TRANSCRIPT

COURSE 1 - MODULE 8 - LESSON 1

New Terms

Hi there.

I must say I am really looking forward to these lessons. It may sound a little surprising, but IRS audits will be a really interesting part of you work when you get to experience them. I don't think I should go as far as saying they will be enjoyable, but being prepared will go a long way to easing the stress and pain that comes with them!

So, to kick off, as in the previous modules, we will begin this one with the introduction of some new terms. Nothing quite as onerous as the ones in the previous modules I might add!

To begin, let's start with the obvious one, audit and what that actually it is and how it is defined.

an IRS audit is a review, an examination of an organization's (or individual's) accounts and financial information. Audits are undertaken to ensure information is reported correctly according to the tax laws. And, audits are there to verify the reported amount of tax is correct.

That's a long winded to say the IRS wants to make sure you reported everything correctly and paid the required tax! Pretty straightforward.

The next term I want to introduce is **PAYMENT SYSTEMS.** This may seem like an obvious one, but here it is a specific term that refers to your organizations internal systems used to pay out income.

Examples of payment systems may include, but certainly not limited to:

- An accounts payable system, which would hold vendor details, payment amounts and income types.
- Interest systems, which would include details about the dates and amounts of interest paid.
- Dividend systems, which could include details about the securities held, the dates, amount and character of dividends paid.

Then we have one that isn't so obvious:

WITHHOLDING LIABILITY ACCOUNT. This is all about the tax you withhold from payments to account holders, vendors, investors etc. This is seen as a LIABILITY against your organization, because your organization owes that tax to the tax authority.

Your organization's chart of accounts (the list of accounts used in its accounting system) will have a Withholding Tax Payable Account as part of the Liabilities group of accounts.

A few examples here could be liability accounts set up for, Backup withholding, NRA withholding, State withholding, etc.

Another term to introduce is:

IRS TRANSCRIPTS: An IRS transcript is a line-by-line report of specific items related to your IRS account.

Several different transcripts types are available, and these include:

- Account transcripts (such as a withholding liability account). These transcripts show a listing of amounts deposited with the IRS and the date of the deposit. Then we have,
- Return transcripts (such as your Form 945, remember we looked at that in an earlier module) which looks like a line by line listing of the information on the return, and finally,
- Wage and income transcripts.

And just to be aware, each of these different transcripts will represent a different view and show different information.

Before we finish this lesson on new terms, there are a couple more I am going to mention. The reason, is that I expect by now you are wondering how an organization (or an individual for that) is selected for audit?

Well, the first thing to say is surprisingly, there is no real guidance on how audits are selected. The IRS do publish guidance for the small business and self-employed and if we look at that we'll see two different approaches described there.

The first is:

RANDOM SELECTION: Sometimes returns, and for that the organizations, are selected based solely on a statistical formula. The IRS compares tax returns against "NORMS" for similar returns. The IRS have developed these "norms" from audits of a statistically valid (random) sample of returns, as part of the National Research Program the IRS conducts. The IRS use this program, The National Research Program, to update return selection information.

The second:

RELATED EXAMINATIONS: This is where the IRS may select returns or organizations when they are linked with issues or transactions with other taxpayers, such as other business partners or investors, where the returns of those related parties were previously selected for audit.

Although not directly related to the information reporting and withholding area we are concerned with here they may give us a little insight into the IRS's thinking?

But there are other possible ways you could be selected too, such as a:

- A history of non-compliance. That's never going to help!
- Cross referencing data, for example 1042-S data with refund requests or Forms 1042 with Forms 5472, 5471. Another couple of new forms for you there. Look at those much later.
- A process where the IRS refers the audit of the organization to a withholding specialist and they determine addition review is required.

As you can see, we can list a few possible ways withholding agents are selected for audit, but as I say there is no real guidance. The main point I am trying to stress is that selection for an audit may appear random and doesn't always mean or suggest there is a problem. Generally, audits are unavoidable and to some extent it is the luck of the draw!

What I hope it shows, is that you should be prepared and if not, you may be in for a whole heap of pain!

Now that we have a few new terms under our belt, let's move on to a discussion of what is a withholding agent audit.