Tax Audit – Red Flags

Robert Simpson  CPA, MST

Partner at Brinker Simpson & Company
Total Returns Filed, Calendar Year 2017, and Percentage Examined, Fiscal Year 2018

**Total:** 196M

**Returns examined**
- 0.5%

**Returns Examined, Fiscal Year 2018**
- 1.0M
  - Correspondence audit
  - Field audit

**SOURCE:** 2018 IRS Data Book Table 9a
Tax Audit – Red Flags
Presented by Bob Simpson, CPA
From Brinker Simpson & Company, LLC

• Hot Items
  o Math Errors
  o Failure to report all taxable income
  o Unusually high expenses
  o Earning more than $200,000
  o Failure to report Foreign Bank Accounts
  o Deductions beyond the standard amounts

What happens when you are “selected”
  o Review Slides

How to Prepare
  o Retain the services of an enrolled agent, tax attorney or CPA
  o Keep good records
  o Gather information to support your case, summarize organize and bring with you

Actual Cases and Outcomes
  o Review Slide
Dear [Name],

We have selected your federal income tax return for the year shown above for examination. We examine tax returns to verify the correctness of income, deductions, exemptions, and credits.

What you need to do
I have scheduled an appointment for you as shown below. If you are unable to keep this appointment, please call me at the contact number above within 10 days.

Appointment Information
Tax Year: 2017 / 2016
Date: 06/05/2019
Day: Wednesday
Time: 9:00 AM
Place:

Room Number:

Issues to be reviewed during the Examination
Your examination will primarily be focused on the following issues:
- Sch C1 - Travel / Commissions and Fees
- Sch C1 - Advertising / Office Expense
- Sch C1 - Contract labor / Wage

What to bring with you to the Examination
Attached to this letter is Form 4564, Information Document Request, that lists the items on your return we will examine and the supporting items you need to provide. Please bring copies of your 2016 and 2017 individual income tax returns. For additional information see the enclosed Publication 1, Your Rights as a Taxpayer, and Notice 609, Privacy Act Notice.

Why the Information Document Request is important
It is important that you read and fully understand the attached Information Document Request. It lists the items you should bring with you to the appointment. To ensure an efficient examination and to save you time, please organize the requested items according to the issues identified above in this letter. If you have any questions or need additional guidance, please feel free to contact me.
What to expect at the Examination
Generally an examination is scheduled to last approximately 4 hours. During the examination, I will review the information you provide. My goal is to complete your examination at the initial meeting. However, depending on the results of the initial meeting and the supporting items you provide, I may ask you to provide additional information or schedule a follow-up meeting. When the examination is completed, you may owe additional tax, be due a refund, or there may be no change to your return.

A video presentation, "Your Guide to an IRS Audit", is available at http://www.irsvideos.gov/audit. The video explains the examination process and will assist you in preparing for your audit.

Who may come to the Examination
If you filed a joint return, you and/or your spouse may attend. You may also have someone represent you at the examination. If you will not be attending with your representative, you must provide a completed Form 2848, Power of Attorney and Declaration of Representative, or Form 8821, Tax Information Authorization, before the examination. You can get these forms from our office, from our website, www.irs.gov, or by calling 1-800-829-3676.

What will happen if you do not respond
If you do not respond to this letter, we will issue an examination report based on the information available to us, which will result in additional tax due. Therefore, it is to your advantage to keep your appointment and to provide the requested records. If you are uncertain about the records needed or the examination process, please call me.

Sincerely,

Examining Officer
Please bring the following documents to your first appointment. This list is not all-inclusive. If you have other records that will resolve the issue, bring them too. In order to reduce the amount of time spent in the audit process, we suggest that you organize your records according to the item being audited. Pull out the specific records needed to match the dollar amount shown on the tax return. Summarize and group your cancelled checks, receipts, and invoices by each item being audited.

**General Information**

Please bring the documentation listed on the following pages with you to the appointment. In addition to the information requested, please be prepared to discuss the following areas in regards to your business (Schedule C). Responses should be limited to business activities in the years under examination. Potential items to consider include:

- A brief description of your business activity. For example: What are your day-to-day activities? Is the business operated on a full time or part time basis? How long have you been in business? Did you have a territory? Did you have to travel? Did you work out of an office? Home? How did customers contact you? This would be the activity that was done in the year we are examining and the business we are examining.

- What type of accounting method did you use and who maintained the records?

- If you had employees, contractors or any other person who helped you with your business, we will need the activity they performed for you in the year under examination.

- A description of how you determined your Gross Receipts. What was your method for totaling your business income? For example, was it monthly? Daily? From a logbook? Sales receipt totals?

**Information due by**

- At next appointment [X]
- Mail in [ ]

**From:**

Name and Title of Requester
Employee ID number
Date (mm/dd/yyyy)
05/13/2019

Office Location:

Catalog Number: Partnered.gov
Part I - Taxpayer's File Copy
Form 4564 (Rev. 9-2008)
Travel, Meals and Entertainment

Verification of the number of nights away from home overnight for business purposes. Include receipts or credit card statements for meals and actual lodging.

A log or diary for travel costs incurred while away from home on business. This information should include transportation tickets, receipts, and cancelled checks. Note: Cancelled checks written to MasterCard, VISA, American Express, Discover, etc. are not sufficient to establish a business expense, even if they are business cards. You must keep the actual receipts or the monthly credit card statements showing each expense in detail.

Records and receipts for entertainment expenses you claimed. These records must show the name and business relationship of the person you entertained, purpose of the entertainment, place, date of the entertainment, and the amount of the expenditure.

Records and receipts showing the cost of business gifts, persons to whom the gifts were made, and the business relationship.

For entertainment facilities, records showing expenses incurred and the total use and business use of the facility. These records must show the name and business relationship of the person you entertained, purpose of the entertainment, place, date of the entertainment, and the amount of the expenditure.

Itinerary of business trips away from home (e.g. conventions, training, etc.)
Information Document Request

Form 4564

Request Number 1-0001

Department of the Treasury – Internal Revenue Service

Name of Taxpayer and Company Division (if branch)

SASU

Description of documents requested

Tax Period(s): 2016/12, 2011/12

Advertising Expenses

Canceled checks, bills, or receipts to verify advertising expenses claimed on the return.

Commissions, Cost of Labor

Copies of all Forms 1099 for commissions paid during the year.

Names, addresses, and Social Security numbers of individual recipients of commissions, if Forms 1099 were not issued.

Copies of contracts or other written agreements for contract labor.

Canceled checks and all other records to verify amounts paid to each individual and on each contract.

Labor Hired.

Copies of canceled checks or statements to show who was paid and the amount for the hired labor.

Provide the names and social security numbers for all persons hired and paid in the tax year.

Copy of Form(s) 1099 and Form(s) 940/941 filed for the tax year if applicable.

Information due by 10/30/2018

Mail in

From:

Name and Title of Requester

Employee ID number

Office Location:

Canceled Number:

Part 1 - Taxpayer’s File Clay

Form 4564 (Rev. 8/2006)
Form 4549  
Department of the Treasury-Internal Revenue Service  
Income Tax Examination Changes  

<table>
<thead>
<tr>
<th>Date</th>
<th>Name and Address of Taxpayer</th>
<th>Taxpayer Identification Number</th>
<th>Return Form No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>6/23/2019</td>
<td></td>
<td></td>
<td>1040</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>1. Adjustments to Income</th>
<th>Perkin End</th>
<th>Period End</th>
<th>Period End</th>
</tr>
</thead>
<tbody>
<tr>
<td>c. Capital gains or Loss</td>
<td>5,049.00</td>
<td>30,902.00</td>
<td>21,547.00</td>
</tr>
<tr>
<td>d. Itemized Deductions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>e.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>f.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>g.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>h.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>i.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>j.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>k.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>l.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>m.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>n.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>o.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>p.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| 2. Total Adjustments | 31,901.00 | 28,547.00 |
| 3. Taxable Income Per Return or as Previously Adjusted | 132,782.00 | 132,645.00 |

| 4. Corrected Taxable Income Tax Method Filing Status | 144,733.00 | 150,416.00 |
| D | D |

| 5. Tax | 27,800.00 | 29,199.00 |
| 6. Additional Taxes/Alternative Minimum Tax | 0.30 | 0.30 |

| 7. Corrected Tax Liability | 27,590.00 | 29,199.00 |

| 8. Less: a. Residential Energy Credit | 160.00 | 160.00 |
| Credits | D | |
| d. | |

| 9. Balance (Line 7 less Lines 8 through 8d) | 27,430.00 | 28,039.00 |

| Other | b. | |
| Taxes | c. | |
| d. | |

| 11. Total Corrected Tax Liability (Line 8 plus Lines 10 through 10d) | 27,430.00 | 28,039.00 |
| 12. Tax Shown on Return or as Previously Adjusted | 21,322.00 | 14,347.00 |
| b. | |

| 14. Deficiency Increase in Tax or (Overpayment) Increase in Tax (Line 11 less Line 12 adjusted by Line 13a through 13c) | 4,093.00 | 4,093.00 |
| 15. Adjustments to Prepayment Credits - Incurred (Decrease) | |

| 16. Balance Due or (Overpayment) (Line 14 adjusted by Line 15) (excluding interest and penalties) | 5,592.00 | 4,962.00 |

The Internal Revenue Service has agreements with state tax agencies under which information about federal tax, including exemptions, or deductions, is exchanged with the states. If this change affects the amount of your state income tax, you should amend your state return by filing the necessary forms.

You may be subject to backup withholding if you underreport your interest, dividend, or patronage dividend income you earned and do not pay the required tax. The IRS may order backup withholding (withholding of a percentage of your dividend and/or interest income) if the tax remains unpaid after it has been assessed and four notices have been issued to you over a 120-day period.
Robert B. Simpson, CPA, MST
PARTNER

Cell: 610.329.3202  •  rsimpson@brinkersimpson.com

940 W. Sproul Rd. • Suite 101 • Springfield, PA 19064
Office: 610.544.5900 • Fax: 610.544.7455
brinkersimpson.com