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A tax, business, and financial planning newsletter for our clients and friends

How To Survive An IRS Audit

If you receive notification of an IRS office audit, knowing what to do can be the difference in whether or not you survive it. Here are the critical steps you should take:

- **Don't ignore the notice.** Usually, you are given thirty days to answer an audit notice. If you ignore the notice, the IRS can automatically adjust your tax liability – and it won't be in your favor.
- **Read the audit notice carefully.** The notice will tell you what items are being questioned and what you should bring to the audit. Sometimes, only one or two items are questioned and it's an easy matter to bring the relevant records to the audit to substantiate your return.
- **Bring only what you need to the audit.** If you bring records or documentation of items that are not shown on the audit notice, you run the risk that the audit may be expanded to other areas of your return. Auditors usually won't be interested in anything beyond what is indicated on the notice unless you bring it up. Simply address the relevant matters as quickly and in the most organized way you

can. **Suggestion:** Provide adding machine tapes showing totals of checks or invoices that reflect the line items in question.

- **Be prepared.** Carefully review your tax return for the year that is to be audited. Organize your records so that you can easily respond to the auditor's inquiries.
- **Don't argue with an unreasonable auditor.** If you're unlucky enough to find yourself face-to-face with a rude or unreasonable auditor, or if you and the auditor can't reach an agreement, ask to speak to the auditor's supervisor and calmly explain the situation. (Use caution, however, because the



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taxPOINTS

Tax-free bonanzas. Gifts and inheritances. No income tax is payable on money and property you receive as a gift or inheritance. Any tax owed is payable by the person who gave the gift or inheritance. **Added benefit:** Appreciated property that you inherit, such as real estate, receives a step up in basis to fair market value allowing you to avoid paying tax on the gain from a subsequent sale.

Tax-free income. Scholarships and fellowships grants are free of income tax if you are in school to receive a degree. The money must be used for books, tuition, supplies, fees, and necessary equipment.

Loophole: Personal injury settlements. Income received from a personal injury lawsuit for tortlike claims is tax-free. Personal injury also includes suits for age, sex, or racial discrimination – all income received on these suits is tax free.

Life insurance is included in your estate for estate tax purposes. If this causes additional taxes to be paid on your estate, your beneficiaries will inherit less. **Loophole:** To get life insurance out of your estate, set up an irrevocable life insurance trust to own the policy. Upon your death, the life insurance proceeds will not be included in your estate for estate tax purposes.



The Seven Commandments For Getting A Business Loan

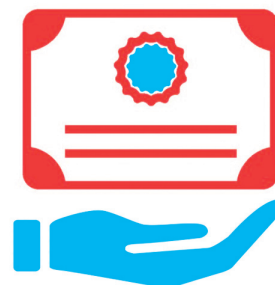
1. **Find a lender that understands your industry.** The best sources for this information are trade associations, business associates and your accountant.
2. **Never depend on only one lender.** While some banks may judge your loan as high risk, others may see it in a positive light.
3. **Always borrow more than you need.** Most businesses underestimate their capital requirements by 15%. Play it safe and request 25% more than you think you'll need.
4. **Borrow before you need the money.** Apply for a loan at least three months before you need the money. This will give you time to shop for the best deal and to negotiate a more favorable loan.
5. **Request a loan when your business looks its best.** Receipt of a major contract or a sudden improvement in profits will impress a lender and improve your chances for successful borrowing.
6. **Borrow enough to build a capital reserve.** Invest the funds you don't need immediately in a money market fund for instant liquidity.
7. **Be prepared to go to lenders other than banks.** When money is tight, banks may turn down a loan request. If a bank says "no", check out alternative sources such as venture capitalists, finance companies, and government agencies.

Maximize Charitable Donations of Stock

To maximize charitable donations of stock, sell shares for a loss, deduct the capital losses on your return, and then give cash to the charity. You get the capital loss write-off plus the charitable deduction – a double tax benefit.

Donate profitable shares directly instead of selling them and donating cash. You can deduct the full current market value of publicly traded shares you've owned for more than one year. Plus, when you give the

appreciated stock away, you get rid of the built-in capital gains tax liability. And, you might also save any alternative minimum tax. So this idea could be a triple tax saver.

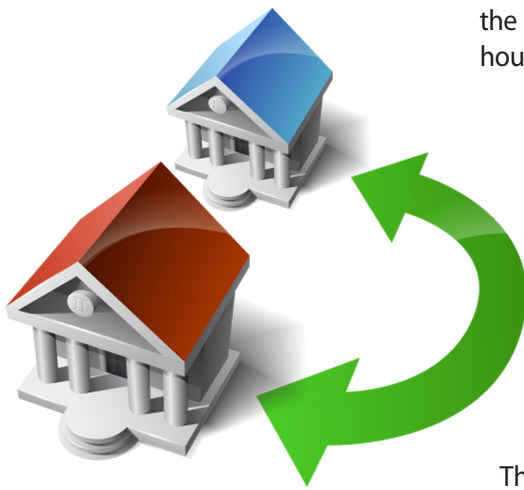


Selling Real Estate Swap And Pay No Tax

If you're thinking about selling real estate that has increased in value, you can defer paying the tax on your profit through a "like-kind" property exchange. It remains as one of the last tax loopholes on the sale of appreciated real estate.

To illustrate the point, let's look at B.J. Lynch, the successful owner of Lynch Plumbing Supply.

B.J. first got his feet wet in the plumbing supply business as a sales representative. He was a natural salesman and quickly set new sales records. But B.J.'s ambitions went beyond being a successful salesman, for he



had always hungered to be in business for himself. It wasn't just a pipe dream either, and from the day his first commission check arrived, B.J. began to set aside money until the time was right to make his move.

By 2002, B.J. was ready to put his plan into action. He invested his savings in a small building, bought an inventory of plumbing fittings and Lynch Plumbing Supply was born

under the slogan, "Make the Lynch Connection".

It didn't take long for the word to leak out that B.J. delivered quality products at a fair price. Contractors, builders, and master plumbers were quick to "Make the Lynch Connection". By 2013, the construction boom was well underway and B.J. was flooded with business. In fact, business was so good that B.J. was forced to rent outside warehouse space to house his expanding inventory.

By 2016, B.J.'s building was bursting at the seams, and it was clear that the rented warehouse space was a drain on the business. It was time to sell the building, give up the costly warehouse storage space and buy a larger building.

B.J. moved fast. Within months, he sold his building for \$800,000, a \$350,000 gain over its \$450,000 adjusted cost basis. He bought a larger building for \$1,200,000, consolidated his operations under one roof, and in no time was pumping our business as fast as it came in.

Things looked great for B.J., but when he and his wife filed their 2016 individual income tax return, he learned that a big piece of his gain on the sale of the building had gone down the tax drain.

Based on B.J.'s \$350,000 capital gain from the sale of the building and 2016 joint return tax rates, B.J.'s federal income taxes had totaled \$38,489, a substantial contribution toward plugging the many holes in Uncle Sam's dike.

A BETTER SOLUTION

Taxpayers like B.J. who wish to sell investment real estate and acquire new investment property can defer capital gains taxes by arranging a swap. For tax purposes, when real estate is exchanged for real estate (a "like-kind exchange"), no gain is recognized at the time of the exchange. Instead, the newly acquired property takes on the cost basis of the old property and the tax on the gain is deferred until the new property is eventually sold. Taxes can also be saved on an exchange of property plus cash for like-kind property. In that situation, the newly acquired property takes on the cost basis of the old property plus the cash.

For B.J., a real estate swap would have meant substantial tax savings. If he had exchanged his \$800,000 building plus \$400,000 in cash for his new \$1,200,000 building, the \$350,000 gain on his original building would be excluded from his 2016 individual income tax return, reducing his federal income taxes from \$38,489 to zero.

That's a tax savings large enough to make anyone smile.



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supervisor – not the auditor – has the authority to expand the scope of the audit beyond the audit notice.)

- **Tell the truth.** Deliberately lying during an audit is a criminal offense. If you're asked a question that you can't handle, simply end the interview at that point. Another reason to tell the truth: an auditor might be testing your truthfulness by asking you questions to which he already knows the answers.
- **Don't give original documents to the IRS.** The IRS has a reputation for its ability to misplace paperwork. Bring photocopies of the necessary documents and give them to the auditor if requested.
- **Make it easy for the auditor.** Avoid a second visit to the IRS office.

The more time an auditor spends on your case, the more likely it is that he'll try to find "adjustments". **Suggestion:** Try to schedule your audit for the morning so the auditor can complete your case and move on to the next one.

- **Be cooperative.** IRS auditors are no different than anyone else. If you begin the audit interview with a chip on your shoulder, you'll only antagonize the agent and make him less willing to compromise. Courteous behavior can be the difference between a favorable or an unfavorable decision.
- **Stick to the subject.** Don't volunteer any information that hasn't been requested or the auditor might turn his attention to items on your return that you're not prepared to discuss.

- **Replace any missing records.** For example, if your medical deduction is being questioned and you can't find your bills, call your doctor's office and ask for duplicates immediately.
- **Know your rights.** In general, it's better to settle any assessment at the audit. You are not, however, forced to accept the auditor's decision. If you think that the auditor's decision is wrong, you can request a conference with the IRS Appeals Division. If that doesn't result in a satisfactory decision, the next step is to take your case to court.
- **Bring your accountant with you.** Although office audits are sometimes straightforward, the presence of an experienced tax professional can often result in a favorable decision.

Ten Sure Ways To Business Failure

Ambitious Americans start more than half a million new businesses every year. Yet every year, about four out of five of these new businesses fail. Most of the reasons why budding entrepreneurs don't succeed could have been avoided. Here are the ten most common.

1. Inadequate working capital.
2. Poor accounting records.
3. Inattention to controlling costs.
4. Weak understanding of financial statements.
5. Improper training of employees.



6. Failure to plan far enough ahead.
7. Weak internal controls that invite theft.
8. Not selling aggressively.
9. Carrying inadequate insurance.
10. Failure to seek professional advice.

