

CPA

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Are YOU Ready?

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Photography (www.josephmoran.com)



5 Steps to IRS Audit Resolution

When taxpayers receive the dreaded notice that their business is going to be examined, the first thing they do is seek your advice. If you prepared the return, you already know there is nothing to worry about because the tax return is perfect in every way! So, of course, for the purposes of this column, we are talking about the new client who walks in with the tax return prepared by that “other accountant,” – not you!

1. Call the Revenue Agent

Call and introduce yourself to the Revenue Agent (RA) conducting the examination. Ignore the date and time (if any) on the examination notice, and negotiate a date and time convenient for you, allowing sufficient time to conduct a thorough pre-audit. This should be a cooperative, even friendly, discussion.

Try to narrow the issues. For example, I usually try to work with the RA to choose the top eight to 12 categories of expense on the tax return to audit. Generally, if I can show there is a competent set of books and records, and can fully document the larger expenditures, there is no need to look at the smaller ones. During this part of the conversation, it is very important to allow the RA to choose those categories. It is in both the taxpayer's and the IRS's interests to have an efficient examination.

2. Do a Thorough Pre-audit

Prior to the IRS examination, my pre-audit is more thorough than the actual examination; I scrutinize every check, receipt, and all of the books and records, trying to learn where all the “bodies” lie, and to understand the client's books, records, and business inside out. Knowing the weaknesses of the case allows me to prepare more effectively for the examination, and in some cases, I decide to offer up those weaknesses to the RA up front as a gesture of good faith.

It is important, especially with corporations, to understand all balance sheet accounts. For example, the impact of tax basis on S corporations may provide adjustments for the examiner. How many of us have observed the dreaded “loan to shareholders” account on the asset side of the balance sheet? You must understand each balance sheet entry as well as you will understand each entry on the P&L statement.

3. The Client Should be No-Show.

In the cover story in this issue, Pamela Young discusses the reasons why the client should be silent. The accountant should act as a buffer between the RA and the client, enabling the client to give thorough, well-thought-out answers to all questions.



“In the pre-audit, I scrutinize every check, receipt, and all of the books and records, trying to learn where all the “bodies” lie.”

**IRS
REPRESENTATION
ADVISOR**

E. Martin Davidoff, CPA, Esq.

4. Follow the Rules for Conducting the Examination

Have the examination in your office, not the client's. This enables you to more carefully control the flow of the examination. Avoid letting the auditor sit alone all day looking over the records on his or her own. It is important that your staff and you spend time with the auditor, getting to know him or her and knowing what he/she is doing. Provide the information to the auditor one part at a time so that you can keep track of what has been examined.

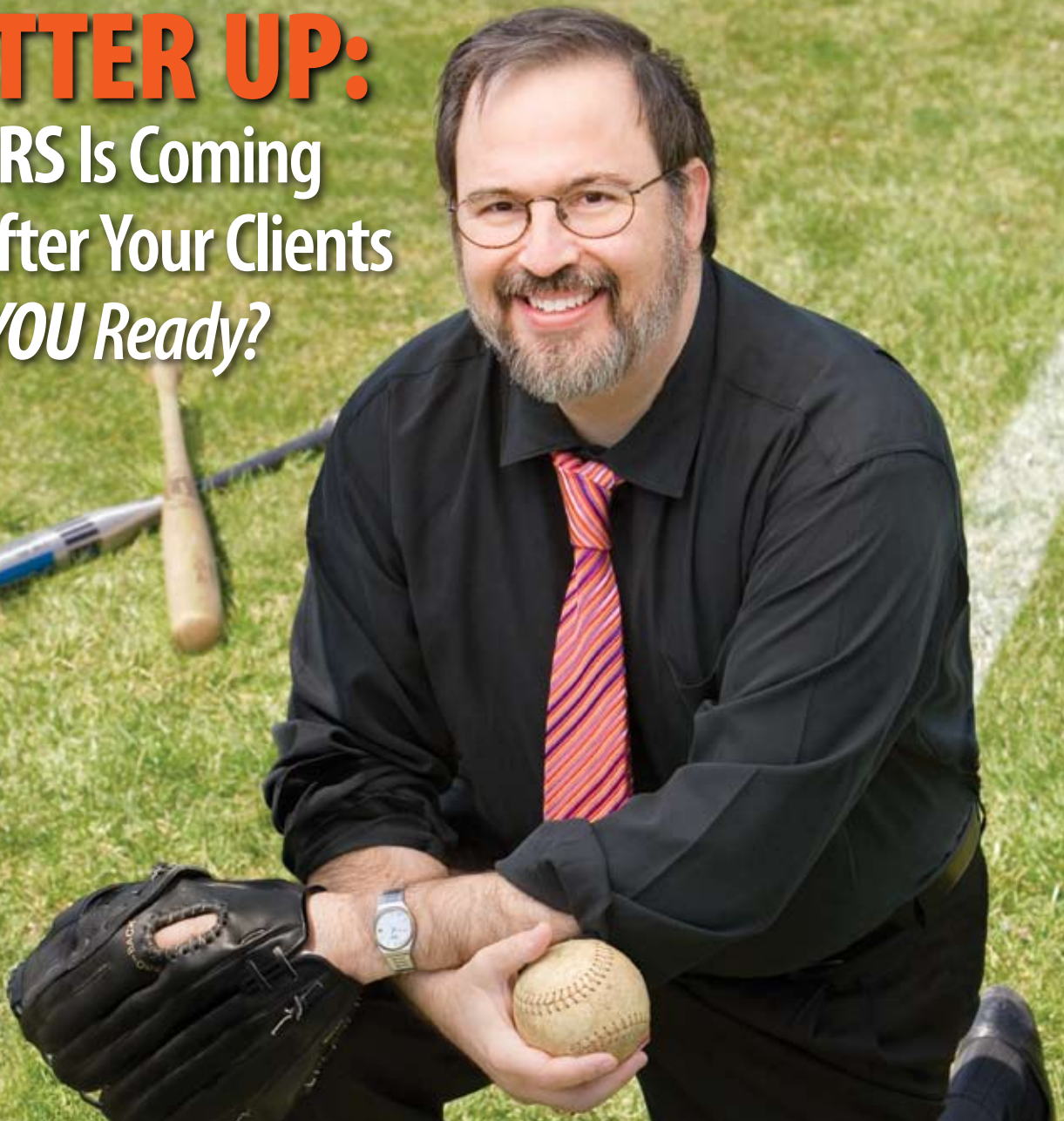
- Never lie or make a misstatement to the RA.
- Never volunteer information, unless it is part of a strategy to do so.
- Do not accept unreasonable timelines to get information back to the RA.
- Meet all commitments made to the RA, or at least call in advance if you cannot do so.

5. Negotiate a Resolution.

Try to arrive at a negotiated resolution of the examination with the RA. By doing so, you save your client the cost of an appeal or the examination of multiple years, and in most cases, you will have a reasonable person on the other end. However, if you do not, make sure you take advantage of your informal appeal rights (by talking to the manager and the territory manager) and your formal appeal rights by timely filing your appeal to the examination 30-day letter. ☺

E. Martin Davidoff, CPA, Esq. is a sole proprietor with more than 25 years' experience practicing as a CPA and tax attorney in Dayton, N.J. Davidoff is the founder and current chairman of the IRS Tax Liaison Committee of the American Association of Attorney-CPAs, and serves as its vice president. Email lisa@copeseminars.com for more information about his upcoming speaking engagements.

BATTER UP: The IRS Is Coming After Your Clients *Are YOU Ready?*



By Scott H. Cytron, ABC

Will the Boston Red Sox ever win another World Series? All seemed lost until 2004 when the Sox beat the St. Louis Cardinals, a title “86 years in the making,” according to baseball aficionados. While the Cardinals may have gotten the last laugh with their win over Detroit in last year’s Series, the World Series of baseball is a lot like representing clients before the IRS.

The entire season builds up to the final two teams, and the one with the best skills actually wins.

The tax accountant wears many hats for his or her clients – and while each professional might sign off on every tax return – there are fewer, brave individuals who go the extra step and represent clients before the IRS. When most of us think of this task, we imagine corresponding with city hall (you can’t beat city hall) and/or getting up in front of what must be very similar to the Supreme Court.

According to those who work in this capacity on a routine basis, the situation isn’t really like that. And as it turns out, representing

clients before the IRS really does have parallels to baseball: You always want to win one for the team.

Batter Up: A Team Approach to the Home Run

Most Americans believe a notice of an IRS audit is akin to a summons to appear before a firing squad. Nothing could be further from the truth, according to E. Martin Davidoff, CPA, Esq., who heads up his own firm in Dayton, N.J. With a focus on IRS representation, Davidoff believes preparation – above all other factors – is key to reducing liabilities for the taxpayer.

“Each case is a lesson in basics, tenacity and luck; each IRS representation matter is considered a project, and the process of managing that engagement is merely project management,” says Davidoff, who authors this magazine’s IRS Representation Advisor column. “In our office, I act as the visionary and technical expert. I set forth the overall steps to be taken and use the appropriate tools at the appropriate time. Those steps, or

The IRS Can Provide the Entire Contents of Its Files for Any Given Year Using A Freedom of Information Act Request, A Critical Factor for Complicated Cases

the plan of action, change as we discover additional information and respond to the actions of the IRS.”

Although Davidoff works in what most accountants think of as a smaller office of only 11 people – all of whom support him in his cases – defining the roles and responsibilities of each person in tandem with every case he takes on is almost as important as the case itself.

“Although the roles could be carried out by one person, we find that we can leverage off my experience and knowledge by splitting the responsibilities,” he says. “We have done so formally by training individuals to function as project managers who develop a set of skills enabling them to most effectively assist me in handling IRS representation matters.”

The process begins when Davidoff’s Tax Controversy manager, Alison Cook, assigns a project manager for each engagement. This person is responsible for ensuring that the firm meets all timelines and has a thorough understanding of the facts of the case. Davidoff relies on the project manager to understand all of the factual nuances so the firm can appropriately consider all options. This person works with the client to gather the information, and even acts as a communications coordinator between the IRS, the client and Davidoff. In addition, the project manager gathers IRS transcripts and prepares a federal tax summary. Davidoff says the titles assigned to such individuals vary, from Tax Controversy specialist to Tax Controversy manager, paralegal or paraprofessional.

“The more senior individuals working as project managers also have developed a set of skills enabling them to effectively complete forms, such as 433A, 433B, 9423, 12153 and 911, and to skillfully communicate with the IRS and other tax agencies,” he says. “An ideal project manager will make sure we establish follow-up timelines

with respect to every communication, as well as have the facts relevant at her fingertips when she meets with me on a client.”

Davidoff uses the pronoun “she” because all of his staff (including his wife, Sheila), with only one exception, is female.

“We all have a tremendous amount of respect for each other,” says Cook. “This is a very deadline-oriented, stressful office; we all have similar personalities, and know when to make it lighter and when to calm

but you have to respect us for doing so. You don’t have to be our best friend, but you have to respect us and know you are coming into an office where we choose to be so involved with each other.”

A Plan of Action

Regardless of what kind of office the accountant works in, a key component of ensuring adequate preparation is gathering and validating the information itself; often, information sources are plentiful.

“To start, we see what the client can provide,” he says. “At a minimum, the client can usually provide me with copies of tax returns, recent IRS communications and the names of other people who may have information useful to succeeding in the representation.”

Often, says Davidoff, information can be provided by the predecessor representative and the client’s CPA/tax preparer. “It is imperative to communicate with other professionals who work in this

capacity or are also representing your client. Predecessor representatives possess a wealth of information about the case that we need to tap into.”

Information gathered from the IRS itself is also key, including information on the taxes due through the use of IRS transcripts.

“The IRS can provide the entire contents of its files with respect to any given year using a Freedom of Information Act request, a critical factor for more complicated cases,” he says. “At the initial meeting my new client leaves with a very specific list of information to provide to me, and if we do not have everything we need, the project managers are aggressive about getting the information from the clients.”

Davidoff says the managers do much more than simply send standard letters or emails. Instead, they get involved by calling the client and doing whatever is necessary to secure the information required.

Batter Up, continued on page 26



**(Team Davidoff) Front row, from left: Camille Raffa, Dana Davis, Brett Rappaport
Back row, from left: Bonni Rubin, Amy Cook, Robbin Weiner, Sheila Davidoff,
E. Martin Davidoff, Alison Cook, Eleanore De Leo**

down. We are very focused and hardworking, but at times, you have to make it light. We care about each other’s families.”

Although the environment sounds contrived, it actually works in the firm’s favor and underscores Davidoff’s strategy in being prepared, because the emphasis is on how the team can respond on the client’s behalf, not to one another.

According to Cook, “When Marty hires, history dictates that it doesn’t work out if you can’t ‘jive.’ It’s important what your background is, where you’ve worked and what your skills are, but we can pretty much tell on an interview if we’re going to be able to mesh well with a new person.”

What’s interesting is that Cook says interviewees are well aware of this kind of environment. In fact, instead of heading off in separate directions at lunchtime, the staff actually eats lunch as a group and really seem to like each other.

“We’re a tight-knit group and we bond,” she says. “It’s OK if the ‘new person’ doesn’t,

Most Examinations Are Computer Generated, and In Some Years, the IRS Targets Certain Types of Entities

Batter Up, continued from page 23

This process is followed by writing up a Plan of Action, a documented list of how Davidoff wants to proceed with the case. Knowing that the plan will change as time goes by and events take their course, the flexibility in execution is key and timelines for follow-up are critical, especially in an agreement with the IRS.

In one firm case, a Plan of Action was established for a man who operated a fast-food establishment. The IRS and the state of New Jersey were threatening to seize the business, but neither the corporation nor the individual had ever filed income tax returns. Most payroll tax returns had been filed, but there were some funds due. In addition, the business owed state sales taxes

“In this case, we had agreements with the IRS to provide one or two 1040s each month for the years 1998 through 2005. However, as it became clear that the records for 1998 and 1999 would be insufficient for us to prepare returns with any degree of accuracy, we negotiated with the IRS to allow us to file income tax returns from 2000 through 2005. Our initial agreement was in writing to the IRS and its contents became another part of our plan of action.”

The key value Davidoff says he added for his client is his work in completing the first item on the Plan of Action.

“Within one week of this engagement, I succeeded in getting the IRS to hold off on its planned seizure. In addition, we had a written agreement as to our timeline to bring the client into compliance with the IRS. After that week, my project manager on the account handled the bulk of the work.”

Let the Tax Advisor Pinch Hit

Before the game begins, a batting order has a set routine specified by the organization’s manager. This routine varies, but usually involves a batting order that emphasizes strengths, skills, experience and, most of all, communication. When accountants work with their client in tax matters, the approach isn’t all that different.

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“I think the one step that the accountant can take to keep the client out of the audit is to have a frank discussion and convince him that his presence would probably do more harm than good,” says Pamela Young, a senior tax partner with Goodman & Company, LLP in Norfolk, Va. “Most clients are relieved to learn their presence is not required, but there are those who think they can handle the examination on their own or believe their participation is important for a favorable outcome. More often than not, this is not the case!”



Pam Young

In addition to handling IRS examinations for individuals and companies, Young, co-chair of the firm’s Tax Committee, provides quality review of tax returns, and tax planning for individuals and entities. She also identifies opportunities and makes recommendations with respect to deal structure for acquisitions and dispositions of businesses, and works in international tax matters. Goodman & Company is a member of Moore Stephens International, Ltd.

Young says the process of identifying IRS examinations is anything but routine. Most examinations are computer generated, and in some years, the IRS targets certain types of entities.

“For example, last year a number of S corporations that paid their shareholders little or no compensation were routinely selected for examination,” says Young. “Probably the most common mistake made by taxpayers is omitting one or more income items from their returns, or having one or more deductions that fell outside the realm of reasonableness with respect to the income reported on the return.”

The second biggest mistake is participating in the examination; when taxpayers are present, Young says they tend to talk too much and inadvertently provide more information than is necessary.

“Sometimes a poor choice of words or misuse of terminology leads the agents to believing that something is improper, even if that is not the case. At other times, taxpayers embellish the truth, anticipating that the pure truth might not be sufficient.”

Young says another mistake taxpayers make is that they tend to become defensive, which sometimes causes the agent to be suspicious. However, the biggest problem is that clients often lose their tempers and raise the anger of the agent or the agent’s superior. The client is well advised to provide the information and documentation requested by the examiner, and to trust the tax advisor to represent him or her.”

Young recalls that her worst war stories involve taxpayers who chose to represent themselves.

“Before they learned that they really did need the assistance of a tax advisor, they had already caused the Service to distrust them and had been so emotionally involved that the agent had become an adversary. That kind of damage to the examination process is almost impossible to overcome at the local office level. Issues that could have been resolved at the examination level must then be dealt with at the appeals level. This causes the entire process to be even more expensive and time consuming than if the client had taken a back seat and not tried to do any of the driving.”

Can An Agent Demand to Interview A Taxpayer Under Audit? The Answer is No. Can the Agent Demand That the Audit Be Conducted At the Client's Office? The Answer is No.

One Confession Leads to a Losing Game

In the Plymouth Meeting, Pa., office of CBIZ Accounting, Tax & Advisory Services, LLC, Robert Brennan, CPA, CFE, often finds himself taking on the roles described by Young and Davidoff. However, he also assists other professionals by working in an expert capacity.



Robert Brennan

“My advice or counsel may include where the audit is to be conducted, whether the client will meet and be interviewed by the agent, when the audit will be conducted, responding to information requests and formulating answers to the agent’s questions,” he says. “When I assist accountants and attorneys whose clients are being audited, I provide information on what the IRS agents can and can’t do during an audit. Can an agent demand to interview a taxpayer under audit? The answer is no. Can the agent demand that the audit be conducted at the client’s office? The answer is no. However, many times accountants or attorneys are not familiar with scope of the agent’s authority when conducting an audit.”

Brennan also helps the client, accountant or attorney develop the technical answers to deductions taken or the reasons why a position taken on a return is valid. Although he now has worked in public accounting for two decades, he is actually a former IRS agent who worked with the Service for 13 years.

“I left the IRS in 1986 because I wanted to expand my financial investigation skills into other than tax cases,” says Brennan. “Forensic accounting was developing into an entirely new field and now has become a household word over the past five years. Leaving the IRS allowed me to expand my base of knowledge and has given me a much broader prospective on financial crimes and the reasons they are committed.”

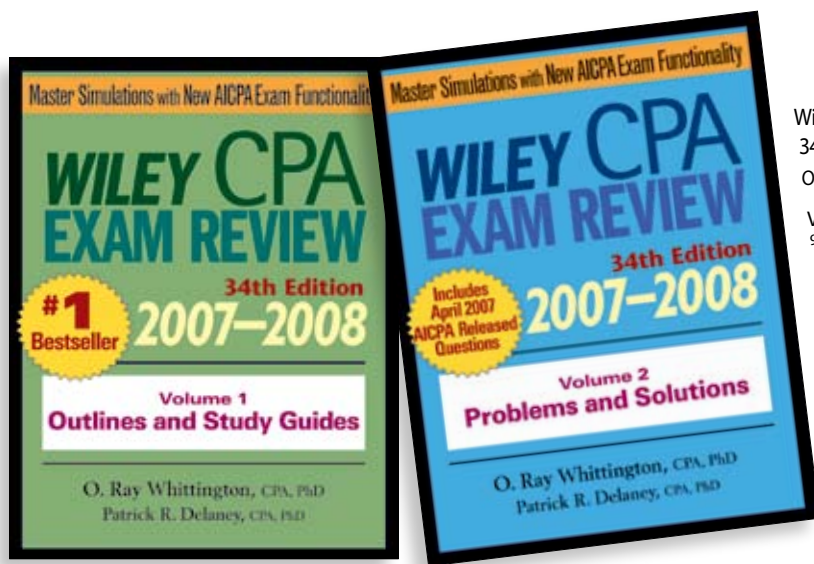
Brennan also has academic ties. As an adjunct professor at Strayer University and Philadelphia University, he believes the future is bright for tax professionals who want to work in the IRS representation arena because of the increased attention to ethics and trust.

“Students are more prepared solely because of the explosion of corporate governance issues and the emphasis textbooks put on these issues,” says Brennan. “Ethics is an important component of the accounting text books today, where the emphasis is on technical knowledge and ethical conduct. In the classroom, I cover not only the technical issues, but also the right and wrong aspects of various accounting frauds that appear in the news.”

To keep their clients out of court, Brennan says accountants should not play the ‘audit lottery’ when preparing returns with the thinking that very few returns get audited. This includes believing that taking deductions or positions on a return he feels are inconsistent, incom-

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Advise Examined Clients: Don't Talk to the IRS

Batter Up, continued from page 27

plete or unreliable will never be audited by the IRS.

"I like to prepare returns with an eye toward how the return would stand up if it was audited. Is there a significant issue in which I need to secure the appropriate documentation to support the position taken on the return? You must do this before the return is selected for audit rather than finding out the details upon notification of audit."

Brennan says the professional must try to eliminate any surprises. In one case, a client came to him indicating he thought he might be audited by the IRS. Brennan asked why he thought that, and the client indicated he had a prior year return put together by a preparer who was under investigation for preparing returns that contained "questionable deductions and tax credits."

"I instructed him that if the IRS shows up at his office or home, DON'T talk to them. Refer them to me or his attorney. Two days later he calls and thinks he has a

problem. He said two agents flashing very large gold badges showed up at his work. The client was so nervous that he let them into a company conference room and proceeded to talk to them for two hours! He thought if he explained what he did and why he did it, all would be OK.

"Upon completing the interview, the two agents left, and since the conference room overlooked the parking lot, the client saw the two agents walking toward their car. Suddenly, they stopped, looked at each other and gave each other a high five. It was at this point the client had

a sinking feeling in his heart that maybe he shouldn't have spoken to them. Sure enough, one year later he was indicted for tax evasion and the main piece of evidence presented by the government as proof of intent to evade the payment of tax was his "confession." That little interview morphed into a full blown confession!"

While this one case may seem isolated, it more than often is the way these proceedings go. As a result, tax professionals who endeavor to represent clients before the IRS must do so with candor, caution and character. After all, what's more important than a winning season? **G**

Scott H. Cytron, ABC, is managing editor of CPA Magazine. Contact him at scott@cpamagazine.com.

Equipment expensing limit is \$112,000

Kess, continued from page 17

need equipment to operate and a location to operate from. Tax breaks can help with both types of needs.

- **Leasehold Improvements.** Usually, capital improvements to commercial reality must be depreciated over 39 years. However, under a special tax break, qualified leasehold property improvements and qualified restaurant property improvements can be depreciated over 15 years. This break applies to improvements made before 2008, unless Congress extends the law.
- **Equipment.** Small businesses can opt to expense the cost of equipment placed in service in 2007 (instead of depreciating it over five or seven years, or longer periods). The expensing limit is \$112,000, which applies to both new and pre-owned equipment, whether purchased outright or financed in whole or in part. However, the dollar limit is reduced when equipment purchases exceed \$450,000, a limit

that effectively bars large companies from using this tax break. The limit is reduced dollar for dollar, so that no expensing can be claimed when purchases for the year exceed \$562,000.

Note: The current high expensing limit, which is adjusted annually for inflation, is set to revert to the old \$25,000 limit after 2009. However, the Small Business Tax Relief Act of 2007 extends and increases the break through 2010. The limit increases to \$125,000 for 2007 (adjusted for inflation) and the phase-out range commences at \$500,000. **G**

Sidney Kess, CPA, J.D., LL.M., has authored hundreds of books on tax-related topics. He probably is best known for lecturing to nearly every state society and more than 700,000 practitioners on tax and estate planning. In 2003, he received special recognition from AICPA and CCH for his many contributions to the tax profession. He created and moderates the annual AICPA Conference on Tax Strategies for High-Income Individuals.

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