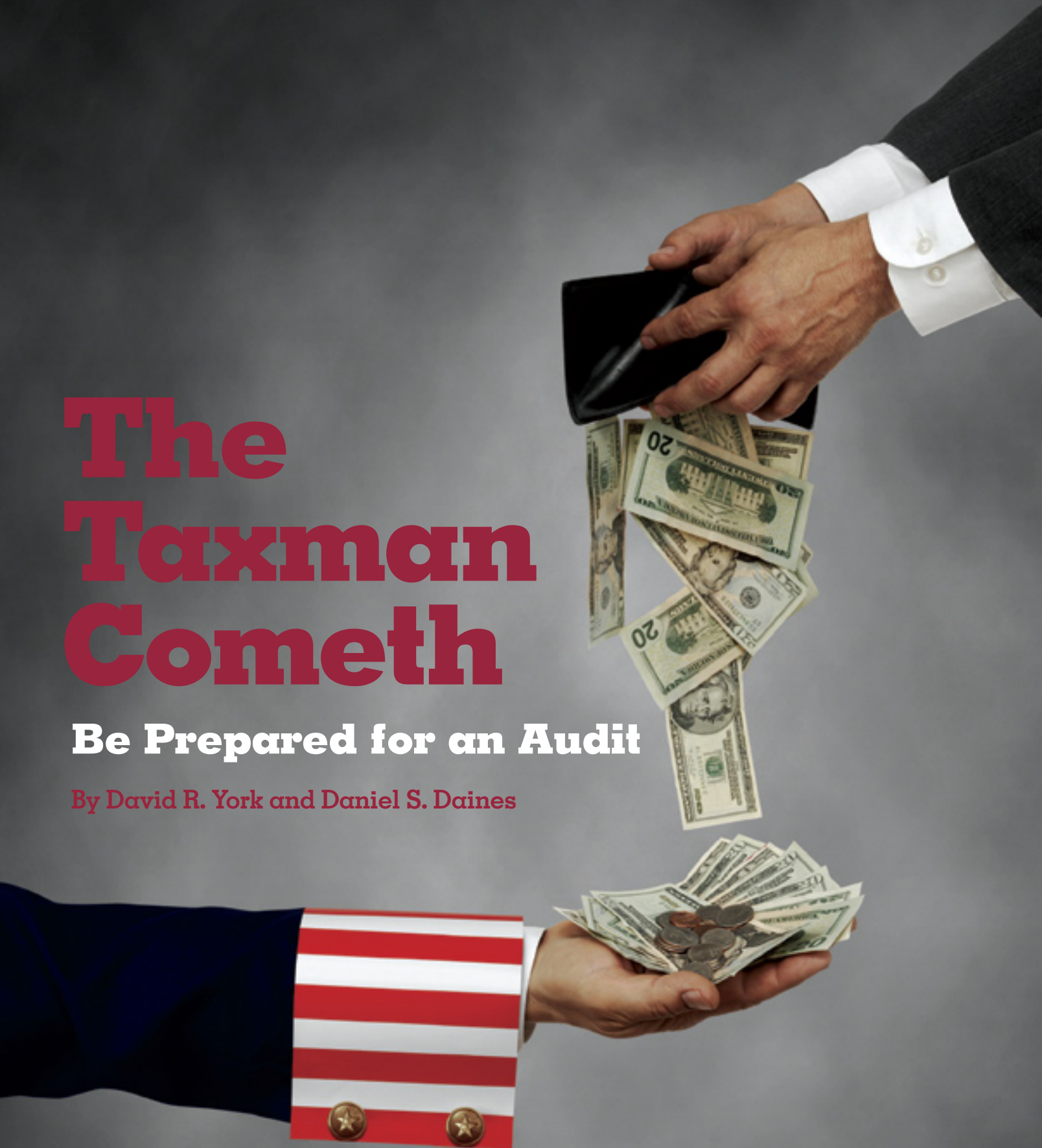


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# The Taxman Cometh

**Be Prepared for an Audit**

By David R. York and Daniel S. Daines



In recent years, Congress and the IRS have become increasingly focused on what they refer to as the Tax Gap, the difference between what the IRS believes should be paid to the government and what taxpayers actually pay. For 2008, the IRS estimated the Tax Gap at just more than \$500 billion. Of that, the IRS believes that underreporting (in the form of unreported receipts and overstated expenses) constitutes more than 82 percent of the total Tax Gap.

As a result, the IRS has dramatically stepped up audit efforts and has allocated additional resources to fund them. It recently announced the hiring of 4,000 new auditors in the Small Business/Self-Employed Division, as well as the creation of a new specialized division called the Global High Wealth Industry Group to target high-wealth individuals. Although audits of all types are on the rise, those with incomes more than \$100,000 are twice as likely to be audited as those with incomes less than \$100,000, and those with incomes more than \$250,000 are six times more likely to face an audit. What should you do if you think the taxman may one day come for you?

### Before the Letter Comes

As the adage goes, an ounce of prevention is worth a pound of cure. The best way to deal with an audit is to avoid one in the first place. Many audits are triggered by errors like inaccurate names and Social Security numbers, missed 1099s, incorrect W-2 figures, and mismatched K-1s. Using a professional such as a CPA to prepare your taxes can reduce your audit risk because he or she understands the complexities involved, knows the myriad of forms required, and uses sophisticated software to accurately calculate your tax liability.

Good record keeping is also critical. Although in general the IRS can only audit your past three years of tax returns, some records should be kept permanently. These include prior tax returns and audit reports, W-2s, real property deeds, legal correspondence, and retirement and pension records. You should also keep records relating to real property, insurance and stock for as long as you own those investments plus an additional three years. Cancelled checks and check registers should be kept for at least three years, though cancelled checks for important payments should be kept permanently.

### After the Letter Arrives

If your tax return is selected for examination, the IRS audit will take one of three forms.

1. **Correspondence Audit.** This is the most common type of audit. Through correspondence, the IRS will tell you if it believes you owe additional taxes, or ask you to send documentation to clarify information on your return. This form of audit is easy if you have kept accurate and complete records.

2. **Field Audit.** A field audit is normally conducted for businesses and rarely for individuals. The IRS will send a group of auditors to a business to examine its books and other documentation.

3. **In-office Audit.** In this audit, individuals or businesses are required to take their tax documentation to an IRS auditor to substantiate claims on a tax return. These audits are typically difficult and the taxpayer bears the burden of proving his or her tax information is correct.

Due to the complexity of tax laws and the adversarial nature of the audit process, taxpayers are often wise to hire a professional to represent them in an IRS audit. A competent tax attorney, a CPA or an enrolled agent can help manage the stress of a difficult audit.

### What If You Disagree?

Although more than 90 percent of all audits are resolved at the audit level, if you don't agree with an auditor's decision, you can appeal the decision to the IRS Appeals Office, which is an independent body created to review and mediate such disputes. If you still can't agree, you can petition the U.S. Tax Court for relief. Once again, competent professional representation can be the key to success.

### Conclusion

Accurately preparing your tax return is the best way to avoid an audit in the first place. If you are audited, accurate and complete records and professional assistance are your best chances for a positive outcome with your encounter with the taxman. ❖

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