



Who's Afraid of an IRS Audit?

Your chances of being audited are increasing.

BY JAMES D. KRICKETT

Surprisingly, the IRS's own figures reveal that, in general, only one or two percent of all taxpayers actually have their returns audited each year. **However, once a large and inefficient federal bureaucracy, the IRS is changing to become more streamlined and, most importantly, catching more tax offenders.**

The IRS enforces the tax law in a number of ways; the more common methods include correspondence (examination by mail) and field (face-to-face audit) examinations. Thus, it is little wonder that one of the more nerve-wracking aspects of taxes for many podiatry professionals is the possibility they and/or their practice will be audited.

According to the latest figures, the IRS audited almost 1.1 million tax returns, approximately 0.5 percent of all returns filed in 2016. The majority of audits conducted

during 2017, 70.8 percent, were via correspondence. The remaining 29.2 percent were field audits. Of the more than 1.1 million audits, almost 34,000 resulted in additional refunds totaling more than \$6.6 billion.

A Smaller Target

Computers are less forgiving than humans. Any podiatrist who hopes to survive and thrive under the new algorithm-based IRS, should follow a few guidelines.

- Always be prepared for scru-

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Agents in back offices are being replaced by computers with complex algorithms that cast a wide net, one that pulls many law-abiding people into the chaos of an audit. The result is that many podiatry practices—and their principals—are being scrutinized far more often than the numbers indicate.

Understanding the tax rules and potential red flags is essential to knowing what information should be saved and for how long.

- Be prepared to move quickly. Information Document Requests (IDRs) and face-to-face audits now move on a shockingly fast timeline

Continued on page 78

IRS Audit (from page 77)

so have a plan of action. Build a relationship with an accountant who can step in quickly when you get the dreaded IRS audit notice.

- Hire a professional. Hiring a professional to prepare the returns is more likely to reduce the chances of errors

ments. Some businesses and practices are required to make quarterly estimated tax payments during the year. If filing as a sole practitioner, a partner, an S corporation or a self-employed professional, estimated tax payments will have to be made if a tax bill of \$1,000 or more is anticipated.

fication issues arise when employers misclassify employees as independent contractors or other non-employees and fail to withhold and pay employment taxes. Fringe benefits issues involve property, a service or cash received that should be treated as taxable wages but are not.

The IRS's 2016 Data Book indicates a greater-than-40 percent increase in all employment tax civil penalties assessed in 2016 from those in 2015. This appears to signal that a greater focus on employment tax enforcement is underway and likely to continue.

In addition to worker classifications and fringe benefits issues being a large target for IRS auditors, according to the latest available figures, as of December 2016, 1.4 million employers owed approximately \$45.6 billion in unpaid employment taxes, interest, and penalties. Lawmakers, as well as the IRS, are aware that noncompliance with employment taxes, such as withheld income taxes, Social Security, and Medicare taxes, is a growing problem.

Employment taxes, including withheld income, Social Security, and Medicare taxes, account for nearly 70 percent of taxes collected by the IRS.

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or overlooking important information that should be taken into account.

- Be honest. While it may be tempting to lie about income or expenses, those who are honest are going to fare better when it comes to avoiding an audit and “surviving” one.

- Watch the deductibles. If not handled correctly or honestly, deductions can be a huge red flag that leads to an audit.

- File electronically. When tax returns are filed electronically the risk of errors from information being keyed in are reduced substantially.

- Consistency is key. Inconsistencies in paperwork happen even to honest people when the accounting is not handled professionally. The IRS, however, is increasingly seeing discrepancies as fraud until proven otherwise.

- Expect no mercy. IRS agents are being allowed no wiggle room and no grace. This attitude is being passed on to the podiatry practices they deal with.

Look What the Auditor Found

When operating a podiatry practice, avoiding costly penalties, fees, and audits is crucial. Among the most common tax mistakes made by those operating a practice include:

- Failing to file and pay taxes on time. Determining the correct tax form and its filing date depends on the structure of the podiatry practice. If, for instance, the practice operates as an S corporation, Form 1120S is used (due on March 15). With a sole proprietorship Schedule C must accompany the Form 1040 (due on April 15).

- Forgetting estimated tax pay-

- Not taking practice or business deductions... or taking excessive deductions. The most commonly overlooked deductions include depreciation, the decrease in asset values over time due to wear and tear; out-of-pocket expenses purchases of new equipment; and automobile expenses. Taking excessive deductions or mixing personal and business deductions are a definite no-no and can lead to a federal tax fraud charge.

- Keeping poor records. With good records, all practice-related expenses can be deducted, inventory tracked and managed, employee payrolls main-

tained—and reported—and the potential for costly errors eliminated.

- Misclassifying employees as contractors. A podiatry practice may treat workers as independent contractors to save money, as payroll taxes are not due for contractors. However, this can end up costing the podiatry practice should the IRS disagree with the label applied.

Employment Tax Bug-a-Boos

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The Trust Fund Recovery Penalty is a weapon that allows the IRS to assess a civil penalty against any “responsible person” who willfully fails to pay over a practice’s withheld employment taxes. A responsible person can be the podiatry practice’s manager or bookkeeper, its principal(s), its payroll service, its accountant—or all of them. What’s more, the rules also make it a crime to willfully fail to collect or pay over these taxes.

Partnerships Versus Partners

The Bipartisan Budget Act of 2015 replaced the rules governing partner-

Continued on page 80

IRS Audit (from page 78)

ship audits with a new centralized program that, in general, assesses and collects tax at the partnership level. Under the new rules that kicked in this year, any income tax resulting from an adjustment is assessed and collected at the partnership level—not from the partners. It is a similar story with any penalty, addition to tax, or additional amount related to an adjustment which is determined at the partnership level.

The new rules outline the procedure a podiatry partnership can use to elect out of the centralized partnership audit program. Only an eligible partnership, one that has 100 or fewer “eligible” partners, may elect out of the centralized partnership audit regime.

An eligible partner is any person who is an individual, regular ‘C’ corporation, eligible foreign entity, S corporation, or the estate of a deceased partner. Unlike other sections of the tax law, a husband and wife are not treated as a single partner for these purposes.

Poor Documentation Is a Death Sentence

Many podiatrists, even those with no intent to commit fraud, all-too-often fall short when it comes

three years from the date the return is filed.

The IRS will usually provide a written request for the specific records needed. If records are kept electronically, the IRS may request those in lieu of or in addition to other types of records.

working documents are easily accessible? Should it be at the location where the podiatrist practices, or the place where all the records are kept to demonstrate to the IRS auditor that there is nothing to hide and that the operation is a legitimate one? Or, should the podiatrist, the practice’s

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Taxpayer Rights

The Taxpayers Bill of Rights, part of the IRS Restructuring and Reform Act of 1998, requires the IRS to provide a written statement detailing the taxpayer’s rights and the IRS’s obligations during the audit, appeals, refund, and collection processes.

These rights include:

- A right to professional and courteous treatment by IRS employees.
- A right to privacy and confidentiality about tax matters.
- A right to know why the IRS is asking for information, how the IRS will use it and what will happen if the requested information is not provided.

manager and/or the its representative trudge down to the IRS office armed only with the specific documents and information requested by the IRS auditor? Not too surprisingly, there is no one right answer.

Hurry and Get It Over

The increased emphasis on small professional practice and business tax audits comes hot on the heels of an IRS announcement that it hopes to speed up the audit process with something called the Fast Track Settlement (FTS) program.

The IRS’s Small Business/Self-Employed Fast Track Settlement program (SB/SE FTS) was created to provide an expedited process for resolving disputes with small businesses and professional practices. SB/SE taxpayers that currently have unagreed factual or legal issues in at least one open year under examination can work together with SB/SE and the Office of Appeals to resolve outstanding disputed issues while the case is still in SB/SE jurisdiction. Once an application is accepted, the IRS’s goal is resolution within 60 days.

Having the Last Word

Until a podiatrist agrees with the IRS, the appeals process remains open. Most importantly, from the initial screening for accuracy that each return receives up to the final appeal has been exhausted, mistakes in the favor of the taxpayer are discovered

Continued on page 82

Many podiatrists, even those with no intent to commit fraud, all-too-often fall short when it comes to documentation and paperwork.

to documentation and paperwork. The IRS appears increasingly determined to find and audit those who fall short. Once sent by the IRS only to those suspected of failing to comply with the tax laws, IDRs are being sent out in record numbers as a screening tool. Even if a podiatrist, or his or her practice, pays its taxes dutifully, it may be penalized for lacking documentation. After all, the law requires every taxpayer to retain the records used when preparing the tax returns. Those records generally should be kept for

- A right to appeal disagreements, both within the IRS and before the courts.

Among the most important of the rights given every taxpayer whose returns are targeted for an audit is whether to be represented by a tax professional, or whether to attempt to answer the IRS’s questions alone. Another important consideration for everyone and every podiatry professional or practice being audited is where to hold that meeting.

Should the meeting be in the accountant’s office where all of the

IRS Audit (from page 80)

in about 25 percent of all cases.

Whether it is a field audit, office audit, or a correspondence audit, at the end of the examination, a 30-day letter will be issued. If the IRS is correct, within 30 days, the examination

representative is usually more knowledgeable and empowered to be more lenient. Of course, even here, the podiatrist does not have to agree. While the additional taxes demanded by the auditor go unpaid, the interest and any penalties continue to accrue. But further appeal is still possible.

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report can be signed and the new assessment paid. Anyone failing to agree with the examiner's findings can appeal at any time before the 30 days is up. An appeal handled by an IRS Appeals Officer can take a year or longer during which the tax bill remains in limbo.

A disagreement over an auditor's findings is usually referred to the appellate level of the IRS where the

Until an agreement is reached with the IRS, from the initial screening of the tax returns for accuracy that each receives, until the final appeal has been exhausted, the appeals process remains open, and payment of the contested tax bill need not be paid. Even better, mistakes in the favor of the taxpayer are discovered in about 25 percent of all cases.

In the past, the IRS was often quite sympathetic to honest mistakes and more than willing to discuss under-payments of taxes that might have resulted from the many so-called "gray" areas of our tax rules. On occasion, they might even negotiate the amount of tax due. While they have never liked fraud, IRS auditors now find their actions limited.

Honesty and clarity go a long way toward preventing, dealing with, and surviving an IRS audit. Naturally, every podiatrist, as well as the podiatry practice, should have a strategy for avoiding audits as well as for dealing with an IRS auditor. A fallback position should those strategies fail should also be in place. **PM**

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James D. Krickett is a well-known tax and financial adviser whose columns are syndicated to more than 65 publications each week. His features routinely appear in the pages of leading trade magazines and professional journals.