

IRS Audit? What, Me Worry?

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Last week, the IRS released information that should be of interest to all of us – statistics on the percentage of tax returns filed for the tax year 2004 chosen for audit during the last fiscal year for the agency (October 1, 2004 through September 30, 2005).

The Good News

Based on these numbers, your chances of being subjected to an IRS audit of any kind are less than 1%, and the form of the “audit” doesn’t necessarily mean a trip to the IRS office for a sit down with a live auditor.

Slightly more than 20% of all audits last year involved direct meetings with a revenue agent or tax examiner, and only .93% of the 130.6 million tax returns filed for 2004 were selected. (That’s a total of about 1.2 million returns.) Most audits are considered “correspondence audits,” where information is requested by letter and mailed in by the lucky taxpayer.

Over 40% of the returns involved questions regarding the Earned Income Tax Credit, available only to taxpayers whose earned income is below \$35,000. In fact, those taxpayers whose taxable income falls between \$50,000 and \$100,000 had the lowest rate of audit for individuals.

Small Business Gets Targeted

If you are self employed, you might take note that the percentage of returns filed by sole proprietors (filing Schedule C of Form 1040) and audited by the IRS is nearly three times higher than returns filed by employees. If you are “audit adverse,” you might consider incorporating or adding a partner. Other than trusts, S corporations and partnerships had the lowest percentage of returns audited.

Audits Focus on Certain Types of Businesses

While the exact selection criteria that the IRS uses to determine audit candidates are a very well guarded secret, it is widely recognized that the IRS targets certain types of businesses, regardless of size. Industries known for cash transactions, certain tax avoidance “schemes” and areas known for abuse like the Earned Income Tax Credit are good examples.

So—Should You Worry?

That depends. If you haven’t been honest with the IRS or have done something illegal, your IRS audit encounter may be, shall we say, quite challenging for you, your accountant and your attorney. However, the best defense against an IRS audit is good documentation of expenses and thoughtful preparation of the original return.

There's no guarantee that you won't receive that dreaded envelope bearing possible bad news from your friendly IRS. But relax—the revenue agent may simply seek clarification of a figure on your tax return or point out a possible mistake (hopefully in your favor!). Be sure to alert your accountant to any IRS correspondence that you receive. She may be able to offer further insight into what the IRS is seeking to know, and may even have on file the details that you need to provide.

Whatever the issues may be, make every effort to cooperate by always providing correct, honest information and explanations. If you do, chances are that the IRS will get exactly what they need, and you will sleep better at night.

Want to know more? The raw data on these audit statistics is available at www.irs.gov in the IRS 2005 Data Book.

Don't Fall Prey to the Latest Scam

Be wary! Recently there have been many complaints to the IRS about an email received from admin@irs.gov, requesting social security and credit card information, along with a request for an address to “send your refund.” The IRS does not send emails. When the IRS wants to reach you, US mail or a phone call are the only methods of communication used.