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5 Red Flags the IRS looks for in your Tax Return (part 2)

In my previous article, I wrote about two of five activities in your tax return that might potentially raise a red flag to the IRS and get you an audit notice, namely property transfers and selected investment losses.

Here are three other activities that may raise a red flag in the eyes of IRS auditors. This is especially so if you are wealthy or have complicated tax profiles and multiple streams of income.

3. Overseas income

There has been a lot of publicity regarding overseas banks like UBS Bank of Switzerland from two years ago and more recently, HSBC Bank in India. UBS has been charged and fined for abetting wealthy US taxpayers in starting bank accounts used to hide their taxable income. Recently, HSBC India has also been investigated over the same thing.

If you have overseas income, US law says you must declare it and pay taxes on it, even if you pay taxes in your host country. On September 9, the IRS concluded an amnesty program for those who voluntarily declare their overseas income for taxation. Now that the amnesty program is over, if you are caught flouting the rules on foreign income reporting you will not only face stiff penalties but also criminal prosecution and imprisonment.

As with the case of UBS Bank, the IRS is going to foreign banks to demand the banking details of their American clients suspected of tax evasion. So if you have overseas income, you should declare it in its entirely.

4. Home loan interest deductions

If you claim big deductions for interest on mortgages and home loans you are most certainly going to raise a red flag to the IRS. Generally, you are allowed to claim for as much as a combined $1 million of total indebtedness on first and second homes, plus $100,000 on a home-equity loan in joint filings. For example, if your home loan is valued at $1.5 million at 6.5% interest, the amount of interest you pay per year is $97,500. If you claim anything much in excess of that (say, $100,000 or more), you would pique the interest of the IRS into your claim.

5. Big spending

The IRS has begun to countercheck your tax returns with your credit card spending. They want to determine if your level of income commensurate with the amount you spend. So if you draw a modest income but go on a shopping spree with your credit cards, you will raise a red flag to the IRS.

These are the 5 major activities that raise a red flag to the IRS. It is estimated that for every $1 the IRS spends on enforcement, it brings in $10 in taxes. For that kind of ‘ROI’, it’s clear to see why the IRS spends so much time and effort in focusing on wealthy taxpayers.