



# 12

## RED FLAGS

THAT INCREASE THE PROBABILITY  
OF THE IRS EXAMINING A RETURN

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# THE 12 RED FLAGS

## RED FLAG #1

Making too much money. While the overall exam rate is around 1%, if income is over \$200,000 the rate goes up to 3.7%. Returns with income in excess of \$1,000,000 will get a visit from the IRS 12.5% of the time.

## RED FLAG #2

The IRS computers have gotten very good at matching 1099s and W-2s to the return, so please make sure we have all items.

## RED FLAG #3

Large charitable deductions compared to the averages will raise the red flag. Several of the software packages today are set up to monitor those variances. If you exceed the average, make sure you have records to back up those deductions and recognize the increased IRS audit risk. (See Chart Below)

## RED FLAG #4

The home office deduction continues to be a major issue for IRS not because it is a compli-

cated deduction but because many taxpayers have poor records; this may be remedied with the new standard deduction for 2013. Remember, the standard is “regular and exclusive use”.

## RED FLAG #5

Rental real estate losses have grown into an especially thorny issue in the past several years. The IRS continues to look at these returns more closely. If you are a “real estate professional”, make sure your time records are in good order.

## RED FLAG #6

Nothing is more cherished than the business meals, travel and entertainment deduction, but the record keeping standards are high and IRS often strike gold when challenging M & E on the self-employed tax payer’s return.

## RED FLAG #7

Claiming 100% of vehicle usage is sure to cause the auditor to take a second look. It is

Adjusted Gross Income	Medical Expenses	Taxes	Interest	Charitable Contributions
\$15,000 to \$30,000	\$ 7,074	\$ 3,147	\$ 9,245	\$ 2,024
\$30,000 to \$50,000	\$ 6,153	\$ 3,830	\$ 9,055	\$ 2,189
\$50,000 to \$100,000	\$ 7,102	\$ 6,050	\$10,659	\$ 2,693
\$100,000 to \$200,000	\$ 9,269	\$10,798	\$13,734	\$ 3,757
\$200,000 to \$250,000	\$21,554	\$18,164	\$18,570	\$ 5,895
\$250,000 or more	\$37,143	\$50,267	\$27,865	\$20,930

Source: GEAR UP 2013

important to keep complete records in this area, someday you will be happy you did.

#### **RED FLAG #8**

Filing a Schedule C with large losses consistently makes the IRS think hobby loss. Businesses experience losses but if it looks like those businesses might be fun, get ready for the IRS challenge. Put together a business plan for any business that is part-time or appears to have a significant element of personal pleasure.

#### **RED FLAG #9**

Businesses that are primarily cash income continue to be a favorite target of the IRS. In 2010 IRS published the Cash Intensive Businesses Audit Technique Guide. One of the best ways to equip your cash intensive business to survive an audit is to review this guide and institute the controls IRS will be looking for to determine the correctness of income and expense.

#### **RED FLAG #10**

Foreign bank accounts are of significant interest to the IRS and over the past several years IRS has had a lot of success in getting foreign institutions to disclose account information. You must let us know whether a TD 90-22.1 or Form 8938 needs to be filed.

#### **RED FLAG #11**

TIGTA recently told IRS that they are not using the \$10,000 currency transaction reports effectively. In a recent audit TIGTA told IRS that the transaction reports were an important indicator of unreported income and IRS agreed. Expect more focus on the part of the agency when they receive those reports.

#### **RED FLAG #12**

Look again at the Chart. If you are taking itemized deductions that are comparably large to income, make sure you are taking deductions that you are legitimately eligible for and have records to back up.

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