

Newsletter

July 2025

Dear clients:

We hope you enjoyed the long holiday weekend. On July 4th, President Trump signed the One Big Beautiful Bill Act (OBBA). The tax provisions within the OBBA may impact your 2025 tax returns as well as future returns. Please look for additional communications from our office in the future as we work through the OBBA and perform our due diligence regarding this new piece of legislation. If you have specific questions about how the OBBA may impact your specific tax situation, please don't hesitate to contact our office.

Sincerely,
Aaron Bagby
Kramer, Jensen & Bagby, LLC

Think the IRS Is Slowing Down? Why That Might Actually Increase Your Audit Risk

You've probably seen the headlines:

["IRS funding slashed."](#) ["Audit rates down."](#) ["Staffing cuts."](#)

If you're a business owner, investor, or part of a high-earning household, you may be thinking: *Finally*, some breathing room.

But here's the reality:

The IRS isn't pulling back. It's just getting smarter about who it goes after.

The IRS Isn't Auditing Everyone—Just the "Right" People

With fewer agents and a push for efficiency, the IRS is relying more than ever on technology, especially something called the [Discriminant Inventory Function System](#), or DIF.

Think of DIF like a risk-scoring engine for tax returns. It compares your numbers—income, deductions, expenses—to national norms for similar taxpayers. The more your return deviates from what's typical for your income level, industry, or filing status, the higher your score... and the greater your audit risk.

Want to dig deeper into the DIF system? [Read](#) the GAO's breakdown on how the IRS selects returns for audit.

What Gets Flagged? Here Are the Most Common Red Flags:

According to industry data and IRS enforcement trends, here are some of the **top audit triggers**:

- **Unreported income** – This includes anything from 1099 income to tips, crypto gains, or rental income. If the IRS has a record of it and you didn't include it, a CP2000 notice

may be coming.

- **Large deductions vs. income** – If you earn \$75,000 and claim \$40,000 in business deductions, expect the DIF to notice. Especially true for Schedule C filers.
- **Crypto transactions** – Digital assets are a growing audit target. If you're dabbling in crypto but skipping IRS Form 8949 or the crypto checkbox, you're on thin ice.
- **Repeated business losses** – If your business consistently reports losses, the IRS may classify it as a hobby, not a business, and disallow deductions.
- **Cash-intensive businesses** – Restaurants, salons, contractors, and others operating heavily in cash are often scrutinized for underreporting.
- **Home office deductions** – A common mistake? Claiming a home office without meeting the strict "exclusive and regular use" test.

Fewer Letters Don't Mean Less Risk

Today's IRS isn't about paper mail and phone calls.

It's about algorithms and matching engines quietly reviewing your data and issuing notices like the [CP14](#) (balance due) or [CP2000](#) (income mismatch) months after you file.

Often, taxpayers don't even realize they've been flagged until interest and penalties have already started piling up.

What You Can Do Now

Here's the good news: You don't need to be afraid of an audit—you just need to be prepared.

- Double-check your return for accuracy and consistency with any W-2s, 1099s, or crypto reports
- Keep solid records of deductions, mileage, and business expenses
- If you're unsure about a past return or received a notice, don't ignore it—review it with a pro
- Know that audit selection is increasingly about patterns, not just income level

Need a Second Opinion—or a Bit of Peace of Mind?

If something on this list hits close to home—or if you've received a confusing notice from the IRS—don't guess.

Our office can help you review your IRS transcripts, explain the notice, and decide if action is needed.

No scare tactics. Just straight answers, grounded in what's really happening inside the IRS today.

Contact our office if you'd like help reviewing your situation or understanding your risk. We're here to guide, not judge.

Navigating IRS Penalty Abatement

Article Highlights:

- **Understanding Reasonable Cause Abatement**

- What Constitutes Reasonable Cause?
- How to Apply for Reasonable Cause Relief
- Who Can Apply?

- IRS Guidelines on Evaluating Reasonable Cause
- Grounds Used for Requesting Abatement
- Exploring First-Time Abatement Penalty Relief

- **Qualifications for First-Time Abatement**

- Is FTA a One-Time Benefit?
- Scope and Limitations of FTA
- How to Apply for FTA

- **Interest Charges Generally Not Eligible for Abatement**

For taxpayers facing IRS penalties, understanding the pathways to request penalty abatement can provide relief both financially and emotionally. From reasonable cause abatement to First-Time Abatement (FTA), this article explores these options, detailing the qualifications, processes, and considerations essential for crafting a successful request.

UNDERSTANDING REASONABLE CAUSE ABATEMENT

Reasonable cause abatement is a provision that allows taxpayers to request the removal of certain penalties based on circumstances that prevented the taxpayer from complying with tax laws. This relief is grounded in the principle that, despite the taxpayer's best efforts, compliance was not possible due to unforeseen events or circumstances beyond their control.

What Constitutes Reasonable Cause? Reasonable cause is determined based on all the facts and circumstances in a taxpayer's situation. Some common situations that might be considered reasonable cause include:

1. **Natural Disasters:** Events such as hurricanes, floods, wildfires or earthquakes preventing timely filing or payment.
2. **Serious Illness or Death:** The illness or death of the taxpayer or an immediate family member that impacts the taxpayer's ability to comply.
3. **Unavoidable Absence:** Situations where the taxpayer is unavoidably absent during critical tax periods may qualify.
4. **Inability to Obtain Records:** If records needed for filing were unobtainable for reasons beyond the taxpayer's control.
5. **Fire, Casualty, or Other Disruptive Event:** Events causing significant disruption to the taxpayer's ability to maintain proper records or file.
6. **Mistake Made Despite Ordinary Care:** Errors made even though the taxpayer exercised ordinary business care and prudence.

How to Apply for Reasonable Cause Relief - To apply for reasonable cause abatement, taxpayers should:

- **Submit a Written Request:** Explain in detail the reason for the late filing or payment. Include documentation supporting the claim, such as hospital records, insurance claims, or any correspondence related to the circumstances.
- **Provide Specifics:** Focus on the timeline of events and how each impacted tax compliance. Specificity aids the IRS in understanding and evaluating the request.
- **Use Form 843 (Claim for Refund and Request for Abatement):** This is typically the form used for penalty abatement requests, apart from initially submitting statements with the late-filed return or payment.

Who Can Apply?

Any taxpayer (or their representative with a power of attorney) assessed with a penalty and having reasonable cause for non-compliance can apply for relief. This includes:

- **Individuals:** Facing personal tax penalties.
- **Businesses and Corporations:** Encountering penalties related to payroll taxes, income tax, etc.

- **Estates and Trusts:** Affected by penalties during administration or distribution processes.

IRS Guidelines on Evaluating Reasonable Cause -The IRS evaluates reasonable cause requests based on guidelines that consider:

- **Ordinary Business Care and Prudence:** Whether the taxpayer exercised ordinary business care and prudence and still could not comply.
- **Circumstances Causing Non-compliance:** The nature of events and their direct connection to the failure to comply.
- **Compliance History:** Previous compliance history can be a factor. Taxpayers with a good history may have a more favorable outcome.
- **Length of Delay:** The duration of the delay and whether the taxpayer made efforts to comply as swiftly as possible after the circumstances changed.
- **Efforts to Comply:** Actions taken by the taxpayer to mitigate or resolve the circumstances preventing compliance.

Grounds Used for Requesting Abatement - While the grounds for requesting reasonable cause relief vary, success often hinges on the strength and documentation of the reason.

- **Successful Grounds:**
 - Medical emergencies with thorough documentation.
 - Natural disasters with official declarations or documentation.
- **Unsuccessful Grounds:**
 - Financial inability to pay (typically not sufficient unless extreme circumstances can be proven).
 - Lack of funds due to a downturn without external unforeseen cause.

EXPLORING FIRST-TIME ABATEMENT PENALTY RELIEF

The First-Time Abatement provides an additional avenue for penalty relief, recognized for its promotion of compliance through forgiveness for a single error.

Qualifications for First-Time Abatement - To qualify for FTA penalty relief, the taxpayer must meet:

1. **No Penalties Prior:** No prior penalties (except estimated tax penalties) for the preceding three tax years, aside from minor deviations.
2. **Filing Compliance:** Filing of all required returns or extensions for the year in question and three years prior.
3. **Current Tax Obligations:** Settlement of any taxes due or actively in an installment agreement.

Is FTA a One-Time Benefit? FTA may sound like a one-time offer, but it can be revived after three successive years of compliance, offering ongoing incentive for good compliance practices if maintained.

Scope and Limitations of FTA

- **Applies To:**
 - Failure-to-File Penalties
 - Failure-to-Pay Penalties
 - Failure-to-Deposit Penalties
- **Does Not Apply To:**

- Accuracy-related penalties
- Fraud penalties
- Other non-compliance-related penalties

How to Apply for FTA

- **Automatic Consideration:** Often applied automatically when a taxpayer who has received a penalty notice calls the IRS to inquire about penalties.
- **Verification Needed:** Tax records and account standing must be verified for eligibility by an IRS representative.
- **Documentation:** Less documentation-intensive compared to reasonable cause, but keeping impeccable records can always benefit the taxpayer.

INTEREST CHARGES GENERALLY NOT ELIGIBLE FOR ABATEMENT

The IRS is required by statute to assess interest on unpaid tax due or penalties. IRS sets and publishes current and prior years interest rates quarterly that are used to calculate interest on underpayment and overpayment balances. The only circumstance when the IRS may reduce the amount of interest owed is if the interest is applied because of an IRS officer or employee's unreasonable error or delay. Among other criteria, the error or delay must have occurred after the IRS contacted the taxpayer in writing about an examination, underpayment, or payment. Meeting the qualifications for abating interest is extremely difficult to achieve.

Understanding and utilizing penalty relief options such as reasonable cause and First-Time Abatement equip taxpayers with vital tools for reducing their IRS burdens. By thoroughly documenting circumstances, maintaining compliance, and being aware of IRS guidelines, taxpayers can alleviate financial distress and continue a path of compliance. As these provisions aim to recognize the unexpected and encourage compliance, they play a crucial role in fostering a more forgiving yet structured tax system for all parties involved.

Contact this office if you believe you qualify for either the reasonable cause or the first time-abatement penalty relief and need assistance applying for the relief.

Thank you for selecting our firm for your tax and accounting needs. We appreciate the confidence you have shown in us, and we remain ready to assist you at any time.

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