

Red Flags for Tax Auditors

No one wants to see an Internal Revenue Service (IRS) auditor show up at their door. The IRS can't audit every American's tax return, so it relies on guidelines to select the ones most deserving of its attention.

Here are six flags that may make your tax return prime for an IRS audit.¹

The Chance of an Audit Rises with Income

In recent years, the IRS has audited less than 1% of all individual taxpayer returns. However, the percentage of audits rose to 1.6% for those with incomes between \$1 million and \$15 million and to 3.1% for those with incomes between \$5 million and \$10 million.²

Deviations from the Mean

The IRS has a scoring system it calls the Discriminant Information Function that is based on the deduction, credit, and exemption norms for taxpayers in each of the income brackets. The IRS does not disclose its formula for identifying aberrations that trigger an audit, but it helps if your return is within the range of others of similar income.

When a Business is Really a Hobby

Taxpayers who repeatedly report business losses increase their audit risk. In order for the IRS not to consider your business as a hobby, it needs to have earned a profit in three of the last five years.³

Non-Reporting of Income

The IRS receives income information from employers and financial institutions. Individuals who overlook reported income are easily identified and may provoke greater scrutiny.

Discrepancies Between Exes

When divorced spouses prepare individual tax returns, the IRS compares the separate submissions to identify instances where alimony payments are reported on one return but alimony income goes unreported on the contra party's return.

Claiming Rental Losses

Passive loss rules prevent deductions of losses on rental real estate, except in the event when an individual is actively participating in the property's management (the deduction is limited and

phased out) or with real estate professionals who devote greater than 50 percent of their working hours and over 750 hours per year to this activity. This is a deduction to which the IRS pays keen attention.^{3,4}

1. The information in this material is not intended as tax or legal advice. It may not be used for the purpose of avoiding any federal tax penalties. Please consult legal or tax professionals for specific information regarding your individual situation

2. IRS.gov, 2025

3. Kiplinger.com, January 15, 2025

4. IRS.gov, 2025

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