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What are your chances for being audited? IRS's 2007 data book provides some clues
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Federal Taxes Weekly Alert, 03/20/2008, Volume 54, No. 12**What are your chances for being audited? IRS's 2007 data book provides some clues****2007 Data Book (Pub 55B, March 2008); IR 2008-43**

IRS has issued its annual data book, which provides statistical data on its fiscal year (FY) 2007 activities. As this article explains, the data book provides valuable information about how many tax returns IRS examines (audits), and what categories of returns IRS is focusing its resources on, as well as data on other enforcement activities, such as collections.

What are the chances of being examined? A total of 1,384,563 individual income tax returns were audited during FY 2007 (Oct. 1, 2006 through Sept. 30, 2007) out of a total of 134.5 million individual returns that were filed in the previous year. This works out to 1.0% of all individual returns filed (slightly higher than the 0.97% audit rate for the preceding year).

Of the total number of returns audited, 503,267 (36.5%) were selected on the basis of an earned income tax credit (EITC) claim (down slightly from the 40.3% rate for FY 2006).

Only 22.49% of the audits were conducted by revenue agents, tax compliance officers, and tax examiners; the bulk of the audits (about 77.5%) were correspondence audits. These percentages are about the same as they were in FY 2006.

About 1.5 million individual returns were farm returns that showed gross receipts from farming (Schedule F). Of this group, only 5,705 (0.4%) were audited in 2007.

The no-change rate (returns accepted as filed after examination) was 12% for individual returns examined by revenue agents, tax compliance officers, or tax examiners, and 16% for correspondence exams.

Here's a roundup of selected audit rates from IRS' latest databook. Because the audit categories aren't organized the same way for individuals as they were for FY 2006, comparisons to the rates for the previous fiscal year aren't possible.

Following are the audit rates for individual nonbusiness returns that didn't claim the earned income tax credit:

... For "selected nonbusiness returns" (includes returns without a Schedule C (nonfarm sole proprietorship), Schedule E (supplemental income and loss), Schedule F (profit or loss from farming), or Form 2106 (employee business expenses), 0.4%.

... For returns with Schedule E or Form 2106 (excludes returns with a Schedule C, nonfarm sole proprietorship, or Schedule F, profit or loss from farming), 1.2%.

... For nonfarm business returns by size of total gross receipts: under \$25,000, 1.3%; \$25,000 under \$100,000, 2%; \$100,000 under \$200,000, 6.2%; and \$200,000 or more, 1.9%.

For returns with total positive income (TPI) of at least \$200,000 and under \$1 million, the audit rate was 2% for nonbusiness returns and 2.9% for business returns. For returns with TPI of \$1 million or more, the audit rate was 9.3%.

The audit rates for entities were as follows:

- ... Fiduciary (estate and trust income tax returns), 0.1% (the same as for FY 2006);
- ... Corporations with less than \$10 million of assets, 0.9% (up from 0.8% for FY 2006);
- ... Corporations with \$10 million or more of assets, 16.8% (down from 18.6% for FY 2006);
- ... S corporations, 0.5% (up from 0.38% for FY 2006);
- ... Partnerships, 0.4% (up from 0.36% for FY 2006);
- ... Estate tax returns, 7.7% (down from 9.66% for FY 2006); and
- ... Gift tax returns, 0.6% (down from 0.77% for FY 2006).

IRS activity on other fronts. Here's a roundup of over valuable information carried in the new IRS Data Book.

Penalties. In fiscal year 2007, IRS assessed 27.33 million civil penalties against individual taxpayers, up from 25.9 million civil penalties assessed in the previous year. Of the FY 2007 assessments, 15.17 million (55%) were for failure to pay, followed by 7.72 million (28.2%) for underpayment of estimated tax. There were 327,822 assessments (1.1%) for "accuracy penalties"—assessments of penalties under Code Sec. 6662 for negligence, substantial understatement of income tax, substantial valuation misstatement, substantial overstatement of pension liabilities, and substantial estate or gift tax valuation understatement, and understatement of reportable transactions under Code Sec. 6662A .

On the corporation side, there were a total of 762,718 civil penalty assessments (up from 701,785 for FY 2006), 82.9% for either failure to pay or underpayment of estimated tax.

Offers in compromise. In FY 2007, 46,000 offers in compromise were received by IRS, and 12,000 (26%) were accepted. Over recent years, these numbers have been dropping; in 2006 for example, 59,000 offers in compromise were received by IRS, and 15,000 (25.4%) were accepted.

Criminal cases. IRS initiated 4,211 criminal investigations in FY 2007. There were 2,837 referrals for prosecution and 2,155 convictions. Of those sentenced, 81.2% were incarcerated (a term that includes imprisonment, home confinement, electronic monitoring, or a combination thereof). By way of comparison, in FY 2006, IRS initiated 3,907 criminal investigations, there were 2,720 referrals for prosecution, and of those sentenced, 81.7% were incarcerated.

Information returns. IRS received a total of 1.825 billion information returns in FY 2007, including Forms 1098 (mortgage interest, student loan interest, and tuition), 1099 (interest, dividends, etc.), 5498 (individual retirement arrangement and medical savings account), W-2 (wages), W-2 (gambling winnings), and Schedules K-1 (pass-through entities). Of the total, only 3.1% were submitted on paper.

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