

How To Prevent Being Audited in 3 Easy Steps

by Kathia V. Toraño, CPA

The *possibility* of a tax audit haunts most business owners and keeps them up at night. The good news is that the IRS audits approximately 1% of all returns every year and the *probability* of being audited is actually quite slim. The not so good news is that you still need to be prepared and in this case, *prevention* truly is the best medicine.

Have no fear. Below you will find three easy steps to turn your business nightmare into your favorite bedtime story.

Step 1: Maintain Good Record-Keeping

Good record-keeping begins with properly separating your business from your personal life. Most of us will be diligent enough to open a separate business checking account and perhaps also a business credit account. However, it seems that as life goes on and the bills come our way, we continue to pay for business expenses out of our personal accounts (missing out on possible business tax deductions) or pay for personal expenses out of our business accounts (distorting the true financial picture of your business and unintentionally claiming false tax deductions).

Reporting higher than average deductions is a red flag for the IRS, as is reporting income higher than \$200K. In no way is this meant to discourage you from making the big bucks and deducting all the business expenses that you are entitled to. On the contrary, make sure that your expenses are properly classified into the accounts that they correspond to and that you have properly documented bills, receipts, and account statements to support your deductions.

Step 2: Double-Check for Accuracy

It is no secret that reviewing your tax returns before signing them is something you rarely do. This task certainly falls into “the boring stuff” side of the business. After all, your tax preparer is a professional and so whatever they choose to report seems to be good with you. Until, of course, the IRS comes knocking at your door.

The truth is that ***management is always responsible*** and you should certainly compare the amounts reported on your tax returns to your financials. Ideally, your tax preparer will walk you through the return and explain what the numbers mean. Embrace the opportunity and ask questions.

Also, remember back in school when the teacher used to remind us to write our names on all the exams, quizzes, and homework? Do it. Make sure to review your name, address, social security number, date of birth, and other identification data at the top of each tax return. You may be surprised by what you find.

I emphasize that you review your returns for accuracy, but no matter how much we double-check our work, typos do happen. Depending on where that typo is located, the IRS will contact you for additional information. Simply prepare a report or written explanation as necessary and return promptly to the address provided along with a copy of the original notice you received. Continue with timely follow up until the matter is closed.

Remember, the IRS only communicates by mail correspondence. Any other type of communication is most likely fraudulent. For instructions on how to handle suspicious IRS-related communication, go to <http://www.irs.gov/uac/Report-Phishing>.

Step 3: Lead with Transparency and Honesty

In the words of Billy Joel, “honesty is such a lonely word... but mostly what I need from you”. Well, both the IRS and I share Billy’s feelings.

After having maintained good record-keeping and double-checking for accuracy, your tax returns and financials may still draw questions when reviewed by someone who is not familiar with your business. It might be the outrageously big bucks you made throughout the year or a series of expenses that are specialized for your business. Whatever the case, be sure to ***lead with transparency and honesty***.

Already, the IRS requests that certain amounts reported on your tax returns be accompanied by additional information, listed in the form of “schedules” at the end of your return. If you feel that an additional explanation is necessary at some point, even though not required by the IRS, discuss with your tax preparer and include along with the other schedules.

As we wrap up, I’d like to remind you that you are not alone. If you are a creative creature and the thought of managing the financial side of your business seems overwhelming... Well, thank goodness because it means that people like me will still have a job! Jokes aside, find a trusted financial partner – interview as many of them as you need to – and begin to face your financial situation head-on.

Your financial peace-of-mind is just around the corner.

Kathia V. Toraño is a CPA and founder of Noble Lion Financial, where she provides business consulting to passionate entrepreneurs. Visit www.NobleLionFinancial.com today and begin taking control over the finances of your business.