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taxes?

Isaac M. O'Bannon • Sep. 12, 2013

To paraphrase Winston Churchill's remarks on the former U.S.S.R., sometimes the Internal Revenue Service can be a riddle wrapped in a mystery inside an enigma. Even seasoned tax preparers often don't know the processes behind the scenes at the agency, and for everyday taxpayers, it can be even more of a mystery than the Sphinx.

I'm not talking about the recent political travails regarding nonprofit groups and exempt status, and not even about the peculiar role the agency will have regarding the new health care laws. I'm talking about the more routine questions that taxpayers and professionals might be wondering.

Some numbers can be easily found, such as the statistical probability of being audited. Overall, it's really low (less than one percent). But that's really a misleading number, since the odds greatly increase for taxpayers in certain income groups or with certain income types, and also is greatly dependent on the types and amounts of deductions and credits applied to a return.

Tax professionals have benchmarks and comparison tools that can look at these risks and, in many cases, can help reduce the odds of a taxpayer facing an audit. (And CPAs and EAs can help represent the taxpayer during an IRS audit.)

But there are still other questions. And for those, we decided to ask Jim Buttonow, a former IRS Large Case Team Audit Coordinator. He's no longer with the agency, instead putting his 19 years' of experience there toward benefitting tax professionals and their clients. He is the vice president and cofounder of the tax technology company [New River Innovation](#), which develops tools like [Beyond 415](#) that are

specifically designed for managing IRS issues, notices and audits. He also blogs for

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and the agent who examines the return decide whether to examine the return. If the manager or agent thinks that the return is substantially compliant and would not have changes, he or she will accept the return as filed, which the IRS refers to as “surveying” the return.

2. Do IRS agents have quotas? How are IRS agents graded on their performance?

Agents are graded on the quality and timeliness of their examinations. Under 1998 IRS reforms, the law doesn't allow specific quotas and grading of agents on their enforcement results. However, most agents don't like to turn in a “no-change” case, especially if they have invested a lot of time in the examination. As part of the quality and timeliness criteria, the agent would be judged harshly if he or she spent too much time on a case with no results. Therefore, agents are encouraged to pursue cases with the largest amount of tax adjustments.

3. What are the chances of an audit?

Overall, your chances of audit are about 1%. However, audit likelihood should be looked at by segment. Certain taxpayers have a high likelihood of audit; for example, large corporations are audited constantly, and high-income individuals (taxpayers who make more than \$1 million in income) have a 12.5% chance of being audited. The IRS also likes to focus field audits on small businesses. The IRS audits Schedule C tax returns more than non-business returns. For example, if you own a sole proprietorship with between \$100,000 and \$200,000 in receipts, you have a 4.3% chance of audit. Surprisingly, the IRS does not examine many S corporations or partnerships (about 0.4% in total). However, the IRS will focus on examining these returns in the next three years. In 2012, the IRS increased examinations of flow-through entities by 18.7%.

4. How many audits result in criminal referrals and prosecutions?

Very few audits result in criminal prosecutions. In 2012, the IRS examined more than 1.6 million returns. There were 2,291 tax criminal prosecutions initiated, with only 1,161 indictments. However, when the IRS and Department of Justice decide to

prosecute, they usually win; the conviction rate is more than 80%, and most

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