

Sales Tax Exams vs. IRS Exams

Issues and Strategies

Presented by:

Eric L. Green, Esq.



About Tax Rep LLC

Tax Rep is a member driven community that helps each other build their representation practice and help taxpayers, with members being able to do so knowing they are not practicing on their own but have other accountants and attorneys backing them up.

If you are interested in joining (and getting today's program for free) you can join Tax Rep at www.TaxRepLLC.com, use TAXREPNOW to save \$100 a month for 3 months and start building your practice today!



Offer in Compromise Workshop 2

Eric Green, Esq.

- ▶ Managing partner in Green & Sklarz LLC, a boutique tax firm with offices in Connecticut and New York.
- ▶ Focus is civil and criminal taxpayer representation before the Department of Justice Tax Division, Internal Revenue Service and state Departments of Revenue Services.
- ▶ Has served as a columnist for CCH's Journal of Practice & Procedure.
- ▶ Attorney Green is the past Chair of the Executive Committee of the Connecticut Bar Association's Tax Section.
- ▶ Eric is a Fellow of the American College of Tax Counsel ("ACTC").



After the Practice 1

Eric Green, Esq.



- ▶ Eric is the host of the weekly Tax Rep Network Podcast, available in iTunes, Apple Podcasts and Google Podcasts
- ▶ Eric is the founder of Tax Rep Network, an online community designed to help tax professionals build their IRS Representation Practice
- ▶ He is the author of the Accountant's Guide to IRS Collection, the Accountant's Guide to Resolving Tax Issues, and the Accountant's Guide to Resolving Payroll Taxes and Personal Liability



After the Podcast 4

CPE

- ▶ There will be 12 attendance check words
- ▶ Please write these down
- ▶ You will need them at the end when you click on the link and go get the certificate



The Ultimate IRS Collection Workshop 5

Schedule

- ▶ Stick to our schedule
- ▶ 10 Minute breaks at the top of each hour
- ▶ Go to the restroom and refill your coffee (or drink of choice)



The Ultimate IRS Collection Workshop 6



QUICK BREAK

We will resume the program in a moment.

State Sales Tax Exams: Need to Know

- ▶ States are broke:
<https://www.ncsl.org/research/fiscal-policy/coronavirus-covid-19-state-budget-updates-and-revenue-projections637208306.aspx>

NEWS / HEALTH / CORONAVIRUS
How the COVID-19 virus has impacted New York state finances



A man walks by a Coach storefront that is boarded up in the SoHo neighborhood on April 23 in Manhattan. Credit: Getty Images/Dave Delgado

By Yancey Roy
yancey.roy@newsday.com @yanceyroym
Updated May 3, 2020 8:23 PM

ALBANY — New York isn't broke, as Gov. Andrew M. Cuomo likes to say.

But with revenue plunging, without further help, it might have to make spending cuts quickly and dramatically — \$10 billion or more. Or raise taxes.



The Point of an IRS Exam

- ▶ Check that the taxpayer is properly handling things
- ▶ Educate the taxpayer
- ▶ It is not designed to punish



Obvious Stuff

- ▶ Sales Tax returns v. Gross receipts on federal return*
- ▶ Sales Tax returns v. POS System
- ▶ Sales Tax returns v. Bank Deposits

* Because of this the state will already suspect that there is an issue before they even show up

States have always been overly aggressive

Methods include:


- ▶ Federal gross receipts
- ▶ Mark-up
- ▶ Industry standards
- ▶ Observation

Federal Gross Receipts


- ▶ Federal Revenue vs State Sales Tax Returns vs. Bank Deposits
- ▶ Should review sales tax returns if client does them
- ▶ This MUST match!

Misappropriating Cash


3 Ways to misappropriate cash from a business



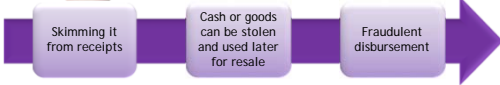
Skimming it from receipts



Cash or goods can be stolen and used later for resale



Fraudulent disbursement



Audit Workshop 16

Flags for the Government

Lessons from DOJ Prosecution of Tony Hu for Sales Tax Fraud

By Matthew D. Lee on December 6, 2016
POSTED BY CRIMINAL TAX, INTERNAL REVENUE SERVICE (IRS), IRS CRIMINAL INVESTIGATION (CI) DIVISION, MONEY LAUNDERING, SENTENCING, USDOJ TAX DIVISION



On Oct. 18, 2016, a federal judge sentenced a well-known Chicago restaurant owner to prison for carrying out an extensive scheme to avoid paying state sales tax collected from customers of his establishments. Two

Department of the Treasury





Sales Tax Exam 17

Sales Suppression

Skimming cash sales – a very old tax fraud

The Evolution of The Skim





Sales Tax Exam 18

This is an old Zapper that's been hard wired into the ECR.



This is a newer Zapper – it's a removable device connected to the PC, not the ECR.



Stew Leonard's



Stew Leonard's

A Sour End to Dairy Scam: Retailing Genius Stew Leonard May Face Jail for Hiding \$7.1 Million From the IRS in a Tax Fraud Case

By JAMES HEWITT
JULY 25, 2002 | 10:49 AM

TAXES STAFF WRITER

HARTFORD, Conn. — Across the country, Stew Leonard is known as the kind of entrepreneur whom other American business people ought to emulate—a humble milkman whose retailing genius made him a big success.

For years, Leonard has lived by the slogan “the customer is always right,” going to extreme lengths to attract patrons to his massive, high-volume dairy store in nearby Norwich, Conn.

He dresses his sales force in funny costumes and provides a free petting zoo for children—the sort of offbeat innovations that prompted visits by executives of Wal-Mart and other top retailing chains curious to find out why Leonard’s store is so profitable.

But there was a surprise behind his success.

While Leonard was collecting accolades, he also was skimming \$7.1 million from the store’s sales using an ingenious computer program that deprived the Internal Revenue Service of an estimated \$6.7 million in taxes.

IRS officials describe it as the largest criminal tax fraud case in the country in which a computer was used to hide the evidence.



The Mark-Up Percentage

- ▶ Cost of items vs. the sales price, calculate mark-up percentage
- ▶ Confirm the cost they use!
- ▶ Subjecting non-taxable items to tax!
- ▶ Trying to apply industry standards that may or may not reflect the client’s situation!
- ▶ Size of the beer glasses



Exemption Percentage

- ▶ Connecticut (and many states) has an exemption for manufacturers if manufacturing is the majority of what they do
- ▶ Auditors often try and find ways to reduce the percentage below 50% to strip the manufacturer of their exemption
- ▶ Case Study later on this



Industry standards

- ▶ These are often pulled out when the auditor runs out of options
- ▶ Should be when there is no documentation
- ▶ Actually when they don't like the documentation results
- ▶ Question the standard (example: 90% cash per auditor, 85% credit according to professional association)

Observation



- ▶ Observation is a terrific technique
- ▶ How do you audit a parking garage?
- ▶ Must be there the entire time or will get skewed results

The IRS

- ▶ Wants the client interview
- ▶ Want the Quickbooks file
- ▶ Rely on industry standards less often
- ▶ Generally fairer, though recent trend has been to get more aggressive

Preparation

- IDR Items v. Everything
- Preparation is key
- Meeting the client
- Walk-Through of the Business



Preparing for the Audit



- Retained
- POA
- Discussion with the taxpayer about how the business is run
- Records (MUST review)

Preparing for the Audit

Instructions to the taxpayer

- Do not speak to the examiner
- Do not Tweet, Facebook, or Myspace anything else about the exam!
- Respond to all requests quickly



Preparing for the Audit



- Walk through
- Look for things that should not be there
- Explain what is there (client who posted the subject to sales tax after the audit notice arrived)

Things sales tax auditors often miss

The auditors often fail to consider:

- ▶ Theft (retail shops)
- ▶ Waste (restaurants and markets)

Why Eric Got in Trouble: CT DRS Logo

Given that Connecticut is broke, the CT DRS has recently changed its logo to reflect its new attitude toward taxpayers....

CT DRS Releases new logo



Actual Client Stories

- ▶ CT DRS Logo
- ▶ The ham
- ▶ Manufacturing exemption
- ▶ Size of the beer glasses
- ▶ Taxable percentage of items sold
- ▶ Industry standard for pizza

Bring a Ham to the Appeal



Manufacturing Exam

- ▶ Manufacturer is growing
- ▶ Moves into a larger building
- ▶ Auditor reviews and finds no changes
- ▶ Calls in 2 weeks, his manager did not like that there was no change
- ▶ Get report, claims they are only 48.2% manufacturer because of the empty space in the new building
- ▶ My memo and political pressure

Manufacturing Exam

Eric, they have accepted that COMPANY is a manufacturer for now... this does not mean that we will be "unconditionally" a manufacturer... we will be tested again. There are a few other points we are still working on. We will let you know if further assistance is required.

Thanks, Brian

Size of the Glasses

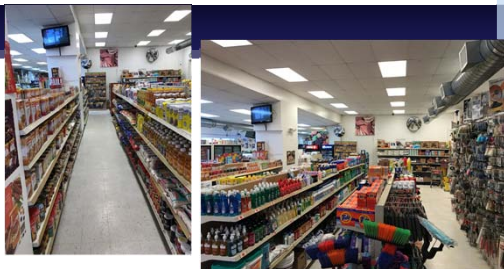
- ▶ Bar is audited
- ▶ Auditor determines massive fraud on the part of the client
- ▶ Based the audit on purchases, price for an 12 oz beer
- ▶ Great...except glasses were 16 ozs
- ▶ Appeals cannot see the glasses, the bar, etc
- ▶ They like pictures!

Glass sizes



Industry Standards

- ▶ Auditor visited client
- ▶ Stated in the audit report that the client was a “mini-mart”
- ▶ Industry standard is 89% taxable
- ▶ Except that client is not a mini-mart but a grocery store
- ▶ Audit reduced from \$189,000 to \$10,300



Industry Standards for Pizza

- ▶ Auditor comes to pizza restaurant
- ▶ Believes the prices are too low based upon "national averages"
- ▶ Uses an industry standard for mark-up on pizza times the number of boxes purchased less the ending inventory on hand
- ▶ Hands the client a bill for \$100,000

Industry Standard for Pizza

- ▶ Great, except the pizza is so cheap because there are 5 pizza restaurants within 3 miles of his location
- ▶ They all charge about the same
- ▶ He cannot raise his prices without cutting his own throat
- ▶ Get menus from competitors
- ▶ Video the making of a pizza



Pizza Restaurant

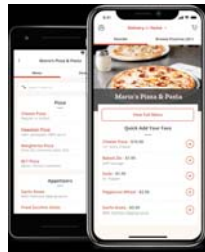
- ▶ Also, obtained copies of his menus and the other 5 places around him
- ▶ Showed large pizza was \$10.95 across the spectrum
- ▶ Cannot charge the \$22 national average
- ▶ Great for the appeal when you can make the auditor look incompetent, mean or both!

Speaking of Pizza...

- ▶ Client owns small pizza shop, opens 6am, sells bagels, coffee, newspapers
- ▶ Lunch is sandwiches and some pizza
- ▶ Dinner is pizza, beer and wine
- ▶ Auditor shows up and does a test from 9am – 11:00 am
- ▶ Determines 90% of sales are cash, applies this and comes up with \$300,000 due (at 6% this means almost \$5 million of unreported revenue)

Speaking of Pizza

- ▶ Am – small items people pay cash
- ▶ Lunch and evening, big ticket items, people pay with credit
- ▶ Industry articles express the change
- ▶ New App is also changing it



Speaking of Pizza

- ▶ Auditor can do an observation test – great test
- ▶ Must observe the WHOLE day or it does not work
- ▶ Punched holes in the audit
- ▶ Settled for \$9,600

Message....?

- ▶ Be creative
- ▶ Show the appeals officer what the auditor either did not see or refused to see
- ▶ Take the appeals officer into the location:
 - a. The beer glasses
 - b. Photos of the grocery store
 - c. Video the pizza making, including the weighing of the ingredients

After the audit

- ▶ APPEAL...always appeal
- ▶ Can you compromise in your state while the appeal is pending?
- ▶ Raise every issue:
 - a. Auditor was biased and ignored information
 - b. Client failed to charge and collect properly
 - c. The numbers are fantasy
 - d. Technology accounts for the difference

The Appeal

- ▶ Explain what the auditor did
- ▶ Explain why it is wrong
- ▶ Document why it is wrong
- ▶ Lead the Appeals Officer where you want them to go



TRN
TAX RESOLUTION NETWORK

The Biggest Tax Screw Ups

Learn from Cases I Screwed Up, So You Won't

July 13, 2020 | 1pm – 4pm Eastern | via Live Webinar

**Brilliant people watch others make the mistake and avoid it altogether...
LET'S BE BRILLIANT!**

REGISTER TODAY FOR EARLY BIRD \$99
Early Bird ends 7/9 Midnight, then \$149

[CLICK HERE TO REGISTER NOW.](#)

Or copy and paste this link: <https://taxradio.com/program-20200713-biggest-tax-screw-ups/>

Due to the in-depth nature of this workshop, attendance is limited to 100 attendees so all attendee questions can be answered.

Join us for this very entertaining and enlightening three-hour special workshop where Tax Attorney and National Speaker Eric Green will walk you through the cases he has screwed up the worst in the last 23 years, the lessons you should take from and how to apply those lessons when you have cases in your office. During the program Eric will review the client situation, what he did and review what should have happened.

TRN
TAX RESOLUTION NETWORK

How to Win an Innocent Spouse Case: The Workshop

July 21, 2020 | 1pm – 5pm Eastern | via Live Webinar

An In-Depth HOW-TO from Start to Finish!

REGISTER TODAY FOR EARLY BIRD \$199
Early Bird ends 7/16 Midnight, then \$299

[CLICK HERE TO REGISTER NOW.](#)


Or copy and paste this link: <https://taxradio.com/program-20200721-innocent-spouse-workshop/>

Due to the in-depth nature of this workshop, attendance is limited to 100 attendees so all attendee questions can be answered.

Join Eric Green as he walks you through the innocent spouse case from start to finish. The program will review joint liability, what practitioners should consider BEFORE they file the return, and what to do with the client that now owes a liability they do not believe they should be responsible for. The workshop will also review how to document your client's case, how to complete Form 8857, and how to prepare and handle the Appeal.

Tax Rep - Don't Take Our Word For It

- "I joined TRN because I realized I needed a new revenue stream outside of tax season. I got trained as a tax resolution specialist. I've been able to really grow my practice and help clients. I've probably increased my revenue now by \$150,000 as a solo practitioner. Without TRN and Eric Green's help, none of that would have been possible." --Patrick Wanzer, CPA



TRN
TAX RESOLUTION NETWORK

Tax Rep Network Members Say

- **Anthony Delucia** – *“Eric, I took your advice and started my IRS representation practice after the course. Without any further advertising other than adding “IRS Representation Practice” to my sign, I added an immediate \$18,000 to my billings on just a few client matters. Marketing to my own clients added more than \$140,000 in income by the end of the first year! The workshop is straightforward and easy to follow, my only regret being that I did not do this sooner. Thank you!”*
- Anthony sold his 1040 practice after 4 years and now only consults in financial planning and representation matters.



Workshop Special

- Join Tax Rep Today
- Use **TAXREPNOW**
- Save \$100 a month for the first 3 months for our Gold Level Membership (includes everything)

