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IRS AUDIT GUIDE

For Business Owners

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INTRO

Audits, whether by the IRS, State, or Local authorities, are something every business owner aims to avoid. High penalties, additional interest, fraud, and criminal penalties are just a few of the reasons why being audited gives way to so much anxiety as a business owner. Not to mention the extensive digging into your everyday lifestyle, both at work and at home, that can make it a very uncomfortable ordeal.

The penalties that can be assessed for inaccurately or failing to report your business's income are staggering, to say the least. According to the IRS, on average, the additional tax owed for a mail audit is around \$7,000 and upwards of \$65,000 for a more extensive, IRS field audit. PLUS underreporter notices and accuracy penalties can add between 20%-75% to your tax bill. In the year 2019 alone, the IRS audited over 750,000 tax returns, which resulted in almost \$17.3 billion dollars in additional taxes.

Over the past few years, the probability of being audited has been quite low (40 out of every 100,000 returns filed have been audited by the IRS, as published in 2019). However, this number is likely to see an increase in the very near future. The IRS is planning to ramp up audits of smaller businesses and their investors by about 50% in 2022, which could result in a surge of audits ranging from mom-and-pop retail stores and technology startups to investment funds. And given that small businesses have the highest degree of noncompliance (at a 56% misreporting rate), they are critical to the IRS. The government generally has three years within which to conduct an audit, and often the exam won't begin until a year or more after you file your return.



The best thing to do with an audit is to learn how not to make yourself a target. This guide will go over what the IRS looks for when targeting an audit, what to do and how to prepare if you are selected for an audit, as well as some tips and tricks from industry insiders on how to best prevent audits in the future. With this outline and beneficial knowledge, we'll show you why Adilas is a preferred software by CPA and accounting professionals across the country and how it can help you avoid costly mistakes down the road.





Part 1: IRS AUDIT TRIGGERS

There are many factors that decide whether or not an auditing agency will target business, including excessive expenses, high income, losses, gains and even random selection by computer screening. In addition, HOW you conduct your business and report your finances play a major role as well.

Tracking Income and Expenses on Paper

By using paper trails and spreadsheets to track your operations and financials, you put your business at risk for inaccuracies and lost information. Most of us know the drill, you keep stacks and stacks of paper on your desk promising yourself that you will get around to organizing and filing the information. Then, tax time comes and you end up spending hours upon hours trying to regain control of the situation and overextending yourself. By doing this and using a disarray of paper stacks to track your finances, it can lead to a higher probability of errors occurring and lost paper trails.

Using Multiple Software Systems

One system tracks invoices and income, another system tracks payroll and expenses, then at the end of the day, you have to take both those figures and input them into another separate system, like Quickbooks, to bring everything together. With 3 different points of entry, a lot of mistakes and unintentional omissions can occur. These errors and omissions can be costly.

Outdated Tracking and Reporting

When it comes to inventory, the cost associated with bringing in your products and the cost associated with getting them sold is very important to track accurately. Lack of tracking and reporting these assets correctly will lead to your company being evaluated inaccurately. And if there's a common theme here, it's that inaccuracy is a definite red flag for an audit.

Preparing Your Taxes Without a Professional

Some tasks are better left to the professionals. By hiring a CPA, accountant, or tax professional who knows the ins and outs of tax law, you will not only gain peace of mind, you will also gain the appropriate advice and knowledge to manage your business finances in the best way possible.

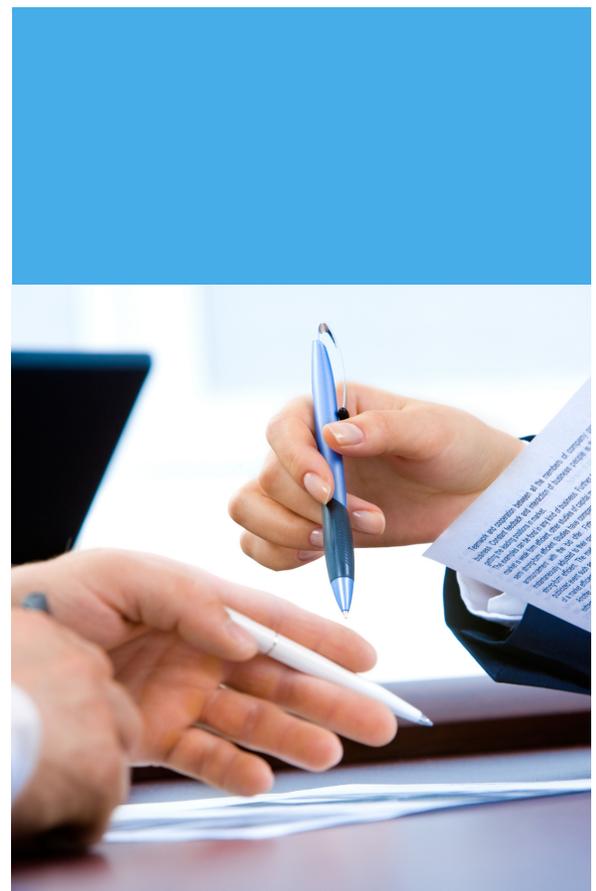




Part 2: WHAT IF YOU ARE AUDITED?

So, your worst nightmare has come true and you have received a letter notifying you that your business has been selected for an audit. It can happen to the best of us and it can be a scary situation. If this happens to you and your business, you do have a couple of options.

- 1. Review the notice carefully and if you think there is a mistake, call the IRS and ask that the audit be canceled.** In this scenario, it is important to gather all the proper documentation that you need such as receipts, bank statements, or proof of funds. With Adilas' "Advanced Search" feature on any aspect inside the system, locating these pieces of information has never been easier.
- 2. If it is not a mistake, consider calling a tax professional. While you can represent yourself, hiring a professional not only alleviates some of the burdens, it can increase your odds of success.** Or, if you already have your own accountant or CPA who is familiar with your finances, then you are already one step ahead, give them a call for their assistance. Inside Adilas, you can add your accountant or CPA as a user to the system and grant them specific financial permissions for them to gather all the intel that they need.
- 3. Do not answer any questions over the phone.** It is better to say that you are not prepared to talk at that time. This gives you time to gather your documents and talk with a tax professional about your options. Treat the IRS like the police, do not talk to them. Like getting a lawyer, let your accountant talk to them.





Part 3: PREPARING FOR THE AUDIT

Even if you are confident that you have reported everything accurately and have supporting documentation, the thought of the audit process alone is terrifying. However, with the right preparation, the process can be smooth, painless, and quickly resolved without the need for everyone's stress levels to increase.



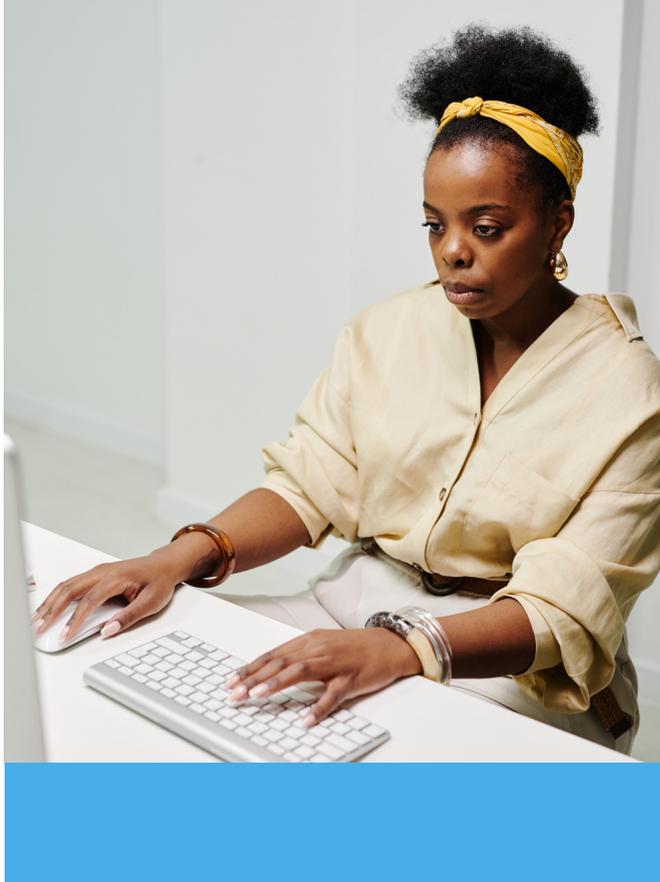
- 1. Review the tax returns that are being audited.** Read carefully through each form and ensure you are well versed on the terminology. By thoroughly examining your tax returns, you may come across the skeletons in your own closet. Being able to find and correct those errors, you will have a better understanding of what you reported and what questions might arise.
- 2. Find the records that were used to prepare the tax return.** This circles back to maintaining proper and accurate documentation. Locate any receipts, bank statements, check stubs, etc. that correlate to your tax return. Adilas allows you to scan all of your documents into your system, so you can easily locate them without having to dig into shoe boxes in your attic. Having these ahead of time will alleviate the stress of not being able to find it when the time comes.
- 3. Research the tax law to make sure you were entitled to a tax benefit claimed on your return.** It is important to evaluate if your business qualified for the amount claimed and substantiate that claim with proper documentation. Consider hiring a tax professional to help you through this process. Auditing yourself is like editing your own book. It's difficult to be objective when you're so close to the process.





Part 4: GOALS FOR THE AUDIT

Based on the type of audit that you have been assessed, there may be different goals. Some audits will just require you to mail in additional documentation, while the more extreme audits (office and field audits) will look very closely at your lifestyle, business activity, and income. Overall the goals for any type of audit are pretty much the same...



- 1. Negotiate the terms.** You have more control of the audit process than you might think. Before starting the audit, be sure to negotiate the start date and the date range of the audit. You may even be able to negotiate the hourly rate for the auditing firm's staff.
- 2. Minimize the financial damage.** As stated previously, the financial effects of an audit can be staggering, let alone the domino effect that this can have on your business's future operations. Some will walk away paying a few hundred dollars, while others will walk away paying thousands of dollars. The goal is to be the former of the two.
- 3. Prevent expansion of the audit and limit the scope of the examination.** The goal is to keep the audit centered around the task at hand. You sure don't want to give any reason to further poke and prod into your lifestyle, operations, and financials.





Part 5: AUDIT TIPS

Here we are, at the final chapter. So far we've covered what triggers an audit, what to do if you've been selected, how to prepare, and the goals for getting through the audit. Next, we will go over five helpful tips that you need to know when it comes to doing your taxes or completing an audit.

- 1. Maintain good records and documentation.** At the risk of sounding like a broken record, this pays off in the long run not only because maintaining records will help you accurately report your finances when tax time arrives, but also to ensure that if an audit should occur, you have full documentation supporting your claims.
- 2. Do not talk too much during the audit.** Provide the auditor with no more information than they are entitled to and don't talk more than absolutely necessary. Make sure that records are easier for them to access, you don't want it to seem like you are hiding anything.
- 3. Do not lie to the IRS.** Avoid combative behavior and be cordial. First impressions matter so resist the urge to make the auditor as uncomfortable as you probably are and be sure to make time for the auditor.
- 4. Read up and know your rights.** Be sure to educate yourself with the proper knowledge by using free IRS publications and commercial tax guides. Or better yet, hire a professional that has the expertise in this field already.
- 5. Plan your cash flow and pay your estimated taxes and taxes due.** This is the ultimate tip to avoid any disruption to your business! Plan ahead and be prepared.





Conclusion: HOW ADILAS CAN HELP

Being audited can be a stressful and costly endeavor, however, with the proper knowledge and tools, it doesn't have to be. Adilas is a trusted software among the field of CPA, accounting, and tax professionals for many reasons. We have been leading the way in SaaS (Software as a Service) ERP for businesses since 2008, by bringing operations and financials together, inside of one dynamic system that can be customized and tailored to fit any industry.

Our software provides all the tools necessary to run your business operations such as inventory management, point of sale, HR/employee management, vendor management, time/project management, and much more. Additionally, it delivers the accounting functionality that you need to track all of the expenses and income that go along with your daily operations. By having these two important facets of your business inside of one system, it is able to automate and connect data points to maintain a clear and accurate picture of the overall performance of your company.

Second, it provides the ability to maintain a complete virtual office for every aspect of your business. You can upload various file types such as JPG, PNG, PDF, video files, and more, with the ability to tie these images to specific aspects of the system, such as your expenses/receipts, deposits, bank statements, purchase orders, etc. Once tax time comes, our Advanced Media Search feature makes finding these records a breeze.

Last but certainly not least, our inventory management system has been designed for accuracy, down to five decimal points to be exact. By micro-tracking the movements of your inventory and the cost associated with those movements, you can ensure that reporting the necessary data to the respective agencies will be exact and precise.

These are just a few of the ways that Adilas can help your business be better prepared for tax season so that you can do everything in your power to avoid an expensive audit later down the road.

If you would like to see firsthand how our software as a service could be utilized for your industry, please contact us for a free demo today!

FREE DEMO



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