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GRAY ♦ PILGRIM

A N D A S S O C I A T E S , L L C

SPRING / SUMMER 2014

Audit Risks

INSIDE THIS ISSUE:

**Foreign Bank
Accounts** 2

Tax Scams 2

**Home Office
Deduction** 3

**Golf Tourna-
ment** 4

Wi-Fi 4

The first question a client asks when they've received the letter from the Internal Revenue Service (IRS) to be audited is "Why me?" They want to know whether they were selected randomly or if there was a reason they were selected. The IRS does have a system where they "rate" returns for their potential issues for audit. This is called the DIF score. What exact items make up the DIF score and how each item is rated is a closely guarded secret within the agency. Common sense also tells us that they are certainly going to choose returns which have a higher potential to generate the most return on their investment of auditor time and effort.

As your income increases, so do your chances for an audit. They may take a second look to see if you meet the typical norms for those in your income grouping. The IRS has developed standards from all the audits they have done and they have taken this data and apply it to each return they review. Think of it as a profile of sorts. For example, they know that if you make X dollars of income, your standard of living should fit into a certain profile. They look at the profit/income that you show and see whether it can support the deductions that you show on the return. It is pretty sophisticated – we've seen how they use it first hand with a few of our clients' audits.

Another area that could trigger audits are returns with higher income especially from sources other than W-2s, or income from largely cash businesses, high auto business usage, losses from a business that could point to it being a hobby rather than a for-profit business, large meals and entertainment deductions, and rentals with losses possibly being offset incorrectly against other types of income. Many sources of income are reported to the IRS directly, so they will match those items against the return filed to determine if there may be unreported or underreported income. This is one reason those 1099 forms are very important.

Having a boring return may keep your audit risk lower, but, you don't want to walk away from taking valid tax deductions and taking advantage of good tax planning. Remember that documentation is crucial to an audit with a successful outcome. Know what your exposure is and make educated choices about deductions.





Foreign Bank Accounts:

This continues to be a hot issue with the IRS. They are trying to get voluntary compliance with taxpayers by reducing penalties if taxpayers disclose foreign accounts that they have. For a time, foreign banks would not disclose information about account holders to the IRS, but this is no longer true. Those who have sought amnesty have

given the IRS more insights into which banks to target to find more U.S. taxpayers who may not have come forward yet.

Failure to report a foreign bank account can lead to substantial penalties – many times 100% of what is in the account, so you lose everything. So if you have any for-

foreign accounts that total more than \$10,000 at any time during the year, you have to file FinCEN Form 114 by June 30th. If you have more financial assets you may also have to attach IRS Form 8938 to your timely filed tax returns.

Tax Scams

Scammers have been very busy sending out false e-mails alluding to be the IRS. They look so real! Well, the IRS does not utilize e-mails at all, ever. They may in the future, but at this time, they never use e-mail, so if you see one from the IRS – assume that it is fake and a scam. Don't respond and don't click on any of the links.

The IRS does telephone you; however, they do not talk to you meanly or threaten you. If you owe taxes, they will work out a payment schedule or give you other options. They may set up a time for an audit, but they will not demand that you pay your bill right then over the phone or ask for your credit card information. If this happens, hang up because it is a scam. Always be wary.

Trust your judgment.



Home Office Deduction

This was a heavily used deduction years ago. You calculated the square footage of the space dedicated as a home office as a percentage of the total square footage of the entire house. You received depreciation for this space, a percentage of your mortgage interest, real estate taxes, insurance, utilities and 100% of anything purchased for the office exclusively.

As you can imagine, some people were a little loose with how much space was used for the office and whether it was used exclusively for business and then when the house was sold, it had to be calculated two separate ways – business and personal use. It made it burdensome when the home was later sold and it became an audit red flag if someone used the deduction because it was so readily abused or misreported.

Now the IRS has come up with a Simplified Method and it is really more user friendly. The IRS, under this method, allows up to \$1,500 for a deduction which is made up of \$5 per square foot up to 300 square feet. If your space is smaller, you simply adjust the square footage used for the office. If your space is larger, you are limited to the maximum of 300 square feet and may want to consider using the prior method which has no such limitations. This deduction addresses the space only so in addition you can deduct 100% of items purchased for the home office. Your deduction for real estate taxes and mortgage interest stays as itemized deductions in total if you can

itemize. You don't have to gather utility or insurance bills. No depreciation to worry about when you sell. This makes it so much easier.

The nice thing is that the IRS allows you to choose which method you want to use and you can switch methods every year if you want! You just have to keep track of the depreciation if you use the prior method.

The home office must be needed, not just a tax ploy. There has to be necessary reason for it to exist and it has to be used regularly for business. What we find is that our business owners need a home office to keep confidential information out of staff view; review QuickBooks; review day sheets/deposit details; calculate/review payroll; review financial statements. Also, many owners are connected to the office server and they check for patient emergency calls and scheduling issues. These are all valid reasons to have a home office even though you may have another office at the practice location.

Now, this doesn't seem all that earth shaking, does it? What this really does is open up the potential for a greater deduction for mileage. You now have a home office so your first business stop of the day is your home office – which eliminates commuting mileage. If you live further from your office, then this could be a big benefit for you.

Having the commuting issue removed can make a huge difference in your car deduction whether you use the standard

mileage method or actual method where you use gas, repairs and maintenance, insurance, and depreciation expenses. What qualifies as business deductions other than from the home office to the practice? Trips to your monthly dental study club meetings and trips for continuing education taken locally as well as mileage to the airport for continuing education out of the area. If you go to a store and buy office items, even if you also purchase personal items, this qualifies totally as a business trip. Additional items are trips to the post office, accountant's or attorney's office, supply showrooms to look at new equipment. We find that those who keep the mileage logs actually have higher mileage because they catch trips that they didn't normally think about. The IRS requires mileage logs for both methods. They will accept a log for a partial year of three to four months if you say it represents typical travel in a year. They ask for logs in every audit we've had. They will check odometer readings on oil change receipts which they also always ask for to see if the log is legitimate. We have log books available (blank ones, of course!) – just request one and we will send it out to you! The simplified home office deduction can turn into a bigger deduction for mileage, so take advantage of it if it fits your circumstances.



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2nd Annual Golf Tournament

Join us for a day of golf on Friday, July 11, 2014 at Greencastle Greens

8:45 Check-In

(Continental Breakfast will be provided)

9:30 Shotgun Start with a scramble format

1:30 Lunch provided

ENTRY DEADLINE JUNE 28th

If you need a Registration Form please contact Kati

717-263-8713 OR kati@gpallc.net



Are you secure on Public Wi-Fi?

It is so convenient and easy to use Wi-Fi at a coffee house, restaurant or airport and more and more places are making it available to their customers. But is it safe for you to use? Whenever you connect your information can be accessed easily from the “air.” There are devices that anyone can buy that can quickly breach security on your phone or laptop and steal your data. This can be your business contacts, e-mail addresses and phone numbers as well as documents you have stored.

The best way to protect yourself is to never use public Wi-Fi. While this is not conducive to your ability to work offsite, it the only true way to

remain secure. Other ways to get around this is use a virtual private network (VPN) which gives you the encryption you need while still using the public Wi-Fi. This can be costly too with monthly payments or more expensive computer investment at your business. You can also use your phone as a hotspot which can be more costly potentially and slower as well.

Just be aware of the risk and minimize it as much as possible.

