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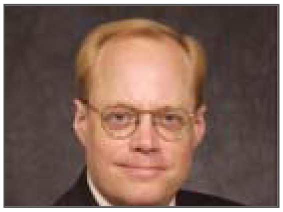

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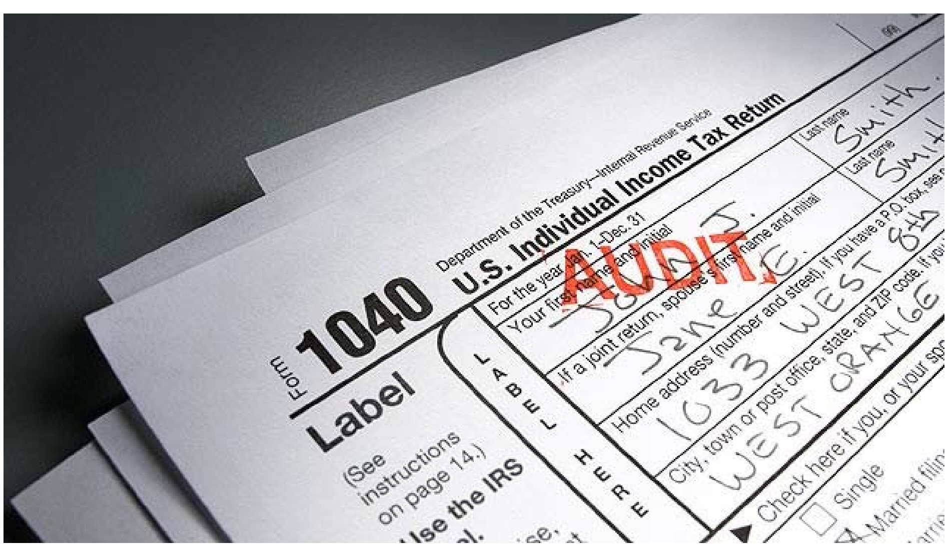
Is Your Tax Return Audit Proof? Why It May Not Matter

Recently, I warned about certain tax mistakes that allow the IRS to audit you *forever*. That was bad news. But here's some good news. Ironically, it ties into the controversies over at the IRS. With budget cuts and all the attention the IRS must now devote to the Affordable Care Act, the IRS is devoting less and less time to tax audits.

Most taxpayers will hardly be disappointed. What's more, it turns out that if you have a high income, you are *especially* better off since audit rates at upper income levels have dropped significantly. Bear in mind that most audits must happen within 3 years, or six in some cases. But eventually, you know you're in the clear. Until then, you might be on edge about having to defend your return.

Fortunately, there is now a 6-year low in audits of high income taxpayers. By 'audit rate' we simply mean the percentage of individuals' tax returns the IRS examines. The examination may be in person or via correspondence, but these days, correspondence is more common. Back in 2011, audit rates for most returns were small.



You stood about a 1 in 90 chance of an audit. But if your income was over $1 million in 2011, you stood a 1 in 8 chance of audit. But now, that high income audit rate dropped down to a 1 in 13 chance. The trend is noteworthy since audit rates rose steadily from 2005-10. But since then, the number of individual audits fell 21.4% for the next five years.

Of course, no one wants to be noticed by the IRS, much less audited. There are many old wives' tales about what triggers an audit. The size of your income is only one factor. Your deductions matter, your tax credits, and even which specific items you claim. But does mere *wealth* trigger an audit?

The IRS's Global High Wealth Industry Group—aka the Rich Squad—has been around since 2009. Audits can start with a plain old Form 1040 but can expand into gifts, charitable issues and excise taxes. A high-net-worth person can expect a holistic approach. All entities connected to the taxpayer are up for grabs, including family companies.

The fact that the Rich Squad is part of the IRS's Large Business and International Division says a lot. They are adept at dealing with complex business and investment structures used by wealthy people. Rich Squad audits take into account the range of assets and entities in a family group. Trained to ferret out data from large and sophisticated businesses, the IRS has turned these big guns on individuals.

That means the IRS may want documentation for virtually everything. It could overwhelm even well-advised taxpayers. Families (even wealthy ones) don't have big tax staffs the way major corporations do. The Rich Squad is not dealing primarily with those who simply have high income on their Form 1040. The focus is not so much with high income as with complicated structures of business entities, trusts and assets.

Whatever your level of income or your risk tolerance, try to make your return pristine.

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