

Current IRS Audit Issues

TSTCI Bookkeepers/Accountants/ Commercial Conference

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Telephone Company Audit Issues

- Taxable USF – Section 118
 - Coordinated exam issue – Industry Directive dated 4/6/2007
 - IRS requires that you demonstrate that all USF revenues have been reported as taxable income

Telephone Company Audit Issues

- USF and 85% Test
 - IRS has informed us they plan to review whether USF should be considered nonmember revenue for the 85% test
 - TAM 9111001

Telephone Company Audit Issues

- Subsidiary Revenues and 85% Test
 - IRS has informed us they plan to review whether the revenues of subsidiaries should be included as nonmember revenues in the parent cooperative's 85% test
 - Rev. Rul. 2002-55

Telephone Company Audit Issues

- Patronage Allocation Issues (for taxable cooperative)
 - IRS required extensive documentation of patronage allocation and notification including copies of notification to members and a detailed list of all members and their allocated amounts for prior years

Telephone Company Audit Issues

- Depreciation Issues (for taxable cooperative)
 - IRS scrutinized asset additions, dispositions, and depreciable lives

Telephone Company Audit Issues

- Accumulated Earnings Tax
 - Imposition of AET on subsidiary of a tax exempt cooperative
 - In theory, AET should not apply as a matter of law

Telephone Company Audit Issues

- Allocation of Expenses Between Cooperative Parent and Taxable Subsidiary
 - Reallocation of expenses from subsidiary to parent
 - Examination of allocation methodology
 - Examination of documentation for intercompany agreements (management, rent, etc.)

Other Audit Issues

- Below Market Rate Loans to Related Parties
- FIN 48 – Uncertainty in Income Taxes

Other Audit Issues

- Other
 - Meals/Entertainment
 - Travel costs
 - Large book/tax timing differences

Conduct of an IRS Audit

- Selection of Returns for Audit
 - High DIF score (Discriminant Inventory Classification system)
 - Information from third parties – informant tips
 - IRS screening of certain returns (based on type of return and total income reported)
 - Other methods

Conduct of an IRS Audit

- Types of Examinations
 - Office correspondence – handled entirely by mail; not complex
 - IRS office interview – usually limited to small individual tax returns
 - Field examination – takes place at taxpayer's office

Conduct of an IRS Audit

- Process of an IRS Audit
 - Initial contact
 - Phone call from IRS agent
 - Written notification of audit

Conduct of an IRS Audit

- Process of an IRS Audit (cont)
 - Information gathering
 - Review the list of requested documents with the agent by phone prior to the office visit
 - Negotiate with the agent the level of detail to be provided
 - Assemble the source documents

Conduct of an IRS Audit

- Process of an IRS Audit (cont)
 - Site visit
 - Initial interview
 - Tour facilities
 - Document review
 - Issue identification, negotiation, and resolution

Conduct of an IRS Audit

- Possible Outcomes
 - No change
 - Agreed changes – pay the assessed tax or receive the agreed refund

Conduct of an IRS Audit

- Possible Outcomes (cont)
 - Unagreed changes
 - Receive a 30-day letter
 - Agree – pay tax
 - Disagree – file appeal with appeals division
 - Do nothing – receive 90 day letter – “notice of deficiency”

Conduct of an IRS Audit

- Appeals Process

- Last stop for administrative resolution
- Appeals officer is employed by IRS, but charged with applying a “hazards of litigation” standard when settling cases with a taxpayer
- Generally, the result is a negotiated settlement as a percentage of the proposed deficiency

Conduct of an IRS Audit

- Practical Suggestions
 - Limit exposure of taxpayer to IRS agent
 - Be nice to the examining agent
 - Avoid personal attacks on the agent
 - Do not lie
 - Act dumb

Conduct of an IRS Audit

- Practical Suggestions (cont)
 - Keep notes on all agent calls or contacts
 - Talk with the agent
 - Be cautious extending the statute of limitations
 - Always calculate the dollar effect of issues and concessions

Conduct of an IRS Audit

- Practical Suggestions (cont)
 - Preparation for the audit
 - Know the weak spots
 - Have all requested records readily available and in good order
 - Do not invest time in issues the agent has fixated upon
 - Treasure the unmotivated agent

The End

Please feel free to contact us:

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