

Not Just for the Rich and Famous: Audits on the Rise -- As the Season Winds Down, the IRS Revs Up

March 23, 2006 12:09 PM ET

KANSAS CITY, Mo.--(BUSINESS WIRE)--March 23, 2006--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, 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

Think you're immune? Think again. This year it's estimated that American taxpayers have a 1 in 107 chance of being audited, and the chances are even greater if you make over \$100,000 -- jumping to 1 in 63.

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 audit "red flags?"

According to the IRS, roughly 16 percent of all taxes owed, or \$345 billion, initially went unpaid in 2001 and that figure is more than likely understated. And 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 stated recently that each individual pays almost \$2,000 more in taxes annually to subsidize those taxpayers who do not pay their share.

But just what is considered cheating? "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."

H&R Block advises that to minimize the risk of an audit, taxpayers should be aware of two common mistakes that typically trigger scrutiny from the IRS:

- Failing to sign the return, and
- Including incorrect Social Security numbers

"Better yet, e-file," Burlison 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."

Where To Get Help If Audited

The IRS is reporting that tax returns prepared using a computer -- either with software or online services -- is up 17 percent over tax season 2005. And this is especially good news for TaxCut users with the introduction this year of Worry-free(TM) Audit Support.

With Worry-free Audit Support, paid TaxCut clients who successfully e-file can now rest easy knowing one of H&R Block's more than 70,000 tax professionals is ready to help, at no additional charge, in the event of an audit. From outlining what to expect and providing guidance on how to prepare for the audit, to having a Block enrolled agent(a) represent the TaxCut client before the IRS, H&R Block can help manage the process -- 365 days a year, not just at tax time -- and it's all free. No one else in the industry can offer audit protection like H&R Block.

For those who choose a paid preparer to do their taxes, 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 to our more than 16 million retail clients. If the IRS audits you, an H&R Block representative will assist you in answering questions regarding the preparation of your tax return.

Audit Flags

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. Taxpayers with casualty 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.

According to H&R Block, here are the main areas taxpayers need to be aware of to help avoid an audit:

- Learn the rules -- There are lots of rules around what needs to be reported and what doesn't;
- Keep up with deductions -- Knowing what's deductible and what's not is key to getting your return completed accurately; and

-- Keep records -- It's always good to keep your records, so that if you were ever questioned you can refer back to your documentation.

"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

H&R Block (NYSE:HRB) is a leading provider of tax, financial, mortgage, accounting and business consulting services and products. H&R Block is the world's largest tax services provider, having prepared more than 400 million tax returns since 1955. The company and its subsidiaries generated revenues of \$4.4 billion and net income of \$636 million in fiscal year 2005 from operations in four principal business segments: tax preparation and advice via in-office, online and software solutions; investment and financial advisory services; retail and wholesale mortgage services; and tax/accounting/business consulting services for midsized companies. Headquartered in Kansas City, Mo., H&R Block markets its services and products under three leading brands: H&R Block, Option One and RSM McGladrey. For more information, visit our Online Press Center at www.hrblock.com.

(a) While enrolled agents are not tax attorneys and cannot provide legal advice, they are knowledgeable tax professionals who are eligible to represent the TaxCut client before the IRS.

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SOURCE: H&R Block