

So, The IRS Has Selected Your Return for Audit

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By Scott K. Tippet



The Internal Revenue Service ("IRS") audits 1% to 2% of small business income tax returns annually for one of two reasons: (1) something about the return (or information reported on the return) flagged the return for a closer review and the revenue agent reviewing the return decided an audit was appropriate; or (2) (bad) luck of the draw – the return was randomly selected for audit. The first reason – a red flag – is far more common than a random audit.

The IRS publishes Audit Technique Guides for use by revenue officers. These guides can be found on the IRS's website [here](#) and provide insight into what the IRS checks for and hopes to discover. Regardless of the reason or type (more on that below), ***the IRS never emails you and never calls without first sending you correspondence BY MAIL (not email).***

There are Four Types of Audits

There are four types of audits, listed from least to most intrusive.

Correspondence Audit

The first (and most common) is a **correspondence audit**, which constitutes about three-quarters of all audits. With correspondence audits, you never meet with a revenue agent face-to-face because everything is done through the mail. In the simplest of audits, the IRS asks for information only regarding certain specific entries on your return.

For example, if your return reported sales of stock and the return failed to indicate the basis, the IRS will write and request you to provide them with basis information (how much you paid for the stock you sold). Once you supply the requested information, the audit may be over (assuming the information provided matches the gain or loss reported on the return).

Office Audit

The second form of audit is an **office audit**, which takes place at their office, not yours. Office audits arise when a return is too complex for a correspondence audit but does not meet the threshold for a field audit. Often, office audits are over itemized deductions, rental incomes and losses, or Schedule C filers. During an office audit, the examiner will ask you questions in an attempt to find other areas to examine. Often, the examining agent will ask for more information, usually documents, and will give you a reasonable amount of time to gather and supply the requested information.

Field Audit

The third form of audit is a **field audit**. This audit takes place *at your office*, not theirs. During a field audit, the examiner will frequently ask for additional information and expect you to provide it reasonably quickly, after all, they are at your office where (in their mind) the records should reside.

Line-By-Line Audit

The fourth form of audit is a **line-by-line audit**, otherwise known as a **Taxpayer Compliance Measurement Program (TCMP) audit**. In this audit, the IRS reviews the returns of lucky taxpayers, line-by-line. The stated purpose of the audit is to build and refine the data points used to tweak the algorithms that determine whether a return should be selected for audit. Still, it is an audit, nonetheless.

No matter the type of audit, the IRS's starting position is to count all income and deny all deductions. For example, in our correspondence audit example, if you claimed a loss on the sale of stock, unless and until the IRS receives the requested supporting documentation, they will deny the loss, adjust your return accordingly, and send you a tax bill with interest and penalties. Office, field, and TCMP audits are the same way. The IRS wipes out your deductions and makes you build them back, providing reasonable substantiation for each type and amount of deduction.

All audits begin the same way regardless of the type: the IRS sends you a letter, often by certified mail, advising you of the audit. The letter always has a response date. Do not ignore this date. If you ignore the date and do not respond, the IRS will either escalate the audit or issue a 30-day letter in which the IRS tells you what changes they propose and how much additional tax, interest, and penalties you will need to pay. If you ignore the 30-day letter, the IRS will issue a Statutory Notice of Deficiency (SNOD), and you will have ninety (90) days to file suit in the United States Tax Court to contest the IRS's findings.

When Do You Need a Tax Lawyer

Certainly, for office and field audits. During office and field audits, the audit examiner will be asking you questions. Audits are unpleasant, and many people simply think that if they answer all the examiner's questions the audit will be over quicker. WRONG. The examiner is asking questions because they are looking for additional areas to audit.

Equally important, statements you make to the examiner fall under **18 USC § 1001**, more commonly known as a "1001 violation." 18 USC § 1001 criminalizes knowingly and willfully making materially false, fictitious, or fraudulent statements or representations made to a federal agent. This is the statute under which Martha Stewart was convicted. What she lied about was not a crime, but lying about it to a federal agent was (and still is) a crime under **18 USC § 1001**. Whether an incorrect answer is merely the fault of a bad memory or may be considered lying to a federal agent is a question over which reasonable minds can and do differ. Just as I often told baseball teams I coached, never put the calling of a close pitch a ball or strike in the hands of an umpire; you shouldn't leave the decision whether it was your bad memory or something worse to an IRS agent. A tax lawyer can help keep this from happening.

When Should You Call a Tax Lawyer

The minute you get the notice in the mail advising you that your return has been selected for audit. An experienced tax controversy lawyer can meet with the audit examiner on your behalf and provide information in a limited, organized manner, which will help limit the scope of the audit. The audit examiner will address questions to your attorney, not you. Tax lawyers' answers are measured and designed to keep the audit as limited as possible. Even with a correspondence audit, your best solution may be to engage a tax lawyer to respond on your behalf or, at the very least, guide your response. Professional counsel can make a significant difference in the outcome, so leave the DIY to other areas.