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The Examination (Audit) Process

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The IRS examines (audits) tax returns to verify that the tax reported is correct.

Selecting a return for examination does not always suggest that the taxpayer has either made an error or been dishonest. In fact, some examinations result in a refund to the taxpayer or acceptance of the return without change.

The overwhelming majority of taxpayers files returns and make payments timely and accurately. Taxpayers have a right to expect fair and efficient tax administration from the IRS, including verification that taxes are correctly reported and paid with enforcement actions against those who fail to comply voluntarily.

TAXPAYER RIGHTS

The IRS trains its employees to explain and protect taxpayers' rights throughout their contacts with taxpayers. These rights include:

- A right to professional and courteous treatment by IRS employees.
- A right to privacy and confidentiality about tax matters.
- A right to know why the IRS is asking for information, how the IRS will use it and what will happen if the requested information is not provided.
- A right to representation, by oneself or an authorized representative.
- A right to appeal disagreements, both within the IRS and before the courts.

HOW RETURNS ARE SELECTED FOR EXAMINATION

The IRS selects returns using a variety of methods, including:

- Potential participants in abusive tax avoidance transactions – Some returns are selected based on information obtained by the IRS through efforts to identify promoters and participants of abusive tax avoidance transactions. Examples include information received from “John Doe” summonses issued to credit card companies and businesses and participant lists from promoters ordered by the courts to be turned over to the IRS.

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- Computer Scoring – Some returns are selected for examination on the basis of computer scoring. Computer programs give each return numeric “scores”. The Discriminant Function System (DIF) score rates the potential for change, based on past IRS experience with similar returns. The Unreported Income DIF (UIDIF) score rates the return for the potential of unreported income. IRS personnel screen the highest-scoring returns, selecting some for audit and identifying the items on these returns that are most likely to need review.
- Large Corporations – The IRS examines many large corporate returns annually.
- Information Matching – Some returns are examined because payer reports, such as Forms W-2 from employers or Form 1099 interest statements from banks, do not match the income reported on the tax return.
- Related Examinations – Returns may be selected for audit when they involve issues or transactions with other taxpayers, such as business partners or investors, whose returns were selected for examination.
- Other – Area offices may identify returns for examination in connection with local compliance projects. These projects require higher level management approval and deal with areas such as local compliance initiatives, return preparers or specific market segments.

EXAMINATION METHODS

An examination may be conducted by mail or through an in-person interview and review of the taxpayer's records. The interview may be at an IRS office (office audit) or at the taxpayer's home, place of business, or accountant's office (field audit). Taxpayers may make audio recordings of interviews, provided they give the IRS advance notice. If the time, place, or method that the IRS schedules is not convenient, the taxpayer may request a change, including a change to another IRS office if the taxpayer has moved or business records are there.

The audit notification letter tells which records will be needed. Taxpayers may act on their own behalf or have someone represent or accompany them. If the taxpayer is not present, the representative must have proper written authorization. The auditor will explain the reason for any proposed changes. Most taxpayers agree to the changes and the audits end at that level.

APPEAL RIGHTS

Appeal Rights are explained by the examiner at the beginning of each audit. Taxpayers who do not agree with the proposed changes may appeal by having a supervisory conference with the examiner's manager or appeal their case administratively within the IRS, to the U.S. Tax Court, U.S. Claims Court or the local U.S. District Court. If there is no agreement at the closing conference with the examiner or the examiner's manager, the taxpayer has 30 days

to consider the proposed adjustments and their next course of action. If the taxpayer does not respond within 30 days, the IRS issues a statutory notice of deficiency, which gives the taxpayer 90 days to file a petition to the Tax Court. The Claims Court and District Court generally do not hear tax cases until after the tax is paid and administrative refund claims have been denied by the IRS. The tax does not have to be paid to appeal within the IRS or to the Tax Court. A case may be further appealed to the U.S. Court of Appeals or to the Supreme Court, if those courts accept the case.