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Avoid IRS Audit Triggers

32 years as a tax lawyer advising clients and handling tax disputes makes me circumspect about addressing this at all. It's only natural to think about it, especially if you have a large income or complicated tax return. See IRS Audit Risk If You're "Rich". There are many views about what will prevent or cause an audit. See 30 Last Minute Tax Tips.

In fact, I sometimes think the subject is better left for witchcraft. If you chew the fat with tax return preparers you'll hear many old wives' tales about what does and doesn't trigger an audit. Still, the latest IRS stats are worth a look. See What's Your IRS Audit Risk?

First the disclaimers. Tax advisers are actually ***required*** by Treasury Department rules to assume ***every*** return will be audited. In truth, there might be only a 2% chance of audit. When I say there's a 50/50 chance a tax deduction will be upheld, I must assume it will be examined. Because of these strict standards, it can be awkward to talk about audit risk.

Real World. You don't want to be audited no matter how sure you are of your return. There's no law preventing you from lawfully trying to make it sail through as long as you fully and fairly complete it. See 10 Ways To Audit Proof Your Tax Return.

For me, here are some obvious rules:

1. ***Report Each Form 1099***. This is plain as day, but it still trips up many people. See Care With Forms 1099 Helps Audit -Proof Tax Returns.

2. ***Report Each Form K-1***. This is the same idea as with Forms 1099. Don't ignore them.

3. ***If You Can, Avoid Schedule C***. It is one of the most likely types of returns (or parts of returns) to be examined. This proprietorship schedule is what you fill out if you operate a small business that is not in a legal entity (such as a corporation, LLC or partnership). Examples are little enterprises you run from your garage, on the internet, or on weekends, even though the bulk of your income may come from wages from your regular job. Schedule C is also the primary place the IRS can audit "hobby" activities that you claim are a business but the IRS disputes. Be especially wary if you have several years of losses in a row.

4. ***Use Care With Noncash Charitable Donations***. If you make them, scrupulously follow the forms, especially Form 8283. Don't get too greedy with valuations, and expect scrutiny, especially on big numbers.

5. ***Pay S Corporation Wages***. If you own an S corporation, make sure the company pays you a fair wage for what you do, since wages are subject to employment taxes. This is the flip side of the "reasonable compensation" issue for C corporations. See When IRS Calls Pay "Unreasonable."

6. ***Beware Real Estate Losses***. If you have rental real estate and lose money, expect scrutiny. Keep especially good records of how much time you spend on the activities, since that can influence whether your losses are "active" or "passive."

7. ***Avoid Excessive Travel And Entertainment***. Even if your income is high, high travel and entertainment expenses for business can make you stick out. Consider carefully if you really meet the business purpose tests before you claim it.

For more, see:

Richie Rich Tax Audits

IRS Wins Big In Six Year Audit Push

What To Give IRS In An Audit

Beware Amending Tax Returns

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