



How Small Business Owners can Avoid an Audit

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So you want to avoid a business audit – who doesn't? The IRS randomly audits businesses all over the country. If you'd like to avoid being one of them, here are six scenarios you should stay away from; they all tend to trigger examinations.

1. Travel and entertainment expenses

The good old days are gone. These days it's best to keep rigorous account of your travel and entertainment (T&E) expenses. The good news is it's easy enough. All you need is a spiral notepad and a bit of discipline – enough to keep accurate records of the amount, time/place and business purpose of your expense. If you're entertaining clients, you also need to include in your notebook the person you entertained, your business relationship with him/her, and why the entertainment took place. (And of course, the date.) Anything over \$75 should also be documented with a receipt or credit card statement.

2. Targeted industries

Ever heard of an IRS audit technique guide? If not, read on. The IRS specifically targets certain industries and professions. Why? Because the IRS believes they're the industries most likely to abuse federal and state tax laws. If you're in one of these industries, your chances for an audit are greater. The good news is you can read the audit technique guide and learn some of the violations the IRS expects to find.

3. Employment taxes

This "red flag" has been around for years. It directly affects small business owners who hire independent contractors rather than hiring full and/or part-time employees. The catch is an independent contractor has to fully qualify as independent by working outside your business for specific hours, etc. The IRS will not consider someone who regularly works inside your office 40 hours a week a freelancer. Why? Because they will generally believe you're controlling his/her work and how it's done rather than vice versa.

4. Sole proprietors

For a long time, sole proprietors have been off the IRS audit radar. Times have changed. Ever since the IRS realized this group has over twice the total of unreported taxes as the country's largest businesses, it's been refocusing its efforts on the smallest of business owners. The bad news is this trend isn't over yet.

5. Fringe benefits

If you and your key employees already make a pretty decent salary, and you've been thinking of providing everyone with some pretty cushy non-cash benefits, think again. The IRS may be on to you real soon. If you're audited, be prepared to justify comp packages that include deferred compensation, employee stock options, and special insurance plans. They've even launched a new program dedicated to tracking down executive fringe benefits.

6. Owner compensation

You own your own business so you can pretty much pay yourself whatever you like? Right? Wrong. You can as long as the IRS agrees with you. But if it considers your salary to be too high for your business and/or industry, it can trigger an audit. Some of these cases end up in court, especially when a C corporation owner's compensation is too high or, on the other hand, the salary of an S corporation owner is too low.

The bottom line is the bottom line. There's no free lunch, but a strong business advisor can help ensure you're steering in the right direction.

If you would like more information on this topic, please contact Jenny Daughetee at 888-556-0123 or jdaughetee@honkamp.com.

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