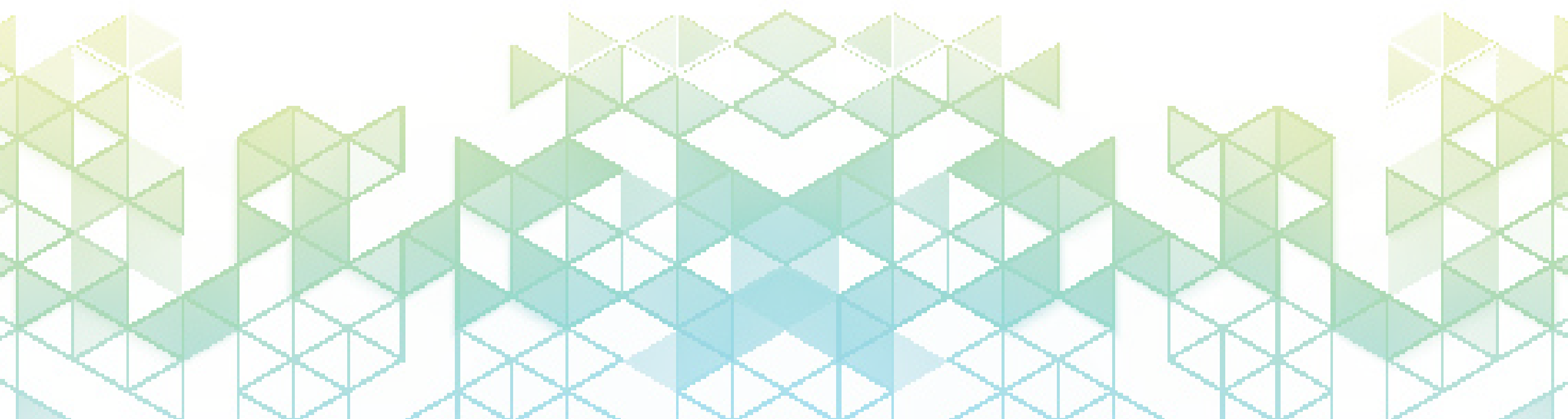
MST

How to Minimize the Chance of an Audit



There are few things that invoke fear and dread like the notification of an IRS tax audit. While your chance of an audit is less than 1%, there are a few things you can do (and avoid doing) to reduce your chances. Here's what you need to know.

How Audits Work

When you think of an audit, you probably picture an IRS agent showing up to your home or business with a briefcase and a magnifying glass, ready to inspect your records for discrepancies. Fortunately, that's far from the truth.

Today, IRS audits are initially triggered by a complex computer program called the Discriminant Inventory Function system (DIF). This program assigns a numerical score to all personal returns and many corporate returns. Those with a high score are chosen for further examination. There are many things you can do to affect this score, and we will go over them below. Please remember, however, that you may not be able to avoid these situations, though they might make you more likely for an audit. If that's the case, just be prepared with your receipts and other paperwork in case the IRS comes knocking on your door (figuratively speaking – most audits are conducted via mail these days).

1. Report all of your income.

The fastest way to trigger an audit is to fail to report all of your income for the year. You may be wondering how you could possibly forget to claim your income, but it's surprisingly common. While most taxpayers remember to report all of the income they earn from an employer, there are other types of income, including:

- Tip income
- Interest received
- Dividends
- Business income
- Capital gains and losses
- Pensions and annuities
- Lump-sum distributions
- Rollovers from retirement plans
- Rental income and expenses
- Farming and fishing income
- Unemployment compensation
- Gambling income and losses
- Bartering income
- Scholarship and Fellowship grants
- Social Security and equivalent Railroad Retirement Benefits
- 401(k) plans
- Passive activities (losses and credits)
- Stock options
- Exchange of Policyholder Interest for stock
- Canceled debt
- Alimony and child support
- Jury duty pay

As a general rule of thumb, you should certainly remember to claim all income that's included on tax forms you receive at the end of the year. When you receive a copy of a form, another copy is mailed to the IRS. If you fail to claim the income, the IRS will notice, and they'll want to know why it was left off your return.

2. File late.

It isn't a proven fact, but many tax experts believe that they see more audits on taxpayers who file their taxes early versus those who file their taxes late. In fact, some tax experts even advise their clients to file an extension when possible. The reasoning is that the IRS is generally less busy in the early months of the year, so they have plenty of time to check over returns filed well before the tax deadline. By the time April 15th rolls around, however, they're overflowing with tax returns, which makes them more likely to miss a potential audit.

3. Be consistent.

The IRS is always looking for consistency with your tax returns. Many audits are triggered by simple issues, such as charitable contributions that are out of line with a person's income. For example, a person who makes $30,000 a year may reasonably contribute $500 to charities, and a person who makes $300,000 per year may reasonably contribute $25,000 to charities. However, it is unusual for a person who makes $30,000 to contribute $25,000 to a charity, leaving themselves with only $5,000 for other expenses. The computer system can catch inconsistencies like these, and they may require further examination.

4. Avoid excessive business tax deductions.

When it comes to business tax deductions, you want to claim everything you can. However, if your expenses seem excessive compared to your net income, you may be setting yourself up for an audit. While it's perfectly fine to claim all legitimate deductions, just make sure you keep your receipts and be ready to plead your case to the IRS if they think something isn't quite right.

5. Avoid being rich – or poor.

While this is obviously tongue-in-cheek, it's unfortunately true. The majority of audits are triggered on the wealthiest and poorest tax returns. The assumption seems to be that people who earn a lot of money are more likely to claim invalid deductions (or hide some of their earnings), and people who earn a very small amount of money may in fact be lying about their income. Though you certainly can't help it if you fall into either the "rich" or "poor" categories, you should know that it enhances your risk of audit.

6. Avoid claiming invalid deductions.

Again, you should claim any valid deduction, but you should always make sure to follow the IRS rules and guidelines. Here are a few deductions that are scrutinized more carefully by the IRS because they're either rare or taxpayers often fail to follow the rules:

- Bad debt expense (for businesses)
- Casualty losses
- Home office deductions
- Medical expenses
- Business travel, meal, and entertainment expenses
- Hobby losses (inaccurately claimed as business losses)
- Work expenses (uniforms, etc.)

7. Amended returns may be suspect.

Because they're out of the ordinary, amended returns may be suspect to more scrutiny than original returns. Still, in many situations they are necessary. If you must file an amended return, make sure you keep all your records handy.

8. Avoid using round numbers.

While the IRS is fine with rounding to the nearest dollar (in fact, most tax programs does this for you automatically), too many round numbers are a red flag. For example, if all of your deductions are rounded to the nearest $5 or $10 mark ($200, $10, $1000, etc.), the IRS might suspect that you're fudging the numbers a bit. Most valid deductions won't be quite so perfect.

Final Thoughts

While an audit can be intimidating, it's not quite the terrifying process that most people expect. Though there are many things that may increase your chance of an audit, you shouldn't avoid taking credits and deductions to which you're entitled, even if it may trigger an audit. Most audits are conducted via mail, and they are fairly straightforward, simply requiring receipts and other documentation. As long as you keep your records organized and ensure your tax returns are correct, an audit shouldn't be a problem.

If you are facing an audit or would like an expert's opinion on your tax return, please contact our office. We are happy to offer assistance and clear up any questions you may have regarding taxes or the audit process.

About MST

MST has been serving clients with distinction for more than half a century. In 1956, we opened our first office in Brunswick, Georgia, with two partners and five employees driven to give individual and organizational clients the pinnacle of business support and consultation. Now, with three offices, 10 partners, and over 100 employees, we are equipped to support a broader clientele with an even more extensive array of specialized services.

Throughout our distinguished growth and history, our foundational focus has remained constant. The entire MST team is dedicated to creating lasting success for our clients and continuing opportunity for our employees. Our achievements have been recognized by Accounting Today as well as by Atlanta Business Chronicle, where we are consistently named in the "Top 25 Accounting Firms."

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