact our toll free number (800) 829-1040 to request the status of case.

You may also try the following link to 1040 Central,  
<http://www.irs.gov/individuals/article/0,,id=118506,00.html>

#### Question

If the IRS audits a taxpayer, asking to change from Cash to Accrual Basis when filing their business return; however, the taxpayer does not change because they simply do not fully understand the concepts.

1. What are the consequences for the taxpayer refusing to "obey" the rules?

2. How can the taxpayer be further advised?

Answer

If the change to the accrual method accounting is warranted the Service will make the change and assess all penalties that are appropriate. For more information, see Publication 538, Accounting Periods and Methods.

Question

If you have an audit and agree with what the auditor determines was wrong and when you get the final report he/she has missed one of the findings that you both agreed on and the additional tax is less than expected.

1) As an EA are you under an ethical or legal obligation to notify the auditor?

Answer

Yes.

2) If the answer is yes and the auditor get combative when you state that you believe there is a mistake on his report would the answer still be yes?

Answer

You should contact the examiner's manager.

3) Is it a policy of the IRS that if you tell the auditor you will appeal their decision and the auditor will reply that he/she will disallow all items that he/she had previously accepted as correct?

Answer

No and if this occurs contact the examiner's manager

Question

One of my CASH basis clients is being audited right now. The auditor is making noise that they are going to disallow the payroll taxes incurred which was not paid on a timely basis. That does not make sense to me. Am I thinking wrong about the issue?

Answer

The cash method requires reporting cash receipts as income when received and expenses when paid. If you use the cash method for reporting your expenses, you must use the cash method for reporting your income. Receipt of income occurs when a business has unrestricted access to income, including income earned. An expense becomes deductible in the year that the expense is paid.

#### Question

My clients are small business. We all know that the law is complex and is 1,000,000's of pages of substantial authority. However, some IRS auditors tell me that they are not required to follow substantial authorities. Instead they only follow their hand book. This creates conflicts with the client (taxpayer) paying my fees to go to appeals. How do I solve this problem?

#### Answer

Examiners will use their professional judgment in evaluating all evidence to reach a conclusion. The examiner should discuss the issues with the representative as the audit progresses. If the issues can not be resolved. the representative may request a conference with the group manager, request to participate in Fast Track Mediation and/or Fast Track settlement where available.

#### Question

I understand that an extension may impact the Service's Audit Section rules on keeping audits open that approach the time buffer to the Statute of Limitations (Statute). Therefore, may Taxpayer agree to extend this Statute to complete the audit and accurately assess any tax liability, including penalty and interest?

#### Answer

Yes, please see Publication 1035, Extending the Tax Assessment Period.  
<http://www.irs.gov/pub/irs-pdf/p1035.pdf>

#### Question

Why does the IRS so often not accept the backup documentation requested of taxpayers? I've seen them not accept church donation documentation and business receipts.

#### Answer

Examiners routinely accept original third party documentation as substantiation. When only copies of third party records are available the examiner may verify amounts with the third party before accepting the copy as substantiation. Publication 1771 Charitable Contributions-Substantiation and Disclosure Requirements provides guidance on substantiation with respect to contributions.

#### Question

In the IRS TDS transcripts, there is a transaction 290 additional tax assessed from an audit. Then there may be a 291 transaction prior tax abated. Does this mean that additional tax assessed from an IRS audit was reduced during/after the audit or was the tax forgiven in a compromise, but was actually due?

This question can not be answered since it contains conflicting information

#### Question

I have a client who says he received a notice at his home business address. The letter was not mailed. It was simply left at the front door and discovered 3 weeks later. The person discovered it weeks later because they typically don't enter the house thru the front door. He usually enters thru the garage. Is this proper notification?

Answer

To contact a taxpayer to initiate an audit, an examiner will either call or send a letter by mail to the taxpayers last known address. It should contain contact information.

Question

Also the person has a small S-corp biz. The notice wants to review records for Jan. 2008-Dec. 2008. Can they ask to see the tax return before the April 15th deadline?

Answer

If the tax return has been filed an examination on the subsequent can be initiated.

Question

Once examination is begun i.e. initiated, how many days does the IRS give taxpayer to prepare?

Answer

The initial contact in a field SBSE examination is either by telephone and or by a call back letter. The date for the initial appointment and first production of records is negotiated date. The examiner, taxpayer and/or representative will set a date that is convenient for both the taxpayer and Service.

Question

I have had horrible experiences with correspondence audits and have heard the same from many colleagues...why are returns with obvious significant documentation, such as extensive unreimbursed business expenses, being selected for correspondence audit? Everyone I've had has involved hundreds of pieces of proof which are summarily ignored if the auditor can't easily read the amounts or understand the business purpose of the expense. These always go to Appeals (or audit recon) placing an undue burden on the taxpayer.

Answer

If the audit is a correspondence audit; the taxpayer can request a face to face audit because the books and records may be too voluminous to mail. The request can be forward to the address provided on the initial letter

Question

Is an IRS auditor required to give the reason that your return was selected for audit?

Answer

No, the source of the return may not be known. Returns are selected several different ways such as:

- § Computer Scoring - Sometime refer to as DIF-Discriminate Information Function. The IRS evaluates tax returns based on a set of IRS formulas that compares deductions, credits and exemptions with norms for taxpayers in each income bracket.
- § National Research Project (NRP): The NRP was designed to collect data that is used to measure payment, filing and reporting compliance.
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Question

I heard of a case where all mileage was disallowed even though the mileage was reasonable because there was no written record. Is that correct?

Answer

Yes, this disallowance is possible, facts and circumstances of the case will dictate the examiners actions. A taxpayer can always go back and recreate a log based supporting documentation such as appointment dates and sale invoices.

Question

Is it acceptable for the tax professional to ask the IRS for the scope of a pending audit?

Answer

Yes. Generally during the initial examination the proposed issues will be identified to the taxpayer. If this does not occur you can request to speak to the examiner's managers.

Question

What are IRS procedures/consequences of failure of taxpayer to comply with audit request, starting with refusal to schedule initial meeting?

Answer

In those situations where the taxpayer refuses to cooperate in an examination, the Service will close the case without the benefit of the taxpayer's knowledge

and records and will rely on third party and internal information to determine the correct tax.

#### Question

What percentage of IRS audits that are performed at the taxpayer's place of business result in a No Change Audit?

#### Answer

For fiscal year 2008 the no change rate for individual returns for a Field examination was 11.2%, for Office examination 10.1%

#### Question

The IRS press release each year (e.g. Tax Tip 2009-08) references what taxpayers should keep in case they are audited in the future. The list says nothing about personal check registers and personal bank statements, yet under audit, the first thing that happens is the taxpayer is asked to explain all deposits to their personal account and any that cannot be explained are automatically assessed as unreported income. Taxpayers should be made aware that not ONLY items on the return will be scrutinized, two years down the road.

#### Answer

This is a good point and we will consider when providing future taxpayer communications.

#### Question

A client is a traveling salesman for a Security firm. He MapQuest's all directions to client's house and saves these. Is this enough written documentation without logging beginning and ending mileage?

#### Answer

No, additional collaborating information such as repair receipts that can verify the beginning and ending mileage is needed.

#### Question

If you receive a letter asking to provide a lot of documents, how do you "engage communication with the examiner"? Do you write a letter to the IRS asking for clarification? Will they respond?

#### Answer

Yes, you should contact the examiner and request clarification. The examiner should have a discussion with the taxpayer or POA concerning the location, type and availability of records early in the audit process. The examiner's request for supporting records should be specific.

#### Question

Is there a time period in which the audit should be completed? We have a situation where the lead auditor has completed his work, but he is waiting on the engineering specialist to review the data. The engineering specialist has been on other jobs for over 6 months. Are we required to wait indefinitely?

Answer

No, there is no set time frame for completing an audit. Requests for a specialist to assist on the case occasionally increase the length of an audit. You can contact the examiner or group manager and request an update.

Question

My client is being audited, she inadvertently shredded majority of her purchase receipts for 2007, and how do we overcome this hurdle? The examiner has seen the left over inventory.

Answer

You may have to reconstruct the purchases. Third party invoices may help in the reconstruction process.

Question

I have a new client who has not filed for about 7 years. He has been notified by the IRS in a Notice of Deficiency back in 2007 (for tax years 2003 thru 2005) he could appeal to Tax Court but he has disregarded that notice as well. He now has hired me to rectify the issues. Are his options forfeited now or can he go back to the step of the original letter to try to resolve his case? Also, he has no assets and does not make much money. Would an OIC be a proper alternative?

Answer

Your client has the rights and privileges afforded to other taxpayers. He should first take steps to file delinquent returns as soon as possible, and then he can then look into payment options such as OIC after the returns are selected.

Question

If audit is being delayed, do you ever use deposits to cut off accrual of interest? How is this done?

Answer

Yes, the American Jobs Creation Act of 2004, P.L. 108-357, 118 Stat. 1418 (the "Act") was enacted on October 22, 2004. Section 842 of the Act added new section 6603 to permit taxpayers to make deposits to suspend the running of interest on potential underpayments of tax. Rev. Proc. 2005-18 provides guidance establishing procedures for taxpayers to make, withdraw or identify deposits to suspend the running of interest on potential underpayments under section 6603. Discuss your options with your examiner.

#### Question

Como said that if your audit results in a change that IRS will continue to audit that taxpayer until it yields a no-change in liability. Do you really mean that? Or, is it that if they are selected for audit on the same issue they will be audited again. In my experience, if there are changes in a particular year IRS expands the audit to the open years if the issue warrants it.

#### Answer

If there are changes in a particular year, the Service will expand the examination to all open years for those issues if warranted. A return that has not been filed when an audit is completed will be treated as any other return filed.

#### Question

Does being under a prior year audit impact a current year filing?

#### Answer

If there are changes in a particular year, the Service will expand the examination to all open years for those issues if warranted. A return that has not been filed when an audit is completed will be treated as any other return filed.

#### Question

What is a non enrolled preparer?

#### Answer

An unenrolled return preparer is an individual other than an attorney, CPA, enrolled agent, enrolled retirement plan agent, or enrolled actuary who prepares and signs a taxpayer's return as the preparer, or who prepares a return but is not required (by the instructions to the return or regulations) to sign the return.

They are permitted to represent you only before customer service representatives, revenue agents, and examination officers, with respect to an examination regarding the return they prepared.

Please see Circular 230 and the Instruction to Form 2848 Power of Attorney and Declaration of Representative.

#### Question

How do we find out if there is fast track settlement agreement with our State (Hawaii)?

#### Answer

Last year, the Fast Track Settlement program for SB/SE taxpayers expanded into new areas including Philadelphia, central New Jersey, and, in California: San Diego, Laguna Niguel and Riverside. The program also continued in the original test cities of Chicago, Houston and St. Paul, Minn. where it launched in 2006.

While survey results indicate that examiners, their managers and participating taxpayers are very satisfied with the FTS process, more data is needed to determine if the program should become permanent. We have therefore extended the pilot an additional two years. Announcement 2008-110 contained in Internal Revenue Bulletin 2008-48 dated 12-1-2008 has information concerning Fast Track Settlement.

Question

Are taxpayers required to maintain mileage logs for the vehicles?

Answer

Generally, yes. Publication 463 Travel and Entertainment, provides you should keep adequate records to prove your expenses or have sufficient evidence that will support your own statement. You must generally prepare a written record for it to be considered adequate.

Question

If a taxpayer has numerous request for documents, Can the taxpayer make copies of the original and send them in a CD Format? How can we reduce the copying costs when numerous documents are requested from the IRS?

Answer

Records are being accepted by the IRS in electronic format. They can be provided on electronic media such as a CD, a thumb drive, memory card, or external hard drive.

Question

Do you ever survey the POA?

Answer

Yes, we routinely receive completed surveys back from representatives.

Question

We learn so much from court cases and research. If too many cases are resolved in a fast-track settlement, it will leave a dearth of cases for review. Will the IRS provide audit results (without names) so we know how the service is treating various issues?

Answer

No currently there is no provision to track or publish the results of a Fast Track Settlement.