ENROLLED AGENT | AMERICA'S TAX EXPERT

NATIONAL ASSOCIATION OF ENROLLED AGENTS

NAEA's Tax Education Series

By America's Tax Experts

5 Secrets to Help you Avoid an IRS Audit

Program for Today

OUTLINE

- Fear of audits
- Are audits inevitable?
- Ending the fear
- Document and Disclose
- 5 Secrets to avoid audits

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We welcome your questions.

Feel free to ask as we go along.

We'll call on you as we go along and try to respond to all questions.

For questions after this workshop, please contact the National Association of Enrolled Agents www.naea.org or your instructor.

Fear of audits

Everyone is afraid of IRS audits. Why?

- Honest people lie on their tax returns
- You avoid reporting a deduction you're entitled to, because it might cause an audit
- You don't take an expense, like Office in Home, because it might be a red flag
- Even when you're right – and honest, the cost of the audit is a deterrent to taking full advantage of tax breaks you have earned.

Audit Realities

Table 9b. Examination Coverage: Individual Income Tax Returns Examined, by Size of Adjusted Gross Income, Fiscal Year 2010

Size of adjusted gross income [1]	Returns filed in Calendar Year 2009 (percent of total) [2]	Examination coverage in Fiscal Year 2010 (percent) [3]
All returns [4]	**100.00**	**1.11**
No adjusted gross income [5]	2.11	3.19
$1 under $25,000	39.62	1.18
$25,000 under $50,000	23.96	0.73
$50,000 under $75,000	13.41	0.78
$75,000 under $100,000	8.21	0.64
$100,000 under $200,000	9.64	0.71
$200,000 under $500,000	2.41	1.92
$500,000 under $1,000,000	0.41	3.37
$1,000,000 under $5,000,000	0.20	6.67
$5,000,000 under $10,000,000	0.01	11.55
$10,000,000 or more	0.01	18.38

Your Chance

The fact is, on a routine personal tax return with income under half a million dollars, your chances of being audited are

less than 1%.

Don't be afraid to take legitimate tax benefits!

Here are some tips to let you get the best tax breaks

AND

Avoid being audited

The Secret?

There are two secrets that allow you to use every tax break the Tax Code Allows

Disclose, Disclose, Disclose!

Document, Document, Document!

Disclose

When there is anything iffy, or questionable on your tax return, or anything that is unusual –

Why wait for IRS to audit?

- Simply include the explanation (disclosure statement).
- Provide enough detail, so if IRS wants to question you, they know the extent of the issue.
- Yes, this probably means filing the tax return on paper.

John sold some stock he got as a gift from Mom. The problem?

- Mom bought the stock in 1975.
- Mom doesn't have the records with the purchase price, date, or stock splits or dividend reinvestments, etc.
- John needs to establish some kind of tax basis in order to report the sale on his tax return.
- John does some research and prints out the reports he finds.
- Using that research, John makes his best estimate of the tax basis of the stock.
- John includes a disclosure statement with the tax return explaining the problem with the valuation and his solution.
- John keeps copies of the printouts with his tax files.

Disclosure Bonuses

2 Major Benefits you get from Disclosure Statements:

1) If IRS pulls your tax return for audit, when they read your explanation and see adequate details, that might be enough to avoid any further audit.

2) Normally, IRS has three years to audit your tax return after you file it.
   - However, if you make a substantial (25% or more) understatement of income (or over-statement of expenses), they have 6 years.
   - When you provide a detailed disclosure statement, even if you have erred by over 25%, IRS is limited to 3 years, instead of 6!

Documentation

Sometimes, you simply can't avoid an audit.

Prepare your tax return with that in mind.

Keep copies of all documents that back up your income and expense information, in your tax file for the year.

- W-2s, 1099s, 1098s, K-1s, etc.
- Copies of receipts for all major asset purchases ($500 or more)
- Copies of all donation receipts
- Details about your dependents (proof age and residence)
- Copies of all tax payments (local, state, federal)
- Copies of the basis of all assets sold
- Copies of accounting records for all businesses
- Photos of office in home and schematic of area
- Anything else necessary to support details on your tax return

Review your total itemized deductions.

- If they are high enough to wipe out your income
  1. Consider reducing the expenses that don't carry over.
  2. Consider using the standard deduction
- Is something causing you to owe alternative minimum taxes?
  1. Can you move that expense (legally) to another part of your tax return – like Sched C, Sched E, Sched F.
  2. Can you eliminate that expense without increasing your taxes?

Special Tricks to Avoid Audit #2

Review your overall net income.

Is it too low to live on, especially considering your family size, and the area where you live?

1. IRS is looking for unreported income.
2. Include a disclosure statement explaining to IRS what you lived on – savings, credit cards, loans, etc.

Special Tricks to Avoid Audit #3

Disputed dependents – a VERY common problem.

When you know that you and your ex-spouse are both going to try to claim the same dependent, defend yourself in advance.

1) Get a release from your ex – Form 8332

2) If you can't, file on paper and include:

- Copy of the part of your divorce agreement that states you are entitled to the dependent
- Proof that your child(ren) lived with you more than half the year. Or that your home was the child(ren)'s primary residence. (school papers, medical records, etc.)
- A support worksheet showing that you paid more than half the support for your child(ren)
- (Note: The State of California has a really good questionnaire. Answer all those questions, and you'll satisfy IRS, too.)

Special Tricks to Avoid Audit #4

"Office in Home" gets audited often – you can avoid that. How? Be consistent with the information on Schedule C.

- Don't show both a Rental Expense AND an Office in Home deduction – if you are renting business space, you probably don't qualify for an Office in Home.
  1. If the Rental expense is a storage unit, show it on page 2 of the Schedule C as STORAGE RENTAL.
  2. If the Rental expense is for equipment rent, show it on page 2 of the Schedule C as EQUIPMENT RENTAL.
  3. Don't show utilities on Schedule C. They belong on Form 8829 – Office in Home
  4. If you are LEGITIMATELY entitled to both a rented office AND an office in home (there are special situations), include a disclosure statement explaining why this is permitted.

Special Tricks to Avoid Audit #5

Meals and Entertainment are always abused – both by employees and the self-employed.

Don't be greedy.

Only deduct legitimate business expenses – not "OK, we said the word 'business' so this is a business lunch!"

Keep logs of dates, times, name of companion and business purpose of meal.

No, credit card statements may not be enough. Keep the receipts.

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Future Sessions

Thank you for joining us for this session of Avoiding IRS Audits

If you are interested in more presentations and topics,

Please talk to your instructor or contact

The National Association of Enrolled Agents

www.naea.org

And remember – EAs ***are*** America's Tax Experts