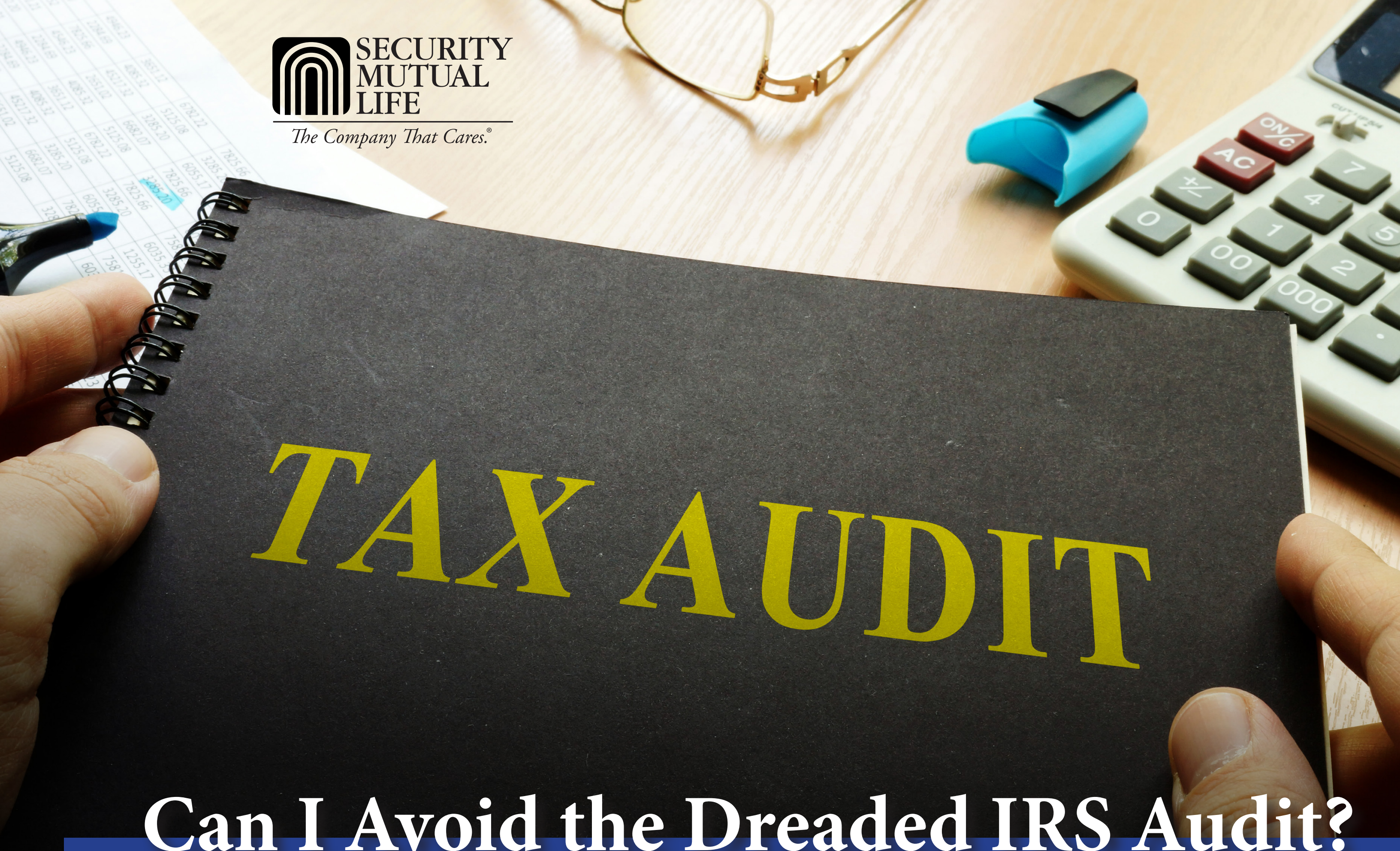

Can I Avoid the Dreaded IRS Audit?

There's nothing like the thrill of opening a letter where the return address says, "Internal Revenue Service."

Ok, we're just kidding. We've yet to find anyone who *wants* to be audited. In fact, there are few things that create more fear and dread than a so-called "exam letter." It very often means that you're looking at a significant time commitment just to put together the documentation they're looking for. It could also mean some serious expenses for additional taxes, interest, penalties, and accounting fees.

Overall, the IRS audits less than 1% of all returns. And in most cases, modern audits are handled entirely by mail.[1] Audit rates have been declining for years.[2] But the fact is that the more money you make, the more likely you are to get audited. According to the Tax Policy Center, people with incomes over $1 million have approximately a 1.6 percent chance of being audited.[3]

So, the numbers are not that high, even for people with higher incomes. But there are still things that increase those odds. A recent article published by Charles Schwab outlined what they referred to as "preventable mistakes" that increase the likelihood of an IRS audit. The good news is that these so-called red flags are well-known, so it's easier to keep your eyes open for them. Here they are, in order.[4]

1. **Undocumented Income.** Keep in mind that most major sources of income will be reported to the IRS, very often in the form of a W-2 or 1099. Some sources, such as wages, will automatically have taxes withheld. Other sources will not. Undocumented income is often the result of a missing 1099. Regardless of where it comes from, you need to make sure all your taxable income is on your return.

2. **Significant Fluctuation in Income.** Another IRS red flag is people whose income varies substantially from one year to the next. This happens frequently with the self-employed. The way the IRS sees it, significant fluctuations may be an indication of underreported income. Schwab has a suggestion on how to deal with this: If you file electronically, most income tax software lets you include supplemental documentation that may help explain the situation.

3. **Business Losses.** The IRS will notice if you lose money every year, or if the amount of the loss is significant. It's OK in the first few years of a new business, when losses are considered routine and predictable. But as the years go by, your business is expected to start making some money. The IRS may be curious if you don't. In fact, especially if your business is a sole proprietorship, they may suspect that it's really just a hobby. The recommendation is that you should maintain thorough records for at least seven years. These records should account for every dollar coming in and going out.

4. **Dubious Tax Deductions.** Keep in mind that the standard deduction for 2025 is $15,000 for individuals and $30,000 for married filing jointly.[5] What we're talking about here is when the itemized deductions are over and above that amount. While they may be perfectly legitimate, certain deductions might provoke additional interest from the IRS. Among them are big charitable donations, losses on rental properties, and "unqualified" home-office deductions. As with everything else, the best defense is to have complete supporting documentation for any deduction on your return.

5. **Undervalued Assets.** This one comes into play more with estate tax returns, which tend to be audited at a higher rate than income tax returns. Many assets are easy to value because they have a public market price. But for those that don't, having qualified appraisals may be a good idea.

And we'll add one more, this one courtesy of Kiplinger: Refundable Tax Credits.[6] Most tax credits are *nonrefundable* tax credits, meaning that they can only reduce the amount of taxes owed. A refundable tax credit is the type of credit where you can end up with a net cash payment, even if your tax liability is below zero. An example of this type of credit would be the Earned Income Tax Credit or the Child Tax Credit. Note that the IRS devotes special attention to these credits.[7]

There's no perfect system for avoiding an IRS audit. The best you can hope for is to have everything well documented in case that day comes.

For More Information Contact:

[1]Taylor, Joy. "What Are Your Chances of an IRS Audit? 18 Audit Red Flags." Kiplinger.com. https://www.kiplinger.com/taxes/tax-returns/602068/irs-audit-red-flags (accessed March 21, 2025).

[2]Picchi, Aimee. "Many taxpayers fear getting audited by the IRS. Here are the odds based on your income." CBSNews.com. https://www.cbsnews.com/news/tax-irs-audit-here-are-your-chances-cbs-news-explains/ (accessed March 21, 2025).

[3]Tax Policy Center. "What is the audit rate?" Taxpolicycenter.org. https://taxpolicycenter.org/briefing-book/what-audit-rate (accessed March 21, 2025).

[4]Adams, Hayden. "How to Minimize the Risk of an IRS Audit." Schwab.com. https://www.schwab.com/learn/story/how-to-minimize-risk-irs-audit?cmp=em-XCU (accessed March 21, 2025).

[5]Phillips, Kelly Erb. "IRS Announces 2025 Tax Brackets, Standard Deductions And Other Inflation Adjustments." Forbes.com. https://www.forbes.com/sites/kellyphillipserb/2024/10/22/irs-announces-2025-tax-brackets-standard-deductions-and-other-inflation-adjustments/ (accessed March 21, 2025).

[6]Taylor, Joy. "What Are Your Chances of an IRS Audit? 18 Audit Red Flags." Kiplinger.com. https://www.kiplinger.com/taxes/tax-returns/602068/irs-audit-red-flags (accessed March 21, 2025).

[7]Tax Policy Center. "What is the audit rate?" Taxpolicycenter.org. https://taxpolicycenter.org/briefing-book/what-audit-rate (accessed March 21, 2025).

SECURITY MUTUAL LIFE
INSURANCE COMPANY OF NEW YORK
SECURITY MUTUAL BUILDING • 100 COURT ST.
P.O. BOX 1625 • BINGHAMTON, NY 13902-1625
607-723-3551 • www.smlny.com
The Company That Cares.®