



Will Your Tax Return Be Audited?

Few things are more unnerving than having your tax return selected for an IRS audit. The IRS uses that "audit anxiety" to help keep taxpayers honest. Audit anxiety is an important part of our voluntary compliance system.

• The TCMP Audit

What determines whose returns will be picked for audit? A certain number of unlucky taxpayers will be picked simply to help the IRS gather statistics. The "TCMP" audit (Taxpayer Compliance Measurement Program) is probably the most exacting audit. These are sometimes referred to as the audits from hell. The taxpayer is required to substantiate every number on his or her tax return. The results from these audits are used by the IRS to compile statistical information that can be used for other audit purposes. These statistical audits have been suspended until further notice, but they could be reinstated at any time.

• DIF Scores Count

Apart from the TCMP program, your return will be evaluated based on your "DIF" score, a set of IRS formulas known as the "Discriminate Function System." About three-quarters of all returns audited are selected by the DIF computer, which compares deductions, credits, and exemptions with the norms for taxpayers in each income bracket.

While these formulas are kept very secret by the IRS, you can count on having a higher audit probability if you fall into certain categories or report certain things on your tax return.

• What interests the IRS?

Some higher risk areas are –

1. Tax shelters. Though most new tax shelter write-offs have been eliminated by tax reform, old shelter deductions will continue to interest the IRS. Returns with passive income and losses are certain to be scrutinized.
2. Tax protests. Both the IRS and tax courts are getting fed up with what they consider frivolous tax protests. If you file a return stating that you owe no tax because the dollar is worthless or make some other such protest, you'll probably be audited.
3. High income. Because auditing higher-income taxpayers is likely to produce more additional tax revenue than auditing lower-income taxpayers, this category is targeted by the IRS.
4. Certain occupations. Taxpayers whose occupations produce cash income, such as taxi drivers and waiters, run a higher risk of being audited. Self-employed individuals, particularly independent contractors, are IRS targets for the same reason; they are more likely to have unreported cash income.



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5. No preparer or a problem preparer. If you have a complex return and prepared it yourself or if your return was prepared by someone on the IRS's problem preparer list, you are more likely to be audited.
6. Certain deductions. The IRS has found it profitable to audit returns that claim office-in-the-home deductions, travel and entertainment deductions, and certain other write-offs where they feel taxpayers stretch the truth.
7. Related party transactions. Taxpayers who involve family members in their financial operations are more likely to be scrutinized by the IRS. Paying wages to your children, lending money to relatives, splitting income among family members, or running a family business will make the IRS more interested in your returns.

What other information is collected but not used at this time?

1. Cash Transactions reports are posted to your personal tax record. These are the reports of cash transactions of more than \$10,000.

If your transaction is legal don't worry about this! It is a crime if you structure transactions to avoid the report. If you receive money from overseas, you must file a special report. This will be important to dual nationals or individuals who immigrated to the United States.

2. When a passport is issued, a note is made in your personal tax record.

• Your Best Audit Defense

Between one and two percent of all individual tax returns filed in any year will be selected for audit. Higher-income taxpayers and those in target categories face a slightly higher audit risk than lower-income taxpayers.

Absent fraud or substantial understatement of income, the IRS has three years from the due date of your return to initiate an audit. Typically, most returns are selected within two years of their filing date.

The best defense in an audit is a two-part strategy:

- (1) Have supporting documentation for all deductions and credits, and
- (2) See your accountant immediately upon notification that you're being audited.

A professional can put your mind at ease, find the information that the IRS wants more quickly than you can, and very likely will save you money in the long run by getting a faster and more favorable conclusion to the audit.

We have a new tax tip each week. Information you can use in your tax planning. The list grows each week and you can read all the topics free.



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