



Tax Audits: Preparing for and Responding to Them

A tax audit is a daunting experience for individuals and businesses. If you are being sent a notice by a state tax authority or the IRS, you should understand the audit process and how to handle it well. Proper preparation and response methods can significantly affect the outcome of an audit. In this guide, a CPA Los Angeles explains why they take place and what you can do to remain compliant while maintaining your financial interests.



What Causes a Tax Audit

Tax audits are initiated when tax authorities see inconsistency or anomalies in a tax return. Triggers are:

1. **Too many Deductions:** Claiming much greater deductions than your peers in your income bracket might attract suspicion.
2. **Unreported Income:** Not reporting all sources of income, such as contract or freelance work, can result in an audit.
3. **Unusual or Unreasonable Business Expenses:** Those who report disproportionately high expenditures without explanation may be interrogated.
4. **Repeated Losses:** Consistently reporting losses, especially for cash-guzzling businesses, can raise flags.

5. **Random Selection:** Some audits occur randomly, even if there are no red flags.

Categories of Tax Audits

The IRS, and also state tax offices, perform various kinds of audits based on the complexity of the case:

1. **Correspondence Audit:** A routine examination conducted by mail, typically asking for records for a particular deduction or credit.
2. **Office Audit:** Takes the taxpayer to an IRS office to provide them with documents and answer questions.
3. **Field Audit:** Conducted at the residence, business, or accountant's office for a full audit.
4. **Taxpayer Compliance Measurement Program (TCMP):** A very comprehensive audit that examines all aspects of a tax return.

How to Prepare for a Tax Audit

If you are actually audited, a [CPA Los Angeles](#) suggests following these steps in preparation:

1. **Read the Audit Letter:** Know what section of your return is under audit and when you need to act.
2. **Gather Documentation:** Gather relevant financial documents such as receipts, invoices, W-2s, 1099s, and bank statements.
3. **Consult a CPA:** A certified public accountant (CPA) can walk you through the process and make sure all the paperwork is correct.
4. **Stay Organized:** Maintain good, well-documented records to substantiate your tax return assertions.
5. **Respond Promptly:** Tardiness may lead to penalties or further interrogation.

How to Respond When Audited

Conducting an audit in a professional and strategic manner is essential to its successful conclusion:

1. **Be Honest but Diplomatic:** Provide only the information requested—nothing more, nothing less.

2. **Remain Calm and Professional:** Don't make unnecessary justifications or defensiveness.
3. **Have Representation:** A CPA or a tax professional can represent you before auditors.
4. **Negotiate if Necessary:** If you disagree with the results, request a reconsideration or provide additional evidence to support your claim.
5. **Keep Copies:** Maintain copies of all correspondence and documents that are sent to the tax authority.

Avoiding Future Tax Audits

Although no method can guarantee that you will not be audited, these best practices can reduce the risk:

1. **Maintain Proper Records:** Maintain proper financial records for three to six years.
2. **Report All Income:** Report all income, including freelance and investment income, accurately.
3. **Consult a CPA:** Let a professional accountant assist you with proper and accurate tax filing.
4. **Avoid Guesswork:** Use precise figures rather than approximations on your returns.
5. **File on Time:** Filing or amendment on time will avoid additional inquiry.

Final Considerations

A tax audit isn't nerve-wracking if you're prepared. Having knowledge of the reasons why you are being audited, responding properly, and having a CPA Los Angeles accompany you can make it go smoothly. Either you're audited or don't wish to be audited in the future, accuracy in your records and doing what you should be doing can help your financial health.