



IRS AUDIT *SURVIVAL GUIDE*

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INTRODUCTION

This guide will:

- Explain how IRS audits are selected
- Outline the usual process of an IRS audits, and the different ways they can conclude
- Give you tips and strategies on making IRS audits as smooth as possible

CODE ACCOUNTING *BUSINESS SOLUTIONS*

If you have any questions about what you've read in this e-book, or would like to discuss your business's bookkeeping needs, feel free to contact Code Accounting for a timely consultation

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To stay up to date on topics related to IRS Audits, bookkeeping, and other financial services, you can find Code Account on our social media platforms

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AUDITS CAN BE SCARY

BUT THEY DON'T HAVE TO BE

An IRS audit is not something you want to have to think about. At best, most people think of an audit as a hassle. At worst they can be detrimental to you or your business's financial livelihood. But as is the case with most business related matters, being prepared is key to mitigating risk. This guide is intended to help you understand how audits work, what's at stake, and in the chance you are selected, what you can do to make the process as smooth as possible

WHY ARE PEOPLE AFRAID OF IRS AUDITS?

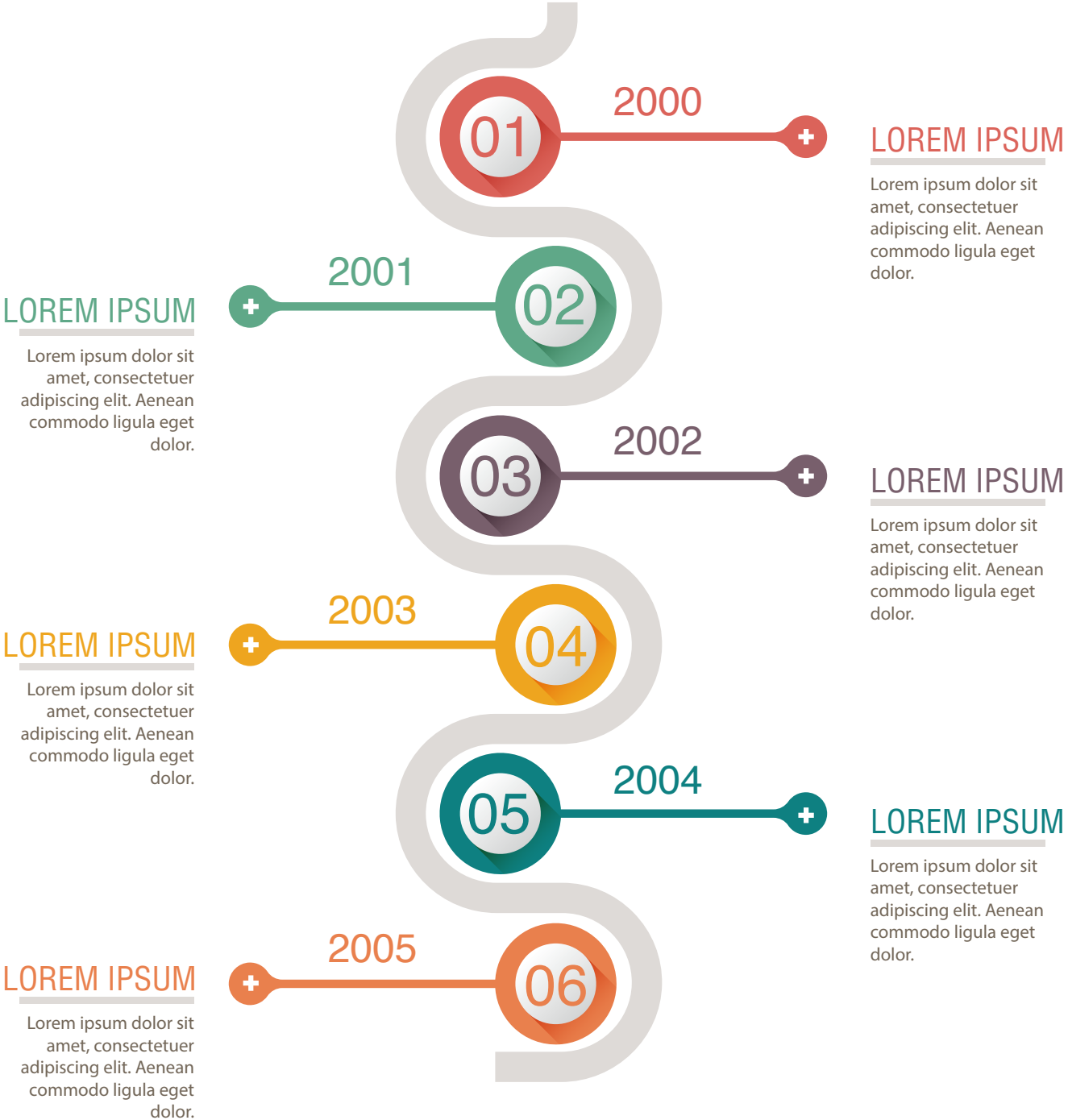
Many business owners will say that an IRS audit is hassle. The request for documents and verification can eat up a lot of time, and being unable to locate the documents required can be incredibly stressful.

An IRS audit can also result in a business paying more in taxes than they did for the year they filed, which can be cumbersome to individuals

and business owners. Audits generally focus on taxes paid within the last year or two, but can go back farther. If a business paid \$10,000 in 2014, but an audit several months down the line finds that they actually owed \$15,000, that's a \$5,00 cost that the business had not accounted for in 2015, and may have to come out of other investments and expenses.

Many individuals and business owners also feel unequipped to defend and advocate for themselves throughout an audit. As tax law becomes more and more complex, the average individual is often unaware of their rights and their true tax liability. IRS Auditors can often be very aggressive, and their findings can be incorrect—but some people, not being aware, end up forking over money that they didn't truly owe.

Finally, in rare cases, an audit may uncover a high level of negligence, which can result in jail time.



WHAT IS AN IRS AUDIT, *AND HOW ARE THEY SELECTED?*

An IRS audit is an inspection of an individual or an organization's tax documents by the IRS to ensure the information provided was accurate. The ultimate purpose of an IRS audit is to make sure that a tax-payer paid the right amount in taxes and is following Generally Accepted Accounting Practices (GAAP). In order to determine which businesses will be selected for an audit, the IRS uses a scoring system referred to as the **Discriminant Inventory Function System (DIF)** and the **Unreported Income Discriminant Formula (UIDIF)**. The higher those number, the more likelihood that your tax liability is different than what was paid, and the higher the likelihood that a business will be selected by an audit.

Certain aspects of a tax return will raise the DIF score, like participation in a tax shelter, as well as large charitable contributions, home office deductions, large travel and entertainment expense or large automobile expense. The purpose of a UDIF is to determine the probability of inaccurate information and the probability of omitted income on a tax

return. A few things can increase the UDIF score. One is if a tax-payer is of high income. High income tax returns are generally more complicated, often resulting in more omissions. Another red flag for a UDIF number is a great number of deductions. These are more likely to be subject to IRS audits in order to ensure all of those deductions were appropriate and applicable. Self employed tax-payers are also often likely to be audited. As more and more individuals in the workforce are self-employed, it's more important than ever that organized tax records are a priority.

A business or individual may also be selected on basis of a related examination. For example, if the IRS is auditing a business, or a business is charged with fraud, the business' partners may also be selected for audit. You will be notified of an audit through the email. It is important to note that the IRS does not initiate the audit process through the phone. In recent times, many telephone scammers have been alerting people that they have been selected for an audit, only to obtain sensitive personal information.

WHAT WILL HAPPEN NEXT?

There are different ways in which the IRS will proceed with the actual audit. The initial letter will provide all of the necessary contact information of your auditor, and tell you what your next step is, so make sure to hold on to that document. They may request that you send them documents through fax or by mail, or they may ask you to come in to an IRS office for an in-person interview. The purpose of these steps is to obtain further information to verify what your tax return reflected.

It is important to provide these documents in a timely manner in order to expedite the audit process. Failing to heed by the timeline set by the IRS may result in the IRS send your case to Tax Court.

WHAT KIND OF DOCUMENTATION DO THEY REQUIRE?

The IRS often requests documents like the following. If you have been working with a certified accountant who has been managing your financial records, these can be easy to obtain:

- Receipts
- Bills
- Canceled checks

- Legal papers
- Divorce settlements including custody agreements
- Criminal or civil defense papers
- Property acquisition
- Tax preparation or advice
- Loan agreements – Include a copy of the original loan with the following:
 - Names of the borrowers
 - Location of the property
 - Financial institution making the loan
 - Amount borrowed
 - Terms (the number of months to pay)
 - Settlement sheet
 - A break-down of how you used the money
- Logs or diaries
- Tickets
- Medical and Dental records
- Medical savings account statements
- A copy of a handbook or other statements showing benefit and reimbursement policies
- Physician statements
- Capital improvement records
- Contract for attendant care IRS Audit Survival Guide
- Theft or loss documents
- Insurance reports detailing the nature of the loss or damage
 - Photos or video showing the extent of the damage (if available)
 - Brief explanation of the loss
- Employment documents
- Schedule K-1 – These are used to report each shareholder's share of income, losses, deductions and credits when an S corporation files its annual tax return.

WHAT HAPPENS AT THE END OF AN AUDIT?

- No change - the auditor determines, based on their findings, that you don't need to alter the amount you paid in taxes.
- Agreed upon changes - The IRS determines there are changes that need to be paid, and you accept these conditions and plan to proceed with the altered exchange of taxes.
- Disagreement over changes - You also have the option to contest the changes the IRS has instituted by requesting mediation or appealing to a court. If you choose to appeal a finding, it's important that your records are impeccably kept, so that you can present as much verifiable information in court or in mediation as possible.

SETTING UP A PAYMENT PLAN

If you do end up owing the IRS in taxes, despite attempts at mediation and taking the case to court, you must eventually pay those taxes. Failure to do so can result in the IRS taking a lien out on your home, freezing your bank accounts, seizing your refunds, or even garnishing your wages. If you don't have the money

you owe to the IRS available right away, you also have the option of setting up a payment plan to pay in installments. Both individuals and small businesses can take advantage of a payment plan option, if they fulfill certain requirements

Individuals:

- \$50,000 or less in income tax, interest, and penalties (combined)
 - Fill out IRS Form 9465 (Installment Agreement Request).
 - Apply through the IRS.gov website with the Online Payment Agreement Application.
 - Call the phone number provided on the IRS letter to request a payment plan
 - Call the IRS Individual Assistance line at 1-800-829-1040.
- \$50,000 or more
 - Fill out Form 9465 as well as Form 433-F

Small business:

- \$25,000 or less
 - Request an "In-Business Trust Fund Express" installment agreement (IBTF-Express IA)
 - If the amount owed is greater than \$10,000 (and below \$25,000), the business must set up a Direct Debit installment agreement (DDIA).
 - Call the phone number on your IRS notice or tax bill Call the IRS Business Assistance line at 1-800-829-4933.
 - Apply through the IRS.gov website with the Online Payment Agreement Application

IRS AUDITS DON'T HAVE *TO BE INTIMIDATING*

An IRS audit doesn't need to be scary, especially if:

- You're not willfully committing fraud. **and**
- You've been maintaining records of your business transactions
- You've been following the regulations that govern your tax liability
- You know your rights

If you've been utilizing the help of a CPA with your bookkeeping, chances are, the required documents are available to you right away, reducing the amount of time you have to spend flipping through paperwork. A good CPA is also staying in the know about tax law and your rights and obligations as a taxpayer. Oftentimes, an IRS audit may conclude with a change that needs to be contested. Your tax professional can help you prepare with all of the necessary, verifiable information you need to advocate for you and move forward, and can even help negotiate on your behalf.

CODE ACCOUNTING FOR MORE TIPS

Code Accounting understands that an audit can stray your focus and lag the growth of your company or your brand by demanding your time and sometimes your money. If you're interested in ways you can make sure you're always prepared for an audit, that your tax preparation is done correctly, and that you are aware of your rights and obligations feel free to contact Code Accounting at [\(510\) 706-2877](tel:5107062877)