

# Small Business IRS Audits Increasing

by [Catalyst QuickBooks Editor](#) on October 17, 2010

To add more stress for small-business owners, a new report from Syracuse University's Transactional Records Access Clearinghouse (TRAC) highlights a troubling trend:



In the last five years, the number of hours the IRS spends auditing small businesses (with assets under \$10 million) has increased by 30 percent. In the same time period, the time the IRS spends auditing companies with \$250 million or more in assets has dropped by 33 percent.

Theorizing as to why smaller companies are being targeted, TRAC writes:

*“Choosing to audit the smaller rather than the larger businesses would on its face help individual [IRS] agents meet their performance targets [for auditing a certain number of returns]. But the decision to audit the smaller companies does not help the government collect more taxes because the data indicate that the larger the business, the larger the dollar amounts of tax under-reporting and back taxes on average that they may owe.” In fiscal 2009 the average amount of tax “under reporting” IRS auditors uncovered per hour spent auditing small to midsized businesses was \$1,025. The average for large corporations was \$9,354.*

According to [CFO Zone](#), the audits will focus on four key areas:

**Worker Classification:** Whether workers are classified as employees or independent contractors.

**Executive compensation:** Salary and non-salary compensation, such as loans, deferred compensation and stock.

**Fringe benefits:** Perks for executives and employees.

**Payroll taxes:** The IRS will be looking closely at Forms 941 and Form 1099/W-2 for issues including withholding and next-day deposit requirements.

The IRS has warned that firms being audited should be prepared to open all their records to the agency. But whether or not your business gets an audit letter, the NRP puts all small businesses on notice that they need to make sure their ducks are in a row.

Why? The NRP may be a short-term project, but its findings will be used to focus a long-term crackdown on business tax compliance in the four areas above.

Dean Zerbe writes in [Forbes](#) -

*“I am concerned by the general trend highlighted in the TRAC report—namely more scrutiny of small and mid-sized business and a reduced focus on large corporations. A large corporation may have on staff a dozen tax attorneys who would be doing origami (or devising new tax strategies) if the IRS doesn’t call. But for small businesses, an IRS audit often requires the time and attention of the business owners or top managers. That means it can disrupt and cause economic harm to a business—even if the IRS doesn’t find anything wrong. The time spent with the IRS is time a business person could be improving and expanding the business and maybe even hiring new employees.”*

According to the TRAC report –

*“The decision to audit the smaller companies does not help the government collect more taxes,” the study concluded. “This is because the data indicate that the larger the business, the larger the dollar amounts of tax underreporting and back taxes on average that they may owe.”*

What are the odds of your small business being audited in the next 18 months, you ask? Some experts peg that number at about 3% or one chance in thirty.

What about if your small business is audited? Overall, if you are prepared and organized, then at worst you will only face paying some additional taxes. If nothing else, you will have definitely learned from the experience.

One last thing – we heard recently that the IRS and other local tax authorities are now requesting the actual Quick Books Data file from small businesses under audit. The IRS has now trained their agents to review the electronic copy of your books and records. So now more than ever it’s important to make sure your business is maintaining accurate and correct books. Haphazardly done books could have huge negative consequences as a result of an audit.

Small business owner beware.

You can read the full report at [TRAC’s Web site](#).