



# Audits

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### Representation

Individual taxpayers who are under audit by the IRS may attend the audit in person without any assistance from a tax professional. However, this can be a dangerous mistake. Although not officially stated, it is the job of an IRS Revenue Agent to conduct an audit with an eye toward finding additional tax owed. With so many gray areas in tax law, and considering the tax code's complexity, an individual who chooses to go it alone is a sitting duck. With extensive tax education and experience, the examiner can take a position to find additional tax due on the return. Without the necessary knowledge, the typical individual is powerless to refute the agent's rationale.

### Selection of Returns for Examination

#### Search for Unreported Income

The IRS performs matching functions to reconcile information reported on Forms 1099 and W-2 with information reported on your return. If income reported by you does not meet or exceed amounts reported to the IRS, you will receive either a bill for tax on the difference or an audit notice.

#### Worker Reclassification Efforts

The IRS conducts employment audits to determine whether workers classified as independent contractors are in fact employees.

#### Schedule C (Form 1040), Profit or Loss From Business

Issues associated with sole proprietorships are common audit triggers. The IRS has several approaches to achieve an increase in income tax, as well as the assessment of self-employment tax.

- **Unreported income.** There is a relatively high potential for unreported income from cash transactions with sole

proprietorships. The IRS will examine your bank records to detect deposits that are unaccounted for, compare revenue and expenses of similar businesses, and in some cases will perform a "lifestyle" audit to reconstruct income based on changes in the sole proprietor's net worth.

- **Losses.** Significant losses reported on Schedule C (Form 1040), or losses continuing over two or more years, may increase the chance of audit. If the IRS is successful in reclassifying an activity as a hobby instead of a for-profit business, losses will be disallowed.
- **Bartering.** The fair market value of products and services received through bartering can be considered business income if the products or services rendered are associated with the sole proprietorship. If the sole proprietor trades through a barter exchange program, the program will issue Form 1099-B, *Proceeds from Broker and Barter Exchange Transactions*.

### Audit Procedures

#### Examination by Mail

**Notice CP 2057.** A CP 2057 notice informs you that there appears to be an income discrepancy on your return. The notice instructs you to review the return and file an amended return to correct the information, if necessary.

**Notice CP 2000.** A CP 2000 notice from the IRS proposes changes to your tax return based on information the IRS has received from third party sources (i.e. Forms W-2, 1099-INT, 1099-MISC, etc.) that the IRS believes has not been reported on your return. You typically have 30 days to respond to the IRS with one of three options.

- To agree with all the proposals.
- To partially agree with the changes.
- To dispute all the changes proposed by the IRS.