TAX POLICY

Tax Tips: 7 Red Flags That Can Get You Audited

By Martha C. White | April 6, 2012 | +

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While just the prospect of an audit is enough to strike fear in taxpayers' hearts, the truth is that fewer than 2% of taxpayers get audited a year. The IRS is tightlipped about exactly what gets your tax return selected for extra scrutiny, but tax pros say it's an ever-evolving combination of factors. None of these red flags is likely to be enough by itself to earn you an audit, but the more you have, the likelier you are to be tagged for greater scrutiny from the tax man.

1. Making math errors. "This is one of the top reasons for an audit," says Dana Levit, owner of Paragon Financial Advisors. She doesn't just mean adding or subtracting incorrectly — although that's definitely at the top of the list. Since most self-filers use tax prep software these days, the arithmetic is done for you. But the program can only work with what you give it, so double-check your data even — or especially — if you've waited until the last minute and are rushing to file as the clock ticks down.

2. Submitting inconsistent information. If you get a W-2, you'll probably never have to worry about income statements that don't match. But if you get 1099s, get paid in cash, or have additional income from other sources, make sure that the amount you declare matches what the IRS has received from other sources. Under-reporting income is the biggest infraction here, says Levit. "If they don't see it on your return, you're very likely going to get a letter." Other inconsistencies can also attract attention, such as if your last name isn't consistent throughout your paperwork or if you transpose a couple of numbers in a Social Security number.

3. Taking outsized deductions. Charitable donations are a legitimate deduction, but don't go crazy, experts advise. Charity deductions in the 1% to 3% ballpark are fine; double-digit numbers could raise an eyebrow. Be especially careful when it comes to non-cash donations that can't be backed up with a canceled check or an acknowledgement from the charity, says Craig Wild, partner at Wild, Maney, and Resnick LLP. And remember: You can't write off the price you paid for a donated item, only the fair market value today. Similarly, there are legitimate deductions and credits for higher education students, but claiming them long after you should have earned a degree can put the IRS onto you, cautions Mark Steber, chief tax officer at Jackson Hewitt Tax Service.

4. Being wealthy. Sorry, 1 percenters; the more you rake in, the more Uncle Sam wants to make sure he's getting his fair share. "Face-to-face audits of individual taxpayers reporting income over $200,000 increased by 34 percent as compared with FY 2010," the IRS Taxpayer Advocate website says. "Also, the IRS is now auditing about one out of every eight taxpayers who reported over $1 million in income."

5. Filing a business return. Although there are plenty of legitimate businesspeople who file Schedule C forms, a handful treat tax time like a hunt for loopholes and give everybody else a bad name. As a result, the IRS often scrutinizes business returns more closely, says Steber. An even bigger red flag is if you lose money consistently, says Levit. "The rule of thumb I'd always use is if you're running a loss three out of five years, it starts to get questionable." This could prompt the IRS to ask you to prove that your business is a bona fide enterprise and not just a hobby.

6. Taking home office deductions. "I believe the IRS looks at home offices," says Wild. "The IRS requires it has to be used exclusively for business." In other words, says Levit, your dining room table doesn't count, and neither does the computer that's also used by your kids for homework and Facebook, even if you're self-employed. If you're a salaried employee who has office space somewhere else, the bar is even higher, she adds. "It has to be for the employer's convenience," not yours, she says. "And I would get that in writing."

7. Hand-writing your return. While this is minor compared to, say, getting your spouse's Social Security number wrong, it's going to stand out just because it's unusual, says Jackie Perlman, tax analyst at H&R Block's Tax Institute. "Once upon a time they were the norm, but now they're not," she says. "Even people who don't e-file can use a computer to go online and use fillable forms." Combined with other inconsistencies, Perlman says, the IRS might suspect fraud.