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Running a small business subjects an owner to various twists and turns on a daily basis. Few events, however, will raise an entrepreneur's blood pressure quicker than a U.S. Department of Treasury letter informing them the business has been selected for an IRS audit. John Gregory EA, tax practitioner and founder of 1040Return.com, recommends steps to take when faced with an IRS audit for self-employed businesses.

“Although the IRS overall audit rate for personal income tax returns is quite low – hovering around one percent each year – a significant portion of these returns include so-called Schedule C self-employed businesses,” explains John Gregory EA, tax practitioner and founder of 1040Return.com. “The Schedule C is a one-page tax schedule used by self-employed business owners to report their business' income and expenses on their personal federal income tax return. Since Schedule C tax return amounts are presented in a summarized fashion, you can expect the IRS to be interested in the details supporting the summarized amounts.”

The good news is that according to the IRS' latest statistics, approximately 75 percent of all personal income tax returns selected for audit are conducted through “correspondence” with the taxpayer. For self-employed business owners, these correspondence audits are usually narrow in scope and limited to providing information on specified types of income or expenses.

Examples of IRS correspondence audit requests that a Schedule C self-employed business owner could receive includes providing copies of business vehicle mileage logs, or perhaps supporting documents used to substantiate business travel and/or

entertainment expenses. The key point to realize in a correspondence audit is that

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expertise from the business owner.

When owners become subject to a field audit of their Schedule C business activities, it is highly recommended that the owner contact a tax professional. While it may not be necessary for the tax professional conduct all aspects of audit, engaging a tax professional offers numerous advantages, such as the following:

- Gauging the scope of the audit or, if the scope is unclear, provide the initial contact with the IRS auditor to clarify and possibly influence the scope of the audit.
- Assisting in quantifying areas of potential tax exposure and, where advisable, become proactive in disclosing errors to avoid the imposition of IRS penalties;
- Actively asserting reasons why the business owner's treatment of income and deductions is proper under the law.
- Identifying areas of missed opportunities where deductions were inadvertently omitted or, in the alternative, capable of being accelerated.
- Determining whether the IRS auditor's requests are unreasonable and worthy of being curtailed.

Further, depending on the facts, the IRS may also impose discretionary penalties, the most frequent of which is the 20 percent "negligence" penalty. Although most penalties can be waived if the mistakes are attributable to reasonable causes, consideration should be given to the incremental costs to fight a penalty waiver battle, which could be in excess of the penalty amount itself.

"IRS audits are never fun," explains Gregory. "But if a business owner maintains reasonably accurate records and treats the auditor with professionalism, the pain and disruption to the owner's business can be minimized."

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