



Wealth Resources Network
The Wealth Achievement Center of CNY

TAX AUDIT SUGGESTIONS

This year, you may be one of the 1.5 million or so taxpayers whose return is selected by the IRS for an audit. In a recent year, over 100,000 individuals in this chosen group received tax refunds as a result of their audits. However, over 80% ended up paying the government additional taxes. If you are one of the taxpayers chosen for an audit, knowing what to expect can make the process a little easier.

With 100 million tax returns filed each year, the odds are only one in 50 that a particular return will be selected for an audit.

Your chances of being chosen for an audit are higher if:

- You have a relatively high income level
- You have a relatively low income level but live in a high income area
- The data on your return does not match IRS data
 - The IRS computers will automatically correlate your data (W-2, 1099 and state returns) with that provided to the IRS by employers, banks, securities firms, real estate brokers, etc.
- You make mathematical errors
- You are involved in an “abusive” tax shelter, or
- You file a complex tax return

Claiming certain “targeted” deductions may also increase your chances of being audited. Returns are frequently flagged for additional review and possible audit if they contain unusually large deductions for medical expenses, charitable contributions, casualty losses or hobby losses.

However, do not let this deter you from claiming legitimate deductions that may be significantly larger than average for your income level. Simply file an accurate, complete and timely return and save all supporting documentation.

If, despite all the odds, you are selected for an audit, you will be informed of that fact and the type of audit to be conducted. Usually the audit will cover a prior year’s return since most audits involve returns for the tax year two years prior. Three types of audits are possible:

A correspondence audit, in which you are required to mail documentation to the IRS supporting the particular items on the return that are being questioned;

An office audit, which involves going to an IRS office for an interview with a tax auditor;

A field audit, in which a revenue agent is sent to your home or office to review records.

This information is not intended to be a substitute for specific individualized tax, legal or investment planning advice. We suggest that you discuss your specific tax issues with a qualified tax advisor.

Securities & Financial Planning offered through LPL Financial, a Registered Investment Advisor, Member FINRA/SIPC.

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TAKE IMMEDIATE ACTION

The first thing you should do upon receiving your audit notice is locate your copy of the return in question and go over it carefully. Gather all the supporting documentation for the return. If the audit is to be conducted in an IRS office, the notification letter probably will outline the specific items that are being questioned and the required documentation for each. In addition, be sure to inform your tax advisor. He or she can advise you of the proper support to submit in a correspondence audit or accompany you on an office or field audit.

When the IRS auditor concludes the investigation, he or she will prepare a Revenue Agent's Report stating conclusions and recommendations. If you do not agree with the findings, you are entitled to a second opinion from the auditor's supervisor. Upon receiving the report, you have the option of appealing to a higher level within the IRS or directly to the courts.

If you choose an IRS appeal first, you must respond to the report within 30 days. A written response is not required if the audit was conducted in an IRS office or through the mail and the proposed changes in tax do not exceed \$2,500.

If an informal meeting at the Regional Appeals Office does not lead to agreement on the adjustments, or if you chose not to follow this course of appeal, the IRS will mail you a statutory notice of deficiency. At this point, you must turn to the courts for further relief.

OPTIONS IN COURT

The Tax Court generally hears cases in which the tax has not been paid. In order to appeal to the Tax Court, you must file a petition within 90 days of the date of the statutory notice of deficiency. If the Court does not find in your favor, you may appeal the decision to a Court of Appeals.

The lure of taking a matter to Tax Court before paying the IRS assessment is a false one. There is no jury, and the record of taxpayers in this court is not favorable. At best, there will be a compromise from the IRS position pre-trial. However, in many cases the Tax Court has found for the government, and cited the opinion of the IRS almost verbatim. Your opportunity for success is much greater elsewhere.

Tax court cases involving disputes of \$10,000 or less for any taxable year may be handled under Small Tax Case procedures, which allow you to argue your own case in court. However, decisions rendered under these procedures are not subject to appeal.

As an alternative, if you have already paid the tax and filed for a refund, you may take your case to a U.S. District Court (in which you have the option of a jury trial) or the Court of Claims. A suit for refund can be filed if the IRS does not act on your refund claim within six months of the date of filing. Such a suit must be filed no later than two years after the IRS has disallowed the claim.

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BUSINESS OPERATIONS AUDITS

If your audit is centered on various business deductions, make sure you provide the IRS agent with a description of the nature of your business. Do not assume that the agent has a clear understanding of your business.

Have everything organized for your presentation

Project a cooperative attitude

Only provide what the IRS agent requests

Utilize a tax organizer or filing system

Remember the IRS agent is only doing his or her job, and did not personally select your return for the audit, the computer did! If your business records are extensive and you maintain a place of business, you can request a field audit. Field auditors are more experienced, and they will come to your place of business. This may represent an advantage if you are well organized, well documented and are confident you are right. However, they are usually quite shrewd - so if you have a few weak areas, it may not be a good idea to insist on a field audit.

WAYS TO SURVIVE AN AUDIT

There are six steps to take to survive an audit once one has been commenced. Most state tax authorities simply follow the actions of the federal IRS. After the federal folks are finished, they send a "helpful" report to the state and taxpayers will get an automatic re-assessment of their prior return.

Hire a professional to help

Say you are being questioned on a tax-shelter investment and a home-office deduction. Even though professional help would likely cost you \$1,000 or more, you would otherwise be at such a disadvantage going up against an IRS auditor and would probably wind up owing even more than the original amount in question. You might consider using an enrolled agent, who is apt to be a former IRS auditor and thus defter at dealing with the agency than other professionals. Call the National Association of Enrolled Agents at 800-424-4339 for candidates.

Postpone the audit if you're not ready

Your audit notice will include an audit date that is 30 days away. However, that may not give you enough time to find a suitable tax professional or to do homework if you are representing yourself. Typically, the IRS allows as many as two 30-day postponements.

Use the time to read "Stand Up to the IRS" by San Francisco tax attorney Frederick W. Daily (Nolo Press, \$21.99 at www.Nolo.com or electronic version for \$15.99). The latest version was updated January 2009. When your audit date arrives, be sure you or your professional shows up. Otherwise, the IRS will disallow everything in question, and you will have just 90 days to prove them wrong.

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Appeal when you believe the IRS is weak

If you lose your IRS audit, ask for the documents supporting the ruling, such as IRS regulations or case law. After reviewing them, if you still believe you are in the right, you have 30 days from the date on your audit report to appeal. And you should. Audit bills, on average; drop roughly 40% on appeal.

If you lose the audit, pay the cash slowly

If your audit bill amounts to \$10,000 or less, you qualify for a three-year installment schedule. You will owe annual interest and penalties at 14%, however. Just hand your auditor a completed Form 9465 for an installment plan.

Try to settle for less

If you think you will never have the cash to settle the full amount with the IRS, you can attempt to negotiate.

Fill out Form 656, Offer in Compromise, and next to "Grounds for acceptance of this offer," type: "Doubt as to collectability of the full amount of tax, penalty and interest." Make an offer of at least 10% of your bill; on average, the IRS accepts 15%. Be patient. The IRS usually takes six months to a year to decide on taxpayer offers.

Request an IRS Problem Resolution Officer (PRO)

If you face financial hardship because of an IRS seizure of wages or bank accounts, or if you have made at least two unsuccessful attempts to resolve your problem through regular IRS channels, you qualify for special help. File a taxpayer-assistance order, Form 911, with your district office's so-called problem resolution officer, or PRO, who will try to fix your problem within two weeks.

Sources: Financial Planning Consultants, Inc.

www.IRS.gov

www.turbotax.com

www.NOLO.com

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