Ten Mistakes People Make with an IRS Audit

By Lee R. Phillips, JD
and Ben Rucker, EA

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Congratulations!! You are probably one of the "lucky" ones to have received an audit notice from the IRS. There are a number of different types of IRS audits, so which type are you dealing with? You have to deal with it, so what are you going to do? Will you get outside help, or go it alone? Should you get outside help? The IRS has said they are looking at one aspect of your business return. Can the IRS open up and now look at your other business returns and your private return? Can the IRS turn this investigation into a criminal action, or can they only get more money from you?

So many questions, and I'll guarantee you're not going to get many answers from the IRS. In this ebook, we will try and answer most of your questions as succinctly as possible. I am Lee R. Phillips, an attorney, and I am working with my associate, Ben Rucker. As an attorney, I have dealt with asset protection issues for forty years. I maintain that the IRS is your biggest asset protection threat. I am admitted to practice in the Federal Tax Court, Federal Court of Claims, and United States Supreme Court. My latest case is a $2 million tax case in the Federal Court of Claims.

Ben Rucker is an accountant. He is an enrolled agent, which means he knows a lot more about taxes than a CPA. CPAs are just bookkeepers. An enrolled agent actually deals with the IRS. Ben is on the good side of the table, your side of the table, but he understands the IRS very well. He spent 8 years as a special auditor/agent for the IRS handling their biggest criminal cases. He taught IRS agents how to audit a taxpayer, what to look for during an audit, and how to nail the taxpayer to the wall. So, he understands exactly what the IRS can do to you and how they do it. Who better to have on your side today?

We mostly handle tax resolution cases, where the client has already been through the audit and the IRS is coming after them for more money—a lot more money. Last year we handled a case where the ten "big shots" in a company each owed the IRS over $10 million. We settled the case for pennies on the dollar, and we kept all ten of our clients out of jail. Yes, this was a criminal case, and the IRS was looking for blood. They were going to make an example out of them.

If you haven't received an IRS audit notice, I'm sure you are worried about getting one. Otherwise, you wouldn't be interested in this ebook. The good news is, we aren't going to beg you to be our client. Get your local accountant to represent you in the audit. When the IRS is hot on your tail and they are looking for blood after the audit, then contact us. We actually do the tax resolution work for a lot of the "tax attorneys" that advertise on the radio and TV. They pick the low hanging fruit that they can easily resolve, and then they farm out the hard stuff to us.

You have to understand that the IRS isn't there to help you. The old adage, "Hi. I'm from the government, and I am here to help you," is a pure fantasy. The IRS will extract money and/or flesh from you, and that's what they aim to do. The only reason an IRS agent puts on a nice act for you is to get you to talk. They are taught to be buddies with you in order to get information. The nicer the guy or gal from the IRS is with you, the more trouble you are in.

The individual agents may or may not play by the rules. Extortion isn't above the IRS agents, and unfortunately the entire agency is moving to a mafia stance rather than being a law and order player.

IRS Extortion

I had a mail audit notice a couple of years ago from the IRS. The IRS said that the medical bills I had been reimbursed for by my Health Savings Account (HSA) were not authorized medical expenses. Plus, they said they were disallowing my IRA contribution. The IRS agent disallowed all $13,352 of claimed expenses and said we owed another $3,791 in taxes. My wife happened to have ALS (she has since died). We had tens of thousands of dollars in actual medical expenses every year. My measly $6,852 in medical expenses were certainly valid medical expenses, and if the IRS didn't like those, I could get ten more groups of $6,852 in medical expenses they might like. I have no clue why they disallowed the IRA contribution.

I carefully collected the receipts and explanations for all of the claims we had made on the HSA and the IRA contribution. I sent everything into the IRS and figured that the case was closed. Nope! In a few weeks I got a letter saying that all of the expenses were disallowed and that I owed the $3,791 in taxes. There was a letter stating that if we didn't agree with the audit results, we could file a case in tax court.

At that point, the average person would head down to their attorney's office. The attorney would explain how he could win this case in a slam dunk. The client would be salivating for a bite at the IRS, because the IRS had kept him up nights and was always on his mind. The attorney would be egging the client on to dreams of victory. Then the attorney would say, "Oh, by the way, that will be a $10,000 retainer fee, and I am sure we won't go over a total of $20,000."

At that point, the client starts weighing his options. On the one hand, he could pay the IRS $3,791, and the whole issue would be finished. But, that's not fair!! The IRS is clearly wrong. On the other hand, the client could pay the attorney somewhere between $10,000 and $20,000 and have a real good chance of winning the case. Of course, if he won the case, he wouldn't owe the IRS a dime—saving $3,791. Let's think. What should the client do?

I went to see Ben, the former IRS auditor, in a rage. (He is in the office suite next to mine.) "Look at what the IRS has done. How stupid could they be," I screamed. Ben quietly said, "Ya, that's what the IRS does. You are going to pay them the $3,791, and the guy auditing your case will get a feather in his cap for collecting money from you." "That's extortion," I screamed. Ben calmly said, "Yup, that's the way it works."

Well, the IRS played that trick on the wrong guy. I immediately filed a case in Federal Tax Court. Sure enough, the attorney assigned to the case took one look at my receipts and said that the IRS agent obviously didn't know what he was doing. He declined to prosecute the case. I was off the hook.

I may have been off the hook with the IRS, but it had cost me a ton of time and frustration. Anyone else would have also lost a lot of money and time fighting the IRS. I guess I did lose a lot of money, because my time and Ben's time filing the case was time lost and represented a lot of money lost. But, I won and it was the principle of the thing.

It's a Mistake

One of my first experiences fighting the IRS was in 1982. A man had started a business, and it was up and running pretty good. He got an audit notice from the IRS that said he owed taxes for 1979. But wait. He hadn't even started his business until late 1980. They were saying he owed taxes for the year before his business even opened the doors. The IRS said the business owed a lot of taxes—more taxes than his gross business income in 1981.

He fought off the IRS for a few months, then he was diagnosed with advanced cancer. He and his wife went to the big university clinic for treatment. Nobody was really paying attention to the mail at home, and the IRS sent him a 10 day notice. "Pay up within ten days or else," it said. The man was in the hospital in critical condition, and he totally missed the ten day notice. His wife wrote out a check one day, and the check bounced. She went down to the bank to see what had happened. The bank informed her that her bank account was gone. The IRS had come in and closed it three days earlier and had taken all of her money. Sure enough, the business account had been closed and confiscated too. The other partner in the business had lost his personal account too. There was enough money in the business account to pay the tax bill, but the IRS had taken everything—business *and* personal. Just to make sure the IRS was protected, they placed liens on both of the owners' houses.

This poor man was dying of cancer and had now been wiped clean financially. He got accountants involved, and I got involved. Finally, I found someone in the IRS that agreed that the IRS had made a mistake. It took a year and a half to resolve the matter, and the poor man spent over $8,000 fighting the IRS.

The IRS paid back all of the money they had taken—with interest. But there was never a recognition or remuneration to compensate for the fact that the man had lost his business. He had to let all of the employees go, because he didn't have any business or personal money to pay them. The IRS didn't care if six people were unemployed. The IRS didn't care that the man was being sued because he couldn't fulfill his contracts. None of that mattered. The IRS had made a mistake, which destroyed the man's life. He was on his deathbed and his thoughts were for his wife and family who had nothing.

Make More Money

Over the last forty years, I have helped thousands of people make more money by cutting their tax bill. I get real satisfaction by taking someone who's paying a fortune in taxes and helping them cut their tax by maybe 20% or even 30%. Last year Ben and I helped a man make an extra $723,480 in spendable money, just by cutting his tax bill. His accountant had screwed him the year before by failing to point out to him that if he took a bigger salary instead of "distributing" most of his income to himself out of the company, that would allow him to maximize the 199A 20% deduction. We used a computer program our company wrote to calculate how much salary he had to take so he could get the maximum benefit out of 199A.

He didn't know and his accountant didn't tell him that he had to take the salary long before his end of year tax calculations were made. We take high-end taxpayers and "coach" them all year to show them how to "create" the numbers they will give the accountant at tax time. All through the year, you are creating the "tax numbers" your accountant will use to figure your tax bill. Most accountants don't get involved until long after the end of the calendar year. At that point, it is too late to do much to affect the numbers the accountant will use.

You have to think all year long. What are the tax consequences of the way I am structuring this deal or that financial transaction? Could I structure this transaction differently so there is a better tax outcome? I am called in to help structure big lawsuit settlements, because how the suit settlement is "structured" can make a huge difference in the tax outcome. We can often put 50% more money in a client's pocket by just structuring the deal with taxes in mind. Ben and I take high-end taxpayers and help them on a month by month basis so we can show them how to evaluate their tax situation as they go along through the year. They may pay us $10,000 or $15,000, but they will often get ten times that in tax savings. Even if they only get twice their money back, or just break even, they have learned how to "think taxes" and that will help them put more money in their pocket year after year.

Only the wealthy and smart folks come to us to learn what to do. They all have the best accountants in town, and that's great. They keep their accountants, but they just learn to think differently when we show them what to do. Most people can't afford to have us work with them one on one, and we don't have enough time to work with the number of people who want us to help. To reach a broader audience, we have prepared a tax course for everyone who thinks they are paying too much in taxes. Just check out [Advanced Tax Tactics](), and let us help you put more money in your pocket.

But putting more money in your pocket isn't what this ebook is about. We are going to help you through an audit. Now let's get into the mistakes we see people making in their audit fights with the IRS.

Mistake 1
You Believe the IRS Randomly Selected You for Audit

The IRS did not randomly select you for audit. What is the IRS looking for? What triggered your audit? Once you figure that out, you can estimate how much trouble you're in.

Everybody talks about what your "audit risk" is. The IRS publishes statistics on what percentage of people get audited, and everybody just assumes that the statistics tell you what your random chance of audit is. The IRS doesn't operate randomly. Although, I will tell you that lots of taxpayers feel like the IRS is totally random in what it does.

Your return was selected for audit for some reason. One year Ben spent weeks at an East coast IRS center. For days, he was given stacks of tax returns on carts, and he had to look at each one to determine what was supposed to be out of the ordinary for that return. The computer had flagged each return because something was out of the ordinary. Why was there a problem with that return?

The Wrong Tax Code

How does the computer know what "ordinary" is?

On your tax returns there is a six-digit code. Most people don't pay any attention to the number, but it is critical. It is called a NAICS code (North American Industry Classification System). This code is very specific to the activities you do in your business. For forty years I have given lectures to companies and business groups on asset protection, business structures, taxes, and estate planning. When I am acting as a public speaker, I run all of those fees and expenses through my company, LegaLees LLC. There are dozens of codes for public speakers. They include motivational speakers, continuing education speakers, standup comedians, sales speakers, and many others. When you put your NAICS code down, the computer compares your return to everyone who has that same code. If your tax return doesn't fit with the "normal" profile of the business described by the NAICS code, then the computer kicks out the return for a human to look at it.

In my early years, I wasn't as much into taxes as I am now, and I had the biggest accounting firm in town doing my taxes each year. Ben's folks do my taxes now, because even the thought of filling out a tax return makes me shake, I don't mind suing the IRS. But I sure don't want to fill out their tax forms.

In the early years, I would get audited every three years. I assumed the IRS was targeting me because I wrote about how people could save taxes. My big accounting firm was putting a NAICS code in my tax returns that classified my public speaking as a small retail store, because they saw income from "sales" when I spoke. When I speak publicly, I sometimes sell self-study courses about legal and tax topics. I have sold almost $100 million worth of my self-study courses. They are very valuable to people. Go to LegaLees.com to see how many there are.

My big accounting firm knew that I sold "stuff," so they figured I was like a small retail store selling stuff. They put a NAICS code on my return that told the IRS I was a small retail store. The wrong code was triggering an audit every three years. My tax return was showing $150,000 a year in travel expenses. Yes, I travel a lot. The computer compared my expenses to other small retail store owners and flagged my return every time. No other small retail store owner had anywhere near $150,000 in travel expenses. The computer flagged my returns and the agents looked at the travel expenses and said, "No way."

Since Ben changed my NAICS code to independent speaker, I haven't been audited. Independent speakers travel, and that justifies the travel expenses. If you are filing any type of a business return, you need to look up the code that is being used and make sure it exactly matches what you are doing in your business or real estate. You can look up the NAICS codes at https://www.naics.com/naics-code-description. The codes are supposed to be written down in different places on different tax returns. The IRS tax forms don't just say NAICS code. Different forms call for the NAICS code using different names for the number code. Where you will enter the NAICS codes on the different returns is shown on the next page.

Check your NAICS code, because that's a primary way the IRS evaluates your tax return and compares it to other returns in your code category to see if you are "normal."

The Wrong Business Structure

The type of return you are filing also has a huge impact on your chances of being selected for an audit. If you file a 1040 return with a Schedule C or Schedule E, your chances of an audit go way up. It isn't the raw fact that you are filing a Schedule C or Schedule E, but it is internal to the IRS. Any IRS agent can audit a return with a Schedule C or Schedule E. Biden increased the number of IRS agents and audits by 300%, or at least that was his goal. In his first 100 days, he started the wheels turning to put an extra $95 billion into the IRS to make sure the IRS increased its audit capacity. That means more fun for taxpayers.

Where to Enter NAICS Code

SCHEDULE C (Form 1040)
Department of the Treasury Internal Revenue Service (99)

Profit or Loss From Business
(Sole Proprietorship)
► Go to *www.irs.gov/ScheduleC* for instructions and the latest information.
► Attach to Form 1040, 1040-SR, 1040-NR, or 1041; partnerships generally must file Form 1065.

OMB No. 1545-0074
2020
Attachment Sequence No. 09

Name of proprietor | Social security number (SSN)

A Principal business or profession, including product or service (see instructions) | B Enter code from instructions ►
C Business name. If no separate business name, leave blank. | D Employer ID number (EIN) (see instr.)
E Business address (including suite or room no.) ►

Schedule C—Sole Proprietorship—Enter NAICS in Box B, Code from instructions

Form 1120 (2020) Page 4

Schedule K **Other Information** (see instructions)

		Yes	No
1	Check accounting method: a ☐ Cash b ☐ Accrual c ☐ Other (specify) ►		
2	See the instructions and enter the:		
a	Business activity code no. ►		
b	Business activity ►		
c	Product or service ►		
3	Is the corporation a subsidiary in an affiliated group or a parent-subsidiary controlled group? If "Yes," enter name and EIN of the parent corporation ►		
4	At the end of the tax year:		

Form 1120—Corporation Return/Schedule K Page 4—Enter NAICS on Line 2 Box A, Business activity code no.

Form **1120-S**
Department of the Treasury Internal Revenue Service

U.S. Income Tax Return for an S Corporation
► Do not file this form unless the corporation has filed or is attaching Form 2553 to elect to be an S corporation.
► Go to *www.irs.gov/Form1120S* for instructions and the latest information.

OMB No. 1545-0123
2020

For calendar year 2020 or tax year beginning , 2020, ending , 20

A S election effective date | TYPE OR PRINT | Name | D Employer identification number
B Business activity code number (see instructions) | | Number, street, and room or suite no. If a P.O. box, see instructions. | E Date incorporated
C Check if Sch. M-3 attached ☐ | | City or town, state or province, country, and ZIP or foreign postal code | F Total assets (see instructions) $

G Is the corporation electing to be an S corporation beginning with this tax year? ☐ Yes ☐ No If "Yes," attach Form 2553 if not already filed

Form 1120S—S Corporation Return—Enter NAICS in Box B, Business activity code number

Form **1065**
Department of the Treasury Internal Revenue Service

U.S. Return of Partnership Income
For calendar year 2020, or tax year beginning , 2020, ending , 20 .
► Go to *www.irs.gov/Form1065* for instructions and the latest information.

OMB No. 1545-0123
2020

A Principal business activity | Type or Print | Name of partnership | D Employer identification number
B Principal product or service | | Number, street, and room or suite no. If a P.O. box, see instructions. | E Date business started
C Business code number | | City or town, state or province, country, and ZIP or foreign postal code | F Total assets (see instructions) $

G Check applicable boxes: (1) ☐ Initial return (2) ☐ Final return (3) ☐ Name change (4) ☐ Address change (5) ☐ Amended return

Form 1065—Partnership Return—Enter NAICS in Box C, Business code number

When you file a business tax return, for either a corporation or an LLC taxed under Subchapter S or Chapter C, your chance of audit goes way down, because only a fraction (on the order of 10%) of IRS agents are trained to audit those returns. You can see return audit rates in the following table. Looking at the table, your tendency will be to think your chances of an audit are random. The numbers are based on the number of audits in each category, but the returns that are audited are selected for a reason. What's the reason?

Audit Odds in Detail: 2018 vs. 2009

Taxpayer Category	Audit Rate % 2018	Audit Rate % 2009
Individuals — Nonbusiness		
Total gross receipts under $25,000 with Earned Income Tax Credits	1.4	2.2
Total gross receipts of $25,000 or more with Earned Income Tax Credits	1.0	1.8
Total positive income of less than $200,000 and no Earned Income Tax Credits or business tax forms	0.2	0.4
Total positive income of less than $200,00 with Schedule E (rental income) or Form 2106 (employee business expenses)	0.8	1.3
Total positive income of $200,000 to $1 million	0.9	2.3
Total positive income of $1 million or more	3.2	6.4
Individuals—With Schedule C or E and Gross Receipts of		
$25,000 to $100,000	0.9	1.9
$100,000 or more	2.1	3.7
C Corporations— With Assets of		
Under $250,000	0.4	0.7
$250,000 to $1 million	0.9	1.3
$1 million to $5 million	0.8	1 .8
$5 million to $10 million	1.1	2.7
$10 million to $50 million	4.6	10.1
$50 million to $100 million	10.6	14.3
$100 million to $250 million	9.7	13.6
$250 million or more	14.1	25.7
S Corporations	0.2	0.4
Partnerships and Multimember LLCs	0.2	0.4

Source: IRS Data Book, 2018, 2009

If your Schedule C or Schedule E is out of the ordinary, you'll pick up an audit every time. Schedule C businesses are sole proprietorships. They are usually small businesses with not a lot of profit. When the business gets bigger, you'll want to incorporate or form an LLC for asset protection purposes and tax reasons. The Subchapter S entities have tax advantages for a small business that Schedule C businesses can't give you. That's another story in our course, *Advanced Tax Tactics*.

We have been working with a client who got audited and lost to the tune of several hundred thousand dollars on his first couple of IRS battles before we got involved. We were able to get the amount he owed the IRS negotiated down by well under 50% of what the IRS said he owed, but we pointed out that the reason this person was audited was because he was filing a Schedule C with over a million dollars in profits. That tax return stands out like a sore thumb, because any operation that is big enough to have a million dollars in profit is always going to be a Subchapter S entity (corporation or LLC), not a sole proprietorship.

This particular person is in love with their old-time accountant, and the accountant says there is no reason to have a Subchapter S entity. This old accountant has never seen the table above and noted that a Schedule C with over $100,000 in profit is more than ten times more likely to be audited than a Subchapter S entity with the same profit. Actually, if the Schedule C shows a million dollars in profit, it is probably 100 times more likely to be audited.

The lovely old accountant told the person we were insane, and filed this person's last year's return with a Schedule C. Sure enough, we have gotten notice of their next audit. We haven't even dared to tell the person they are on the chopping block again, because official notice hasn't been sent out to the taxpayer yet. Because we have an IRS power of attorney for the client and have a high level status with the IRS, the IRS communicates with us electronically and we see anything associated with the client in real time when the IRS interacts with the client's file.

The Rat and a Criminal

It is possible that you are being audited because someone has turned you in. A tax snitch is rewarded by the IRS for snitching on you because the IRS will pay them 10% of whatever the IRS collects. The IRS is quite selective in what they audit from a tip. There are lots of people who try to sic the IRS on their ex-spouse, boss, neighbor, or whoever. The IRS knows that, and they don't chase every "lead" someone gives them. Actually, they chase very few tips. They need to have pretty good evidence before they follow a tip.

Whether it is through a tip, a business transaction, or some other way the IRS gets you on their radar, the IRS can conduct an audit to check you out. They are still not conducting a random audit. In fact, when the IRS is just "checking you out," this is a dangerous audit.

There are basically three types of audit.

1. A **correspondence audit** where they send you a request for more information about your return.
2. An **office audit** where they ask you to bring information into an IRS office and meet face to face with an IRS agent.
3. A **field audit** where they send one or more agents to your office or home to get more information. Field audits are actually rare, but I have been blessed with three field audits on my business.

The agent rolls into the office with a supervisor in tow, and they take over my conference room for a week. It ties up my secretary for a week and my accountant shows up several times. It costs me thousands of dollars in time and expenses. It costs the IRS a ton of money to keep two agents at my office for a week. My only satisfaction is the most they ever got was $3,000 because my accountant made a mistake. I don't see why they can't come in and do a two-hour audit and say, "Yep, this guy is making a good faith effort to pay his taxes." At that point, they could go audit someone who really isn't paying their taxes. Why do they have to come in and see every check, every receipt, and see if I am wearing clean underwear that day?

Whenever the agents have been here, they have stayed in the conference room, and we haven't associated with them except to deliver documents they wanted. An IRS agent is busy and business like. If an agent ever comes on to you as a buddy or wants to chit chat, that's when you need to change your underwear, because if you understand what's happening, you'll crap your pants.

The IRS will conduct a "lifestyle audit." They are trying to get you to talk about vacations, summer houses, cars, football games you go to, designer clothes, and the list goes on. They are trying to figure out what you do and what your lifestyle is. How do you justify a $500,000 loge at the local football stadium when you are reporting $50,000 in annual income? They are looking for a substantial underreporting in income. That's criminal, and you are on your way to jail.

The auditor will ask you what your car is, where you vacation, how many rental units you have, and so on. Of course, all of these questions are just part of "casual conversation." Ben says I would be stunned at how easy it is to get folks talking. He says they end up bragging about their wealth, business deals, real estate, and everything else. He related one case to me of a guy that lived in a multi-million dollar house and was getting earned income credit.

I asked how Ben knew to audit this guy. The computer kicked out his return because he was showing a $100,000 interest write off on Schedule A when he was showing $40,000 in income and claiming earned income credit. Ben went out to the guy's house and started building a cash "T chart" on the guy. He just started to write down the income on one side of the T and the expenses on the other side. It soon became obvious that the guy was substantially underreporting his income. There was no way he could even begin to pay his expenses on the income he was showing. I asked what happened to the guy, and Ben said he had no idea. Once he referred the case to the criminal division, he was through with the case, unless he actually worked on the criminal case.

As soon as the agent asks you a lifestyle question, you stop the interview, and you lawyer up. You have the right to stop an audit at any time. The agent will be back with a subpoena or find some way to get what he wants, but you can stop the audit at any time.

The bottom line is, don't be naive. The agent is not conducting an audit because your number was randomly picked out of a hat. Why are you being audited? What triggered the audit?

Mistake 2
You Fail to Respond Timely

Life is about timing. The IRS isn't much different. The vast majority of audits are correspondence audits. You get a letter from their IRS that says they need more information about your deduction, exemption, or some other part of your tax return. You'll assume they really want the information and that they will give you a fair hearing rather than play the extortion game like they did with me. Supply them the information they are asking for. If you have the evidence to back up your tax return, you are probably home free.

Make sure you answer timely. There will always be a date by which you are expected to answer. Answer the IRS before the due date. It gives the appearance that you are cooperating. Frankly, people (even IRS agents) like people who cooperate with them, and the cooperative person tends to get a little better treatment.

Most of the time with most of the agents, they are just doing their job, and if you can make their job easier, they like that. IRS agents have a list of "cases" they are working, and they get a mental satisfaction (if not an actual bonus) for getting a case off their plate. They are actually buried under cases most of the time. It makes their life easier if you answer timely and even early if possible.

When you answer, put a copy of the original audit letter in with your correspondence back to the IRS. I am sure you would be stunned to know that the IRS loses stuff all the time. It helps if you make sure your case number and other information is written all over everything you send to the IRS. If your information gets dumped off the cart with a ton of other pieces of paper, they need to be able to match each piece of your paper back to your case. So, make sure there is a case number or something that will tie each piece of paper that you sent them back to you.

Whenever you send anything to the IRS, spend the extra money and send each piece of mail by certified mail. More than once in my life I have gotten notice from the IRS that I didn't send something in timely or that I never filed my tax return, or something like that. I have always sent everything to the IRS with a certification on it. I have simply produced the certification and been able to prove that I sent the document to the IRS on a specific date. That has saved me penalties and saved my hide on several occasions.

Always keep a copy of everything you send to the IRS. If they lose what you send or say you never sent it, you'll have the certification and a copy of what was sent. It is easy for you to reconstruct the correspondence and prove that you sent it. The IRS has a log of what you sent, and if their log doesn't match your certified mail records, it's their problem. It's not your problem, at least in theory.

Today, pretty much all the correspondence Ben sends to the IRS is electronically delivered. With a power of attorney for a client, he can see almost all the records the IRS has on his client. Ben does the taxes for my 90 year old mother-in-law. She doesn't have to worry about saving all of the 1099Rs that come to her or the other things people send her about her year-end tax stuff. You know, the stuff you are supposed to save and give to your accountant. Ben can simply go to the IRS file and see everything anyone has filed associated with my mother-in-law's taxes. That's great, because he can make sure everything that has been reported to the IRS about her is reflected on her tax return. That cuts down the chances of an audit significantly.

Ben and his crew can see the dates the IRS has associated with your file and the actual correspondence the IRS has sent you. All this helps our client when we fight a case. The cases we handle are larger, and it definitely costs to have us represent someone in a fight with the IRS. With the information and the experience we have in dealing with the IRS, most of the time we can get at least the penalties all waived. A taxpayer himself or herself has a small chance of getting IRS penalties waived and no chance of getting IRS interest waived. Very often we get penalties and sometimes even interest waived, and those savings to the taxpayer more than pay for our fees.

The first case I ever worked on with Ben was for a man that had already spent almost $200,000 on accounting and legal fees fighting the IRS. He didn't have any appeals left and he had been given a final notice (pay up or go to jail) for a little over $700,000. He had about two weeks before the IRS said they were coming after his money or body. Within the two weeks, Ben had won a battle with the IRS and had gotten the amount this man owed to under one third what they said he had to pay and had gotten the penalties waived. We charged him a couple thousand dollars. We should have charged more, but this was the first time I had referred a client to Ben. Ben was fresh out of the IRS and didn't understand how valuable his experience was to a taxpayer. The man is a real estate developer/investor, and he has become a good friend who takes care of our real estate needs. Yes, we are real estate investors and small business folks, probably doing about the same things you are doing.

Mistake 3
You're Unprepared

The IRS is going to do its homework before they meet with you or review your correspondence. If you are meeting with an agent in their office or the agent is coming to your place, the agent is going to spend a fair amount of time reviewing your records. The agent knows what the IRS is looking for, and the agent will have done his/her homework before they ever lay eyes on you. In the discussion above, I alluded to the fact that the agent has a file on you, and they have access to computers that can see everything related to your taxes—and more.

For example, you may not pay much attention to it, but every time you do a cash transaction over $10,000, the IRS gets a report on that transaction. They don't get a report when you buy a car or something like that, but if you buy silver or assets like that, they get a report. This is all done under the pretense of preventing money laundering, but the IRS makes good use of it also.

The auditor will be paid to do some good old gumshoe detective work on you. The auditor will simply do a Google search on you. If you are advertising something, you will be saying how great it is, how many you have sold last year, how people can use the product to make a million dollars like you have. Doing a simple internet search, the auditor can get all the property you own, your employment, your companies, and a lot more. People tend to brag on the internet and paint themselves in a great light.

Ben Googled a guy he was looking at, and the local news had done a story on him about how great he was at real estate investing. Ben found over 50 pieces of real estate connected with the guy's phone number. Those phone numbers were on ads for the sale of the real estate all across the country. Funny thing, none of those sales had been reported. It's amazing what comes from Google searches, and social media is a treasure trove. What about all those pictures in the Bahamas that have the same dates that you were on a business trip to Miami that was a total write off?

IRS agents aren't limited to Google. The Accurint computer program is available to the IRS agents. It will give them everything about you. The family of the woman I just married paid to have a program check me out. It may not have been as powerful as Accurint, but they had all the dirt on me. Every piece of property I had ever owned, every employer I had ever worked for, every company I had ever created, even the photo cop in Sarasota that got me on a prohibited right turn on red. (That was a cheap shot. There was a little unlit sign that I missed at 4 am.)

The IRS agent can find out everything about you down to your latest credit card charges and what brand of underwear you have on and are soiling during your interview.

The agent is going to talk to you. He will ask you questions about your banking, your investments, your real estate. He already knows the answers to all the questions, but he is checking to see if you are telling him the truth. When you start lying, the agent knows you are lying, and he knows he has got you.

You will likely be stunned when you see what the IRS has on you. The auditor will show up with a file that can be inches thick. The auditor has reviewed your file. Not only will the auditor have reviewed your file, the computers have reviewed your file, and another IRS agent reviewed your file before it was selected for audit. The odds are definitely against you. There is almost an 80% chance you will owe the IRS more money at the end of the audit.

Unfortunately, this whole process doesn't really follow the system of justice the founding fathers of the United States put into place. With the IRS you are guilty until you prove your innocence. The burden of proof is definitely and openly placed on the taxpayer—you. Therefore, you need to have your ducks in a row before you get to the audit.

Not only is the burden of proof on you, the IRS has the home court advantage. The auditor is doing hundreds of audit interviews a month. He has learned the psychological tricks to put you in the box where he wants you. You are only going to go through the audit process once or twice in your lifetime. It is foreign to you, strange, intimidating, and just not pleasant. That's where Ben has an advantage over the average taxpayer and even most CPAs. He has done the audits from the IRS side of the table for years. He audited the big cases that went criminal, and then he helped prosecute the criminals in court. When we represent a taxpayer in an IRS negotiation, it's a "been there done that" for us. If you can see the IRS trick play coming, you know what the move is and how to counter it. That's Ben's advantage.

You need to have your papers prepared so you can quickly respond to the auditor. You need your receipts or whatever you need to counteract each aspect of the audit. Taxpayers often think that their audit will be limited to the issues stated in the audit notice. That's not true. Your entire tax return and the related tax returns of your business(es), real estate holdings—everything—is on the table in an audit. In fact, your last three years of tax stuff is all being audited. If there is a problem that the IRS can find in one year's return, chances are the same problem can be found in your other years' returns. The IRS will look as far and as deep as they want. In fact, if the auditor finds a problem in one year's return, he is obligated to look at the other years for the same problem.

When you are preparing, make sure you understand how your tax returns and calculations are derived. I will admit, I play with the tax laws and am not an expert on how the forms are filled out and how everything comes together on the form. I need the help of Ben or, in the old days, I had to have my accountants participate in the audits.

Do you need help in the audit? Unless you filled out the tax returns that are under audit or at least know them really well, you probably will need your tax person to be with you in the audit. You certainly have the right to have your tax professional at the audit.

Your tax professional may not be comfortable with the IRS audit procedures, but he or she should know your tax forms inside and out. They should also have the advantage over you of being "detached" from the emotional issues associated with your audit. It's your money and flesh that the IRS is after, not the professional's, so they aren't as upset as you are. Taxpayers will lose their cool, argue with the auditor on issues that really aren't relevant, or they will tip their hand and give out a lot more information than is really required. Any information the IRS auditor gets that he didn't already have probably helps him and hurts you.

Take Notes

You need to be prepared to take notes in the audit. Write down everything the auditor asks for and what you give him. Write down questions he asks. Obviously, write down your homework assignments. The auditor may ask you to provide additional documents or paperwork if the audit will have a second session. It isn't unusual to have a couple of audit sessions before the audit is finished.

When the auditor asks for a paper you have, give the paper to her and then when she is finished looking at it, take it back. Don't let the auditor get a stack of your papers. If she has all your papers at the same time, she can lay everything out and then start to compare things and find inconsistencies. If the auditor only has one piece of paper at a time and you always take the paper back and put it back in your ordered file, it is less likely the auditor might notice something they hadn't seen before. Letting the auditor study your papers for a long time just provides more opportunity for the auditor to see avenues they can go down to get more money out of you.

Don't ever give the auditor more information than they are actually asking for. Take other papers out of any file or folder you give the auditor. Especially make sure you don't give the auditor any information related to a tax year that is not under audit. It sounds easy, but it is actually hard to "sanitize" your files and paperwork so that you don't give the auditor any more information than what they are specifically asking for. Your objective is to keep any information out of the auditor's hand that might give more information than absolutely necessary to answer the auditor's question.

If it is a field audit where the agent is in your office, he will give you a list of your files and documents he needs. The implication is, the agent needs all the files, and once the agent has all the files, he will go through the files. You don't need to get everything and make a big pile in front of the agent. Don't make the auditor wait for anything, but feed one file or document to the auditor at a time. Ask what the auditor wants to see first. When the auditor is through with that file, give him the next file he is asking for. Take the file or document you have retrieved from the auditor and put the file away.

The agent can copy your papers. If the agent asks you for a copy of a paper, make yourself one also. You need to build a file that looks exactly like the agent's file, at least with the paperwork the agent got from you. The agent should be verifying your numbers or justifying his numbers with the papers you are giving him. If the agent is copying everything you give him, politely make an excuse, and stop the audit. You need professional help.

Basically, the only reason an agent starts copying everything is if he is making a criminal file. If the audit is building a criminal case, you need CPAs, enrolled agents, lawyers, Ben, somebody there with you that knows how to fight a criminal case. Nickel and diming your pocketbook with a disallowed deduction here and there is one thing. Looking at jail time is another. You certainly know if you have done anything illegal, so you probably have nothing to fear. However, I am afraid that the IRS is being weaponized against some people, for example the Tea Party, and policing your acts and collecting some more revenue may not be the only purpose of an IRS visit these days.

Be credible and organized. The papers show the IRS agent you are telling the truth. If you don't have a paper the agent asks for, just say you don't have it and tell the agent you can or can't get it for a later session. But, you have to write down a list of what the agent asks for, or you will never remember everything. That's why you need to go in prepared to take notes.

It is possible to record an audit session, but you have to notify the IRS at least ten days in advance and have your own recording equipment. Of course, you'll have to permit the IRS to make their own recording. If the IRS records your audit, you are entitled to a copy or transcript of the recording. The IRS has 30 days to give you the recording when you request it. Most audits are not recorded.

Mistake 4
You Don't Have the Papers

You need to keep the papers that verify the numbers you have reported on your tax return. How can you prove to the IRS that your tax numbers are correct? The only way you can prove anything to the IRS is if it is in writing. You need to save your tax related papers for a long time. The IRS has three years from the date the return is due (April 15th usually) or the date you actually file your return, whichever is later, to start their audit. If the IRS claims you committed fraud, then the three-year rule goes out the window, and they can audit any year you have ever filed.

Ben recommends that you keep your tax information, all of it, for at least 10 years. He scans his receipts and then throws the paper receipt away. His filing system in the computer lets him quickly retrieve a receipt using a date, a vendor, or an amount of expenditure. If you save everything on a computer, you'll have to print it out to show the IRS, but you don't have to store a lot of papers. If you are in the audit and need the paper printout for something on your computer, you'll have to give it to the agent the next time you meet. Obviously, before your first visit, you should print out whatever you think is relevant and then order all your papers.

There are tons of papers that might enter into an audit. Pretty much every number on your return might have to be proven. All of the expenses, exemptions, childcare, alimony, bad debts, investment returns, everything has to be proven. Of course, if you have a business, everything is up for grabs there. A list of papers you might be asked to supply in an audit is included in the appendix.

If the auditor asks for a paper you don't have, you can certainly create the paper for your next audit session. It isn't illegal to recreate paper trails and reconstruct your story. Of course, the reconstruction needs to be true and based on the facts. You can't make things up, but you can recreate what was once there or should have been there. You can go back through your emails and find the receipt the airline or home improvement store sent you and then print the receipt. You can get people to give you receipts that they never gave you in the first place. You can "construct" your file or "reconstruct" your file. That's perfectly legal.

Ben has helped many clients reconstruct their financial records. He will take all the bank statements and credit card statements and categorize all the entries by putting them into QuickBooks. Technically, the IRS requires a receipt for every expense. You will have a hard time coming up with receipts, but if the expense was from an office supply store or a company that specifically supplies goods or services to businesses, the IRS will often accept the credit card or bank entry. For example, I do computer downloads, searches, and other things I get charged for which are absolutely business expenses. The IRS will probably accept those as expense deductions even without a receipt. If the expense could be personal or business, you're going to lose the argument.

It may be necessary to get someone to corroborate your statements to the auditor. You can get statements from various parties. Have the party write out their statement then sign and date the statement. It isn't necessary, but if the signature on the statement is notarized, then the agent can rely on the fact that the person's signature was really made by that person. The notary, acting as an agent of the state, is verifying that the person and signature are legitimately attached to the person represented.

It is possible to bring a person into your audit to make a statement to the auditor or corroborate your story. An audit obviously isn't a court proceeding, but if you think of your defense as a court defense and prepare your proof as if the audit were a court proceeding, you should adequately be able to prove your points.

An enrolled agent, like Ben, can often access the IRS files on your behalf. Some people think an enrolled agent is somebody who flunked out of accounting school. Not so!! An enrolled agent has a ton more tax training than a CPA. CPAs are basically glorified bookkeepers. They know some tax stuff, but they don't normally specialize in tax issues. An enrolled agent does only taxes. They usually work closely with the IRS and can often access a lot of the information the IRS has in your file. By accessing a file and seeing what the IRS is looking at, Ben can compare what he is seeing to what is on a return. Often, the problem that the IRS is looking at becomes evident and can quickly be addressed.

One of the important points to be made is that when you are in the audit, remember that you are not just giving your documents to the IRS agent. You let the agent look at the paper she requests, then you take the paper back and put it back in your files before you give the agent the next paper she wants. Never just hand over all the stuff you have and let the agent rummage through your papers. Your paperwork can give the agent avenues of investigation that she hadn't thought about before. The agent will be looking for anything she can find. Yes, it is a fishing trip, and agents love to go fishing. Your job is to keep the agent focused on proving the numbers she supposedly is trying to verify.

Mistake 5
You and Yours Have Loose Lips

The agent is always going to be somewhat nice. You want the agent to be businesslike and get right down to the numbers. As I have explained above, if the agent is your buddy and chatting with you about everything, you're in trouble. The agent is digging for information. When the agent is doing small talk with you, your audit isn't about the numbers. Oh, the numbers may be on the table and the agent is going through the motions of looking at the numbers, but the chit chat is going in lots of different directions. If this is how the audit is going down, you are in big trouble. The audit is really a lifestyle audit or a financial-status audit.

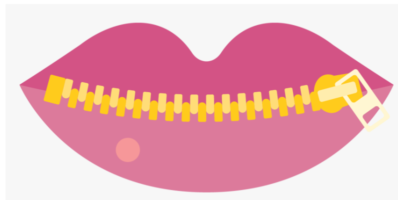
The agent is looking for a "substantial underreporting of income." If they can figure out that you have underreported your income by 25% or more, then they've got you. That's a crime, and at that point they want a pound of flesh, not just more money.

I remember in my early years of grade school, one of my friends in the neighborhood had a daddy and then she didn't. Her daddy was a doctor in town, and the IRS took him away for a couple of years to jail. As a ten year old, you don't understand what happened, you just know this girl you were friends with lost her daddy and it had something to do with taxes. He came back to the family after a year or two and went back to being a doctor, but he was gone for some of his daughter's grade school years.

Now that I understand a little better, the daddy had obviously underreported his income. You'll never (well hardly ever) go to jail for taking a deduction you have some logical reason for taking. The deduction may be disallowed, and you'll owe more money to the IRS, but you won't go to jail for taking the deduction. However, if you don't report all your income, that's when you are looking at jail time.

If the IRS agent gets you talking about your Alaskan hunting trip with the fly in and everything else, you're just feeding the agent justification for looking at you closer, because you are an HVAC guy, and HVAC guys don't usually have enough money to pay the big bucks to go to Alaska and shoot the big bucks.

We're going to assume you're not stupid and are reporting all of your income, and your audit is all about the numbers. Loose lips still sink ships. At least, they could sink your IRS audit ship.



Be careful not to "give additional information" when the auditor asks you a question. You may be thinking that if you can justify the numbers with the backstory, then the auditor will be pleased and feel like you're being cooperative. Of course, the auditor is a person and is probably a great guy, but he is sitting across the table from you for a purpose. It's a business meeting for the agent, not a social meeting. If you are really old, you'll remember *Dragnet*, the old cop show where Joe Friday always said, "Just the facts, ma'am." (He never actually said that, but everybody associates that statement with the show.)

Just answer the questions as succinctly as possible. I understand that is hard. It's hard for anyone. Pause and count to ten before you answer and think, "What is the shortest answer I can give to that question?" Can I just answer yes or no? You are under no obligation to explain anything unless the auditor asks for a further explanation. In fact, if you launch into an explanation on every question, the agent may become frustrated, because he wants to get your audit over with and get onto his next audit. You've got to remember that this is a big deal to you, but the office agent has ten more audits to do before he can go home.

We could beat a dead horse here, but the message needs to be clear. Keep your mouth shut. There isn't anything wrong with silence. In a transcript of your audit (if one is ever made), silence doesn't ever show up. There is no record of your silence. You will never please the auditor and get him or her on your side so they will cut you some slack. It doesn't work that way. Don't even try. Remember the auditor is there for a specific reason. Why was your return selected for audit?

As a side note, I have to tell you about my dear mother. She started out in banking and was promoted to bank manager in her early 20s. Then she became a mother and her children became her full-time job. She died about 11 years ago. She always did her own tax returns. She would always "throw in" a few hundred extra dollars to make sure the IRS was happy and didn't audit her. I think she viewed it as making an offering to the IRS Gods or something. I couldn't convince her that the IRS didn't give a damn about her extra offering. They want the numbers. "Just the facts, ma'am."

If you don't know the answer to a question the auditor asks, don't make up an answer. Just say you don't know, or you don't know now, but you could find out. There isn't anything wrong with saying you don't know—if you don't know. On the other hand, if you make up an answer and it is wrong, you could be in bigger trouble. Tell the agent you need time to research the answer. That's an ok answer.

I think you've got the message, but unwitting taxpayers often give the IRS agent the rope he needs to hang them. Don't get caught in that trap.

As long as we are talking about spilling the beans, there is one more observation you should be made aware of. Your enrolled agent and your accountant are not your buddies either. The information you give them is not private between you and them. The IRS can force them to talk. There is no "attorney/client" relationship between you and your enrolled agent or accountant like there is between you and your attorney. Attorneys have a special relationship with their clients which keeps your conversation with them private. The attorney/client privilege is unique to an attorney and doesn't in any way apply to your enrolled agent or accountant. So, don't spill your heart out to your tax guys/gals. Stick to the business of the audit. Why is your return being audited?

Mistake 6
You Give the Agent Access to Your Business

As I said, the IRS has graced my business with their presence three times. Field audits are actually quite rare, but if the IRS calls for an audit at your business, handle the situation with kid gloves. You have got to get all your employees on the same page. The IRS auditors are not office cronies. Make sure the employees know that there is not to be any watercooler talk with the IRS agents. With a field audit, there is even a higher chance that the IRS is looking for more than the numbers on your tax return that is under audit.

They may be looking at your operation to make a comparison between the numbers that show up on your return and the "wealth" they see at your operation. Have a location in your office set aside for the auditor. Give the auditors a clean desk, conference table, or someplace to work. Make sure the space you dedicate to the audit doesn't contain any information that might relate to the audit.

Keep the auditor in the space you provide them. Have a runner available to go and retrieve information the auditor wants. Yes, they can ask for any information that relates to your return. You might call that a fishing trip for the auditor, but he can do that and fish as much as he wants. Make sure the runner only gives the auditor one thing at a time and picks up the papers the agent asked for before the agent gets another batch of papers. This needs to be done as much as possible. The auditor may want to keep a file for awhile. That's not good, but you probably have to comply. Just don't put any more information in the auditor's hands than absolutely necessary, and don't leave it with the auditor any longer than necessary.

Don't let the auditor just wander through your facility. Ideally, he comes in, goes to his room, and walks out when he is finished for the day. Your employees need to know that what he is doing is none of their business, and they shouldn't ask or answer any questions. If the agent asks an employee a question, they shouldn't say anything and refer him to you or your tax person. This is a rare situation where you actually want your employees to say they don't know anything. If the agent wants to look around and chit chat with the employees, you have got a big problem, and anything your employees say can and will be used against you. The auditor is comparing what he sees on your tax return with what he sees and hears at your facility.

Mistake 7
You Lose Your Cool

You need to understand that an IRS audit is going to be uncomfortable. Guys can compare it to a prostate exam. Being a guy, I am not sure what the gals can compare it to. Maybe delivery of a baby would be a good comparison. (I am sure that a baby delivery is far worse.) They were wheeling my wife in for her second delivery, and she made the statement to me, "I remember now. I said I wasn't going to do this again." Whatever you want to compare it to, an IRS audit isn't pleasant. You have to "buck up" and just know it is going to be trying for you.

You have to remember that the IRS doesn't follow the standard legal norms. With the IRS, you are guilty until you can prove your innocence. It will take time to put together everything you need to make your proof. They may have only stated that one part of your tax return is under audit, but the entire tax return is actually under audit.

In one of my field audits, the IRS specifically said my travel expenses were under audit. I happen to have a system where I keep every receipt for each trip and put the receipts in an envelope. The receipts are tallied for each trip, categorized, and reimbursed. I could prove every dime down to the McDonald’s receipts. This was way before I knew Ben or got into much tax stuff. Within minutes, the agent doing the audit in my office looked at a select few of the envelopes and determined that my expenses were all acceptable. He did make a mistake and told me something that has made me thousands of dollars over the years. He said, “Why do you keep all your meal receipts? Why not just take the per diem?”

Lots of my associates get fat on the road, but I never have time to eat, so some days I actually don’t eat anything. If you just take the government per diem (a published amount for each city) at https://www.gsa.gov/travel/plan-book/per-diem-rates/per-diem-rates-lookup for the food, you don’t need any receipts. The per diem rate is way more than I ever spend on food, so if my actual expenses for food were $18 and the published per diem is $68, I get reimbursed for the $68 and effectively make an extra $50. That comes out of my company as an expense and is not income to me. Nice tip the agent gave me years ago. In pure tax savings, that tip from the agent has given me around $3000 each year.

The agent in my office established in 30 minutes that my travel expenses were in order, but the agent and a supervisor spent the next five days in my office. They found under $500 in additional money I owed the IRS. It was frustrating to have them verify the issue they came to look at in 30 minutes and then spend another five days going through everything. They kept the office CFO, me, and others running for five days. Our work came to a halt. The CPAs were there off and on running up my bill. It cost me at least $5000 to entertain the agent and his buddy for five days.

Your patience will wear thin. DON’T lose your cool. Be polite and business like. Set and keep a good tone with the agents.

Never lie. The numbers will ultimately come out, and numbers don’t lie. Besides that, the agent instantly knows when you are lying. The agent is doing this stuff every day and has been doing it for twenty years. He can spot a lie fifty miles away.

My wife went to law school and then got a job as a clerk for a judge. (That’s a big deal for a new lawyer.) After a court session, the judge would walk back into his chambers and tell her the guy had been lying. She questioned how he knew that. He simply said, you can spot a lie a mile away. After a year working in the court, my wife could also spot the lie a mile away. She told me, “You just know the guy is lying. It’s easy.” It’s easy for your IRS auditor to see your lie. You might think you are convincing, but don’t lie.

Ben was auditing a guy one day, and the guy had claimed his babysitter as an employee and deducted all the wages she had been paid. Ben pressed him to describe how this girl was his employee and what the girl’s duties were. The guy was on a roll and was describing this girl as the most fabulous business employee ever. She was represented as the most important employee in the man's business. Finally, Ben ended the audit. He then simply called the girl. After talking to her, it was obvious that she was the best diaper changer on the block, but she wasn't an employee in the guy's business. Ben knew the guy was lying.

An IRS agent can basically call or otherwise contact anyone to corroborate your story. Publication 1 and form 609 explain what the agent can do. The IRS does have to give you notice before they contact third parties. They routinely throw in notice of the possibility they will be contacting people. There is a little piece of paper in your audit notice that says the IRS might contact third parties during your audit. The paper also says that if you are caught lying to the agent, aka, "providing false information," then the IRS can add additional penalties and prosecutions. The agent wants your case off his docket, but if he/she is really mad at you, they can always keep your audit going. They can open new years or other businesses for audit. The auditor can start issuing subpoenas to your banks or brokers, he can start contacting third parties, and he can generally cause lots of trouble for you. The short story is, don't lie to the IRS agents. Nobody likes to find out that someone has been lying to them. Making the IRS auditor mad at you during the audit isn't a good idea.

I asked Ben if he had ever had someone lose their cool with him. He said nope. He proudly informed me he wasn't a jerk, and then proceeded to say he always treated people he audited with respect, and they always treated him with respect. In fact, he says people often come up to him and he can't place them, but they are acting like his best buddy. Then he finds out that he had audited them. Unfortunately, there are those jerks out there. When you get one of those, just bite your tongue real hard and keep your cool.

Mistake 8
You Challenge the IRS Laws

The United States Tax Code is massive, confusing, and full of loopholes. You can take advantage of as many loopholes as you want or as many advantageous tax sections as you want. 280(A)(g) is a code section that is kind of fun. It is black and white law. Just be conservative, and it can give you as a small businessperson some extra money every year. People and even accountants look at 280(A)(g) and don't really see how it can be used in a business setting. They can't see all the applications of the law. The course to help people cut their taxes that Ben and I have created, the *Advanced Tax Tactics*, shows you how to use 280(A)(g) in a number of ways. It should save you a couple thousand dollars each year with that section of the IRS Code alone. If you use the IRS laws the way the *Advanced Tax Tactics* shows you, you should be able to cut your adjusted gross income by 10% - 30%. We think that is a good goal.

Using the IRS Code is not challenging the IRS laws. There are entire groups of people and individuals that figure they don't have to pay taxes. There are lots of avenues of thought that say you don't have to pay taxes. There is the thought that you are a sovereign person, thus the IRS doesn't apply to you. There are those who say the IRS is unconstitutional. The excuses for ignoring IRS laws go on and on.

You may have heard that there are constitutional trusts that you can put your wealth in and it is exempt from taxation. There is a popular trust being marketed today where they claim you don't have to pay tax on money generated within the trust because it moves the income forward indefinitely, and until you take the money out, there is never a tax on it. People say you can put money offshore and then use a credit card that is paid by the offshore account, and all the money made offshore can be used for your support without ever incurring a tax.

The 16th amendment to the US Constitution was adopted in 1913. It says:

The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration.

The history of taxes since then is very interesting. The *Advanced Tax Tactics* is a workbook with about 6 hours of lecture where Ben and I go through tax advice for you. I give a few minutes on the history of US tax rates. I give examples of how devastating taxes are to your financial wealth. Almost nobody really understands how destructive taxes are to your ability to accumulate wealth. It's bad—really bad.

BUT whatever you think, there is no way to challenge the IRS tax code. It is there. There is no person, business, trust, or other entity that is not fully subject to its laws. Use the laws to the best advantage you can, but you can't say they don't apply to you. You can't say that you can create a company, trust, or something else that can't be reached by the IRS. You can't place your money anywhere on earth that the IRS can't reach.

If you go into the audit thinking that somehow you or your creation of a trust or something is outside of the IRS laws, you will lose. If you are an American or someone earning money in the United States, you are subject to IRS laws. Period!!

Mistake 9
You Fail to Negotiate

The IRS will negotiate.

You have to realize that the IRS will never initiate a suggestion of negotiation or settlement. You have to bring the topic up. The auditor is just there to audit, not to negotiate. In fact, the auditor can't really negotiate with you. However, you can nudge the auditor toward getting the audit over with. The auditor has basically a quota of how many audits he needs to get done and how long he can keep an audit open. The auditor needs to do a thorough job, but he also needs to get it off his plate.

You can threaten to bring in your accountant and start going through everything with your accountant looking over the auditor's shoulder. That's going to take a ton more of the auditor's time. You're going to have to pay your accountant, so the threat to get an accountant involved could cost you and not get you anywhere. But, the auditor's clock is running, and it's only human to want to get a job done. Yes, IRS auditors have families and like to go home and do the things you like to do, so it is possible the auditor will let you agree to something and stop the audit pain rather than get an accountant involved.

You can keep the auditor's clock running if you start bringing in deductions you may not have claimed. For example, you didn't claim a home office deduction, because you thought it might be an audit flag. Well, the audit flag is now flying high, you are in an audit. You may as well start trying to add all the stuff you left off your taxes because it was easier to take the standard deduction or because you thought that specific deduction might increase your chances of audit. Starting to calculate your taxes using different items will possibly give you a decrease in overall taxes, and it will keep the auditor's clock running.

If there are some items that you legitimately disagree with the auditor on, you can ask to have the auditor's supervisor look at the issues. Give the auditor a point and tell the auditor if they will give you another point you are arguing over, then there's no need to get the supervisor involved. However, if the auditor insists on winning every point, then you don't have much to lose if you insist on getting the supervisor involved. It is your right to get a supervisor involved if you think the auditor isn't being fair or is being belligerent. You can't be belligerent, but the auditor can't be belligerent either.

When the audit is done, you will get a report. You can absolutely have the auditor go through the report and rerun their numbers so you can see what happened and be satisfied that there isn't any math errors. The auditor will want you to sign a Form 870 to say the audit is closed. You don't have to sign, and within 30 days you can make an appeal of the auditor's findings or sue the IRS in Federal Tax Court.

The appeals officer has to work with the auditor's report, and can't start the audit over again. The appeals officer can wheel and deal with you. The agent really isn't authorized to negotiate the numbers, but the appeals officer is. The lawyers in the Tax Court can also wheel and deal. You can negotiate on your own, but without a lot of savvy, you probably won't get too far. Ben is the expert at dealing with the appeals agents and lawyers, because he understands exactly where their on and off buttons are and what they can and cannot do.

Basically, the audit agent can't negotiate anything. You'll have to go to appeals once the audit has been completed and you have gotten the results. You either head to appeals or the Federal Tax Court. The appeals agent can negotiate and the lawyers you are going up against in tax court can negotiate. There are several stages in the appeals or court process where it is appropriate to negotiate. Just charging into the appeal hearing or the court isn't going to get you very far.

Ben negotiates in a number of places along the way. It isn't appropriate to be negotiating interest when the topic is the actual assessment amount that is being levied against you. The negotiation dance becomes quite orchestrated. Ben laughs, because there is a "tax attorney" that is on the radio all the time advertising that he gets your tax bill down from a billion dollars to only a hundred dollars. He only knows half the dance, but to his credit he knows he doesn't know the full dance. So, he comes to Ben to negotiate the hard parts and then he takes over and negotiates the simple stuff—before he takes the bow in front of the client.

Actually, we call this whole process of negotiation with the IRS "tax case resolution." It doesn't matter if we are working with someone who hasn't filed taxes for a decade or somebody that the IRS says owes them a ton of money, we can resolve problems with the IRS. It isn't easy, but because our folks know the IRS inside and out, we can get a lot further than the standard tax attorney, CPA or even enrolled agent.

Mistake 10
You Insist on Total Victory

Sometimes you get so mad at the IRS you can't see straight. When you are wrapping up an audit, that is not the time to want to prove your point or get even with the IRS. Give the auditor his or her bone and pay them to go away. Well, you don't pay them, you pay the tax bill. If they have been reasonable and given a little here or there, then it is a draw. Give the agent his victory lap.

You need to remember this audit is taking up your time, if not depriving you of sleep. What's your time worth? How much are you paying your tax guy to be there with you in the audit? The first time I was audited, the IRS got an extra $500 out of me, but it cost me $5,000 in accountant fees and employee wages to play games with the auditor. That's a lot bigger loss than the tax bill. I lost not to the IRS, but because of the IRS. The young man with cancer I talked about earlier basically lost everything—not to the IRS but because of the IRS. If you can pay what the guy wants in the audit and have the case closed, that may well be your cheapest avenue.

Additionally, if the case stays open, the IRS can rummage around just that much longer in your life. Even though you don't have any smoking guns or dead bodies in your closet, who knows what the IRS might see or do. You just want them gone.

You don't have to figure you are going to get even with the IRS by drawing out the audit and keeping the clock running. Remembering the first field audit in my office, I do have to smile when I think the IRS paid two people to be in the field for a week and they got an extra $500. The IRS had expenses that were at least ten times what they got out of me. My audit was a lose-lose, for me and the IRS.

I'll Say Goodbye—You'll SayHello

You can get even with the IRS by using their own laws. For example, get the *Advanced Tax Tactics*, and let's cut your tax bill by 20%. Of course, you can cut your taxes. You'll be using laws your CPA has never told you about. Oh, your CPA or enrolled agent knows a lot about all of the tax laws, but they never bring you in and put their arm around you and say, "You know, we need to show you how to make your real estate or your little business work as tax shelters. You need to learn about some tax laws."

There isn't much you can do as an individual taxpayer to control your taxes, but if you learn to use your real estate and/or your business as tax shelters, then you can really blossom financially. Of course, you want to keep the income producing part of your life, but you want to expand your tax options. You've got to think all year long, "What's the tax result of what I'm doing? Can I make the deal better if I change what I'm doing to get a better tax result?" Most people only look at their business and real estate as income producers with a few tax advantages. But they are income producers with huge tax advantages. You can't work harder, but you can play the tax game a lot better. Your CPA and tax professionals have never shown you what to do. Why? They know what to do. Why don't they tell you?

It's easy. They keep their mouth shut because as soon as they start teaching you or showing you how to use your real estate or small business as a tax shelter, they take on a big liability if anything goes wrong. The problem may come in something as simple as Congress changing the law. But, if anything changes or goes a direction you didn't expect, suddenly you are mad at the CPA or tax advisor. They have learned to keep their mouth shut.

If their only function is to take the numbers you give them and then plug those numbers into the computer program, they don't have any liability exposure. Why risk everything they have built up to teach you how to get better tax results? You've got to create the "tax numbers" you give the tax guy. Those numbers are created every day of the year.

We supply things like the *Advanced Tax Tactics* and our half-day Tax Summit that we do several times a year. Additionally, we hold people's hands and "coach" them for a year to teach them how to "create" their numbers. Once people see what to do, they can keep doing it. When we first started to help people under the coaching program, we figured it would take a year. At the end of the year, people have learned a ton and can do it themselves, but lots of people stay for another year or two because they make more money each year, and they love the advice all year long.

The rich know and use the IRS laws and leverage their deals by structuring them with the best tax outcome. There's no reason you can't do the same thing. When you need resolution of an IRS issue, don't forget that's where we shine.

Have fun in your tax audit. :) There is a mock-Latin aphorism that floated around law school in my class. I think the Latin phrase can be applied to your IRS audit. The phrase is *Illegitimi non carborundum.* It is loosely translated as "Don't let the bastards grind you down." Often an IRS audit is a game of nerves and endurance. Don't let them wear you down. Just get it over with and move on.

Let's make more money and sleep at night knowing we are straight with the IRS. I'll say Goodbye to you now. You'll say Hello to us sometime in the future. We can help resolve your tax issues. We can help you make more money—without more work, so give us a shout. Just call 800-806-1998 or drop me a note via email to info@leephillips.com.

Order the *Advanced Tax Tactics* using coupon code **AUDIT** and get 50% off the retail price.

In fact, we'll also give you a coupon code so you can attend the Tax Summit at a $500 discount. The Tax Summit is two days of virtual tax training. If you use the coupon code and make the *Advanced Tax Tactics* tax deductible (just write it off as a business expense), the *Advanced Tax Tactics* is basically no cost to you. You don't have much to lose, because your investment has a 30-day money back guarantee. That means *Advanced Tax Tactics* is basically guaranteed to give you more money in your pocket.

With more money and the IRS out of your hair, you can do the things you want with your spouse or special person. You can spend more time with your kids or just doing whatever else you want to do. The peace of mind that comes from knowing you are getting more money in your pocket and not worrying about what the IRS is up to is worth every effort you make and every dime you spend getting to that point in your life. ■

APPENDIX

Documents Needed to Verify Audit Items

Exemptions (children)

- Birth certificates.
- If divorced, submit divorce decree and Form 8332 indicating which parent will claim the exemption.
- Canceled checks and receipts for amounts you spent on support of children.
- Records of what others spent on the children, including amounts received from Social Security, welfare and other outside sources.
- A Social Security number must be obtained for each child and reported on your return.

Exemptions (other than your children)

- A dollar listing of the cost of the dependent's support.
- The amount of income received by or for the dependent.
- A compilation of what each member of the household spent toward household expenses.
- Name, address and Social Security number of persons with whom dependent lived during the tax year.
- Copies of canceled checks and receipts to verify amounts spent for the dependent.
- A Social Security number must be reported for each person claimed as an exemption on your return.

Medical Expenses

- Canceled checks and receipts for all medical and dental expenses.
- Itemized receipts for drugs and medicines.

Medical Travel

- A physician's statement showing the days on which you had an appointment.
- Receipts for parking and tolls.
- Taxicab receipts or a log showing number of miles you traveled for medical reasons.

Medical Insurance Premiums

- Your insurance policy, along with canceled checks/receipts indicating premium payments.

Taxes

- Canceled checks or receipts for taxes you paid. In the case of state and city taxes, furnish copies of prior year's state or city tax return, along with canceled checks showing payment.

Interest

- Canceled checks, along with receipts or statements from creditors indicating amounts of interest you paid. For mortgage interest, present year-end statements.

Investment Expenses

- Canceled checks and receipts.

Sales of Stocks/Securities

- Copies of brokerage firm's confirmation slips that show buy and sell prices.

Contributions

- Canceled checks, receipts or a statement from a religious organization or other nonprofit group. (A canceled check is no longer sufficient for contributions of $250 or more.)
- For donation of property, show a receipt from donee, a list of items contributed and fair market value of items at time of contribution. For large contributions, a professional appraisal is required (see Form 8283).

Casualty Losses

- Damage reports from police or fire department.
- Receipts or canceled checks indicating the basis of the involved property and the date you acquired it.
- Documents showing fair market value of property before and after the casualty.
- Records of appraisals or damage estimates. Repair bills or estimates of repairs.
- Insurance reports on reimbursement amounts.
- Photographs, if available, indicating the extent of loss or damage.

Child Care

- Canceled checks or receipts, along with the name, address and Social Security number of the individual caring for your child.

Alimony

- Canceled checks showing payment.
- A copy of the divorce or separate-maintenance agreement.
- Current address of former spouse and his or her Social Security number.

Reimbursed Education Expenses

- Canceled checks and receipts for tuition and for other pertinent expenses, such as books, meals, lodging.
- A report from your employer on reimbursement it provided, along with a statement of the purpose of your study and that it was required for your job or otherwise qualified as a tax-free reimbursement.
- School transcript showing courses taken and when.

Bad Debts

- Name and address of debtor.

- Promissory notes or other written documentation of legal debt. Proof of the improbability of collecting the funds.

Travel & Entertainment Expenses
- *For business travel:* Canceled checks and receipts for gas, oil, auto insurance and lease payments; auto repair bills; invoice for business auto; log or diary showing business miles driven.
- *For entertainment:* (1) Receipts and canceled checks indicating date, amount, place, person entertained and the business purpose for the activity. (2) A statement from your employer that shows the amount of reimbursement and says you were required to incur such expenses.

Home Office Expenses
- Receipts or canceled checks for mortgage interest, taxes, rent, utilities, office repairs, furniture and equipment.
- A statement from your employer that it requires you to work out of your home for its convenience, and that it doesn't provide you with an office.
- Photos of your office area (it need not be a separate room). Keep in mind that no personal activity can take place in space set aside for business unless it's used for inventory storage or is a day care business.

Rental Income and Expenses
- *For proof of income:* (1) Receipts for rents, deposits and fees. (2) A list of your tenants, their monthly rents and the months of occupancy.
- *For expenses:* (1) Canceled checks, invoices for repairs and costs associated with rental units, such as gardening. (2) Year-end mortgage statement, plus canceled checks for payment of interest and taxes. (3) To prove depreciation, documents showing original cost, tax bill for year property was purchased, plus rental record for the year prior to the tax year the auditor is examining.

Business Income & Expenses (These are Schedule C items)
- *For proof of income:* All available records, such as bank statements, cash-receipts, journals, invoices and Forms 1099. Also included are records of loans and receipts indicating repayment, and statements for sales of real estate or property.
- *For expenses:* Ledgers and journals, invoices, payroll tax returns, and canceled checks and receipts.

IRA Rollovers
- Trustee forms and account statements showing that withdrawn funds or securities were rolled over tax-free within 60 days of withdrawal.

Penalty-free IRA Withdrawals
- Receipts or canceled checks showing qualified expenditures for higher education expenses, certain home purchase costs, etc.

Dependent Child Tax Credit
- Same as for dependent exemption.

Education Tax Credits
- Receipts or canceled checks showing qualified tuition and fee expenditures. For Hope Scholarship credit, report cards showing student carried at least half a fulltime load for at least one academic term during the year.

College Loan Interest
- Receipts or canceled checks showing payment of qualified tuition and/or room and board expenses within a reasonable time before or after the loan is taken out.

Depreciation of "Listed Property"
- For autos; computers and peripheral equipment; video, audio, photographic equipment; and cellular phones: usage logs or other documentation showing business and personal use.■