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# The Inflation Reduction Act just became law, and gives more money for IRS tax enforcement. Here's how small businesses can prepare.

Will the new law result in more audits of small businesses? As a CPA, I have to believe it will.


The Internal Revenue Service is getting billions in new funding for tax enforcement under the Inflation Reduction Act.Chip Somodevilla / MCT

by Gene Marks | Columnist, For The Inquirer

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The Inflation Reduction Act — which was signed into law by President Joe Biden on Tuesday — contains provisions aimed at improving health care and climate change. But it contains something else that could have a significant impact on small businesses: $80 billion in additional funding for the IRS. According to the Congressional Budget Office, that funding will yield an additional hundreds of billions of new tax revenue from "enforcement."

To step up enforcement, $46 billion will be spent on hiring more agents. There will also be more scrutiny over cryptocurrency transactions and a modernization of the agency's infrastructure. Treasury Secretary Janet Yellen, in a public letter sent to IRS Commissioner Charles Rettig this month, stressed that new enforcement should focus on large corporations and high-net-worth individuals, and not small businesses or households making less than $400,000 a year. However, not everyone is convinced.

"The IRS will have to target small and medium businesses because they won't fight back," Joe Hinchman, executive vice president at National Taxpayers Union Foundation, told the New York Post. "We've seen this play out before … the IRS says, 'We're going after the rich,' but when you're trying to raise that much money, the rich can only get you so far."

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So will the Inflation Reduction Act result in more audits of small businesses?

As a certified public accountant (CPA), I have to believe it will. That's because — regardless of Hinchman's concerns about the extent of these audits — many of my clients in the Philadelphia area are generally family-owned companies or business-to-business entities that oftentimes do earn more than $400,000. Most of these earnings get reinvested back in their businesses. But unfortunately, that won't stop the tax agency's audit efforts.

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Which is why it's likely that there will be much a higher level of future scrutiny of business tax returns than in years past. So it's important, as a business owner, to be prepared. What are some of the steps you should be taking now?

Keep records organized

"I advise clients of a few ways to minimize the chance of an audit," said David Lopez, a CPA in Philadelphia. "First, you should remain consistent with how you categorize your transactions from year to year. Second, make sure to utilize the skills of a licensed, experienced tax professional, and, finally, ensure you transmit a full tax return … meaning, do not exclude any of the forms and schedules required by the IRS."

Lopez believes that a high level of organized record-keeping will also help mitigate any concerns in case of an audit.

"I once represented a client in an IRS audit and the auditor removed any questions and potential assessments because they felt the documents were so well-organized and presented that the business was a law-abiding entity and most questions could be answered by reviewing the file we prepared," he said. "Our client made the auditor's job easier."

Avoid these red flags

Adrienne Straccione, a CPA with Wouch, Maloney & Co., in Horsham, says there are a number of red flags to avoid that could potentially trigger an audit. Some of these include calculation errors, taking deductions outside the range of industry norms, reporting continued losses, and failing to timely file payroll tax returns.

And, like Lopez, Straccione agrees on the importance of keeping good records.

"Record retention is critical for small businesses," she said. "The IRS, for example, requires taxpayers to keep tax records for at least three years from the date the tax return was filed. If you are unable to produce a requested document, the auditor may consider this a finding that leads to a negative impact on the audit results."

Don't ignore IRS requests

Timely responses, according to Jacob Cohen, a CPA in Philadelphia, are critical because ignoring any requests from the IRS will also lead to more problems. "The key thing is that the IRS will provide deadlines for supplying documents and information, and it's important to make sure that you meet those deadlines and provide complete documentation to the best of your ability," he said. "If you need additional time to gather the documents, ask for an extension."

Pay on time

Finally, and perhaps most important, is simply following the rules and paying what you owe.

"The easiest thing that small-business owners can do to avoid an audit is to file and pay their taxes timely and completely," Cohen said. "If returns are filed late and taxes are not paid timely, then there is a high likelihood of increased IRS scrutiny."

If you do get audited and don't agree with the findings, don't worry: You still have options. If you don't believe that you are being treated fairly by the auditor, you can nearly always request a meeting with the auditor's supervisor or even appeal any findings that you think are not equitable.

Know your rights

The IRS cannot withhold information, should clearly explain why you are being audited, and provide the statutes and regulations that the agency says you may have violated. Straccione notes that taxpayers are provided certain rights, including the right to representation by an authorized representative (i.e., tax professional).

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“Be aware of your rights as a taxpayer and limit the scope of the audit to the business under audit,” she said. “At the completion of the audit, the auditor will present his or her findings. If you disagree with the findings, you may have a right to appeal.”

All of this advice is great. But as a CPA, I’ve learned that there’s no guarantee of avoiding an audit, even if you do all the right things. IRS audits are randomly selected. They can be triggered by a red flag on your return, or initiated by a simple mistake that prompted additional questions.

“In reality, you may do everything correctly and still get audited,” Lopez said.
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