

# I AM UNDER AUDIT—WHAT DO I NEED TO DO?



TEXAS TAX GROUP

OUR TEAM OF FORMER TEXAS COMPTROLLER  
STATE TAX AUDITORS IS YOUR BEST DEFENSE

# 12

ANSWERS TO  
COMMONLY  
ASKED QUESTIONS  
FROM EX-TEXAS  
COMPTROLLER  
AUDITORS





When you receive a Texas Comptroller audit notice, the first thought that likely comes to mind is “Who can I talk with to get honest and accurate advice about my audit?”

Initially, many businesses turn to their tax manager, CPA or accountant. Although these individuals may have some limited experience with Texas tax audits, they probably don’t know the specific rules when it comes to taxability, record requirements and estimation techniques (to name a few).

For this reason, Texas Tax Group’s team of ex-Texas Comptroller State Tax Auditors put this eGuide together to answer some of the more common questions that come up before, during and after the audit.

## THIS GUIDE IS MEANT TO HELP YOU GAIN HONEST INSIGHT INTO THE AUDIT PROCESS.

Take a read through. Hopefully we’ve hit the mark and this helps you with your questions. Don’t ever hesitate to call (1-855-892-8348) or email (Dino.Marcaccio@taxastaxgroup.com) with any questions you have. ★



Regards,  
Dino Marcaccio  
Founder – Texas Tax Group  
Former Texas Comptroller Auditor – 16 years



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# WHAT ARE MY RIGHTS ?



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**E**very Texas taxpayer should know their rights. The Texas Comptroller, Glenn Hegar, has outlined your rights for you in the [Texas Taxpayer Bill of Rights](#). Make sure you know, and review these rights, as soon as you get your audit notice.

The first 7 rights deal directly with those businesses selected for state tax audit.

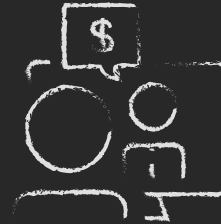
1. You have the RIGHT to fair and equitable treatment
2. You have the RIGHT to privacy and confidentiality
3. You have the RIGHT to understand the taxes you pay
4. **You have the RIGHT to pay only what you owe**
5. **You have the RIGHT to representation**
6. You have the RIGHT to contest a decision
7. You have the RIGHT to request a waiver of penalties
8. You have the RIGHT to simpler tax filing
9. You have the RIGHT to courteous, accessible assistance from a real person
10. You have the RIGHT to know how government spends your tax dollars

Unfortunately, these fundamental rights are sometimes overlooked and therefore it is up to you and your representative to know and defend your rights.

# HOW LONG DOES AN AUDIT TAKE?

State tax audits can take anywhere from a couple of months to more than a year. However, most state tax audits take 4-6 months from the date of the Entrance Conference to the date of the Final Notification of Exam Results. In addition, [expect to add another 3-12 months if you disagree](#) with your auditor's findings and request a redetermination hearing.

Ultimately, the length of your audit depends on, among other variables, the experience of your auditor, size of your company, number of records and the organization and the availability of your records.



[ADVICE FROM TEXAS TAX GROUP: Conduct 'pre-audit' activities such as Gross Sales and Sales Tax Reconciliations, review of asset and expense purchases and verification of resale and/or exemption certificates. This will shorten the timeline of your audit.](#) ★



WHAT  
RECORDS ARE  
REQUIRED  
AND HOW  
FAR  
BACK DO  
THEY GO ?

The records required for a state tax audit are outlined in [Tax Rule 3.281](#) subsection (b) of the Texas Tax Code. Subsection (e) states that you must keep those records for a minimum of four years.

As you can see, the record description in Tax Rule 3.281 subsection (b) is somewhat vague and generic in nature. A sample '[Records Demand](#)' letter describes in greater detail the specific accounting records required for an audit.

Does this mean you need to have every single business document going back 4 years ready for immediate access? [Yes and no.](#)

Unfortunately, every auditor and audit situation is different. Therefore, what records have to ultimately be made available is hard to determine until you begin working with your auditor.

**ADVICE FROM TEXAS TAX GROUP:** Certain types of records need to be 100% available. In other cases, audits can be conducted by reviewing selected sample sales or purchase transactions and projecting those error results (if any).

Watch out for sample or estimated audits. The results can be very inaccurate and can result in tax assessments which can easily be 2 to 3 times the tax actually owed.

It is a fact that auditors can come up with almost ANY type of sample/estimate audit procedure even if the results are not representative of your business activity ([link to Rule 3.282](#)). ★



WHAT IF MY  
RECORDS ARE  
**MISSING**  
OR  
UNORGANIZED?



4

**M**ost businesses under audit are small to medium in size and do not always have complete or organized records. In certain cases, it may take a great deal of time to locate missing records. Often the owner does not have the resources to gather records demanded by the auditor because he/she is busy running their business.

In these cases, **auditors have unlimited authority** to decide when and how to estimate tax due by issuing various record demand letters and estimation documents. In certain cases, the auditor can significantly overestimate the tax and leave the business owner with a tax bill that will put him/her out of business.



DO I HAVE TO  
LET  
AN AUDITOR  
TAKE MY  
RECORDS  
OFF-SITE?

The general answer is 'no.' [Tax Rule 3.281\(f\)](#) states that records must be made available for a 4 year look-back period. [Nowhere does the tax rule state that records must be allowed to be taken off-site by the auditor.](#)

You are required to make your records available for audit, but you are NOT REQUIRED to:

- (1) Allow your records to be taken 'off-site'
- (2) Allow auditors to make copies of your records, except for special circumstances.

**TEXAS COMPTROLLER STORAGE ROOMS:** Each of the 22 Texas Comptroller Audit Offices have record storage rooms. Most of these rooms are small and do not have shelves. In addition, there is no system to track your records, except for the auditor's handwritten notes or maybe their business card taped to your boxes. Just imagine your records scattered on the floor of these storage rooms with other business's records for months at a time.



**TEXAS TAX GROUP RECOMMENDS:** [Keep your records in your office. Request that the auditor come to your office to conduct the audit.](#)

[On average, this shortens the audit time, keeps the auditor focused and increases the likelihood of an accurate tax bill.](#)

[Alternatively, hire Texas Tax Group and we can manage and host the audit at one of our offices, or manage the audit at your place of business.](#) ★



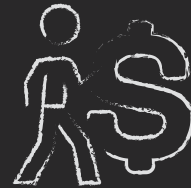


## HOW DO I BEST PREPARE FOR AN AUDIT?

The most important part of the audit actually takes place before the auditor ever shows up.

To prepare for an audit, it is best to verify the completeness of your general records and then conduct a pre-audit of your sales and purchases as they relate to Sales Tax. The Sales & Use Tax returns should be reconciled to the taxes your records say were actually charged and collected. Any resale or exemption certificates needed should be gathered and reviewed for completeness.

Remember, the more work you put into preparing for the audit, the smoother it will go.



TEXAS TAX GROUP'S TEAM of former Texas Comptroller State Tax Auditors can assist you with these tasks.

We identify potential problem areas and then attempt to quantify the estimated possible tax due. If certain transactions are found to be subject to tax, our consultants will then determine if a detailed or sample approach is best. ★



IS THERE A  
**WAY**  
TO  
CHALLENGE  
THE AUDITORS  
FINDINGS  
PRIOR TO AN  
AUDIT BEING  
BILLED?

**B**usinesses have two ways to officially challenge an auditor's findings prior to their audit being billed. The first option is to request a Reconciliation Conference. This resolution process is judged by the audit manager or supervisor.

The second option is to request an Independent Audit Review Conference (IARC). An IARC allows businesses to address their disputes with an 'unbiased' third party called the Independent Audit Reviewer (IAR).

Although the IAR does not work directly for a Comptroller office that conducts audits, they still work for the Comptroller.

Preparing for and attending an IAR is a serious matter. It is your last chance to correct potential errors in an audit. To even be approved for an IAR the business owner (or representative) must clearly state the contentions (arguments) and provide supporting documentation as well as relevant tax research documents which may include: Tax Statutes, Tax Rules, Letter Rulings and/or Administrative Hearing). All documents must be provided prior to the IAR conference to the auditor and Dispute Officer in an organized fashion. The oral presentation may include witnesses and notarized affidavits. If you lose at the IAR then you will receive a tax bill and have no choice but to enter the time intensive and dangerous Administrative Hearings process.

**ADVICE FROM TEXAS TAX GROUP:**

Although an IARC will not be granted until the Exit Conference, we suggest you reserve your right to an IARC as soon as possible. This puts the auditor on notice and keeps the audit from being billed without your knowledge.

Note: An Independent Audit Review Conference may be held in addition to or instead of the Reconciliation Conference. ★



WHAT DO  
I DO IF I  
RECEIVE A  
TAX  
BILL  
AND I  
DISAGREE  
WITH IT?



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If you receive your Notification of Exam Results and still disagree with your auditor's finding, you will most likely want to request a redetermination hearing. To do this, you are required to send a letter with a statement of grounds to the Texas Comptroller's Office. This must be done within 30 days of the statement date on the [Notification of Audit Results](#) or 20 days in the case of a jeopardy (fraud) determination. [Tax Rule 1.7](#) contains the law on how this is done. Parts (a), (b) and (c) of Tax Rule 1.7 state:

- (a) The Statement of Grounds must contain the reasons the taxpayer disagrees with the action of the agency. The taxpayer must list and number the items or transactions, individually or by category, with which he or she disagrees. For each contested item or category of items, the taxpayer must also state the factual basis and the legal grounds to support why the taxpayer argues that the tax should not be assessed or the tax should be refunded. If the taxpayer disagrees with the agency's interpretation of the law, specific legal authority must be cited in support of the taxpayer's arguments.
- (b) If an item or transaction, or category thereof, is not listed in the Statement of Grounds, it may be barred from consideration in a hearing.
- (c) In the event that the taxpayer's Statement of Grounds fails to list and number items or transactions, individually or by category, or fails to state the factual basis and legal grounds upon which relief is sought, the case may be dismissed.

In other words, [The Statement of Grounds must be specific as to the adjustments being contested as well as the legal grounds for your arguments. If you intend to request a redetermination hearing on your own, we urge you to carefully draft your hearing request and to:](#) (1) number and name all contentions and (2) include any legal grounds for your arguments such as statutes, tax rules, Comptroller Letter Rulings and Administrative Hearings.



WHAT IF I  
RECEIVE A  
TAX BILL AND  
CANNOT  
PAY  
IT?


**U**nlike the IRS, the Texas Comptroller will NOT negotiate for pennies on the tax dollar. This means that all the additional tax, penalties and interest assessed must be repaid within 30 days of receiving your Notification of Audit Results.

If you absolutely cannot pay your assessment, the Comptroller's Enforcement Division offers one option as a last resort in the form of a payout agreement. But they don't make it easy and not everybody qualifies.

The following are just some of the requirements in order to even be considered for a standard Enforcement payout agreement:

- A letter from your business proposing the agreement.
- Certified copies of loan applications from two lending institutions attempting to satisfy the liability. If denied, a letter from each stating the reason for the denial.
- A minimum of a 25% down payment.
- Financial statements dated within the past three months.
- A sales tax bond or a personal guarantee of an officer or a third party guarantor.
- Copies of your last three Federal Income Tax Returns.
- Three credit and banking references.
- All other state taxes for which you are responsible must be current.

In addition, Enforcement typically only allows payouts for a maximum of 24 months. They also charge Prime plus 1% interest on your additional tax, penalty and interest charges for the life of the loan.



## IS THERE A CHANCE FOR PENALTY AND INTEREST CHARGES TO BE WAIVED?

It's possible, but not probable if you leave the Comptroller's office to their own device. We rarely see the Comptroller's office grant a waiver on its own.

At a minimum, the taxpayer must:

- File a hearing request (a request for redetermination)
- Make a case for why the waiver is applicable

Texas Tax Group negotiates for penalty and interest waivers on a case by case basis. The process involves filing for an administrative hearing and then making a case for why the taxpayer deserves consideration.

#### PENALTY CHARGES:

- **The 10% Regular Penalty Charge** is often assessed based on various factors and will be shown on the final tax bill. Some of the reasons for its application are: (1) significant number of late tax return filings, (2) records were incomplete, (3) cooperation was poor or (4) if this was a 2nd follow up audit.
- **The 50% Fraud Penalty Charge** will apply if the tax assessed was over 25% of total tax due. This is a very serious assessment and can easily result in the officer(s) being directly responsible for the entire gross audit liability. See Sec. 111.0061.

#### INTEREST CHARGES:

All audits will initially have interest charged on the tax bill. The interest charge is 4.25% and is calculated as 1% over the Federal Prime Rate (currently 3.25%). This floating interest rate is calculated as of the 1st calendar day of each year and has remained unchanged from 2008 through 2015.

[See the Texas Comptroller's page titled 'Interest on Credit and Refunds and on Tax Due.'](#)



WHAT  
CHANCE  
DO I HAVE  
IF I GO TO AN  
ADMINISTRATIVE  
HEARING?

**B**usiness owners lose 90% of Administrative Hearings. In fact, even if the Administrative Law Judge rules in your favor, the Comptroller may still reject the Judge's decision.

This is why it is so important to resolve your issues with the auditor during the '60 day period' (after you are accepted into the hearings process but prior to the hearings attorney being assigned).

If you do decide to go all the way to an actual hearing, you will need to provide an overwhelming body of evidence in the form of business records and tax research documents, etc. to the assigned Comptroller Hearings Attorney.

Bottom line: It is tough to win hearings, even if the auditor used unfair methods to over-assess tax. Therefore, it is usually best to prepare for your audit before it begins and if needed resolve the case with the Hearings Attorney prior to the actual hearing. Please refer to the Texas Comptroller's January 2015 brochure titled 'The Rules of Practice & Procedure'.

## Common last words from Administrative Law Judges:

“Based upon the lack of evidence provided by the Petitioner (business owner), I uphold the entire audit assessment.”

So remember, an actual Administrative Hearing should be your last resort.



WHO DO WE  
HIRE  
IF WE NEED  
REPRESENTATION?

**B**UYER BEWARE: The State of Texas does not regulate state tax consultants!

And hiring the wrong consultant can be a costly mistake. So make sure you do your 'due diligence'.

Be sure to ask the following questions:

1. Does the firm specialize in Texas taxes?
2. Does the firm hire ex-Texas Comptroller auditors as their consultants?
3. Does the firm maintain offices in Houston, Dallas, San Antonio and Austin?

State tax audits can cost your company time, money and even business. Between complex audit methodologies, gray areas in the tax code, changes to Comptroller audit policy and a lengthy administrative hearings process, there are just too many risks to go it alone.

Leverage Texas Tax Group's team of former Texas Comptroller State Tax Auditors for Superior Audit Results, Maximum Refunds, Definitive Answers and Peace of Mind.

**LEARN MORE:**

Dino Marcaccio founded Texas Tax Group in 2007 after spending 16 years as an auditor with the Texas Comptroller's Office. He asks you to look up the other State Tax Consultants and compare them to Texas Tax Group and then make your decision.

Texas Tax Group currently represents over 200 active audit defense clients and has filed over 400 Administrative Hearing Requests over the last 9 years resulting in millions of dollars in reduced audit assessments. In addition, TTG has negotiated over 450 settlements for our clients. ★

Call us at 1-855-892-8348



Call us at 1-855-892-8348,  
for a free 20 minute consultation, today!



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