



**January 24, 2012**

## How the IRS Chooses Who To Audit

An IRS audit is the thing most taxpayers are afraid of. But most of this fear comes from not knowing what an audit is all about, what it entails and most of all, what to do when you receive an audit notice. So if you know a few basic things about the whole matter, it takes a lot of fear out of it. Receiving an audit notice does not mean that you have committed an offence. In fact, audits can result in acceptance of the tax return without change or even a refund. If that be the case, how does the IRS choose who to audit in the first place? There are several factors that govern who the IRS chooses to audit. Firstly, some tax returns are chosen for audit through the screening of a computer. An IRS computer compares data from a return to average numbers from other people's tax returns in similar situations looking for variances. The data that is reviewed by the computer are things like charitable donations, interest income and variations from averages in your income bracket or zip code. If a major variance is detected, that tax return is chosen for audit.

Secondly, tax returns are chosen for audit based on comparisons with other documents like your W2s. The computer sees if your tax return matches up with your W2 and if there is a mismatch, that return is called for audit.

Thirdly, there is the category called "related examinations". This is where returns may be selected for audit when they involve issues or transactions with other taxpayers, such as business partners or investors, whose returns were selected for audit. And finally, some returns are selected for audit purely at random.

Most taxpayers would not face an audit their entire lives. According to IRS statistics, those earning below \$200,000 per year had only a 1% chance of being chosen for audit whereas the rate of audit for those earning above \$1 million a year was about 12.5%. All in all in 2010, the IRS audited nearly 1.6 million individual returns, slightly more than 1% of the total filed. Most of the audits were conducted via letters, and others through field examinations by an IRS agent. If your tax return is chosen for audit, you will be notified via a phone call or snail mail, never via email.

Some of the more common people called for audits are those that make charitable contributions, those earning cash income (like waitresses or bellboys) and those claiming deductions from a home office.

The best defense in an audit is accurate documentation. It is important for you to think through those items reported by third parties and make sure you have the documentation that matches up with them. And you should always have copies of your expenses and official receipts. If these are in order, you should have no fear of an audit.