

# What to Do If the IRS Audits Your Memphis Business

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An IRS audit changes the tone of a business week fast. A Memphis owner can open the mail in River Oaks, Raleigh, East Memphis, or along the Austin Peay Highway corridor and find a federal notice that suddenly turns old invoices, mileage logs, 1099s, payroll records, and bank statements into urgent issues. The problem usually is not just tax due. The problem is timing, records, cash flow, and the risk of saying the wrong thing too early. For a Memphis business, especially a sole proprietor filing Schedule C with Form 1040, an audit is less about panic and more about controlled response.

In Shelby County, many small businesses operate as single-member LLCs, informal family businesses, home-based service companies, salons, trucking operations, food businesses, cleaning companies, rideshare operations, and independent contractor ventures. That matters because the IRS tends to focus on records, income matching, and deduction support. A business owner in 38108 near the Austin Peay corridor may face the same federal examination standards as a firm near River Oaks in 38120 or a professional practice near Germantown in 38138. The zip code changes. The IRS rules do not.

Memphis also sits in a tax environment that catches business owners off guard. Tennessee does not impose a state income tax on wages, so many local owners focus almost entirely on the federal return. That makes the IRS audit the main income tax enforcement event for a large share of Memphis filers. For owners who have never dealt with a federal examiner, the first notice can feel larger than it is. Most audits are limited in scope. Most begin with one issue, one year, or one income mismatch. The damage often grows when the response is late, incomplete, or emotional.

## What an IRS audit usually means for a Memphis business

An audit is the IRS checking whether the tax return matches the records behind it. For a small business, that usually means comparing the filed return with third-party documents, bank activity, payroll filings, bookkeeping records, and the deductions claimed. The IRS may look at income that appears underreported, expenses that look high for the industry, or credits and losses that do not fit the usual pattern.



The three common audit formats matter because each one signals a different level of pressure. A correspondence audit is handled by mail and is the most common. The IRS asks for documents tied to a narrow issue, often one or two line items. An office audit requires an in-person meeting at an IRS office. That usually means broader review and more follow-up questions. A field audit is the most extensive. The IRS visits the business location or the representative's office and reviews operations in a deeper way.

For Memphis owners, a large share of early audit trouble starts with mismatches. A 1099-NEC may show contractor income that never made it onto the return. A 1099-K from a payment platform may not align with the gross receipts reported on Schedule C Profit and Loss from Business. Payroll tax filings may not match what the income tax return reflects. The IRS Notice CP2000 Underreporter notice is a common trigger. It is not a formal audit opening letter in the classic sense, but it often becomes the first serious contact because the IRS believes income was omitted or reported incorrectly.

That is one of the most important local realities in Memphis right now. As platform reporting expands, more small operators receive third-party reporting than they did a few years ago. The 1099-K reporting threshold was \$5,000 for tax year 2024, with a scheduled phase-down to \$2,500 for tax year 2025 and eventually lower. That means more Shelby County business owners who use payment apps, card processors, and online marketplaces now fall into automated IRS matching systems. A sole proprietor in Hickory Hill or Whitehaven can trigger review without any fraud issue at all, simply because the reporting trail became wider.

# Why some Memphis businesses draw more scrutiny than others

The IRS does not audit every business with messy books. It usually reacts to patterns. In Memphis, several patterns show up often. Cash-heavy businesses face questions because deposits and reported income do not always line up neatly. Contractor-heavy businesses face worker classification issues and 1099-NEC reporting issues. Self-employed owners who claim high vehicle expense, meals, travel, or home office deductions without support often invite questions. Businesses that report losses year after year while still paying personal living costs also stand out.

Schedule C filers deserve special attention here. Many Memphis business owners are not filing corporate returns at all. They are filing individual returns with business income attached. That means the audit reaches both business and personal areas at once. The examiner may look at the business income and then compare it with household deposits, dependent claims, filing status, and refundable credits. A return that includes Schedule C, Schedule EIC Earned Income Credit, or Schedule 8812 Credits for Qualifying Children can receive extra scrutiny if the numbers look inconsistent.

That does not mean the owner did anything wrong. It means the IRS sees one return as one data set. In a city where many businesses are family-run and many households depend on the same return for both business reporting and tax credits, a federal audit can affect more than one part of the filing picture.

## The first letter matters more than most owners expect

The wording on the first IRS letter sets the path. Some letters ask for documents only. Some propose additional tax. Some schedule a meeting. A CP2000 usually says the IRS received information from third parties that does not match the filed return. A Letter 525 Examination Report generally follows an examination and sets out proposed changes. Many notices carry a 30-day response deadline. Missing that window can push the case toward automatic assessment, interest growth, and fewer options to dispute the changes early.

A Memphis business owner who receives an audit notice should read for four things immediately: the tax year involved, the exact issue being examined, the deadline, and whether the IRS is asking for documents or already proposing changes. That distinction matters. If the IRS is still asking questions, the case is more open. If the IRS has already computed additional tax, the owner needs a tighter response with records and explanation.

One of the biggest errors in local audit cases is over-answering. Owners often try to explain everything. They send boxes of records, personal commentary, side issues, and unrelated documents. That can expand the case. The IRS asked about one item and suddenly receives enough material to question ten more. A disciplined response keeps the audit tied to the issue actually raised.

## Records that usually decide the case

IRS audits turn on proof. For Memphis businesses, that proof usually comes down to whether the records were created close to the time of the transaction and whether they match each other. Bank statements alone rarely carry the whole case. The IRS wants a credible trail.

- Income records such as invoices, sales logs, deposit records, 1099-NEC forms, and 1099-K statements
- Expense support such as receipts, vendor bills, lease statements, utility records, and payroll reports
- Mileage and vehicle use logs when auto deductions are claimed
- Bookkeeping reports that match the return, especially Schedule C totals
- Prior year returns when the audit issue appears across multiple years

That record problem hits hard in Memphis service businesses. A mobile mechanic in Frayser, a stylist in Orange Mound, a rideshare driver in Midtown, or a catering operator near South Memphis may have income from cash apps, tips, bank deposits, and platform transfers. If those streams were mixed with personal funds, the audit becomes harder fast. The IRS may reconstruct income from deposits and then place the burden on the owner to prove which deposits were not business income.

Vehicle deductions are another pressure point. Many owners rely heavily on business driving across Shelby County, from Whitehaven to Downtown Memphis, from University of Memphis areas to East Memphis and out toward Germantown. The deduction can be valid, but the proof has to exist. The standard mileage rate was 67 cents per business mile for tax year 2024. If the owner claimed a large mileage deduction without a mileage log, the IRS may disallow it even if the driving really happened.

## **What happens when the audit involves payroll or contractors**

Some Memphis business audits start as income exams and then widen into worker classification and payroll compliance. That is common in businesses that pay helpers informally. A business may issue no W-2 and no 1099-NEC, even though workers were paid regularly. The IRS may then ask whether those workers were employees or independent contractors.

The distinction carries real financial exposure. If the IRS decides workers were employees, the owner can face back withholding issues, payroll tax exposure, penalties, and interest. The W-2 January 31 employer deadline and the 1099-NEC January 31 payer deadline matter because the IRS compares these filings against the business return and the workers' returns. Missing forms create easy audit entry points.

For Memphis owners in construction, delivery, trucking, home health, beauty services, and property maintenance, this issue appears often. A business may think it stayed simple by paying cash or using a payment app. In an audit, that simplicity disappears. The examiner asks who was paid, for what, how often, under whose direction, and with what records. If the business controlled the schedule, supplied the tools, and directed the work in a continuing relationship, the contractor label may not hold up.

## **Office audits and field audits carry a different kind of risk**

A correspondence audit can often stay narrow. An office audit or field audit usually signals that the IRS wants context, not just paper. For a Memphis business, that can include looking at the business location, operations, staffing pattern, and internal records. If the business runs from a home office in Berclair or from a storefront near Elvis Presley Boulevard, the examiner may want to understand what activity actually occurs there and how it connects to the deductions claimed.

The home office deduction often draws attention because owners misunderstand it. The simplified method allows \$5 per square foot up to 300 square feet, for a maximum of \$1,500, but the space must be used regularly and exclusively for business. A dining room table used for both family meals and bookkeeping usually does not qualify. In an office audit, vague answers about business use can damage the credibility of the entire return.

Field audits also raise practical concerns. The examiner's questions can spread from the original issue into daily operations. That is why many businesses choose to have records reviewed through a representative rather than through direct back-and-forth at the business site. Controlled presentation matters. Good records matter more.

## **Memphis small business pressure points that often surface in audits**

**tax shield protection**

The local economy shapes local audit issues. Memphis has a heavy concentration of logistics, transportation, warehousing, health support work, food service, beauty businesses, contract labor, and side-gig income. Those sectors generate recurring audit themes. Fuel expenses, subcontractor payments, mileage, mobile payment receipts, cash handling, and mixed personal-business accounts all appear again and again.

There is another local factor that a lot of owners miss. Shelby County has a broad spread between lower-income neighborhoods and higher-income corridors. A sole proprietor near Austin Peay Highway in 38108 may claim the same federal deductions as an owner near River Oaks in 38120, but the audit risk often increases when the return contains multiple moving parts across personal and business categories. That can include Schedule C income, dependents, the Earned Income Tax Credit, and the Child Tax Credit. For tax year 2025 filed in 2026, the Earned Income Tax Credit can reach about \$7,830 for three or more qualifying children, and the Child Tax Credit can be up to \$2,000 per qualifying child under age 17 with up to \$1,700 refundable through the Additional Child Tax Credit. Those are lawful credits, but they increase the importance of return accuracy because the IRS checks identity, residency, and income consistency carefully.

That point is shareable because it surprises many Memphis owners: a family-run Shelby County business return can carry business profit reporting, self-employment tax, dependent status, and refundable credits in the same filing, creating a much wider audit footprint than many owners realize. A return can be correct and still draw attention if one part does not match the records feeding the rest.

## **Self-employment tax is often the hidden issue behind the audit**

Many audited Memphis owners expected income tax questions but overlooked self-employment tax. Schedule SE Self-Employment Tax applies at 15.3 percent on net earnings of \$400 or more. Owners who understate gross receipts or overstate expenses are not just changing income tax. They are also changing Social Security and Medicare tax on business earnings. That doubles the stakes.

This shows up often with rideshare and delivery workers around Midtown, the Medical District, and East Memphis. A driver may receive a 1099-NEC, a 1099-K, and year-end platform statements. If the owner reported only the net bank deposits and ignored fees, reimbursements, and gross payment reporting structure, the return may not match IRS records. The right answer is not always the higher number the IRS proposes, but the return has to be reconciled carefully with business expenses and platform documentation.

Quarterly estimated tax history can matter too. The IRS Form 1040-ES Quarterly Estimated Tax system exists because self-employed owners do not have wage withholding. An audit may expose that the business had profit for years without estimated payments. That does not create the audit by itself, but it often appears alongside balance due issues and penalty questions.

## **When the audit letter points to underreported income**

If the IRS says the business underreported income, the issue often begins with matching documents. The IRS computer sees a form filed by a payer and looks for it on the return. If the owner left out a 1099, entered the wrong amount, or reported income on the wrong line, the mismatch can trigger a CP2000. Some owners assume **tax refund loan** that because Tennessee has no wage income tax return, federal matching will be lighter. The opposite is usually true. Federal reporting becomes the whole story.

Underreported income cases need a careful distinction between gross receipts and taxable profit. A payment platform may report gross transfers. The return may reflect net after refunds, chargebacks, fees, or reimbursements. The owner may be right, but the numbers must tie out. Unsupported statements like “the app got it wrong” or “that money was not all income” do not win audit arguments on their own.

For businesses using Cash App, Chime-connected accounts, GreenDot, Varo, or traditional checking accounts, the banking method does not change the IRS standard. The examiner still wants a clean trail from deposits to books to return. That is where strong preparation before filing matters, and it is also where audit response support becomes critical after the notice arrives.

## **When the audit expands beyond one year**

Many owners focus only on the notice year. The IRS may do the same at first. If the records are weak or the issues repeat, the review can spread to earlier or later years. That is common where the same deduction pattern appears every year, or where unfiled returns and back taxes already exist. An owner who has not filed all required returns should assume the audit may reveal more than one-year exposure.

If there are missing returns, the broader IRS resolution picture matters. The IRS often expects taxpayers to become current, which commonly means filing the last six years of returns to get back into filing compliance. Installment agreement options under IRS Form 9465 may become relevant after the audit if additional tax is assessed and the balance cannot be paid in full. In more severe hardship cases, the IRS may consider Currently Not Collectible status or an Offer in Compromise, but those are separate resolution tracks from the audit itself.

## **What strong audit response looks like in practice**

The best audit response is controlled, documented, and narrow. It does not argue every point emotionally. It does not bury the IRS in unrelated paper. It addresses the notice, supports the return where support exists, and corrects issues where the return was wrong. That balance matters. A business that refuses every adjustment without evidence loses credibility. A business that agrees to changes too quickly may give up valid deductions and favorable positions.

For many Memphis owners, the biggest benefit of experienced audit response support is translation. IRS language can be formal and blunt. The business owner needs that language converted into practical action: what records matter, what issues are dangerous, what can be explained, and what should not be expanded. That is especially true when the owner filed a return that includes Schedule C, self-employment tax, contractor payments, or refundable family credits on the same Form 1040.

A professional review also helps separate tax preparation issues from identity issues. Sometimes a notice is not really an audit problem at all. It may involve identity verification under the IRS Taxpayer Protection Program, an IRS Letter 5071C Identity Verification request, a Letter 4883C identity theft hold, or a Notice CP01A Identity Protection PIN issue. Those cases can delay processing and create confusion, especially if the owner expected a refund. An audit response has to identify the right lane before answering in the wrong one.

## **Why timing matters even when the business expects a refund**

Some Memphis owners assume an audit only matters if tax is owed. That is false. A business can face examination while also waiting on a refund. If the return includes the Earned Income Tax Credit or Additional Child Tax Credit, the PATH Act §201 February 15 Hold already blocks release of the refund before February 15. Deposits for those returns often do not land until the first week of March even when filed early. If the return then hits an identity verification issue or audit review, the wait grows longer.

That has local consequences. In neighborhoods with high EITC concentration such as Whitehaven, Orange Mound, Frayser, and parts of the Austin Peay corridor, a delayed business return can affect rent, utilities,

transportation, and payroll. Memphis is a city where many sole proprietors are also heads of household. The federal audit issue and the family cash-flow issue often sit on the same return.

## **What Memphis owners usually regret after the fact**

- Answering the IRS too late
- Sending records that do not match the filed return
- Ignoring contractor and payroll reporting problems
- Claiming deductions without logs or receipts
- Trying to handle a widening examination without support

Those regrets are common because most owners spend their time running the business, not organizing audit files. A restaurant operator near Beale Street, a contractor working jobs across Shelby County, or a seller using online payment platforms from a home office near Wolf River Greenway can all end up in the same position. The business activity was real. The records were the weak spot.

## **Why local context matters in an IRS audit response**

National tax software does not see Memphis the way a local office does. A preparer who works the Shelby County market sees recurring patterns that matter in an audit. They see mixed-income households where W-2 wages, contractor income, and Schedule C business activity land on one return. They see businesses operating from homes, vehicles, salons, churches, shared spaces, and family storefronts. They see returns affected by 1099-NEC reporting, payment platform mismatches, and refund timing pressure.

They also see that Memphis owners often compare local services against national chains such as Jackson Hewitt, Liberty Tax, H&R Block, or software products. The real difference in an audit case is not branding. It is whether the return was prepared with enough support, whether the preparer understands IRS notice procedure, and whether the response stays disciplined. That is where tax shield thinking matters in the real sense of the phrase. The goal is not to hide anything. The goal is to protect the taxpayer with accurate filing, documented positions, and a controlled response when the IRS asks questions.

## **Where TaxShield Service fits when a Memphis business gets audited**

TaxShield Service handles tax preparation, IRS notice response, audit response support, back tax filing, and identity theft tax fraud assistance for Memphis and the broader Shelby County market. The office works with sole proprietors, independent contractors, Schedule C filers, W-2 workers with side businesses, and family-run operations across areas including Austin Peay, Raleigh, East Memphis, River Oaks, Midtown, and Whitehaven. The business operates as an IRS Authorized E-File Provider with an active Electronic Filing Identification Number and PTIN Registered Tax Preparers.

That matters because an audit response usually starts with the filed return itself. If the return needs explanation, amendment, supporting schedules, or document reconstruction, the work has to be done by people who understand Form 1040, Schedule C, Schedule SE, 1099 reporting, and IRS notice procedure. If the return also affects expected refund timing, tax refund services, tax refund advance questions, or tax refund loan alternative planning for later filings, the business needs a preparer that sees the full picture.

TaxShield Service also serves clients who later need filing support for the next season after an audit year, including IRS e-file, W-2 filing, 1099-NEC filing, self-employed tax filing, and same day tax refund online intake

for eligible returns. That does not change the audit rules. It does mean the owner can deal with one office that understands the prior issue before the next filing season begins.

## Next move for a Memphis business that has an audit notice

A Memphis owner who receives an IRS audit letter usually needs the notice reviewed before anything is mailed back. TaxShield Service provides in-person tax preparation and phone-based tax preparation coordination for Memphis and the surrounding Mid-South, including Bartlett, Germantown, Cordova, Collierville, Southaven, and West Memphis. The office is open Monday through Saturday 9 AM to 7 PM. For businesses that need audit response support, IRS notice review, or cleanup of a Schedule C return before responding, TaxShield Service can be reached at (844) 503-0401. The office also handles ongoing tax refund services, tax refund advance online applications, and refund advance up to \$7,000 for eligible filed returns after IRS e-file acceptance, with direct deposit options that include traditional bank accounts, GreenDot, Chime, Cash App, and Varo. For a Memphis business owner staring at an IRS notice, the first goal is simple: keep the response controlled, keep the records matched, and keep the case from getting bigger than it needs to be.

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