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ACCOUNTING

Five IRS audit mistakes to avoid

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The IRS audits about one million taxpayers each year. While the agency is understaffed, that doesn't mean you'll slip through the cracks. IRS software automates the selection process now by flagging returns that show abnormalities: Perhaps the return deviates from what's normally filed, or it's been linked to a family member, investor, or business partner who is being audited. Also, the more money you make, the more likely you are to be audited.

An audit may consist of a simple letter from the IRS or, when the stakes are higher, you may need to meet with an auditor in person. In either case, common mistakes can almost guarantee you don't come out on top. They include:

1. Ignoring IRS requests and deadlines

Failure to respond to IRS requests for information won't stop the agency from taking action. The IRS has the power to request your tax information directly from financial institutions (banks, brokerage houses, credit card companies, etc.). If it's an audit of a personal return, they could contact your employer. If it's an audit of a business, they could contact both customers and vendors. All of these powers arise when the taxpayer (or authorized representative) fails to communicate or respond to the IRS's Information Document Request (IDR). If the audit proceeds without your cooperation, the IRS can and will issue a Revenue Agent's Report (RAR) and finally a Statutory Notice of Deficiency. Generally, you will have 90 days to file a court petition to The US tax Court. Again, failure to respond to this notice can cause the taxpayer to forfeit appeal rights. The IRS then begins collection procedures, which can include filing federal tax liens, wage garnishments, and levies. In Texas, we have a "homestead" protection - ordinary creditors cannot seize and sell your homestead. However, the IRS is no ordinary creditor. They HAVE the POWER to seize and sell your residence to pay your tax debts. Missing an IRS audit appointment could start you down this path.

2. Not filing past-due returns

One of the first steps in addressing an audit is to make sure you have filed all tax returns that are overdue. Don't let the fact that you may not be able to pay the taxes affect the filing. Late filing penalties accrue at the rate of 5% per month, while late payment of the taxes incurs penalties of 0.5% per month plus interest. If you failed to file at any time in the past, the IRS can prepare and file those returns for you as a Substitute for Return (SFR). Those returns, however, will not include the deductions and credits you may be entitled to receive. The IRS will begin collecting the tax due shown on these returns (which may be inflated due to deductions and credits having been omitted). If these returns indicate you may be owed a refund, there is a limited amount of time that refunds will be returned to the taxpayer on late filed returns. You could also risk losing Social Security benefits as well as your ability to obtain home, business, or education loans.

3. Lying

The most common tax-related lies are underreporting income (usually income received in cash or received outside the U.S. as foreign income) and claiming false deductions, both of which can trigger heavy IRS penalties, fees, and interest. And then there's tax evasion and tax fraud, which can be criminal offenses that could land you in prison. When an auditor uncovers a cardinal sin like substantially underreporting your income or failing to report foreign bank and financial accounts, you may be heading down a long, dark path that could cost you dearly.

4. Not contesting when there's a good reason.

Don't be intimidated. The IRS promises a right to professional and courteous treatment as well as the right to appeal disagreements. Utilize those rights when it makes sense. For face-to-face audits, you can speak to the auditor's manager if you don't like the way the audit is being handled. After an audit concludes, you can still contest it with the IRS Office of Appeals and have the decision reviewed. If the appeals officer agrees with the auditor, you can go through the court system.

5. Not seeking expert help

A qualified CPA can represent you before the IRS in a tax audit. This help is critical because you need someone on your side who knows not only tax laws but also IRS procedures. They'll know how to present your case to both IRS Appeals and/or Tax Court. In addition, they could determine whether your penalties should be contested. When all else is said and done, a qualified CPA can help you negotiate payment of the tax bill, including applying for an installment agreement, and/or an offer in compromise, which allows you to settle your tax debt for less than the full amount.

Take IRS audits seriously because the IRS certainly does. If you don't take control of an audit from the beginning, you lose your power to file, contest, or appeal on your own terms.

Steven Bankler has more than 42 years of experience in the accounting industry. Steven's expertise lies in consulting, planning, tax, and asset protection as well as exit strategy services for closely held businesses. He also provides litigation support (both as a testifying expert witness and a consulting expert), business negotiations and estate planning. Visit www.bankler.com for additional tax strategy tips and to learn more about Steven Bankler, CPA, Ltd.