GRAGG FINANCIAL
Beyond the Traditional

Taxpayers invest about 13 hours preparing their tax returns, according tothe IRS's instruction for Form 1040.

More specifically, the IRS says that the average nonbusiness taxpayer spends nine hours preparing a tax return, which includes three hours of record keeping. For taxpayers who file a business return, expect around 24 hours, with about half of that spent keeping records.

No wonder it's easy to make a mistake. Time-consuming or not, the IRS isn't always in a forgiving mood when errors pop up.

Even if you hand your records to your accountant or CPA, forgetting important documents can delay your refund, force an amended return, or worse, trigger an audit.

7 ways to minimize audit risks

1. You've probably heard it before, but let's start with the basics. One of the biggest mistakes folks make is **filing a return before they have all their 1099s and W-2s**

By now, you've probably received any corrected 1099 forms. But in the future, be careful about filing by early February (gosh, I know that feels good, but…) and getting a notice in late February that your brokerage firm has adjusted your original 1099.

2. One reason taxpayers get into trouble is the**failure to report income** from:

- regular wages (W-2),
- Social Security (SSA-1099),
- pensions, IRA distributions, and annuities (1099-R),
- partnership income (K-1),
- income from an independent contractor gig (1099-NEC),
- rent or royalties (1099-MISC),
- real estate sale proceeds (1099-S), and
- income from interest (1099-INT), dividends (1099-DIV), or capital gains (1099-B).

The income above is derived from various sources, but they share a common thread: They all trigger a form. If income triggers a form, the IRS will receive a duplicate copy.

Good record-keeping and reliable tax software that reminds you of the previous year's activities can help eliminate errors.

If possible, stay consistent with the same tax software, which will remind you of the forms you used the previous year.

Good record-keeping

Did you receive the form in the mail? Put it in your “tax drawer.” Did you receive an email alerting you that your 1099 is available? Save the email in your tax year 2023 email folder. Don’t have a tax year 2023 folder or tax drawer, then create one.

We can’t overemphasize the importance of good record-keeping.

3. Watch out for business losses Most businesses lose money in the early stages. But if your business is losing money year after year, it could raise suspicions that it is simply a hobby.

You may love golf. You may even teach beginners how to play. But if your golfing business can’t turn a profit, the IRS may decide it’s a hobby.

Or it may raise suspicions that you are misreporting income or expenses. This can be especially true for cash-based businesses.

That doesn’t mean you shouldn’t report losses. Keep detailed records for at least seven years demonstrating legitimate expenses.

4. Let’s turn to deductions. Is a charitable deduction outside of what is considered “normal,” i.e., much higher than the average charitable deduction based on your income?

Be sure you keep careful records. Overall deductions for donations to public charities, including donor-advised funds, are generally limited to 50% of adjusted gross income (AGI). The limit increases to 60% of AGI for cash gifts, while the limit on donating appreciated non-cash assets held more than one year is 30% of AGI.

The **home office deduction** is becoming increasingly popular, but you must be self-employed and conduct most of your business from home. If your company allows you to work from home and you are a W-2 employee, don’t even consider taking the home office deduction.

Starting in tax year 2013, the IRS began allowing taxpayers to take what they call the simplified option. It is a standard deduction of $5 per square foot, a maximum of 300 square feet.

It’s much simpler than the standard method, and there is no recapture of depreciation upon the home's sale, but your deduction will probably be lower.

5. As a business owner, **your income may fluctuate**. But wild swings in income can put an unwanted spotlight on your tax return because it may raise suspicions that you may not be reporting all of your income.

Consider a note when filing if expenses or income changes dramatically. Most software programs will let you include documentation that sheds light on your unique circumstances.

Other deductions: How much is too much?

How much is too much? No one really knows, but if it is too far outside the norm, IRS computers may flag your tax return. Again, keep detailed records that substantiate your deductions.

6. Does the IRS suspect that you have **$10,000 or more in foreign accounts** and have not filed a FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR), or if they believe you reported incorrectly or have misreported values on the FBAR, you may be subject to an audit, according to Bloomberg Tax.

7. Avoid abusive tax shelters. More recently, questionable transactions identified by the IRS include abusive syndicated conservation easements, abusive micro-captive insurance company arrangements, and Malta retirement plans (Bloomberg Tax).

In addition, scams involving the earned income tax credit, sick leave, family leave, and false fuel tax credit claims can trigger an audit.

Key tax filing dates

April 1, 2024 - RMD due if you turned 73 in 2023.
April 15, 2024 - Tax Day (unless extended due to local state holiday).
April 15, 2024 - Deadline to File Form 4868 and request an extension.
April 15, 2024 - Deadline to make IRA and HSA contributions for tax year 2023.
October 15, 2024 - Deadline to file your extended 2023 tax return.

Source: Intuit

Bottom line

It's impossible to bulletproof a tax return completely, and high-income taxpayers will come under more scrutiny simply because of their income.

But you can reduce the risk, and if audited, you will be in a better position to quickly answer questions and put the exam in the rearview mirror.

If the IRS contacts you, you probably won't receive an invitation for an at-home audit. Instead, you will receive a letter detailing the money the IRS believes you owe, along with penalties and interest.

The IRS will give you a specified amount of time to prove that your original filing is correct. Provide the documentation requested. If everything looks good, you'll be clear.

Please let us know if you have any tax-related questions. As always, thank you for choosing us as your financial advisor. We are honored and humbled by your trust.

The Gragg Financial Team