

IRS Audits: Real Case Stories

By Hans Kasper, MS-CPA, PS, Bothell, Washington

From 1973 to 1976, I was an IRS agent in the Chicago District. During that time, I audited a wide range of companies in type and size. Because of these and many more audit cases, I am able to see where the IRS is going with an audit before other accountants can. I also have worthwhile insights about how

competitors. The competitor suspected that the company was not paying the excise tax.

I pulled copies of the returns from the service center and sure enough, no tax was being reported or paid. I called the company and set an appointment for the audit. I started going through the books and

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to prepare a return that will help prevent an unnecessary audit.

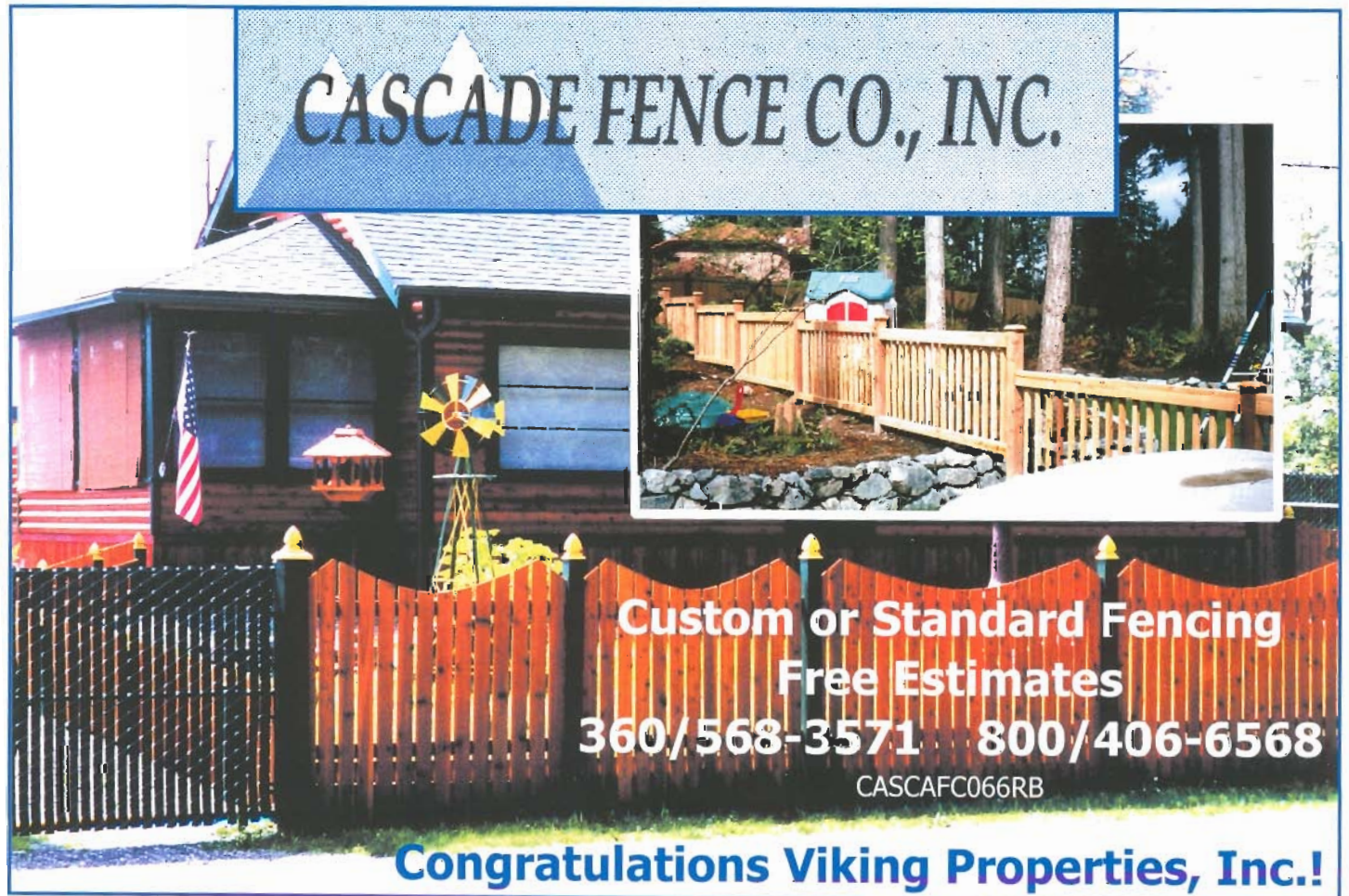
The following are a few stories of my experience inside the IRS.

Excise tax

I was assigned a case where a company that was manufacturing truck parts was turned in by one of its

records and found that the truck parts were for government contracts that stated that the excise tax was due on these parts.

I noticed that one of the owners had a picture of an airplane on his wall. Therefore, I got him into a conversation about how much he loved his airplane and then I asked him for copies of the excise tax re-



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turns for the plane. He filled them out and threw them at me. After they hit my chest and fell to the floor, I thought, I'll bet he feels the same way about the excise tax on truck parts.

I went down to the IRS information division to retrieve microfilm copies of the processing records of the corporate and the owners' income tax returns and guess what I found? The other owner had never filed personal income tax returns for the last five years. A fraud case just does not jump out at you, you build it little by little, and in this case, all of the parts were starting to add up

They did not go to jail, but they still owed \$1,000,000 in taxes plus significant penalties and interest, and they had to pay a huge sum for criminal defense attorneys.

Travel and Entertainment

Some companies like to spend large amounts on travel and entertainment and, in some industries, it is necessary. I was assigned a case where, for the size of the company, the T&E expense seemed a little high. As I got into the audit, I realized that there was only one salesman-the owner-and his T&E expenses per year amounted to \$250,000 in 1975 dollars. Now let me tell you that is some real money.

As I started going through the receipts for the expenses, I noticed some interesting things. I noticed receipts for mink coats, washing machines, TVs, and so on. I asked the outside CPA about these items and he said that they were for corporate gifts to clients. I asked the accountant what the purpose of these gifts were and he said that this was the only way that the company could get the buyers' in the retail chains to purchase the company's products. Let us put this in English-these were corporate bribes and payoffs to purchasing agents. These purchasing agents were on the take. The items were for their wives and their own homes.

To complete the audit, I disallowed 100% of the company's T&E expenses due to a lack of documentation and excessive gifts, and I went back three years.

I have also seen a wedding and 45-foot yachts buried in the cost of goods sold.

I Told You Not To Talk To This Guy

I had an opportunity to audit a company on the **near south side of the city**. Before an audit, the company's accountant will coach the owner what

to say and what not to say. The owner was a wonderful fellow with a very fine product line. As the audit proceeded, I would ask him questions about his business. In the tax law at that time, there were certain items that had to be perfectly timed and recorded in

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the corporate minute books to be able to achieve a tax deduction.

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I said nothing further about it until the closing meeting when the accountant was present. When I brought it up, the accountant said to the owner, "Harry, I told you not to talk to this guy, didn't I? Now look what you've gone and done."

Need I say more to make my point to you?

The Cost of Living

When an auditor starts work at the IRS, they go through six months of training in tax law and audit techniques. It was during the last stage of training that I was assigned to audit a small retail store. Upon going through the books and records, I could not get the deposits on the books to balance to the tax return and neither could the accountant.

I asked the accountant to prepare a cost of living analysis for the owner and the business. Congress has given the IRS the authority to prove the income of the taxpayer. This is a simple task. All deposits to your bank accounts are income unless you can prove otherwise. However, if not all of the income is deposited, then the second method of proving income is a cost of living analysis. In that case, your income is equal to your cost of living unless you can prove otherwise.

Well, the cost of living analysis showed \$30,000 more per year of income than what had been reported on the tax return. Boy, was the accountant nervous! Yes, I did send it up for a fraud review, but it was rejected. I assessed the additional tax and a negligence penalty.

The only reason that I asked for a cost of living analysis was that the books and records were not properly kept. Need I say more?

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