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HOW IRS AGENTS EVALUATE EVIDENCE

By Victor Sy, CPA, MBA

The IRS is back in full force. Leaner. Stronger. After reeling from congressional hearings and keeping a low profile for many years, the IRS has reorganized and is back. Their mission then was to protect taxpayers. The mission now: go raise revenues. It is time to prepare for audits again. Let's learn how agents evaluate evidence against you. Plan your tax preparation to pre-empt an IRS audit.

1. IRS agents are trained to gather facts, all available facts, on both sides of the issues. They gather **evidence**, not proof (evidence is something to prove a fact while proof is the result of such evidence).
2. The Internal Revenue Code requires all taxpayers to keep **adequate records**. There are times, however, when such records were lost or even never existed. This is when oral testimony comes into play. IRS agents need not accept oral testimony that must be verified from other sources of evidence.
3. In my 34 years of helping taxpayers against the IRS, taxpayer **credibility** is the most critical factor in winning or losing an audit. It is this credibility that leads agents to accept or reject oral testimony or written evidence.
4. Agents keep a **summary of conversations** with taxpayers as documentation for their case files. This is why I get nervous when taxpayers talk directly with agents. I have one rigid rule that I keep for my clients: never, never communicate with agents directly. It makes our job of defending you really difficult. I remember a client who called and argued about the ownership of a rental property that was the main issue of their audit. He followed this up with several letters. Unfortunately, he was going the **wrong way**. He tried so hard to convince the agent of a position that was bad for his pocket. It took me quite a bit of subtle convincing, gentle persuasion, and lots of luck to turn the case around for an eventual win. But it is not something that I enjoyed. These are the sort of circumstances that make CPAs, Enrolled Agents and Tax Lawyers get nervous and wary.
5. When neither documentation nor oral testimony is available, you may use an **affidavit** to attest a statement (use Form 2311). The agent, on the other hand, could use that same affidavit to record your testimony as a witness or to prevent you from changing your testimony should the case go to trial.
6. Have you observed examiners (agents) preparing **worksheets** during the interview? These are work papers to document facts and corroborate evidence and conclusions.
7. A secondary source of information is hearsay. It is what a witness says that another person was heard to say. The trustworthiness of this type of evidence lies on the reliability of source.
8. **Contemporaneous writings** made at the happening of an event have great value during audits because it shows what was in the mind of the taxpayer at that time. For example, auto mileage jotted down right after the trip has more significance than a logbook reconstructed three years later, just before an audit.
9. After facts have been gathered, the Internal Revenue Manual instructs auditors to arrive at a definite conclusion by a **balanced and impartial evaluation** of all evidence. If you have experienced an audit, you may feel otherwise, and for good reason, especially if you lost the audit.
10. The bottom line: If you want to win in a potential audit of your current tax return in two or three years, prepare for it **now**. Keep complete and accurate records. Do not take positions that could not be defended in an audit. For example, do not claim \$2,000 of charitable contributions if you can only support \$300. Do not claim business expenses of \$8,000 on gross revenues of \$3,000. Be sensible. Save taxes with proper planning and good tax advice, not from make-believe numbers that wave little red flags. Or big flags. The personal demeanor and integrity of your tax accountant will win, or lose, audits for you.