Arizona Tax Essentials: Preparing for an IRS Audit

By Lawrence 'D' Pew, AZ Tax Resolution Attorney

The tax audit. If you have hypertension, the very concept can worsen your condition. Being prepared and anticipating what the Internal Revenue Service (IRS) will expect from you is key to managing the stress associated with a tax audit. In this segment of the Pew Law Center's Arizona Tax Essentials series, I'll discuss various taxpayer concerns with audits and the different types of audits conducted by the IRS.

As a Taxpayer, Who Can I Represent Before the IRS?

As an individual taxpayer, you may appear on your own behalf before the IRS in any proceeding. But if you want to represent another person or an organization within the U.S., then:

- *To represent your partnership, you must be its general partner or its full-time regular employee.*
- *To represent your employer, you must be its full-time regular employee.*
- *To represent an organization, corporation, or association, you must be an actual officer or its full-time regular employee.*
- *To represent a trust, guardianship, estate, or receivership, you must be its full-time regular employee.*
- *To represent local government, you must be its regular employee or an officer who's acting within the scope of official job duties.*

Just because someone prepared and signed off on (or didn't sign) your tax return doesn't mean the preparer has any authority to represent you, the taxpayer, in proceedings before the IRS. Tax preparers can only represent clients as to the information contained in the filed return, and even then that representation is limited to communications with IRS customer service or IRS agents. In dealings with IRS appeals officers, revenue officers, or IRS counsel, you're on your own. Unless, of course, you retain a tax professional to represent you in all matters raised by the federal agency.

At the IRS, the Office of Professional Responsibility (OPR) has enforcement powers over tax professionals who represent taxpayers. The OPR regulates enrolled actuaries, agents, appraisers, certified public accountants (CPAs), and attorneys who practice before the IRS and in tax court. Furthermore, experienced tax resolution attorneys like Lawrence 'D' Pew must be members in good standing with the State Bar of Arizona.

Understanding IRS Audits – How Bad Can It Be?

The IRS uses the audit process to confirm the accuracy of the information provided on a tax return. Before the agency begins, it must provide written notice to the taxpayer of an audit of personal or business records. When you receive that audit notice, the last thing you should do is bury your head in the sand and ignore it. Instead, be proactive – find a reputable tax resolution attorney and get to work organizing your records and reports in preparation for anything the IRS auditor may request.

After the audit is complete, about 80% of the cases will result in the assessment of additional taxes. Why? Because most taxpayers are unable to substantiate the information they reported on the audited return. Unfortunately, people often face increased taxes because of poor record-keeping – when the IRS requires evidence to support an item on the return, the taxpayer can't find proofs. The problem only worsens when the taxpayer is asked to look back several years and find verifying documentation.

Why Would YOUR Tax Return Be Selected for Audit?

There are many reasons why the IRS selects a particular taxpayer's return for audit, including:

- *Random selection by the IRS computer.*
- *The payor's records (issued 1099s or W-2s) do not match the information provided on the taxpayer's return.*
- *Compliance sampling by the IRS of a specific business sector that the taxpayer happens to be in.*
- *There is some relationship with another taxpayer selected for audit (such as a business associate or investor).*

Should the examiner uncover problems in reviewing past records, the initial investigation may lead to audits of prior years' tax returns. Therefore, it is important to understand that, once the audit begins, it can lead to a more indepth investigation by the tax examiner. Most taxpayers benefit greatly by having a tax resolution lawyer directly involved early on in the audit process.

Will the IRS Protect My Rights as a Taxpayer During the Audit?

The taxpayer has the right to due process of law, to fundamental fairness, and to legal representation when facing a government audit. Be mindful, however, that the *tax examiner is not responsible for protecting your taxpayer's rights*. During an IRS audit, the taxpayer has the right to:

- *Be treated courteously and professionally by all IRS employees.*
- *Privacy and confidentiality.*
- *Know why the IRS is seeking information, how that information will be used, and the consequences of not providing that information.*
- *Self-representation or the representation of a tax professional or attorney.*

- *Appeal any disagreement on proposed changes.*

The taxpayer will need to provide documentary evidence to prove that the stated income and deductions on the return are correct. The IRS provides a written request for specific documents that it wants to review. Should the examiner determine that income was under-reported, a tax will be assessed.

What Types of Audits Are Possible?

Three little audits – not by the hair of my chinny chin chin! Has story time with your child recently included the *Three Little Pigs*? The nursery rhyme is a metaphor for any IRS audit. Each pig builds the house it believed would resist the blows of the Big Bad Wolf. The first house was built of straw, and the wolf blew it down. The second house was built of sticks, and the wolf blew it down. The third house was built of bricks -- the wolf huffed and puffed, but could not blow it down.

If you want to protect your financial "house" from the "blows" of an IRS auditor, then build the sturdiest house – *with substantiation through financial records, detailed descriptions, and receipts* – one that will not fall apart under close examination.

Each of the three IRS audits requires a certain level of preparedness as each involves an increasing level of scrutiny. The three audit types are the:

- *Correspondence Audit*
- *IRS Business Office Audit*
- *Home Audit or Field Audit*

Where the audit is to be conducted is specified in the notice and is an important indicator of the seriousness of the tax matter at hand.

What Is the Correspondence Audit?

The correspondence audit is the least worrisome of the three types and usually involves simple tax returns. More often than not, the return was missing an important document such as a W-2 (reporting wages), 1099-INT (reporting interest income), or 1099-MISC (reporting other income). It is also possible that documents are needed to support a deduction taken by the taxpayer. In the correspondence audit, the agency tells the taxpayer to send the examiner photocopies of specific documents.

What Is Involved in the IRS Business Office Audit?

When a taxpayer receives notice of an IRS business office audit, the matter is a bit more serious. An appointment time will be scheduled for an audit meeting between the taxpayer and the agency. The written notice specifies the documents that the taxpayer must bring to the local IRS office for examination. The examiner may ask for explanations on deductions and is on the lookout for any unreported income. If you receive notice of an IRS business office audit, you should prepare by involving your tax resolution lawyer well in advance. That way, he or she has time to fully prepare you for what you should and should not do. In fact, at the Pew Law Center we recommend that your tax attorney handle the business office audit for you.

What Is Involved in the IRS Home or Field Audit?

The last type of audit is the IRS home audit, or field audit, which should be taken very seriously. In this situation, the IRS notifies the taxpayer that it will conduct an audit at the taxpayer's residence or the taxpayer's business. Because of the importance of the matter, the IRS sends its most experienced examiners to conduct audits out in the field. You should definitely consider representation and advocacy from an experienced tax resolution attorney with this type of audit.

Do IRS Auditors Ever Make Mistakes?

Sometimes IRS examiners make mistakes and may even introduce errors, causing problems for the taxpayer. They may fail to inform individuals on how the information provided by the taxpayer will be used by the IRS. They may fail to inform the taxpayer of the consequences of not providing requested tax information. They may be so pressed for time that a thorough analysis is not forthcoming. They might overlook information provided by the taxpayer. The consequences of an erroneous audit could be an incorrect tax assessment, interest on an incorrect assessment, and possible penalties for tax fraud.

What Is the Result of an Audit?

When the IRS concludes its audit, there are three possible results:

- ***No Change.*** There is *no change* to the return because the taxpayer provided all the supporting documentation needed.

- ***Agreement to Change.*** The taxpayer and the IRS *agree* to changes because of what was determined during the audit. When the taxpayer agrees to the IRS' proposed changes and signs off on the report, then any tax owed will be collected.

- ***Disagreement to Change***. The taxpayer and the IRS *disagree* on the changes proposed following the audit.

When the taxpayer disagrees with the IRS' proposed changes, then the process continues with a possible conference with supervisory IRS employees, fast track mediation, and appeal within the IRS and in court.

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Lawrence 'D' Pew is an experienced tax, bankruptcy, and transactional attorney, and founder of the Pew Law Center, PLLC, a leading Arizona tax and bankruptcy law firm focused exclusively on debt relief. With offices in Mesa, the law firm serves Arizona residents in the greater Phoenix area, including Scottsdale, Mesa, Tempe, Gilbert and Chandler. As a client-oriented law firm with a mission to always exceed client expectations, the Pew Law Center has helped over 2,000 people file for bankruptcy and eliminate over $100 Million in debt.

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