Tax Audit Triggers, Bracket Management, Phase-Outs and More

A Quick Guide to Some Interesting Numbers

Is it tax season *already*? In truth, it's always tax season. As we near the 4th quarter of the year, however, we are able to take a much closer look at the current and subsequent year tax picture for each of our clients.

At three-fourths of the way into the year, we have better estimates on final income, realized and unrealized capital gains/losses as well as next year's projected income. We've also completed the majority of charitable contributions through appreciated securities, Roth conversions and Required Minimum Distributions. In a nutshell, we just have more accurate data at this point in the year. Working in conjunction with your Tax Preparer, it is an opportune time to look closely at maximizing strategies to minimize tax liability. Some of the opportunities will expire on 12/31, so, alas, tax season is indeed coming upon us.

In that spirit, we'd thought we'd share a few key numbers and considerations.

Ever wonder about **audit triggers**? Here's the latest statistics from The Kiplinger Tax Letter:

- 2015's individual audit rate was 0.84%... one in 119 returns. The bulk of these audits were correspondence exams done by mail, usually focusing on one or two issues.
- *Some individuals get more IRS attention*:
  - Filers claiming the earned income tax credit…1.75% were audited last year.
  - Sole proprietors. The Service examined between 2% and 2.5% of taxpayers who ran a business and attached Schedule C reporting over $25,000 of gross receipts.
  - Upper-income earners. Folks with incomes of $200,000 or higher had an audit rate of 2.61%...one in every 38 returns…compared with 0.76% for those with lower incomes.
- *Millionaires get the most scrutiny*. 9.55% of tax returns reporting incomes of at least $1 million were audited in 2015, compared with 7.5% in the prior year. And the audit odds increase exponentially for people lucky enough to be super-rich. IRS examined a whopping 34.69% of individuals with incomes of $10 million or more. A specialized group within the agency tackles the audits of high-wealth individuals. Revenue agents take a comprehensive approach in auditing these ultra-rich folks by reviewing not only their 1040 forms, but also returns of entities they control.
- Some return **red flags** could increase the risk of an IRS audit.
  - Taking an early payout from an IRA or retirement plan
  - Taking large charitable write-offs.
  - Deducting gambling losses or not reporting gambling winnings
  - Cash transactions of $10,000 or more
  - Deducting business meals and entertainment.
  - Claiming 100% business use of a vehicle.
  - Writing off a large loss on Schedule C from an activity that looks like a hobby.
  - Taking higher-than-average deductions.
  - Claiming day trading losses on Schedule C.
  - Deducting rental losses or alimony.
  - Failing to report all income – the IRS receives copies of all 1099s and W-2s you receive.
  - Failing to report an overseas bank or investment account is also a major audit trigger. IRS and the Justice Dept. are working aggressively to curb offshore tax evasion and to get U.S. owners of foreign accounts to comply with the strict reporting rules.

And, a sneak peek at some tax rates, phase outs, limitations thresholds and brackets:

- Ordinary Income tax - seven different Ordinary Income tax brackets – 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%
- Capital Gains tax - four different Capital Gains tax brackets – 0%, 15%, 20%, 28% (bullion, gems, art, stamps, coins, antiques)
- Alternative Minimum Tax (AMT) – 26%/28%
- Net Investment Income Tax (NIIT) - 3.8% on interest, dividends, gains, passive rental income, annuities and royalties (NOT S Corp distributions)
- 0.9% Medicare Payroll Tax if wages >$200k for single and $250k for marrieds.
- Medicare Part B Premium – if 65 or over, your Medicare premium is impacted by your Modified Adjusted Gross Income on your return two years prior to the calendar year of premium payment.
- Personal Exemption Phase-out (PEP) and Pease limitations on Itemized Deductions
- Additional brackets for high income taxpayers (the "supertax") - 43.4% tax rate on Ordinary Income and a 23.8% tax rate on long-term Capital Gains PLUS state income taxes.
- And, don't forget state sales/income taxes, gift taxes, estate taxes, and yes, even, death taxes.