Expect more IRS audits

The Inflation Reduction Act, which was signed into law in August 2022, allocated $80 billion to the IRS over the next decade for hiring additional personnel and improving processes and technology.

The IRS has not yet said how many positions it plans to add; however, Treasury Secretary Janet Yellen has directed the agency to develop a strategic plan by mid-February. According to a recent study by the Treasury Department, this amount of funding could be used to hire up to 87,000 new IRS agents.

In response to public concern, the IRS has moved to assure Americans that the additional audit activity will affect only those making $400,000 or more and that additional staff will be spread across a variety of positions, not just enforcement officials.

In any event, the increased funding for the IRS is likely to result in more audits in the coming years. But how exactly do audits work, and how long does the IRS have to audit you?

How do audits work?

An audit is a review and examination of a taxpayer's accounts and financial information to ensure reported information and tax amounts owed are correct according to tax law.

Being selected for an audit does not necessarily mean there's a problem with your taxes. Some audits are based upon random selection, where a taxpayer's returns are compared against "norms" for similar returns. Other audits may involve issues with certain filings or transactions with other taxpayers whose returns were selected for audit.

When you've been selected for an audit, you will be notified first via mail. The IRS will never initiate an audit by telephone. The remainder of the audit may then be conducted via mail or in-person, or a combination of both.

How long does the IRS have to audit you?

The statute of limitations for an audit tends to get a little tricky.

In general, the statue of limitations for an audit runs three years from the time you file your return. Technically, the statute of limitations clock starts running on the later of your filing date or the actual due date, so filing early will not necessarily start the clock earlier. And, if you fail to file or forget to sign your return, it is not considered a valid return, and the clock does not start until the error is resolved.

In some situations, you could face an audit up to 6 years after your return was filed or due, whichever is later. For instance, if you omitted more than 25% of your income, the statute of limitations is doubled to 6 years. If you overstated your cost basis on the sale of an asset that reduced taxable income by more than 25%, the statute of limitations is doubled to 6 years.

Worse yet, there are circumstances in which the statute of limitations never runs out, meaning the IRS can audit you indefinitely. If you never file a return or file a fraudulent return, there is no time limit. While never filing a return or filing a fraudulent return seem like obvious reasons for no time limit, there are many less obvious situations. For example, forgetting to include certain forms when required such as form 3520 for receiving a gift or inheritance from a non-U.S. person or Form 8938 for overseas assets causes the statute of limitations clock to not even start.

The IRS's time limits are anything but simple, and there are many exceptions to the general three-year statute of limitations rule. Many people could face audits for more than three years, if not indefinitely. This is why it's imperative that you work with a seasoned CPA when filing your taxes, as even minor mistakes and oversights can cause an audit and lead to large civil penalties and potential criminal liability.

Final Thoughts

This document is intended to provide a brief overview of IRS audits and changes that can be expected now that the Inflation Reduction Act is law. It is not a substitute for speaking with one of our expert advisors, but underscores the importance of working with your CPA to ensure that your tax return filings are timely and accurate. Please contact our office if you have any questions regarding audits or proper tax preparation.

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