

# IRS Audit Alert!

## What Could Flag Your Return for Audit?

By Cathy Mueller, EA

Receiving a notice of audit from the IRS can be very unsettling. Even if you can prove that your return was prepared correctly, dealing with an IRS audit is frustrating and time-consuming.

Every year the IRS randomly selects a small percentage of individual and small business tax returns for audit. The odds of your return being selected for a random audit are very low. However, the probability of your return being audited due to a “red flag” is much greater. Therefore, you should carefully document all common red flags that might trigger an audit before you file your taxes with the IRS. You should not avoid taking all legitimate deductions for fear of being audited.

Taxpayers reporting business income and expenses on Schedule C are more likely to be audited than other individuals. The higher your self-employment income the more likely you are to be audited. If your Schedule C income exceeds \$1 million, your chance of audit is ten times greater than if your self-employment income is less than \$25,000. Your risk of audit might be reduced by incorporating your business. You should carefully consider all the implications of incorporation before making that decision. Comparing the corporate tax rate with your personal tax rate is important when deciding between a C-corporation and an S-Corporation.

The following factors may cause your individual or small business tax return to be selected for IRS audit.

1. **Income reported to IRS but not on your return.** If the IRS received Form 1099s reporting income paid to you by individuals or entities and your return does not reflect all of the income reported, you will hear from the IRS.
2. **Deductions higher than the norm.** If your business expenses or personal deductions are more than the average amount claimed for your income level or type of business, your tax return might be scrutinized and possibly selected for IRS audit. However, you can reduce the risk of audit by including with your return documentation of the deduction and possibly an explanation as to why an expense was reasonable and necessary.
3. **Categories being scrutinized by IRS.** The IRS has identified certain types of expenses, deductions and credits that are frequently exaggerated or claimed without justification. Deductions targeted by IRS may change from year-to-year. Below are some of the items the IRS may question:
  - a. Automobile, travel and entertainment expenses
  - b. Office-in-home deduction
  - c. Itemized deductions such as mortgage interest and charitable contributions
  - d. Earned Income Tax Credit
  - e. Filing Status and Dependency Exemptions
  - f. Casualty and Net Operating Losses
  - g. Tax credits
  - h. Rental Activities

### Types of Audits:

1. **Service Center Audits** are generally handled by mail. These audits are usually a result of document mismatches, mathematical errors, or omitted schedules.

2. **Correspondence Audits** are usually a result of questionable deductions or credits. The IRS sends a series of notices questioning specific items and requesting a written explanation or documentation from the taxpayer.
3. **Office Audits** which are handled at a local IRS office. The taxpayer is asked to appear at the office on a particular date and is given a list of specific documents to bring to the audit.
4. **Field Audits** which are conducted at the taxpayer's home or place of business. The IRS will send a notice with a proposed date and time for the audit and a description of the exact information and documentation the taxpayer must have available at the time of the audit.

If you receive a notice of audit from the IRS you should respond without delay. Ideally you will have a relationship with a tax preparer that will help you to deal with the IRS. Most audits can be handled by mail. If the IRS requires you to attend an audit in person, you should be accompanied or represented by your tax professional. Your preparer can accompany you to the audit and answer questions about how your return was prepared. However, we recommend that you choose an Enrolled Agent, CPA or attorney. He/she may communicate directly with the IRS on your behalf and ensure that your rights are protected during the audit. You will be required to sign a Form 2848, Power of Attorney for tax matters to give the professional your permission to represent you during the audit process.

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**About Cathy Mueller, EA**

Cathy is Director of Peoples Tax and Business Services with 20+ years of experience as a tax professional. She has a Bachelor of Science degree in Business Administration from Virginia Commonwealth University with a major in Accounting (including Advanced Corporate Taxation). Cathy is an Enrolled Agent, licensed to represent taxpayers before the IRS. She has earned designations of Chartered Tax Professional, from the Income Tax School, as well as Accredited Tax Preparer and Accredited Tax Advisor from the Accrediting Council for Accounting & Taxation, Inc. She has also completed the advanced education in taxpayer representation to become a Fellow of the National Tax Practice Institute.

**About Peoples Tax**

Peoples Tax & Business Services is a local Richmond, VA business founded in 1987. Peoples operates five Richmond-area offices providing individual and small business tax preparation. Peoples received the Better Business Bureau Torch Award for Marketplace Integrity and has an A+ BBB rating. Peoples' Triple Guarantee assures you of Accuracy, Year-Round Service and Satisfaction or you pay no fee! For information call 804-204-1040 or visit [www.peopletax.com](http://www.peopletax.com).

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