



Hudak & Company

**Statement of Warren Hudak, EA, CPA
Before the U.S House of Representatives
Committee on Small Business,
September 14, 2016**

Among the Taxpayer Bill of Rightsⁱ provisions are:

The Right to Challenge IRS' Position and Be Heard—Taxpayers have the right to raise objections and provide additional documentation in response to formal IRS actions or proposed actions, to expect that the IRS will consider their timely objections and documentation promptly and fairly, and to receive a response if the IRS does not agree with their position.

The Right to Pay No More than the Correct Amount of Tax—Taxpayers have the right to pay only the amount of tax legally due, including interest and penalties, and to have the IRS apply all tax payments properly.

The Right to Retain Representation—Taxpayers have the right to retain an authorized representative of their choice to represent them in their dealings with the IRS. Taxpayers have the right to seek assistance from a Low Income Taxpayer Clinic if they cannot afford representation.

Chairman Chabot, Ranking Member Velazquez and members of the House Committee on Small Business, thank you for the invitation to participate in today's hearing reviewing the state of audits at the Internal Revenue Service.

My name is Warren Hudak, President of Hudak & Company, which is located in Lemoyne, Pennsylvania. I am an enrolled agent, certified public accountant, and small business owner. I testify today as a member of the National Association of Enrolled Agents. The opinions I express in this testimony are mine alone.

My firm provides comprehensive tax services including return preparation, planning and representation before the IRS. We work with all categories of small businesses (sole proprietorships, partnerships and S-corporations), nonprofit organizations, and individuals. Our representation services include audits, negotiating installment agreements, offers-in-compromise, collection due process hearings, appeals, and penalty abatements.

Today I share with you my perspectives as both a tax practitioner and a small business owner. While I participate under the auspices of NAEA, the opinions I express in this statement are mine alone.

Over the last five years, we have witnessed a significant shift in the number and quality of IRS audits. This shift, of course, has coincided with a dramatic decrease in funding levels at the agency. We've seen a 24 percent decrease from 2010 to 2014ⁱⁱ in the number of staff performing audits. Enrolled agents, as the taxpayer's representative, have had a front row seat to the effect of this funding on enforcement actions by the IRS.

In short, the agency relies more heavily on automation and faceless decisions and less on auditors in the field. Many new auditors are not properly trained and have only a cursory knowledge of the Internal Revenue Manual, which is the foundational document guiding all the actions IRS takes during the course of an auditⁱⁱⁱ.

Importantly, IRS examinations may range from the simple issuance of an IRS notice asking for clarification of a single tax return item that appears to be incorrect (correspondence examination) to a face-to-face interview and review of the taxpayer's records. While there are significant problems associated correspondence audits, I will focus my testimony today on field audits.

Because of the decline in resources we have seen two rough trends with audits: greater pressure to make each audit a success for the government and poorly trained and prepared auditors.

Pressure for a Win

As resources have dwindled, we have witnessed an increase in techniques we believe are intended to bring in more revenue not necessarily the correct amount of taxes. Many of these techniques are intimidating and all too familiarly carry a presumption of guilt. For instance, recently I represented a taxpayer that received an audit notice. At the audit, it was clear that a Form 1099 from a credit or debit card payment entity had triggered the audit. We immediately explained that the income reported by the credit card company had been split between two businesses tax returns and consequently had been properly reported and taxes paid. The original purpose of the audit having been explained, the auditor then clearly did not want to "waste" a scheduled afternoon audit proceeded to spend the rest of the afternoon randomly fishing around in the taxpayer's records. In the end, our client suffered no changes in tax liability but owed a substantial amount of practitioner fees.

While practitioner representation fees can be expensive, not have representation can be even worse. Increasingly, we find auditors that are bypassing taxpayer representatives who hold properly executed powers of attorney^{iv}. Most taxpayers want to cooperate, so when the auditor shows up at their place of business they go out of their way to answer questions and attempt to explain business practices. One of my favorites:

Auditor: "How often do you make cash deposits?"

Taxpayer: "As needed."

Auditor: "Is that once a day, once a week, once a month?"

Taxpayer: "Maybe once a week"

The Auditor later expands the audit because he sees instance when a deposit was not make every week.

Taxpayers rarely understand the agency's purpose for the audit. It is to collect information to substantiate the tax return in whole or in part. Taxpayers usually provide rambling explanations that either provide reasons to expand the audit or lead the auditor to inaccurate conclusions. Often the direct contact becomes a way to maximize tax, as the IRS expands the audit scope.

Another problem area is what I refer to as the "friendly-stop-by." The auditor just happens to be in the area and drops off a summons. Or, the auditor presents the audit report directly to the taxpayer with the signature lines tabbed and suggests the taxpayer sign accepting the report without consultation of the appointed representative. Unfortunately, in both these instances these innocent actions significantly prejudice the clients' right to challenge the IRS's position.

Another technique used to maximize pressure on the taxpayer is the use of third party contacts. We see the IRS send third party summonses to vendors, financial institutions, clients, and even neighbors. This behavior is seen as a way of pressuring the taxpayer to agree to proposed return adjustments. One can only imagine how much pressure it puts on the taxpayer when the IRS auditor calls clients, vendors and neighbors and says "I am from the IRS. I'm wondering what you can tell me about Joe Taxpayer." Taxpayers feel intimidated and often completely capitulate in order to preserve their business reputations.

Training makes a Difference

As intimidating as many of these techniques are, we find that lack of training also harms taxpayers in audits. New auditors are not well-versed with the Internal Revenue Manual. Many enrolled agents find themselves in situations where they are literally providing auditors with highlighted copies of pertinent sections of the IRM. For instance, we recently had an auditor ask for 10 years of records, even though the statute of limitations allowed him only three years.

We have found ourselves with auditors working remotely from their homes. We had to tell them we will not provide them with sensitive financial information until they are able to substantiate the records will be kept in accordance with IRS procedures.

One of my enrolled agent colleagues told me she has had a number of instances when she has forced an audit into appeals because it is clear that the subject matter of the audit is beyond the knowledge of the auditor. Other auditors are often over their heads with case load and subject matter as demonstrated by simple audits going on for months.

These may seem like trivial matters but as they say “time is money” and endless audits or uninformed auditors cost small businesses money and loss of focus on their core business.

Closing

Taxpayers have rights, including the right to challenge IRS’ position, and the right to pay no more than the correct amount of tax. While we as a nation have a noble tradition of *pro se* representation, that path is fraught with peril, especially for the small businessman or woman. Small business owners do not have the expertise to go toe-to-toe with IRS, even in the best of times, when IRS staff is fully trained, carries a reasonable workload, and is provided with the proper tools. Just as important, small business owners don’t have the time to go toe-to-toe with IRS.

Fortunately, taxpayers also have the right to retain representation. Even with this solution in place, we need to be sure IRS is not making end runs around representatives, and we need to be sure IRS is making focused, reasonable queries of small business owners, and of all taxpayers for that matter.

ⁱ The Taxpayer Bill of Rights in its entirety: <https://www.irs.gov/taxpayer-bill-of-rights>

ⁱⁱ TIGTA audit, *Trends in Compliance Activities Through Fiscal Year 2014*, November 10, 2015, reference number 2016-30-004: <https://www.treasury.gov/tigta/auditreports/2016reports/201630004fr.pdf>.

ⁱⁱⁱ IRM Part 4 is the Examining Process: <https://www.irs.gov/irm/part4/>

^{iv} Form 2824 (Power of Attorney and Declaration of Representative): <https://www.irs.gov/pub/irs-pdf/f2848.pdf>