

Advanced Schedule C Audits

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1

1



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2

The Examination Process

Audit Authority

IRC §7602, “Examination of books & witnesses”

Return Selection-Determined by the “Discriminant Income Function” (DIF Score)

TPI-Total Positive Income (Any losses and/or negative return amounts are treated as zero.)

The National Research Program (NRP)

The NRP measures the payment, filing and reporting compliance of taxpayers via specified audits.

NRP Audit Categories:

- 1) No IRS contact Audits
- 2) Correspondence Audits
- 3) Office Audits
- 4) Calibration Audits

Reengineered IRS Exam Process

- ❑ **Planning** – The IRS expects to provide improved & increased communication expected
- ❑ **Managerial Participation** – Group managers are expected to be more visible & accessible
- ❑ **Risk Analysis** – Additional fraud criteria has been established

Polling Question



Preparing for the Schedule C Audit

- ☐ Review of the case documentation and substantiation
- ☐ Review of any relevant case law matter (IRC provisions, Treas. Regs., Court Cases, etc.)
- ☐ Interview of the taxpayer
 - Practitioner's Position
 - IRS Examiner's Position

Types of Schedule C Examinations

- ☐ Office Audits
- ☐ Field Audits
- ☐ Egg Shell or Complex Audits

Examination Administration

- ☐ Date and Time of Examination
- ☐ Type Examination
- ☐ Place of Examination
- ☐ Exception for small businesses (Schedule C)
- ☐ Site Visits
- ☐ Place of Exam Change request
- ☐ Right of Consultation

Financial Status / Economic Reality Exams

- ☐ Focus on taxpayer's lifestyle
- ☐ Use limited by RRA 98'
- ☐ Reasonable indication of unreported income must exist prior to pursuing this type exam per IRC §7602(e)
- ☐ ILM 200311032 – Invocation of IRC §7602(e) may be premature when no determination of unreported has been made

Indirect Methods of Proof

- ❑ Authorized by IRC §7602(e)
 - Net Worth & Expenditures Method
 - Bank Deposits Method
 - Third Party Information Method

- ❑ IRC §446(b) – Allows the IRS broad discretion to determine the TP's income when inadequate records or insufficient documentation exists

Polling Question

Unreported Income Audit Selection Tool

- ☐ Unreported Discriminate Index Function (UI-DIF)
 - Rates the probability of income omitted from returns
 - Returns considered “high risk” for unreported income
 - Returns may receive a UI-DIF score in addition to the basic DIF score

Schedule C Audit Case Administration

- ☐ Determine if any specific Schedule C issue requires IRS managerial discussion
- ☐ Maintain contact w/TP regarding the case
- ☐ Determine if any Schedule C item should be conceded and/or partially conceded
- ☐ Keep the auditor focused on surveyed issues
- ☐ Control exam-consider using an AEWP
- ☐ Consider the “summons” authority of IRS

Tax Advisor-Client Privilege

- ☐ Mandated via IRC §7525
- ☐ Conveyed to Federally Authorized Tax Practitioners
- ☐ Includes communications between client the client's representative
- ☐ Applies to any civil (non-criminal) federal tax proceeding
- ☐ Required by law to be protected by TP's representative

The Market Segment Specialization Program

Established to train IRS tax examiners for specialized markets or industries. Audit “guidelines” known as ATG’s were developed for each type industry, most of which affect small business & Schedule C filers, a few noted as follows:

- Architects & Landscape Architects
- Attorneys
- Business Consultants
- Cash Intensive Businesses
- Child Care Providers
- Farmers
- Restaurants & Bars

Polling Question



17

17

Rules of Engagement- Schedule C Audits

- ☐ Thoroughly interview the client
- ☐ Secure books, records and relevant documents
- ☐ Review the tax return/list all LUQ's
- ☐ Organize all case support documents
- ☐ Perform any required case law research
- ☐ Contact Examiner, discuss expectations & time frames
- ☐ Keep the Examiner "focused" on the any tax year/period under audit
- ☐ Require that all requests be submitted via an IDR (Form 4564)
- ☐ Do not volunteer information

18

IRS Audits & QuickBooks Issues

- ❑ Examiners are attempting to validate “audit trails” and the reliability of the taxpayer’s records
- ❑ A U.S. District Court upheld the enforcement of a Summons for “electronic records” (the taxpayer’s QuickBooks files)
- ❑ IRS agents will request the “administrator’s password”
- ❑ Defenses to “electronic/QB records” requests
 - Provide the IRS Agent year-end QB Financial Statements
 - Provide the IRS Agent with a detailed G/L
 - Ensure the Financial Statements & G/L agree w/the tax return
 - Determine if any information is considered “privileged”
 - Convert the TP’s records to the 2012 version of QuickBooks

IRS Publication 2017 (Currently Obsolete)

- ❑ If the taxpayers’ records are not maintained or established by a proper accounting system, it is recommended that the practitioner organize the taxpayer’s books and records in accordance with the (former) IRS Pub 2017 as follows:

Advertising Expense

Yellow Page Ads	\$ 1,214.99
National Directories	937.14
Local Newspapers	763.47
Business Cards	<u>391.67</u>

Total Deduction \$ 3,307.27

Ensure all totals agree w/the tax return/explain any differences



Case Consulting

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Table of Contents

Goals and Objectives	3
I. The Audit/ Examination Process	4
II. The Reengineered Examination Process	6
III. Preparation for the Schedule C Audit Process	7
IV. <u>Types of Examinations:</u> Correspondence Audits Office Audits Field Audits Complex Audits	8
V. Examination Administration	9
VI. Financial Status or Economic Reality Audits	12
VII. Indirect Methods of Proof	12
VIII. Unreported Income Audit Selection Tool	12
IX. Practitioner Case Administration	13
X. Attorney (Tax Advisor) Client Privilege	13
XI. The Market Segment Specialization Program	14
XII. Rules of Engagement-Examinations	15
XIII: IRS Audits & QuickBooks Issues	16
XIII. Appendix-Audit Engagement Work Program	17

Advanced Schedule C Audits

Goals and Objectives:

The Examination Compliance Function of the Internal Revenue Service (IRS) is operating and functioning at a heightened level, with special emphasis towards Schedule C filers. The IRS has hired and attempted to train a significant number of additional Revenue Agents (RAs) and Tax Compliance Officers (TCOs). Tax Practitioners have a number of issues to be concerned with when representing taxpayers before the Examination Division of the IRS. Not only is the IRS examining the taxpayer, but the preparer/practitioner is under review as well. Therefore, procedurally there has been a change of focus, which includes the actions and/or inactions of the practitioner. The audit/examination process **has changed and is constantly evolving** and unfortunately redirects the focus towards practitioners. This presentation will attempt to prepare you for the new procedures and the new audit/exam personnel you may encounter.

In the past the IRS has stated in public news releases that they intend to “ensure fairness of the tax system.” However, as stated in the past, based upon the cases I have personally worked, I have not encountered an overwhelming sense of “fairness” during the examine process. The responsibility of ensuring “fairness” during the process of the examination lies with the tax practitioner representing the taxpayer. The practitioner must also protect the taxpayer’s rights and guard against IRS personnel abuse their discretion or authority during the processing of auditing/examining the taxpayer.

Advanced Schedule C Audits

I. The Audit/Examination Process

Audit/Examination Authority:

The Internal Revenue Service (IRS) obtains its authority to “audit” or “examine” a taxpayer (TP) from Internal Revenue Code (IRC) Section **7602**, “Examination of book and witnesses.”

Return Selection:

Technically, once a return is filed with the IRS the audit process begins and the IRS invokes certain statutory authorities. Every tax return filed with the government is reviewed and scored by a “TOP- Secret” process that generates information providing the probability that, *if an audit is ensued, additional tax assessments may be generated.* This review and scoring process is best known as the *Discriminant Income Function (DIF)*. Each return processed is then automatically assigned a DIF score. Thus, the higher the score of a screened tax return, the higher the potential, for selection as an audit candidate.

Another component of tax return scoring procedures of the audit process is known as “Total Positive Income” (TPI). Under this process, the IRS computers basically extract and summarize all of the positive income values noted on the tax return. Any losses are treated as zero. This additional or alternative system generally is utilized to reduce reliance upon and/or eliminate the use of Adjusted Gross Income (AGI) as a factor in deciding the potential for additional assessments should a return be audited or examined.

The National Research Program

To measure payment, filing and reporting compliance for different types and various sets of taxpayers the IRS has developed the National Research Program (**NRP**). The NRP is based upon the theory of developing in stages. The initial stages of the program focused upon individual income taxes, while current and future stages are expected to measure other taxes and other types of taxpayers (such as Corporations, Pass-Thrus, etc...).

NRP Audit Categories:

- **No IRS Contact Audits** – Filed tax returns are reviewed based solely on information already available to the IRS.
- **Correspondence Audits (*Less Intrusive)** – Correspondence audits are generally less intrusive than office audits and are typically conducted via mailed correspondence and limited telephone contact.
- **Office Audits (*Somewhat Intrusive)** – With these type exams the IRS obtains more information regarding the taxpayer, prior to the examination from agency records and other resources, and focuses on “selected areas” of the return.
- **Calibration Audits (*Intrusive)** – These type examinations are performed on a select group of returns (criteria for selection unknown). Each line item of the return (remember from above “line-by-line”, “dollar-to-dime”) will be reviewed. However, in contrast to TCMP audits, taxpayers will not be required to provide line-by-line “**substantiation.**”

Also bear in mind that the returns associated under this program are selected on a random basis (the same as the TCMP audits were). An examination under the NRP process was created to consider the entire taxpayer and not just the tax return line items.

For example, the DIF formula considers not only your income and deductions, but it also accounts for the location of your home, the size of your family (exemptions), and even your occupation.

Tax Exam Classifiers

Once a return has been identified by the computer as having audit potential, it is remitted to the District Office (or Campus) and is manually screened by the classification division. Although the “classifier” has identified the main items that the Examiner/Auditor should focus upon, the IRS Examiner has the authority to “**expand the scope**” of the exam issues, more so related to Schedule C audits.

II. The Reengineered IRS Examination Process

New and improved “examination” procedures have been developed and implemented by the IRS. The new examination procedures are comprised of three major components as follows:

- PLANNING
- INCREASED MANAGERIAL PARTICIPATION; and
- RISK ANALYSIS.

Planning:

The Service expects to provide improved and increased communication. The Revenue Agent or Tax Compliance Officer is expected to discuss such things as a “**mutual commitment date.**” Also, an “Engagement Agreement” is required to be discussed and presented to the taxpayer or his/her representative at the Office Audit level. However, it is optional at the Field Examination Level (but is yet required to be discussed).

Managerial:

The Group Manager is expected to be more visible and accessible under the reengineered process and is expected to be involved at a very early stage of the examination. The Managers are also expected to agree as to how the audit will proceed or be conducted. You should expect more Managerial presence at the initial meetings or conferences as well. The Managers will also assist in developing the scope of the examination. However, examiners will continue to be allowed to use their “judgment” (better known as discretion) regarding various issues whether they are complex or not.

Risk Analysis:

The NRP process has developed “guides” to assist the examiners. Additional criteria regarding **fraud** have also been established. Specific dollar amount thresholds and compliance initiatives have also been established. The new risk analysis procedures are used to determine whether to expand or reduce the scope of the examination.

III. Preparation for the Schedule C Audit Process

The representative should know *more* about the taxpayer you are representing than the IRS Agent does. Yes, the agent probably has access to more resources and possibly more technology than you. However, you have access to something much more valuable than the IRS Agent, *you have **direct access to** “The Client, The Taxpayer.”* Being prepared also includes knowing *what can be substantiated and what cannot*, as well as knowing before hand *which issues to concede, and which issues are non-negotiable*.

Interview of the Taxpayer-The Practitioner’s Position

As stated above, you “the representative” should know more about the client than the IRS Tax Examiner. To accomplish this task, the practitioner should conduct a **thorough and probing interview** of the taxpayer with respect to the issues identified per the Examiner’s Information Document Request (IDR), Form 4564. A thorough interview of the taxpayer is required to prevent the IRS Examiner for performing one of the following actions:

- ☐ Bypassing the practitioner, and/or
- ☐ Issuing a “Summons”

Additionally, conducting a thorough interview allows the practitioner to recognize any “exposure” of potentially critical or damaging information, and allows the practitioner to fully develop the “facts and circumstances” of the case issues.

Interview of the Taxpayer-The Examiner’s Position

The Examiner will generally attempt to solicit the presence of the taxpayer to conduct an interview of the taxpayer at the initial stage of the audit. However, if the practitioner has fulfilled his duty, with respect to conducting the “thorough & probing” interview of the taxpayer, there should be no need to have the taxpayer present during the administration of the examination unless the practitioner decides the presence of the taxpayer is necessary to bolster the elements of the case. Additionally, IRC §7521(c) prevents the compulsion of appearance of the taxpayer.

IV. Types of Examinations

Generally, there are two types of audits or examinations, the Office Audit, and the Field Audit. Here we will discuss the procedural differences of these audits and possible case approaches.

Office Audits-Correspondence Audits

There are two categories of “office audits.” The simplest form of an office audit is the “correspondence audit.” This type of audit is the least thorough of all techniques, *nonetheless effective*. Notices are remitted to the taxpayers requesting verification of certain components of the return, (it may be a deduction, tax credit, etc.)

Office Audit-In Office Visit

This is the next level of an official IRS audit. Usually one or more deductions and/or return components are selected for review. An office audit is usually conducted at a Service Office (not to be confused with Service Center). Tax Auditors (TA) or Tax Compliance Officers (TCO), are normally assigned these type audits.

Field Audits

This final level of taxpayer review is the most detailed and thorough of all audits and examinations. The most experienced IRS employees perform these type audits. They usually have an extensive and impressive educational background. They are called Revenue Agents or RA’s. An audit conducted by a RA is generally done so at the taxpayer’s place of business or residence. RA’s have significant latitude and discretion to expand the scope of the audit and to review or examine additional tax years if deemed appropriate without managerial approval. Because of a Revenue Agent’s background and authority, a higher level of “preparedness” and “awareness” should be involved regarding the entire audit process and consultations with your clients.

The following type returns are usually selected for these type audits:

- (1) Issues which require in-person (or on-site) review of the taxpayer’s books and records and/or facilities and assets.
- (2) Large Schedule C returns with complex transactions.
- (3) Small business returns (Corporations, Partnerships) with complex or significant issues.

Egg Shell or Complex Audits

Generally, an “egg shell” or “complex” audit is one that involves extremely sensitive issues and/or potential criminal elements. An audit may become complex and/or criminal elements may develop at any stage of the examination, whether it is a correspondence, office, or field audit. The representative should be cognizant of the issues of any type of audit and be able to determine when referral to a competent tax attorney is necessary. Thus, the initial interview of the TP as noted above is pertinent and should not be approached lightly. Any expected tax attorney referrals should occur **“prior to”** significant and detailed questions being asked by the representative, during the interview stage if the practitioner believes such action is warranted. When a practitioner is engaged by a tax attorney, he/she is usually required to sign a “Kovel” letter or agreement to protect the client’s privileged matters (civil & criminal).

Potential Elements of an Egg Shell or Complex Audit

- ☐ Failing to keep proper books & records
- ☐ TP has no records or poorly keep records
- ☐ TP attempts to falsify, destroy or alter records without a plausible explanation
- ☐ TP refuses to provide or make certain records available
- ☐ The TP’s personal living standards & asset acquisition is inconsistent with the TP’s reported income
- ☐ Promotion of self-serving statements without documented proof
- ☐ Repeated procrastination with respect to making & keeping appointments

V. Examination Administration

Date and Time of Examination

The IRS (Service) will generally schedule the time frame for an examination during the normally scheduled workdays of the Service. Also, examinations are usually scheduled throughout the year without regard to seasonal fluctuations in the business of particular taxpayers or their representatives (tax season). [**Treas. Reg. §301.7605-1(b)(1)**]

Selection Regarding the Type of Examination

The Service will determine whether an examination will be an office examination, or a field examination based upon the complexity of the return, and which form of

examination would be more conducive to effective and efficient tax administration.
[Treas. Reg. §301.7605-1(c)(1)]

Place of Examination

The Service will make an initial determination regarding the place for the examination. This determination also includes a decision regarding the IRS district (or Campus) to which an examination will be assigned. Requests by taxpayers (and/or their representative) to transfer the place of the examination will be decided on a case-by-case basis. [Treas. Reg. §301.7605-1(d)(1)]

Exception for Small Businesses

If an examination is scheduled by the Service at the taxpayer's place of business and the taxpayer represents to the Service **in writing** that conducting the examination at the place of business would essentially require the business to close or would unduly disrupt business operations, the Service, **upon verification**, will change the place of examination to a Service office within the district (or Territory/Area) where the taxpayer's books, records and source documents are maintained. [Treas. Reg. §301.7605-1(d)(3)(ii)]

Site Visitations

Regardless of where an examination takes place, the Service is authorized to visit the taxpayer's place of business **or residence** (home office) to establish facts that can only be established by direct visit, such as inventory or asset verification. The Service will generally make the site visitation on a normal workday of the Service during the Service's normal duty hours. [Treas. Reg. §301.7605-1(d)(3)(iii)] Site visitations are now being *conducted at a much earlier stage in the examination* process (as well as other compliance areas). Under this new process, site visitation requests have usually been made and/or conducted in conjunction with the initial conference.

Place of Examination Change Request

Generally, the Service will consider, on a case-by-case basis, written requests by taxpayers or their representatives to change the place of the examination after considering the following several factors: [Treas. Reg. §301.7605-1(e)(1)(i-vi)]

- The location of the taxpayer's current residence.
- The location of the taxpayer's current principal place of business.
- The location of the taxpayer's books, records, and source documents.
- The location at which the Service can perform the examination most efficiently.
- The Service resources available at the location to which the taxpayer has requested a transfer, and
- Other factors that indicate that conducting the examination at a particular location could pose undue inconvenience to the taxpayer.

Right of Consultation

The Service is required to **immediately suspend a taxpayer interview** if such taxpayer clearly states to the examining officer (anytime during the interview) that he or she desires to consult with an **Attorney, CPA, EA**, or any other person permitted to represent the taxpayer before the IRS. [IRC §7521(b)(2)]

Representatives Holding a Power of Attorney (POA)

Any attorney, CPA, EA, or any other person permitted to represent the taxpayer before the IRS, who is not disbarred or suspended from practice before the Service, and who has a written POA executed by the taxpayer *may be authorized* by such taxpayer *to represent the taxpayer in any interview* described in subsection (a). An officer or employee of the **IRS may not require a taxpayer to accompany the representative** in the absence of an administrative summons. *Such officer or employee*, with the consent of the immediate supervisor of such officer or employee, *may notify the taxpayer directly* that such officer or *employee believes such representative is responsible for unreasonable delay or hindrance* of an IRS examination or investigation of the taxpayer. [IRC §7521(c)]

VI. Financial Status or Economic Reality Examinations

Financial Status or Economic Reality type audits typically focus on a taxpayer's lifestyle or standard of living regarding the application of audit procedures. However, pursuant to the *Restructuring & Reform Act of 1998 (RRA 98')*, the IRS is generally precluded from utilizing "financial status" and/or "economic reality" type techniques

to perform an audit or examination, **unless** the IRS has a reasonable indication that there is a likelihood of unreported income [IRC §7602(e)]. Pursuant to IRS Legal Memorandum (ILM) **200311032**, the IRS concluded “*the invocation of IRC §7602(e) is premature when examining agents request bank records and personal records at the time the IRS hasn’t made a determination regarding the existence of unreported income.*”

VII. Indirect Methods of Proof

In an attempt to determine or establish the accuracy and completeness of taxpayer filed returns, the IRS may resort to “indirect methods” of verifying and investigating taxpayer tax returns. [IRC §7602(e)]. IRS Agents may resort to such indirect methods as:

- ❑ Net Worth & Expenditures Method
- ❑ Bank Deposits Method
- ❑ Third Party Information Method

The above listing is not all-inclusive, as **IRC Sec. 446(b)** allows broad discretion for establishing the appropriate method of determining a taxpayer’s income. Indirect methods of proving income are utilized extensively in situations where the taxpayer **did not maintain adequate books and records** or insufficient documentation and substantiation.

VIII. Unreported Income Audit Selection Tool

The IRS strategy also includes methods to address the issue of unreported income not identifiable through reports from payers, for example the gross receipts of a business. A new tool was placed into use in **2002** for identifying returns with a high probability of unreported income and has substantially increased in use through **2009**. The tool is known as Unreported Income Discriminate Index Function (UI-DIF).

IX. Practitioner Case Administration

A well-prepared representative should not be intimidated by the new exam reengineering procedures and should be prepared to represent, assert, and defend the client’s justifiable positions and taxpayer rights during all phases of the engagement. To enhance the “preparedness” process, the representative may consider utilizing a

practice tool, such as an “engagement work program.” Utilization of an “engagement work program” will assist the representative in formulating thoughts, procedures, and legal applications. It also serves as a step-by-step, guide for new personnel, to ensure that company standards, rules and guidelines are being adhered to for quality control purposes. An example of a typical **“Audit Engagement Work Program”** is included in the *appendix*.

Issuance of a Summons:

Upon selection of a return for audit and the examination has ensued, an IRS Agent may utilize their “summons authority” pursuant **IRC §7602(a)**. Pursuant to a report issued by the IRS entitled **“Anatomy of a Tax Audit”** (November 2008) the IRS, acknowledged that the. practice of issuing a “summons” during an examination has “steadily increased”. However, the IRS provided no plausible explanation to justify the increase of summonses, neither did the report attempt to clarify if this practice was appropriate. The report did acknowledge that taxpayers (or their representation) may continue to refuse to produce documents considered “privileged”.

X. Attorney-Client (Tax Advisor-Client) Privilege

Pursuant to RRA 98’ (P.L. 105-206), the traditional attorney-client privilege was extended to “federally authorized tax practitioners” (FAT practitioner), specifically Enrolled Agents (EAs) and Certified Public Accountants (CPAs). This act was codified via **IRC §7525**, **“Confidentiality Privileges Relating to Taxpayer Communications.”** The fundamental purpose of the privilege is to make confidential, except under certain excludible conditions, communications between a client and the client’s attorney (tax advisor).

Therefore, if a FAT practitioner provides or receives “tax advice” *in confidence*, that information is considered privileged and should not be disclosed to any third party without the taxpayer’s consent or appropriate court order enforcing such disclosure. Only the client or taxpayer can waive privilege regarding a tax matter. The privilege is that of the taxpayer’s, not the representative. The assertion of the tax-advisor privilege is limited to *non-criminal* matters before the Internal Revenue Service, and

any non-criminal tax proceedings brought by or against the United States. [IRC §7525(a)(2)(B).

NOTE:

Tax preparation does not encompass the sanctity of privilege. This provision applies to **both** attorneys and non-attorneys. Other limitations and exceptions are:

XI. The Market Segment Specialization Program

To develop highly trained examiners for a particular market segment, the Department of the Treasury created the *Market Segment Specialization Program* (**MSSP**). In the author's opinion, this program was created specifically for **Revenue Agents** in contrast to Tax Compliance Officers. MSSPs are focused on specific industries and contain specific techniques related to each industry. These specific techniques are commonly referred to as **Audit Techniques Guides** (ATGs). These particular guides provide the step-by-step examination techniques recommended by the IRS. They contain common as well as unique industry issues, business practices, specific industry terminology, detailed analysis formats, worksheet and workpaper suggestions and other vital information to assist examiners and auditors with performing detailed and near flawless examinations.

XII. Rules of Engagement-Schedule C Audits & Examinations:

The ultimate goal of the IRS Agent/Examiner should be to determine the accuracy of the taxpayer's tax return filing rather than primarily concentrating on "finding unallowable deductions and/or unreported income". However, to properly manage an audit engagement, it is recommended that certain rules of engagement be applied and enforced as much as practically possible. The following list of rules is suggestive and is not to be all inclusive as follows:

- ☐ Thoroughly interview the taxpayer (ask probing questions but be cautious)
- ☐ Secure the TP's books, records, tax return and other relevant documents
- ☐ Review the return and make a list of any questionable items
- ☐ Organize the documents and records in a professional & presentable manner
(Refer to IRS Publication 2017 via the Power Point presentation)

- ☐ Review all documents and substantiation in preparation of the audit and create a potential list of issues that should and/or should not be conceded
- ☐ Perform tax law research regarding any “questionable” issue and document your conclusion
- ☐ Contact the Examiner and schedule the audit at a time and place most convenient for you and/or the taxpayer
- ☐ Discuss any expectations and procedures with the Examiner during the initial meeting to establish any ground rules
- ☐ Discuss the expected “timetable” of the audit
- ☐ Inform the examiner that all “official” request for documents should be achieved via a formal IDR (See Form 4564 via the Power Point presentation)
- ☐ Keep the Examiner “focused” on all relevant items pertaining to the tax year under investigation
- ☐ Control the exam by isolating the Examiner from the TP and/or other employees and limit access to use of the copier (assign a clerk to make copies)
- ☐ Do not “volunteer” information and/or additional records unless this information is exculpatory with respect to exam issues
- ☐ Subsequent to the Examination, consider submitting formal request for the Examiner’s work papers

XIII. Schedule Audits & QuickBooks Issues:

The IRS has purchased a significant number of QuickBooks licenses and they have also implemented training of their examination agents with respect to the use of QuickBooks records. These IRS Agents are currently prepared to conduct audits (under the new QuickBooks training) and these Agents have been instructed to request and/or require a copy of your QuickBooks records via a “flash drive” and/or a “data disc” for their explicit use concerning the audit engagement.

Practitioners should be concerned about unauthorized access to financial data and information which is “outside the scope” of the tax year under examination. Additionally, QuickBooks data and information is subject to manipulation and

unauthorized adjustments once it is provided to a “third party” and the necessary precautions have not been made to limit the Examiner’s access to prohibited data.

Practitioner Point:

Once the QuickBooks data has been provided to the IRS on a “voluntary basis” the practitioner and/or taxpayer has allowed the IRS free and unlimited access to any and all information contained on the data discs. Attempting to “assert privilege” at a later date may prove to be futile. Privilege is required to be asserted prior to the IRS gaining access to any sensitive or privileged information.

Detailed references, suggestions and potential defenses concerning this matter are noted via the Power Point presentation.

APPENDIX-American Society of Tax Problem Solvers

IRS AUDIT ENGAGEMENT WORK PROGRAM

Type Audit/Examination: _____

Client Name: _____

Prepared By: _____

Form: _____

Date Completed: _____

Tax Year: _____

Reviewed By: _____

I. Pre-Engagement Administration

- A. Prior to the initiation of the engagement consider the following issues:
1. Does this engagement involve possible procedural aspects of practicing before the IRS for which this firm has limited experience and/or expertise? If so, develop steps to compensate for any deficiencies?
 2. If this is a new client, will accepting this engagement conflict with any of the firm's policies regarding acceptance of potential clients?

II. Audit Engagement Initiation & Planning

- A. Has the exact nature of the IRS request been identified by the firm and understood by the client?
- B. Review applicable tax returns and workpapers to:
 - 1. Identify exposure items (return errors, etc.).
 - 2. Quantify the potential tax impact.
 - 3. Calculate and document any statute of limitations.
- C. Establish a meeting with the client to:
 - 1. Define the firm's and the client's responsibilities and the scope of representation to be provided.
 - 2. Discuss exposure items and related substantiation to ensure that the firm understands the relevant facts and underlying issues. Discuss methods resolving all exposure items.
 - 3. Determine strategy for conducting the audit by deciding: (1) the **location of the examination**; (2) the extent of the **client's presence at examination**; and (3) the client's willingness to negotiate certain issues.

[illegible]

D. Legal Authorization & Case Commitment Consideration:

1. Execute a Power of Attorney regarding the client.
2. Prepare and authenticate the engagement letter:
 - **Confirm** client understanding of responsibilities and the scope of the engagement.
 - Summarize actions to be taken.
 - Estimate cost of the engagement, **confirm fees** and secure retainer.

E. Assign personnel appropriate for the engagement function:

1. Assemble and organize requested information.
2. Establish a file for information requested by the IRS.
3. Retain a copy of all documents given to the IRS.
4. Establish a system to identify and record which documents have been provided to the IRS (and when) to maintain proof of compliance and reduce redundancy.

F. Research and document potential exposure items.

III. Engagement (Functional Considerations)

- A. Schedule an initial conference with the examining agent and identify the scope of the examination.

- B. Consider a strategy to provide information to the agent utilizing the following procedures:

1. Designate a contact person to provide any and all properly requested information.
2. Require that all information/document requests be submitted via **IRS Form 4564 (IDR)**.
3. Index and retain a copy of all information provided to the agent.

- C. Analyze any relevant issues presented by the agent:

1. Examine each proposed adjustment, considering each for technical and factual accuracy.
2. Document and quantify the impact of each proposed adjustment. Rank the adjustments in order of potential successful resolution.
3. Consider pertinent IRC section references such as:
 - a) **IRC §446**
 - b) **IRC §6001**
 - c) **IRC §7525**
 - d) **any other related sections**
4. Review the **IRM-Examination Handbook Part 4.10**; determine if Auditors' procedures/ADJs are appropriate.
5. Analyze and document your basis of **requesting** and/or **not requesting** the auditor's work papers.

[illegible]

	Done-Yes	N/A-No	Disposition/Comments:
D. Inform the client of any proposed adjustments and determine a strategy utilizing the ranking of the adjustments. Discuss the client's willingness to pursue marginal issues with a low probability of success and document conclusions.	_____	_____	
E. Segregate adjustments into negotiable and non-negotiable categories. Determine appropriate resolutions.	_____	_____	
<u>IV. Engagement Analysis</u>			
A. Perform detailed review the revenue agent's report (RAR) to verify accuracy of content and computations.	_____	_____	
B. Arrange to meet with client to explain RAR results.	_____	_____	
1. If the client agrees with the changes, instruct the client to sign the RAR, make arrangement for payment (if applicable), and mail it to the appropriate address.	_____	_____	
2. If the client wishes to pursue matters beyond this engagement, document and explain the potential available options and courses of actions.	_____	_____	
C. Determine and quantify the effects of the RAR on carryforward items, document the findings, note recommendations, prepare & distribute supplemental report.	_____	_____	
D. Ensure copies of the RAR are properly routed to the appropriate client/office files.	_____	_____	
<u>V. Post-Engagement Case Management</u>			
A. Ascertain and document client feedback and review firm and individual staff performance determining whether:	_____	_____	
1. Required engagement checklists, forms and other required documentation and procedures have been properly	_____	_____	

Program Key:

Every **"No"** or **"N/A"** answer requires a detailed explanation or inclusion of a brief memorandum.
Every **"Done"** or **"Yes"** answer requires a workpaper reference.