

# **FIND THEIR PAIN**

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## Market Segment Specialization Program Guides

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MSSP 41: Farming --Specific Income Issues and Farm Cooperatives  
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MSSP 60: Low-Income Housing Credit  
MSSP 61: Aviation Tax  
MSSP 62: Carpentry/Framing  
MSSP 63: Car Wash Industry  
MSSP 64: Alternative Minimum Tax for Individuals  
MSSP 65: Garden Supplies  
MSSP 66: Placer Mining Industry  
MSSP 67: Sports Franchises  
MSSP 68: The Laundromat Industry  
MSSP 69: Child Care Providers  
MSSP 70: General Livestock  
MSSP 71: Tip Rate Determination Agreement -- For use by any employer with tipped employees, other than in the food and beverage industry and the gaming industry  
MSSP 72: Tip Reporting Alternative Commitment -- For use by any employer with tipped employees, other than in the food and beverage industry and the gaming industry  
MSSP 73: Food and Beverage Industry  
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MSSP 80: Business Consultants  
MSSP 81: IRC Section 183: Farm Hobby Losses with Cattle Operations and Horse Activities

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MSSP 82: Shareholder Loans *SITUATIONAL*  
MSSP 83: Commercial Banking  
MSSP 84: Retail Gift Shops  
MSSP 85: Partnerships *SITUATIONAL*  
MSSP 86: Poultry Industry  
MSSP 87: Swine Farm Industry  
MSSP 88: Cost Segregation Audit Techniques Guide

### **Audit Technique Guides**

- Accuracy
- Aerospace Industry
- Aviation Tax
- Coal Excise Tax
- Commercial Banking
- Construction Industry
- Credit for Increasing Research Activities
- Cost Segregation Audit Techniques Guide
- Drywallers
- Executive Compensation - Fringe
- Benefits Audit Techniques Guide
- Factoring of Receivable Audit *SITUATIONAL*
- Techniques Guide
- Farm Hobby Losses
- Farmers Audit Techniques Guide
- Farming - Specific Income Issues and Farm Cooperative
- General Livestock
- Hardwood Timber Industry

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- IRC 162(m) Salary Deduction Limitation Audit Techniques Guide
- The Laundromat Industry
- Lawsuit Awards and Settlements
- Masonry and Concrete Industry
- New Vehicle Dealership Audit Technique Guide
- Nonqualified Deferred Compensation Audit Techniques
- Oil and Gas Industry Partnerships
- Passive Activity Losses
- Placer Mining
- Poultry Industry
- The Port Project
- Reforestation Industry
- Rehabilitation Tax Credit
- Retail Industry
- Scrap Metal Industry
- Shareholder Loan (ATG)
- Split Dollar Life Insurance Audit Techniques Guide
- Sports Franchises
- Stock Based Compensation Audit Techniques Guide
- Swine Farm Industry
- Tobacco Industry
- Veterinary Medicine

## **MSSP Pizza Restaurants**

Pizza restaurants are basically cash businesses, the potential for skimming exists. The type of entities discussed in this guide are the family owned mom and pop types of establishments. The "chain" or "franchise" types of pizza parlors are not addressed in this guide due to the nature of their operations, that is, the close control maintained by the franchise of these establishments does not lend itself to the approaches discussed in this guide.

Overall, documentation of income and expenses in this industry has been found to be lacking. In most instances, the cash register tapes are not retained and income is not deposited intact. There is generally little or no documentation to verify the gross receipts reported on the tax return. Purchases are often paid in cash and the purchase invoices are not kept. Employees are often paid in cash, sometimes, in order to avoid the payroll taxes.

The Providence district used the unit volume markup computation to attempt to overcome these obstacles. The project group found that it was necessary to contact the pizza restaurant suppliers to obtain the original purchase invoices on all identified cases. The ingredients purchased and used in the making of pizzas and grinders were used to determine total pizza and grinder sales.

### **THE PIZZA INDUSTRY - SKIMMING, CASH PAYROLL, CASH PURCHASES**

It has been suggested that skimming may be common in the pizza industry. The Providence District's examinations support a finding that skimming of receipts and understatement of purchases in the pizza industry is not unusual. The task is to identify and examine those pizza establishments in which skimming takes place to achieve greater compliance in the industry.

Information obtained from various sources in Providence strongly indicate that the practice of paying employees "off the books" is common in pizza restaurants. Moreover, purchases are often paid in cash with no invoices or receipts to document the expenses.

By obtaining supplier invoices and compiling the quantity of ingredients purchased for the pizza and grinder items, the number of pizza and grinder sales

can be redetermined. Flour, sauce cheese, and grinder meats are all used in the computation. In addition, the total amount of pizza boxes and grinder rolls can be used to support the computation.

Some pizza restaurants may be difficult to audit. Almost all of the restaurants encountered by the project group were closely held entities with basically no internal control over cash. The group also found the pizza restaurant owners to be a tight knit community. Information such as what questions and what techniques the Service is using in audits would be quickly communicated through out the community.

In addition, the books and records maintained by many of these pizza restaurants are not detailed or complete. Cash receipts book often consists of a sheet of paper with a summary of 12 months sales. Many times, the preparer uses the sales reported on the 12 sales tax returns, with no other backup. The restaurant usually keeps the cash register tapes long enough to determine if the employees are stealing, then the tapes are destroyed. (b)

Examinations have also revealed that several taxpayers took cash out of the drawer without reporting the amount as income. There is virtually no audit trail to determine the amount of funds spent for business and personal expenses. When it is time to make a deposit, some taxpayers would pocket some of the cash and

deposit only that portion necessary to cover those expenses to be paid by check. It was found in many cases that business expenses **as well as personal living expenses** were paid with cash taken from the cash drawer. Audits in Providence have uncovered as much as \$700 per week in cash being taken out of the cash drawer.

Furthermore, the project group also found that many pizza restaurant owners are aware of the Government's need to establish certain facts to fully develop the unreported income issue. Most of the individuals encountered by the project group appeared to live modestly with no apparent great accumulation of assets. Therefore, examiners should be alert to look beyond this to develop the underreporting income issue.

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The starting point is to identify all pizza restaurants in your area. This can be done by using the telephone yellow pages. However, this can be a time consuming task. If there are quite a few pizza establishments in the area, it may be necessary to use a service that provides this type of information.

**American Business Lists Inc.**, is a company which compiles a list of all businesses by industry.

**American Business Lists** will provide a list of all pizza restaurants in your specific area. The listing not only indicates the restaurants by location, but

more importantly indicates the owner of the business.

A catalog can be obtained by calling or writing:

**American Business Lists**  
**5711 South 86th Circle**  
**P.O. Box 27347**  
**Omaha, Nebraska 68127**  
**(402) 331-7169**  
**FAX (402) 331-1505**

Once the pizza establishments and their owners have been determined, the next step is to use IDRS to secure the EIN of the businesses and the SSN for the individual owners. Secure a transcript of the account and whenever possible request a RTVUE for each return. This is the first attempt in eliminating those returns that reflect little or no audit potential. Obviously, you want to secure those returns which show the greatest audit potential. The actual securing of the original returns can be accomplished by working jointly with the Planning and Special Programs Chief in the District. When the list of returns is prepared, the Chief-PSP can expeditiously requisition the returns using special project codes.

The original tax returns should be screened. In the Providence District, the initial screening process was undertaken by comparing gross receipts to purchases. Also considered were factors such as adjusted gross income relative to taxpayer's family size, large increases in interest income, very low or no net profit, location of the pizza parlors, that is, neighborhood characteristics and seasonable variations, and any other classification techniques to identify the

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cases with the best audit potential. Additionally, it is important to secure and screen the shareholder's returns for each targeted corporation for potential indications of unreported income.

Once the targeted cases were identified, these cases were separated into several examination phases. By using several staggered phases, the project was more manageable and easier to monitor.

Because the Providence District covers a small geographical area, canvas letters were sent to all known pizza restaurant suppliers in the R.I. area. See Exhibit 2-1. This information was very helpful in the screening process. If the purchases amount per the third party suppliers exceeded the purchases claimed on the tax return, there was an apparent problem that warranted explanation. In addition, there were situations where the owner destroyed all of the purchase invoices for a particular supplier and did not claim a deduction for purchases from that supplier. By canvassing all of the known suppliers in the area, these situations were discovered. This scheme probably would not have been detected without contacting all of the suppliers. (10)

Obviously, the geographical size of the district will dictate the feasibility of sending this letter. It may be impossible to canvass all suppliers in the larger districts. Therefore it may be more practical to obtain a list of suppliers from each agent so only those suppliers will be contacted.

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Internal Revenue Service  
District Director

Department of Treasury

Person to

Contact

Telephone

Number: Refer

Reply to:

Date:

The \_\_\_\_\_ District is now beginning Phase \_\_\_\_\_ of the Pizza Project. We have now identified approximately \_\_\_\_\_ pizza restaurants that we are interested for this phase of the project.

Information is requested relative to the total amount of sales made by you to the attached list of establishments. Your help in connection with an official investigation concerning these taxpayers would be appreciated.

Please enter on the attached worksheet the total sales made to each establishment for the years indicated. If no sales were made to the establishment, please enter a "-0-" next to the name of this business.

A Self-addressed envelope is enclosed for your convenience. Please return the enclosed worksheet by \_\_\_\_\_. If you cannot meet this deadline, please notify me as soon as possible and the necessary arrangements can be made. Failure to respond will result in the immediate issuance of a summons. You

should direct any inquiry to Revenue Agent

We are making this request under the authority of Section 7602 and 7609 of the Internal Revenue Code. The information you furnish will be held in strict confidence.

Thank you for your assistance in this inquiry and if you have any questions, please feel free to contact me.

Very truly yours,

REVENUE AGENT

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### Chapter 3

#### PREAUDIT

Exhibit 3-1 is a copy of the suggested Initial Pizza Restaurant Information Document Request. It is very important to request this information prior to the initial interview.

The Initial Pizza Restaurant IDR appears to be lengthy and can seem to be intimidating, but it is necessary that this information be obtained early. Requesting this information prior to your first visit will make for a faster and more efficient audit. It is important that the books and records used to prepare the tax return are available at the first meeting. The purchase invoices should also be available so they can be fully analyzed. Make sure that the taxpayer has a menu available at this meeting so that the menu prices can be clearly determined. These prices will prove to be important later in the examination.

It is crucial to analyze the business and personal bank accounts, tracing all the nontaxable sources of income. It is important that a detailed analysis be performed during the initial stages of the examination. An accurate and complete initial IDR will expedite the examination and provide for a more thorough initial interview.

The examining agent's preaudit should consider the following steps:

1. Cash T at the owner/shareholder level.
2. Use of other available sources to verify income such as Forms 8300, TECS inquiry, IRP' s, and CID information items.
3. Use of public record sources such as city and town halls, Registry of Motor Vehicles, Secretary of State, and Business Cumulative Index (B.C.I.).
4. Emphasis should be on sales/income, cost of goods sold and inventory.
5. Payroll expense and only large and extraordinary expenses should be identified.
6. Request copies of all related and subsequent returns not included in the package.

7. When requesting IRP documents, request current and subsequent years.
8. Whenever possible, contact the State Division of Taxation for any state sales/income tax examination reports.

Obviously, it is very important to be as prepared as possible for the initial interview.

Who am I selling to?

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What am I selling?

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When do they need what I am selling?

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Where will what I am selling be done?

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Why would prospects want what I am selling?

Benefits (Not Features) –

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Secrets –

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Hidden Benefits –

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Random Thoughts –

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**Step 1...**

**Open with a great first sentence, this is critical to engage the prospect. Questions, damaging admissions, or damaging knowledge about the prospect provide some of the best openers.**

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**Step 2...**

**Select the most important benefit you listed under the why section of concept worksheet.**

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**Step 3...**

**Describe the most important benefit in detail. And follow-up with other benefits and secrets. Be sure to avoid the hype of words like amazing and incredible as they are empty and contain no proof of your claim.**

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***(Other Benefits and Secrets):***

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**Step 4...**

**Tell them exactly what they will get.**

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**Step 5...**

**Provide proof through testimonials.**

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**Step 6...**

**Tell them what bad things can happen if they fail to act now. Remember that people always opt to keep what they have versus taking a risk to gain more.**

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**Step 7...**

**Restate, in different words, the benefits of what you are selling. Make it crystal clear and about a three-second read. Never make prospects work to figure out what you are selling or what benefits they will get from what you are selling.**

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**Step 8...**

**Eliminate their risk by offering a guarantee.**

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**Step 9...**

**Offer instant gratification.**

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**Step 10...**

**Add the postscript(s)**

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**Step 11...**

**Go back and insert the headlines and sub-heads.**

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**Step 12...**

**Let it percolate.....*Change anything that you believe needs changing, but do not start all over. Analysis paralysis affects many would be copywriters, don't catch the malady.***