New High Wealth Taxpayers Group Formed by IRS

The IRS has formed a Global High Wealth Industry Group within their Large and Mid-Size Business Operating Division (LMSB or the Division). This new group is designed to centralize and focus the IRS's compliance efforts involving high wealth individuals and their businesses. In speaking to the AICPA's National Tax Conference on October 26th, 2009, IRS Commissioner Douglas Shulman indicated that the new group will allow the IRS to take a unified look at all the business enterprises controlled by high wealth individuals and better understand that individual's entire economic picture. The IRS has already started hiring agents and specialists and their initial examinations will focus on an enterprise or integrated approach.

Many of our clients have multiple businesses. The new LMSB division is a major change by the Internal Revenue Service and we are concerned that a selection for examination by this Division will create a significant burden and could take a considerable amount of time. One of the areas we expect the Service to examine will be the facts supporting the classification of a business interest. An owner in a business must classify their interest in a business enterprise as active or passive. Generally, a business holding real estate is classified passive. However, if certain requirements are met, the real estate business can be classified as an active activity and those taxpayers that are in the real estate trade or business may classify their real estate business interests in which they participate as active by declaring themselves real estate professionals. The law creating these requirements dates back to 1986. Since that time, the IRS has done little, if anything, to check the appropriate classification of taxpayer's business interests. If, under this new program, the IRS requests verification of appropriate classification, the burden could be difficult if not onerous. Support will require showing a partition of time spent in each activity and many businesses do not require timesheets or daily logs of owner/employee day-to-day activities.

What should you do?

1. Begin keeping some type of journal or detailed calendar of your activities and efforts related to your businesses.
2. Review the financial statements of each company carefully to insure that all revenue and expenses are recorded correctly and that expenses are qualifying business expenses.
3. Review your tax return carefully to insure that it is prepared in compliance with all applicable tax laws.

It may be appropriate to consult with your tax professional to assist in a review of each business. You should not assume that your tax preparer has made this review as preparation of a tax return is not an audit. The tax return preparation process utilizes data supplied by you without reviewing the detail. Accordingly, if you have any concern as to the appropriate treatment of any items of income and expense, contact your tax professional for a detailed review of your business records.

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