# IRS TARGETS INDUSTRY GROUPS

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Historically, IRS examiners have been assigned to audit taxpayers in many different industries. On one day, an examiner audited a grocery store and on the following day the examiner may have audited a computer retailer or a medical doctor. As a result, experience gained in one audit did not significantly enhance the examiner's experience for purposes of conducting other audits. Under its Compliance 2000 program, the Internal Revenue Service has been attempting to identify and reduce non-compliance through efficiency, legislative changes, tax form simplification, education, and enforcement. In addition, the Internal Revenue Service has significantly modified its examination process in a manner designed to increase the efficiency and experience of its examiners.

The Market Segment Specialization Program (MSSP) has been the initial approach by the Internal Revenue Service to improve efficiency and compliance by focusing on taxpayers as members of particular groups or industries. These groups have been defined by type of business (gas stations, grocery stores, etc.), technical issues (passive activity losses), and types of taxpayer or method of operation (i.e. cash intensive businesses). As examiners focus on the tax compliance of a particular industry, they have gained experience on specific issues to be examined for a particular type of business, whether or not the issues are set forth on a tax return. MSSP examiners spend the majority of their time auditing taxpayers in the market segment for which the examiner has become a specialist. Some may specialize in examining the construction industry while others may specialize in examining restaurants.

Under MSSP, examiners are routinely advised about industry changes through trade publications, trade seminars and information sharing with other examiners. As such, there is an increased understanding of the market segment, its practices and procedures, and the appropriate audit techniques required to identify issues unique to the market segment under examination. Utilizing information gained through the MSSP, examiners attempt to reconcile discrepancies when income and/or expenses set forth on a taxpayer's return are inconsistent with a typical market segment profile or where the reported net income seems inconsistent with the standard of living prevalent in a geographical area where the taxpayer resides. As a result, information and experience gained through the examination of returns for other taxpayers becomes the barometer for judging the accuracy of a particular return under examination.

Market segments are being identified by their unique features requiring specialized audit techniques, technical or accounting knowledge, or the need to comprehend the specific business practices, terminology and procedures. The IRS has implemented more than 100 market segment projects under MSSP, including architects, attorneys, auto body/repair shops, bail bondsmen, beauty/barber shops, car wash and auto detailing businesses, casino gambling, check cashing establishments, childcare businesses, construction contractors, restaurants and bars, various segments of the entertainment industry (motion picture/television, athletes and entertainers, music), garment industry, gasoline distributors, grocery stores, mobile food vendors, insurance agencies, jewelry dealers, liquor stores, parking lot operators, pizza parlors, real estate agents/brokers, real estate developers, recycling businesses, scrap metal businesses, taxicabs, the trucking industry, and used auto dealers.

Once the IRS identifies a particular market segment project, a group from its Examination Division may develop audit guidelines based upon the market segment's unique business activities. The audit guides, which are publicly available, are used by examiners to develop a pre-audit planning strategy. The audit guides explain the nature of each respective market segment or industry, the type of documentation that should generally be available, and the nature and type of information to search for during a tour of the business premises. The audit guides specifically identify potential sources of additional income not otherwise readily apparent from the type of business activity being examined.

The MSSP audit guides are designed to focus IRS examiners on the typical methods of operation for businesses operating within a particular market segment. For example, with respect to restaurants and bars, the audit guides identify the potential for skimming since they are basically cash intensive businesses. However, the audit guides acknowledge that "chain" or "franchise" businesses may not participate in skimming to the same extent due to the somewhat intensive internal controls typically required in their operations.

The MSSP audit guides identify issues to be raised during an interview with the business owner/operator, including the need for a detailed discussion about internal controls, source of funds utilized to start the business, a complete list of suppliers, identification or business records that might be available and the individual that maintains the business records. The examiner will also explore the manner of business operations, including the hours and days it is open, the number of employees, the responsibilities of each employee, identification of the individual that maintains control over inventory (beer, wine, etc.), cash and credit card receipts, and the cash register tapes. Examiners are trained to search out payments of personal living expenses by the owner/operator from the business operations.

With respect to cash intensive businesses, examiners will attempt to reconcile reported tax return income to the taxpayer's financial status. Since certain businesses do not always deposit all of their cash receipts, the audit guides provide various methods by which an examiner may be able to reconstruct total gross receipts and expenditures. Cash intensive businesses may not have much documentation available to verify gross receipts. Purchases may be paid in cash and the purchase invoices may not be retained. Employees may also be paid in cash in order to attempt to avoid payroll taxes.

If the examiner believes the business may not be reporting all of its income, the examiner will issue a formal summons to suppliers and other third-parties for records of sales or deliveries to the business, including original purchase invoices, during the period under examination. The examiner may then mark-up the purchases by a reasonable amount based upon MSSP industry standards to determine what are known as the audited sales for the business. Absent a reasonable explanation for a discrepancy between audited sales and reported sales, the IRS will determine income tax adjustments (and maybe penalties) based upon the discrepancy. If the discrepency is significant or the facts indicate it might be intentional, consideration will be given to the imposition of civil fraud penalties or, possibly, a recommendation for criminal sanctions.

MSSP has revolutionized the process of examinations by the IRS. Businesses within a targeted market segment should be reasonably familiar with the IRS audit guide for their particular market segment or industry. Preparation is the principal factor affecting the outcome of any tax examination by the IRS or the Franchise Tax Board.