

Not Just for the Rich and Famous; As Audits Increase, Taxpayers Should Seek Professional Assistance to Avoid Trouble with the IRS

March 28, 2005 9:40 AM ET

KANSAS CITY, Mo.--(BUSINESS WIRE)--March 28, 2005--Leona Helmsley, who once claimed that "only the little people pay taxes," was found guilty in 1989 of tax evasion, fined and sentenced to prison. Heidi Fleiss, the infamous Hollywood "madam" who made millions from her escort service, didn't report her ill-gotten gains and was convicted in 1997 of tax evasion.

And in 1992, long before her most recent legal problems, Martha Stewart was ordered to pay \$220,000 in New York state tax. A judge ruled that Martha's claim of not spending a lot of time at her East Hampton, N.Y. home wasn't a credible excuse for failing to pay her taxes.

Over the years there's been no shortage of high-profile cases involving luminaries who've gotten into trouble with the tax man. But while the travails of celebrities garner the biggest headlines, H&R Block (NYSE:HRB) cautions that the rich and famous aren't the only ones who can suddenly find themselves under the watchful eye of the IRS.

Audits on the Rise

Last year, the total number of individual taxpayer audits topped 1 million for the first time since 1999, according to the IRS, and that number will likely keep growing. The IRS has announced plans to add more than 2,000 positions to its audit operations this year.

The increase in audits brings up some important questions: How many Americans actually cheat on their taxes? How many taxpayers "fudge" a little on their tax returns but don't really think of it as cheating? And whether you're a cheater or not, what are the chances of being audited?

According to H&R Block, even though the vast majority of taxpayers are honest, the cost of those who do cheat is felt by all. In fact, the IRS Taxpayer Advocate 2004 Annual Report stated that each individual pays almost \$2,000 in taxes annually to subsidize those taxpayers who do not pay their share.(1)

"A lot of people think it's OK to fudge a little bit on their taxes, whether it's claiming a dinner out with friends as an unreimbursed business expense or taking cash under the table for moonlight work," said Kathy Burlison, H&R Block tax professional. "Not every cheater will be audited; but some will. And once that happens, the original tax savings can't compare to the ultimate bill for tax, penalties and interest."

Odds for Audits Increase with Income

In 2004, the IRS audited 1 in 129 returns filed by individuals and families. But for those with incomes over \$100,000, the odds jump to 1 in 68.

H&R Block advises that to minimize the risk of an audit, taxpayers should be aware of red flags that typically trigger scrutiny from the IRS. "Taxpayers actually can attract unwanted IRS attention with two of the most common mistakes that can attract unwanted IRS attention -- failing to sign the return and including incorrect Social Security numbers," Burlison said. "It really does pay to double-check your return before filing.

"Better yet, e-file," she said. "It's quicker and you'll be notified of an error within 24-48 hours. Then you can easily correct the mistake and resubmit the return. Remember, e-filed returns are 99 percent accurate versus 81 percent for paper returns."

In making a determination about who to audit, the IRS relies on sophisticated computer technology to identify potential audit targets, including a highly confidential computerized formula that checks your return against specific computer models.

A questionable return is then flagged and scrutinized by IRS agents. Burlison said there are a number of areas that the IRS examines closely when determining whether to launch an audit.

These include:

- Unreported income. If you received money (interest, dividends, wages, gambling winnings, etc.) that was reported to the IRS, the IRS will notice pretty quickly if it's not on your tax return. And just because a payment -- such as interest under \$10 or contract work under \$600 -- wasn't reported to the IRS by the payer, that doesn't mean you can omit it from your tax return. Any money you receive is taxable, unless the law specifically exempts it from tax.
- Itemized Deductions - Taxpayers who itemize are more likely to draw scrutiny from the IRS than those who do not. A key trigger for the agency is deduction amounts that appear to be outside the norm, whether for medical expenses, vehicle expenses, or business meals.
- Casualty Losses - Although losses from fire, theft or storms are deductible, they can only be deducted if the total losses exceed an insurance reimbursement by \$100 and exceed 10 percent of an individual's adjusted gross income after the insurance payment is received. Unfortunately, some taxpayers in areas hard hit by natural disasters have seen this as an opportunity to claim casualty losses even if they didn't suffer any damage. Audits help discourage this practice. Taxpayers with legitimate losses should maintain complete records in case their returns are selected for review.
- Hobby Losses - The IRS takes a dim view of individuals who work full-time but also operate side businesses that are essentially hobbies and perennial money-losers. Therefore, it pays to keep detailed records of all business expenses, and to make sure they're separate from personal expenditures. If you're claiming business expenses, run the business like it's meant to make money and keep records to track what you're doing to improve your profitability.

"Given the risks of an expensive audit, paying strict attention to the rules is the only smart decision you can make," Burlison said. "There are lots of rules around what needs to be reported and what doesn't. What's deductible, what's not and what records you have to keep. A tax professional that works with many taxpayers throughout year will have the knowledge and the experience to stay on the right side of the rules. An added benefit in choosing H&R Block as your tax preparation provider is our audit assistance service, provided free of charge through our Standard Guarantee. If the IRS audits you, an H&R Block representative will assist you in answering questions regarding the preparation of your tax return.

"Remember that even if you haven't been audited in the past, it doesn't mean you won't be in the future," Burlison said. "And it only takes one audit to ruin your day."

About H&R Block

Celebrating its 50th anniversary in 2005, H&R Block is the world's largest tax services provider, having served more than 400 million clients since 1955. The sixth largest retailer in the world, H&R Block has more than 12,000 locations serving taxpayers primarily in the United States, Canada and Australia.

H&R Block's subsidiaries deliver tax services and financial advice, investment and mortgage services, and business accounting and consulting services. H&R Block

(1) See IRS National Headquarters Office of Research, Tax Gap Map for

Year 2001 (Feb. 24, 2004).

CONTACT: H&R Block
Denise Sposato, 816-932-4909
dsposato@hrblock.com
or
Weber Shandwick
Dave Fransen, 952-346-6255
dfransen@webershandwick.com
SOURCE: H&R Block