



Uncle Sam wants you: Avoiding an audit

By Mike Slotopolsky

THE ECONOMY IS STILL IN TATTERS

forcing many government agencies to cry out for more dollars. This is just one reason that the odds of being targeted for an IRS audit is greater now than ever before and the wealthier you are, the greater the risk.

Among taxpayers who reported \$10 million or more of income in 2010, more than 18% were audited, up 80% from 2009. The audit rates were higher for other high-income taxpayers, too. The report shows that among taxpayers who reported \$5 million to \$10 million in income, nearly 12% were audited, compared with 6% in 2008. For those earning \$1 million to \$5 million, audits rose to 7% in 2010 from 4% in 2008. Overall, the IRS increased audits by about 11% last year resulting in 1.58 million audited returns, costing the IRS 53 cents for every \$100 collected.

Even if you're not in the high income group being audited with alacrity, there are a few well-known areas to steer clear of which can increase the likelihood of an IRS audit. I advise clients to stay away from being a sole proprietor or single member LLC, filing Schedule C tax returns. The IRS audits more Schedule Cs than any other entity. The IRS also zeroes in on certain deductions – automobile usage, travel, entertainment – that result in larger dollar captures. Before you file make sure you review these categories with a tax advisor and be prepared to have the proper backup to substantiate the deduction.

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Last year, 1.58 million returns were audited, 11% more than 2009. In 2000, there were only 600,000 audits. Just over 1% of all personal returns were audited last year. The odds of being audited? One in 100.

Never use round numbers; it's a dead giveaway that the number was an estimate of the actual amount incurred. Report all income the IRS knows about or can find out about, including year-end government reporting forms like 1099s and W-2s. The IRS has computer matching software that links these forms and can easily come up with reporting differences.

The IRS is known to target certain jobs, like contractors and attorneys, as well as cash businesses. If you fall into these groups, it's best to speak to a CPA to review strategies to make you less auditable. In today's technological world, it's important to be careful about who you talk to about business. The IRS has a program that awards informants up to 30% of monies collected from unreported tax income. There are forms and hotline numbers the IRS provides to make the process easily accessible.

There are three types of audits. The first is where the taxpayer is notified to send additional documentation to prove deductions. This is usually handled by mail and involves correspondence with back-up documentation. The second is

an IRS office audit where you review documents and answer other questions in person at an IRS office. The last is a field audit where the agent visits the taxpayer's home or business, reviews records, interviews the taxpayer and employees, and tours the place of business.

Most taxpayers are understandably afraid and annoyed when they receive an audit notice and question what caused the audit. No one but the IRS really knows the answer. But once selected you can ask why and usually the agent tells you why your return was picked. The IRS can audit more than one year's returns if they've disallowed most of your deductions and have reaped a substantial amount of additional tax. But if they don't collect additional tax at the audit, they cannot audit you again on the same item for the next two years.

After the audit is complete, you receive the 4549 Income Tax Examination Changes form, detailing the judgment. If you owe tax, the report will have interest and penalties computed. If you don't agree with the report, there are options. Ask for a supervisor and contest the outcome. If this doesn't work, you can move up the chain of command and speak to the chief of the Examination Branch, Examination Division. From there, you can appeal the case with an officer who has the authority to settle the case.

The future prospects for audits don't get any better. The agency has hired additional agents for field audits, and the government, in dire need of raising additional tax dollars, is cracking down on tax evaders. The best defense is a good offense which means reviewing books and tax returns before filing. □