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Tips on Surviving an IRS Audit

Just the word "audit" can put the fear of God into people, especially those who own small businesses still trying to establish themselves in today's competitive market. There's no doubt going through an IRS audit can be a stressful time for anyone, but by following simple tips you can make it a less frustrating experience. With some planning and a clear picture of what the IRS is looking for, you should increase your chances for a relatively pain-free audit.

So, what exactly is the IRS looking for? The bottom line is that IRS auditors are experienced in tracking down the truth when it comes to your business's income, assets, and liabilities. They'll likely scrutinize your business practices and check for any errors you may have made in the filing process to make sure you've paid every dime you owe. The following areas are those most typically gone over with a fine-tooth comb:

- **Unreported income.** The IRS will seek out (and most likely find) any amounts that were left off of your tax filing--whether accidentally or intentionally omitted--and assess tax, interest, and penalty charges on any missing amounts. Should the IRS auditors find proof of significant fraud, you may find yourself facing criminal prosecution and jail time. Bottom line: report all income to the IRS, since it's better safe than sorry. You may also want to think about hiring a tax professional to help you out during the audit process.
- **Personal vs. business expenses.** You should be ready to prove that all costs you've claimed as business expenses were, in actuality, business-related and not for personal uses. Auditors will pay particularly keen attention on deductions categorized as entertainment, meals, travel, and transportation. Retain all your receipts and be ready to provide specific answers to questions about how each expense relates to your business. You may want to make notes on the backs of receipts at the time you incur the expenses so

you aren't trying to jog your memory months later. Maintaining detailed expense logs may also be a good idea.

- **Employee or independent contractor?** If your business makes use of independent contractors, the IRS is going to want to verify that they truly are an independent contractor and not an employee disguised as an independent contractor so you can avoid paying payroll taxes on that individual. If the worker in question has a business of his or her own and offers services to other businesses, the IRS will probably agree that the worker is indeed an independent contractor. If, however, you control where, when, and how the individual works, the IRS may consider that person an employee. You don't want to misclassify a worker because you may face increased taxes, interest, and penalties--making your mistake an even more costly one.

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