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QuickBooks Solves Tax Audits; QuickBooks Ruins Tax Audits

Actually, QuickBooks can help prevent audits too, but like so much else, it all depends. No one wants to wind up in a [tax dispute](#). You want to file your returns, every income item to match up, every claimed deduction or credit to be approved, and every schedule to pass muster. And you're willing to do everything you can to avoid an [audit](#).



Still, some tax returns will be [examined](#), although the nature and scope of audits is changing. Traditionally, some audits were full-on office or field audits. Today, the vast majority of audits are by correspondence, considerably less threatening and considerably less interactive.

You don't have an unlimited number of chances to explain and justify what you've claimed before the proposed adjustments are written up and shipped off to the next level of the IRS. You want to provide timely responses and targeted responses. You don't want to go to court over whether the IRS can get access to certain documents.

Most audits are handled informally through Information Document Requests (IDRs) issued by the IRS that looks like memos. You don't legally have to comply, but if you don't, the IRS will issue a formal summons that could land

you in court. Provide receipts and other supporting information if the IRS asks.

What if the IRS asks for an electronic copy of your accounting software, say QuickBooks or something equivalent? Why make it easy for the IRS to mine your own data? In examining the returns of small businesses, the IRS is increasingly requesting electronic files for accounting programs like QuickBooks.

You may need professional advice about your situation. So far, the law says they can ask and, in general, you should comply. But advisers debate the nuances. In particular, you want to make sure that you are providing no more of your data than a request reasonably covers.

Even something like multiple years can be a potential problem. In general, the IRS instructs its examiners to request electronic copies of accounting records for the tax year under examination. Sometimes, they will request records of other years when needed to verify a current-year item from prior- or subsequent-year accounting.

Privilege issues—including attorney client privilege or work product doctrine—require special handling. Work-product protection is different from attorney-client privilege. Attorney-client privilege protects communications between clients and their lawyers, whether or not dealing with anticipated litigation. Discussions with lawyers are privileged, but discussions with accountants are not, unless the accountants are subcontractors of the lawyers.

What if you have customer lists, personnel data and more embedded in your software? In some cases you may be able to redact materials, but be careful how and what you address in this way. You want to cooperate, but you don't want to turn over data that hurts your business or provokes inquiries into other areas the IRS isn't already considering.

If you express concern to the IRS that your off-the-shelf software has lots in it you aren't comfortable disclosing, the IRS can choose to issue a summons. That could mean you can fight about it in court. There's nothing new about the IRS wanting electronic data.

Yet traditionally such inquiries involved big businesses. [Small businesses](#) are defined as those with assets less than \$10 million, and they often use off-the-shelf software such as [QuickBooks](#). In contrast, big businesses usually have

customized accounting systems that facilitate providing the IRS only with what they want.

The [American Institute of CPAs](#) AICPA proposed allowing companies to redact software to release only relevant data, but the IRS rejected the request. The IRS suggests that small businesses should back-up at year end, limiting IRS access to one year at a time. The IRS also said it would allow businesses to reduce the detail for years not under audit.

Yet fears remain. Electronic records are a larger part of audits today. Plan ahead.

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.