Avoid That Audit

By Rachel Goldstein

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You probably aren't too concerned about being selected for an audit. Well, if you're a freelancer, avoiding an audit should always be on your mind as you file your taxes. Why? Because, no matter how straight you play it, freelancers get audited much more than salaried employees do. No - the United States IRS doesn't have it in for independents, but the numerous deductions that we file set us apart from other taxpayers.

So what can you do to keep the IRS from noticing your return? Below find hints and suggestions to keep the IRS away! These tips are particularly relevant to those in the US, though other tax systems may be similar -- check with your accountant for details. And please note that the information provided here should by no means be used as a guide to filing your taxes! These are merely suggested tips and hints. Be sure to seek professional advice in taxation, as in all business matters.

Six Steps to an Audit-Free Tax Return

1. Be Careful With Deductions

The IRS's favorite target is the home office deduction. In order to qualify for a home office deduction, your office needs to be your "principal place of business" and used "regularly and exclusively" for business. In plain language, this means that your home office needs to be the place where you spend most of your time and make the majority of your income.

You'll also need to keep your personal life out of your home office. For example: a trick that I heard the IRS sometimes uses is to ask the taxpayer being audited "Do you use your computer for 50% personal and 50% business or 5% personal and 95% business?" If you answer 95% business, you have flunked the test -- the answer needs to be 100% business. This example demonstrates the strict enforcement of the guidelines for the home office deduction. We'll talk about this more in Home Office Deductions for Freelancers.

You also need to keep other deductions that you want to take to a reasonable level. Keep a receipt for all deductible expenses, especially food, entertainment, travel, and automobile costs. These are often the deductibles that are most scrutinized by the IRS. You should also keep expenses in a log, along the following information:

The name and location of the expense

Amount paid

Date and time

Company the expense was incurred for

If an entertainment or food expense: the person you entertained or dined

If an entertainment or food expense: the discussion you had

2. Where You Live Vs. Your Income

If you live in a very high-income area, but you only claimed that you earned $15,000 that year, this is a red flag for an audit. The IRS will want to know how you spread $15,000 out to pay all your bills. Unless you live with your mother who pays the mortgage or rent, there's no way that you could survive in Aspen on this income... and the IRS knows it!

Also, if your income is much lower than last year's taxable income, this IRS will wonder where you're hiding the money, and will want to investigate.

3. Avoid Inconsistencies

If there are inconsistencies, the IRS will catch them. Be sure to file the same information on your federal taxes that you filed on your state returns.

4. Don't Make Mathematical Mistakes

If the IRS's computer system catches mathematical mistakes on your forms, a person will take a look at your returns personally. This is more attention than anyone wants spent on their tax forms, so make sure your math is correct before you file.

5. File a Neat Return

I recommend typing up or "efiling" your returns. If your returns are hard to read, you might have to translate your returns over the phone or in person.

6. Report All Your Income

It sounds like common sense, but some people are tempted to be dishonest. Your clients must issue you and the IRS a 1099 when you are paid over $600. This means that the government knows what you were paid on each job. Report the right amount on your taxes to avoid an audit.

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