

Update: July 2010

## Tax Intelligence

# Tax Credits and Incentive Audits and How to Respond

### Situation

The IRS has been hiring additional revenue agents and officers nationwide since the beginning of 2009 to step up the enforcement of the tax code. This is the largest hiring initiative in recent history. The hiring push started with the fiscal year 2009 omnibus bill, which contains \$630 million above the IRS current funding level to address noncompliance through improved technology, collection efforts, and audits. The additional staff will focus on corporate compliance and international issues. The IRS goal is to target closing the \$345 billion annual tax gap.

As a result of the hiring, many corporations will notice an increase in audits. The increase will be at both the federal and state levels. Due to the economy, states are taking a proactive approach to implement more efficient cost controls for state tax credit programs. Federal or state audits can be triggered by many factors from irregularities on tax returns to yearly audits performed on corporations. Unfortunately, many audits are not simple and require detailed information from the corporation. A federal or state audit is usually initiated by an audit letter which provides the detailed information regarding the audit. Corporations must be able to respond and justify the information provided on the tax return.

### Solution

When a corporation receives a federal or state audit letter, the following steps will provide initial guidance when responding to the request:

- The corporation should review the audit letter for the years targeted, the scope of the information requested and any documentation accompanying the audit letter.
- The corporation should focus on assembling the requested information and documents. The initial review of the audit is intended to identify items that are likely to be questioned or challenged. Corporations should respond as accurately as possible to the audit agent without going beyond what has been requested. Corporations may need to seek guidance from the tax professionals who assisted with the return.
- The audit agent may request to review in person the requested information and documents.
- The corporation should specify a contact person and request that the agent direct all communications to that individual. In some instances, the contact person will need to provide a power of attorney to discuss any audit matters with the agent.
- If the audit agent has additional questions, the corporation may request additional questions or identified issues be provided in writing.
- When an audit is finalized, the audit agent will typically provide a preliminary audit report. Depending on the preliminary audit report, it may be beneficial to request a meeting with the agent to resolve the proposed adjustments. If this is not possible or practical, the next step would be to protest the agent's proposed adjustments.

### Value

Safeguarding your company is a great responsibility, since the pressures of today's economy have forced staff reductions on many employers. With the federal and state taking a more aggressive approach to audits, it is more important than ever to protect your company on federal positions, documentation and internal controls. If your company is interested in receiving more information on handling audit responses, please contact Pete Krieshok at (314)214-7325 or via email at [pkrieshok@talx.com](mailto:pkrieshok@talx.com) or visit our corporate blog at <http://blog.talx.com>.