

Audit Red Flags

What raises eyebrows at the IRS?

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Are you worried about being audited? The fear may be overblown as only 0.86% of taxpayers had their federal returns examined in 2014. Last year, 7.5% of millionaires had their returns scrutinized. Much of this is down to low staffing at the IRS. In 2011, during more prosperous times for the agency, the IRS audited 1.11% of returns. Still, no one likes extra stress courtesy of the IRS. Let's look at some red flags that might get you extra IRS scrutiny.¹

A Schedule C that hints at some odd bookkeeping. Schedule Cs get a close look annually as the IRS seeks to remedy the tax gap (the difference between federal taxes owed and federal taxes paid). As Schedule Cs are often filled out by solopreneurs and small business owners themselves, the chances increase for claiming substantial deductions that may be hard to substantiate.²

Taxable income of \$1 million or more. Millionaires work with accountants for a reason – generally speaking, returns prepared by tax professionals raise far fewer red flags than DIY ones. If you will make around \$1 million this year, look back at the first paragraph of this article and consider whether or not it might be wise to defer some potentially taxable income into 2014.²

Bad math. The IRS does spot mediocre mathematics in returns. However, it also finds unreported and underreported taxable income through the same scrutiny. The IRS says taxpayers and preparers made 2.3 million math mistakes on their 2013 federal returns. Not only are these general errors, but also errors in the calculation of income, as well as missing information.³

Huge deductions. Is your money-losing small business venture truthfully just a hobby? Did you really donate \$6,000 worth of office supplies to a charity, and do you have the receipts to back that up? The IRS routinely checks returns for deductions that seem outlandish.²

Living large. Does the IRS peruse social media? Yes it does, as we all do. The IRS has done good detective work for years; its investigators know to check out DMV and employment records to get a better picture of an errant taxpayer. Today, photos and posts on Facebook and Twitter can telegraph potentially valuable nuggets of information, particularly about young taxpayers who have come into wealth that their returns don't seem to show.

Keep it simple. File early and accurately. Keep your receipts and other pertinent papers on file. Spend a little time each month arranging your financial matters so that taxes can remain a relatively painless process.

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Citations.

1 - time.com/3721148/irs-tax-returns-audits/ [2/24/15]

2 - kiplinger.com/slideshow/taxes/T056-S011-irs-audit-red-flags/index.html [3/15]

3 - bankrate.com/financing/taxes/irs-catches-millions-of-math-mistakes/ [3/31/15]