

## Does Your Income Level Affect Your Odds of Winning the Audit Lottery?

By Brandon N. Mourges

Yes, and perhaps more than you might expect. And as your income increases, if your tax return is selected for audit, it is more likely that you will be subject to increased scrutiny and a larger proposed assessment of tax.

In a recent report from the Treasury Inspector General for Tax Administration (TIGTA) entitled "Improvements Are Needed in Resource Allocation and Management Controls for Audits of High-Income Taxpayers," TIGTA noted that nearly half of the IRS' audit resources are devoted to taxpayers in the \$200,000 to \$399,000 income category. (A full copy of the report can be found here: <https://www.treasury.gov/tigta/auditreports/2015reports/201530078fr.pdf>.) Further, in 2014, while only 0.86% of all individual income tax returns were subject to audit, those with incomes between \$500,000 and \$1,000,000 were selected for audit at a rate of 3.62%.

While those with relatively higher income may pose a greater risk for tax noncompliance, TIGTA advised the IRS to conduct a cost-benefit analysis to make further findings on how to better allocate its resources to the most significant audit risks. TIGTA questioned the separation of responsibility for, and allocation of audit resources for, audits based upon currently prescribed income levels. Still, this does not provide any consolation for those selected under the existing IRS selection framework.

<b>Audit Coverage Percentage by Fiscal Year</b>					
<b>Adjusted Gross Income</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
No Adjusted Gross Income <sup>1</sup>	3.19%	3.42%	2.67%	6.04%	5.26%
\$1 to \$24,999	1.18%	1.22%	1.05%	1.00%	0.93%
\$25,000 to \$49,999	0.73%	0.73%	0.70%	0.62%	0.54%
\$50,000 to \$74,999	0.78%	0.83%	0.64%	0.60%	0.53%
\$75,000 to \$99,999	0.64%	0.82%	0.64%	0.58%	0.52%
\$100,000 to \$199,999	0.71%	1.00%	0.85%	0.77%	0.65%
\$200,000 to \$499,999	1.92%	2.66%	1.96%	2.06%	1.75%
\$500,000 to \$999,999	3.37%	5.38%	3.57%	3.79%	3.62%
\$1,000,000 to \$4,999,999	6.67%	11.80%	8.90%	9.02%	6.21%
\$5,000,000 to \$9,999,999	11.55%	20.75%	17.94%	15.98%	10.53%
\$10,000,000 or More	18.38%	29.93%	27.37%	24.16%	16.22%
All Returns	1.11%	1.11%	1.03%	0.96%	0.86%

*Source: IRS Data Books for Fiscal Years 2010 through 2014.*

Under its current framework, the IRS identifies high-income taxpayers as those with income of at least \$200,000. The Large Business and International (LB&I) Division covers audits for taxpayers with incomes of at least \$5,000,000, while the Small Business/Self-Employed (SBSE) Division covers audits for taxpayers with incomes less than that threshold. The manner of the audits conducted by each Division may vary and there is not always consistency. Bottom line: For high-income taxpayers, it is perhaps more likely than not that they will experience an IRS audit at least once in their lives.

TPI Range	Tax Returns Filed in Calendar Year 2013	Audits Closed in Fiscal Year 2014	Audit Coverage
\$200,000 to \$399,999	4,111,527	62,159	1.5%
\$400,000 to \$599,999	828,622	20,245	2.4%
\$600,000 to \$799,999	334,678	10,523	3.1%
\$800,000 to \$999,999	174,408	6,470	3.7%
\$1,000,000 to \$1,999,999	284,055	14,230	5.0%
\$2,000,000 to \$4,999,999	125,758	9,117	7.2%
\$5,000,000 plus	52,078	6,309	12.1%

Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of Audit Information Management System and tax return data.

And while taxpayers with a higher income are more likely to be selected for audit, they are also more likely to have a lengthier audit with considerably more tax assessed as a result. While the average audit time for a taxpayer with an income between \$200,000 and \$399,999 is approximately 12 hours, those with an income exceeding \$5,000,000 face an average audit time of over 30 hours. And, for those falling in those respective income levels, the average additional assessment recommended is over \$7,000 and \$139,000, respectively.

TPI Range	Count	Total Dollars Recommended	Average Dollars Recommended	Total Audit Hours	Recommended Dollars Per Audit Hour
\$200,000 to \$399,999	62,159	\$439,079,280	\$7,064	726,258	\$605
\$400,000 to \$599,999	20,245	\$192,728,249	\$9,520	244,212	\$789
\$600,000 to \$799,999	10,523	\$142,383,345	\$13,531	134,586	\$1,058
\$800,000 to \$999,999	6,470	\$116,791,097	\$18,051	87,254	\$1,339
\$1,000,000 to \$1,999,999	14,230	\$290,023,366	\$20,381	297,050	\$976
\$2,000,000 to \$4,999,999	9,117	\$314,110,939	\$34,453	181,638	\$1,729
\$5,000,000 plus	6,309	\$879,706,150	\$139,437	193,559	\$4,545

Source: TIGTA analysis of Audit Information Management System and tax return data.

Given that those with higher incomes are perceived to pose a higher risk of non-compliance in the eyes of the IRS, those individuals will continued to be targeted for audit at higher rates. Studies performed by the Department of the Treasury continue to address existing protocols to increase productivity systemically on a dollar-for-dollar basis. Since the effectiveness of audits increases as income increases (based on a cost-benefit analysis), it is likely that the percentage of higher income taxpayers selected for audit will continue to increase in the near future. This premise is bolstered by continuing budget deficits and mandated decreases in spending for the IRS. Perhaps more than ever, it is necessary that high income taxpayers be vigilant in preparing accurate and timely income tax returns and that their representatives advocate effectively when selected for audit.

If your tax return is selected for audit, you should contact a tax professional to discuss your options. For a free consultation, please contact Brandon N. Mourges at (410) 951-1149 or via e-mail at [bmourges@rosenbergmartin.com](mailto:bmourges@rosenbergmartin.com).