



Don't panic; don't assume you're in the wrong; work to state your case.

When you first notice the letter from the Internal Revenue Service (IRS), your first reaction probably will be panic followed by several questions:

- Why am I being audited?
- Did I do something wrong?
- Where did the IRS get these figures?

To help lower your heart rate and answer your questions, let's review the IRS procedures. This helps us gain a better understanding

of what's going on. We want to emphasize that you should respond *promptly* after receiving the audit letter. Ignoring it will only create a problem.

Types of audits

There are three basic categories of IRS audits. In order of involvement, they are:

1. Correspondence Audits: These generally are handled by mail.



Editor's note: Kent Vickre and Dwight Raab write a tax and finance column for each issue of *Pioneer GrowingPoint*® magazine. Vickre is the state coordinator of the Iowa Farm Business Association. Raab is the state coordinator of Illinois Farm Business Farm Management. They address issues that influence agribusiness success.



2. Office Audit: The audit is performed at the IRS office.
3. Field Audit: These audits typically take place at the taxpayer's place of business. However, you may request the audit take place at your tax or legal representative's office.

Correspondent audit

The most common audit notice a taxpayer receives is the CP2000 Notice, "Notice of Proposed Adjustment for Underpayment/Overpayment." These account for the majority of audits. The IRS uses the Automated Underreporting System (AUR) to match the reported amounts against your tax return. This IRS information comes from W2 and 1099 forms submitted by your employer, banks and other payers. If the program notices a discrepancy, it generates the CP2000 Notice.

Keep this in mind: This is a proposed change to your tax return. Be sure to review the information in the "Showed on Return" column and compare it to the "Reported to IRS (or proposed by IRS)" column.

We always urge taxpayers to discuss these IRS notices with their tax preparer. Sometimes the discrepancy is simply because the amount is entered on a different line or schedule. This can easily happen if you haven't given all your 1099 forms to your tax preparer.

For example, you may have entered cash rent income as miscellaneous farm income, hence your tax preparer reported it on your Schedule F form. However, the person paying you the cash rent reported it to the IRS on a 1099 as rent, which should be reported on the Schedule E form as "Rent Income." The reported amounts don't match your tax return, which triggers a CP2000 Notice.

After reviewing the notice, follow the instructions on the notice by either agreeing with the changes and paying any tax deficiency, by disagreeing with some of the proposed changes or by disagreeing with all the proposed changes. If you disagree with any of the information, you'll need to provide an explanation and documentation when returning the form. You can either call or mail your response as stated on the notice.

Office and field audits

When we hear the phrase "IRS audit," we tend to think of these more-involved audits. Reasons the IRS selects you for such an audit may include:

- Random selection: You're picked by statistical formula.
- Document matching: We explained this above.
- Computer screening: A process where your tax return is compared against a "norm" for a similar return. Then, depending on the comparison, the return is reviewed by experienced auditors and managers. Based on their review, an auditor may contact the taxpayer.
- Related examinations: Returns may be selected if they involve issues or transactions with other taxpayers — such as business partners — whose returns were selected for an audit.

The IRS will notify you by either mail or phone (this will never be

announced via email). The audit notice will include several items for you to review such as Publication #1 ("Your Rights as a Taxpayer"), Notice 609 ("Privacy Notice Act") and/or an Information Document Request.

Marshal your forces

At this time, we suggest you contact your tax preparer and discuss the amount of involvement you want from him or her. This is your decision; you can represent yourself, have the tax preparer accompany you to the audit or have them attend the audit as your representative.

The actions a representative can take on your behalf depend on the type of individual, the instructions for Form 2848 ("Power of Attorney and Declaration of Representative," see Part II) and Form 8821 ("Tax Information Authorization"). Having a tax expert on your side typically helps resolve the audit more quickly.

To get prepared for the audit, review the Form 4564, "Information Document Request." This list contains the items the examining agent will want to review. Be sure to have all information requested: Typical items will include bank statements, canceled checks, receipts, etc.

Provide proof

Remember, an audit isn't an accusation of error. However, you do have the burden of proving to the auditor that the information on your return is accurate. If you discover you've lost records, reconstruct them as accurately as possible. Ask vendors for duplicate receipts or copies of any missing 1099s. By providing all the information requested, the audit can move along more quickly.

The audit may consist only of a meeting that lasts a few hours or it could consist of numerous meetings. At the end of the first IRS appointment, the auditor will discuss a mutual commitment date. This is the date the auditor expects to issue a report of proposed changes or determines there will be no change. This date is based on the information known after the discussion of mutual responsibility. The date can be modified if necessary.

Anticipating the outcome

When the audit winds up, you can expect one of three outcomes:

- No change: The taxpayer has substantiated all the items the IRS has questioned.
- Agreed: The IRS has proposed changes, and the taxpayer understands and agrees with those changes.
- Disagreed: The IRS has proposed changes, and taxpayer understands but disagrees with the changes.

If you agree with the audit, you'll be asked to sign the report and pay whatever money you may owe. If you disagree, you can appeal to the agent's supervisor. If needed, you can appeal to Appeal Office of the IRS. If necessary, your next appeal would be in U.S. Tax Court.

For more information and details on IRS audits, visit <http://www.tax.gov/Individual/audits>.

If the IRS contacts you, the important thing is to avoid panicking. Start making plans to discuss your case calmly to find a fair solution. 