

## Will your tax return be audited?

Few things are more unnerving than having your tax return selected for an IRS audit. The IRS uses that "audit anxiety" to help keep taxpayers honest on their tax returns.

### *DIF scores count*

The IRS evaluates tax returns based on their "DIF" scores, a set of IRS formulas known as the "Discriminate Function System." About three-quarters of all returns audited are selected by the DIF computer, which compares deductions, credits, and exemptions with the norms for taxpayers in each income bracket.

While these formulas are kept very secret by the IRS, you can count on having a higher audit probability if you fall into certain categories or report certain things on your tax return.

### *What interests the IRS?*

Some higher risk areas include the following —

1. Tax protests. Both the IRS and tax courts are getting fed up with what they consider frivolous tax protests. If you file a return stating that you owe no tax because the dollar is worthless or make some other such protest, you'll probably be audited.
2. High income. Because auditing higher-income taxpayers is likely to produce more additional tax revenue than auditing lower-income taxpayers, this category is targeted by the IRS.
3. Certain occupations. Taxpayers whose occupations produce cash income, such as taxi drivers and waiters, run a higher risk of being audited. Self-employed individuals, particularly independent contractors, are IRS targets for the same reason; they are more likely to have unreported cash income.
4. No preparer or a problem preparer. If you have a complex return and prepared it yourself, or if your return was prepared by someone on the IRS's problem-preparer list, you are more likely to be audited.
5. Certain deductions. The IRS has found it profitable to audit returns that claim office-in-the-home deductions, travel and entertainment deductions, and certain other write-offs where they feel taxpayers stretch the truth.
6. Related party transactions. Taxpayers who involve family members in their financial operations are more likely to be scrutinized by the IRS. Paying wages to your children, lending money to relatives, splitting income among family members, or running a family business will make the IRS more interested in your returns.

7. Abusive tax shelters and offshore accounts. In the last few years the Internal Revenue Service has detected a proliferation of abusive trust tax evasion schemes. It also believes some people are using offshore credit cards to evade paying U.S. income taxes. The Service intends to expand its efforts to crack down on abuses in these areas.

*Your best audit defense*

Unless there is suspicion of fraud or substantial understatement of income, the IRS has three years from the due date of your return to initiate an audit. Typically, most returns are selected within two years of their filing date.

The best defense in an audit is a two-part strategy:

1. Have supporting documentation for all deductions and credits.
2. See your accountant immediately upon notification that you're being audited.

A professional can put your mind at ease, find the information that the IRS wants more quickly than you can, and very likely will save you money in the long run by getting a faster and more favorable conclusion to the audit.