



# Individual Income Tax Audits

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# History of Individual Income Tax Audits

- Individual income tax returns are routinely reviewed by Taxpayer Compliance specialists and CID investigators.
  - The returns are reviewed before refunds are issued or credits against tax are allowed.
- Historically, the Department did not audit individuals except for occasional residency audits.

# History of Individual Income Tax Audits

- Starting in May 2015, the Department began development of an individual income tax audit program housed within the Field Audit Income Tax Division.
- Currently, the division is staffed by three auditors and one assistant director.
  - The auditors are remote employees and located throughout Louisiana.

# Types of Individual Income Tax Audits

Generally, audits of individual income taxes involve one or more of the following:

1. Adjustments to federal AGI and itemized deductions
2. Adjustments to Louisiana specific items such as Schedule E deductions and credits
3. Residency audits

# Audit Selection Methods

Queries based on  
Federal Tax  
Information

Referrals from other  
LDR divisions

**Audit  
Selection**

Referrals from other  
agencies and  
whistleblowers

Random selection of  
unusual items

# Audit Procedure

1. The auditor issues a letter to the taxpayer explaining that the taxpayer's return(s) have been selected for audit, which years are under audit, and what items on the return are under review.
  - Audits may be limited scope audits (specific items on certain schedules or forms) or comprehensive audits reviewing income, deductions, expenses, and credits in general.

# Audit Procedure

2. The auditor notifies the taxpayer (or representative) whether the audit will proceed as a correspondence audit or field audit.
  - Correspondence audits are conducted by mail, email, and teleconferences.
  - Field audits are conducted on site at the taxpayer's business or representative's office.
  - The type of audit is based on the complexity of the issues and amount of documentation.

# Audit Procedure

3. The auditor examines the documentation and applies federal rules in allowing, limiting, or disallowing items on the federal return.
4. The auditor provides the taxpayer and representative with proposed audit adjustments.
  - The taxpayer and representative may agree, disagree, or partially agree with the proposed adjustments.
  - Amended returns should not be filed in response to an audit.



# Audit Procedure

5. If the taxpayer agrees with some or all of the proposed audit adjustments, the taxpayer may pay the additional tax, interest, and penalties.
  - If the taxpayer amends the federal tax return to conform to the state audit adjustments, the Form 1040X should be provided to the auditor.
  - The auditor will then adjust the federal income tax deduction in arriving at additional Louisiana income tax due.

# Audit Procedure

6. If the taxpayer disagrees with one or more proposed audit adjustments, the audit is transferred to the Audit Review and Appeals Division.
  - The audit is assigned to a Reviewer who independently reviews the audit adjustments.
  - After review, the Reviewer issues a Proposed Assessment to which the taxpayer may file a formal protest within 30 days.

# Federal Record Keeping Requirement

- The IRS imposes a wide range of record keeping requirements depending on the particular item of income, expense, deduction or credit.
- Except in a few cases, federal law does not require any special kinds of records
  - **Exceptions:**
    - Charitable contributions
    - Employee expenses

# Record Keeping Requirement for LDR Individual Income Tax Audits

- LDR is bound by federal rules when allowing or disallowing a particular federal item of income, deduction, expense, or credit.
- If the IRS requires a particular record for an item, LDR requires the same record.
- If the IRS is not specific as to a particular record for an item, LDR requires reasonable documentary evidence to support an item.

# Audit Example

- John Taxpayer files a 2016 Form 1040 reporting \$75,000 in wages, \$20,000 in Schedule C losses, and \$10,000 in charitable contributions.
- The return is selected for audit by the Department.
- The auditor requests supporting documentation for the Schedule C income and expenses as well as the charitable contributions.

# Audit Example

- **Schedule C Losses**
  - The taxpayer reported no income and \$20,000 of supplies expense. The taxpayer cannot provide any supporting documentation for the supplies expense.
  - The auditor disallows the entire \$20,000 Schedule C loss due to the lack of supporting documentation.

# Audit Example

- Charitable contribution
  - The taxpayer reported donations of \$10,000 to a church in 2016. The taxpayer provides the auditor with an acknowledgment issued by the church.
  - Upon review of the acknowledgment, the auditor determines the acknowledgment does not state whether the church provided any goods or services in consideration for the \$10,000 donated.
    - See IRC Section 170(f)(8)(B) .
  - The auditor denies the charitable contribution.

# Audit Example

STATE OF LOUISIANA  
DEPARTMENT OF REVENUE  
FIELD AUDIT INCOME TAX DIVISION  
INDIVIDUAL INCOME TAX SECTION

Taxpayer: John Taxpayer  
617 N. Third Street  
Baton Rouge, LA 70802

Account No: 1234567-600  
Audit ID No: A999999999  
Tax Year: 2016

## AUDIT SCHEDULE

### Summary of Audit Findings

1. Federal AGI increased by \$20,000 due to disallowed Schedule C losses.
2. Federal itemized deductions decreased by \$10,000 due to disallowed charitable contributions.

### Preliminary Adjustments to Return

|                                    | Original Return | Adjustments | Audited   |
|------------------------------------|-----------------|-------------|-----------|
| Federal Adjusted Gross Income      | 55,000.00       | 20,000.00   | 75,000.00 |
| Federal Itemized Deductions        | 10,000.00       | (10,000.00) | -         |
| Federal Standard Deduction         | 6,300.00        | -           | 6,300.00  |
| Excess Federal Itemized Deductions | 3,700.00        | (3,700.00)  | -         |
| Federal Income Tax                 | 6,015.00        | -           | 6,015.00  |
| Louisiana Tax Table Income         | 45,285.00       | 23,700.00   | 68,985.00 |
| Louisiana Income Tax               | 1,475.00        | 1,317.00    | 2,792.00  |
| Consumer Use Tax                   | -               | -           | -         |
| Total Income and Consumer Use Tax  | 1,475.00        | 1,317.00    | 2,792.00  |



# Penalties on Audit Adjustments

- Delinquent Filing Penalty (25%)
  - Assessed based on unfiled returns
  - Calculated at 5% per month (25% maximum)
- Delinquent Payment Penalty (25%)
  - Assessed based on late payment of tax due
  - Calculated at 0.05% per month (25% maximum)
- Negligence Penalty (10%)
  - Assessed based on unfiled returns and failure to make prior audit adjustments in current audit period

# Penalties on Audit Adjustments

- Understatement Penalty (15%)
  - Assessed based on understatement of tax table income of 25% more of audited federal AGI
- Intentional Understatement Penalty (20%)
  - Similar to the 15% Understatement Penalty, except the taxpayer demonstrates a willful intent to disregard the tax laws of Louisiana
    - Example: Auditor requests taxpayer provide federal tax returns in accordance with LA R.S. 47:295(D); taxpayer refuses and auditor issues administrative subpoena to compel production of federal returns

# Current Audit Projects

- Audits of unreported income relating to damages payments from the Seafood Compensation Program for Oyster Leaseholder Interests
- Audits of hobby reclassifications under Treasury Regulation 1.183
- Audits of paid preparer's clients when the preparer has been identified as filing fraudulent returns

# Additional Information

- Individual income tax audit FAQs
  - <http://revenue.louisiana.gov/FAQ>
- General individual income tax audit questions
  - [IndividualIncomeAudit@la.gov](mailto:IndividualIncomeAudit@la.gov)