Hess & Hess, LLP

Quarterly Tax Newsletter

Samuel H. Hess, CPA
HESS & HESS, LLP
PO Box 1610 • Blowing Rock • NC • 28605-1610
Office: 828-295-3131 • Fax: 828-295-4995
sam@hessandhesscpa.com • hessandhesscpa.com

Robert M. Hess, CPA
HESS & HESS, LLP
PO Box 1610, Blowing Rock, NC 28605-1610
Office: 828-295-3131, Fax: 828-295-4995
bob@hessandhesscpa.com, hessandhesscpa.com

IRS Audit Rates Over Time

IRS audit rates for individual income tax returns have fallen since 2010, but this pattern could reverse as the agency ramps up enforcement. The Inflation Reduction Act of 2022 provided the IRS with an influx of about $80 billion to modernize outdated technology and rebuild a depleted workforce.

Total positive income ranges*	Tax year 2010	Tax year 2019
No total positive income	20.6%	1.1%
$1 – $25,000	1.0%	0.4%
$25,000 – $50,000	0.6%	0.2%
$50,000 – $100,000	0.7%	0.2%
$100,000 – $200,000	0.8%	0.2%
$200,000 – $500,000	2.3%	0.2%
$500,000 – $1 million	3.6%	0.6%
$1 million – $5 million	8.2%	1.3%
$5 million – $10 million	13.5%	2.0%
$10 million or more	21.5%	8.7%

*Total positive income excludes losses

Source: Internal Revenue Service, 2022

Due Date Approaches for 2022 Federal Income Tax Returns

Tax filing season is here again. If you haven't done so already, you'll want to start pulling things together — that includes getting your hands on a copy of your 2021 tax return and gathering W-2s, 1099s, and deduction records. You'll need these records whether you're preparing your own return or paying someone else to prepare your tax return for you.

Don't procrastinate. The filing deadline for individuals is generally Tuesday, April 18, 2023.

Filing for an Extension

If you don't think you're going to be able to file your federal income tax return by the due date, you can file for and obtain an extension using IRS Form 4868, *Application for Automatic Extension of Time to File U.S. Individual Income Tax Return.* Filing this extension gives you an additional six months (to October 16, 2023) to file your federal income tax return. You can also file for an extension electronically — instructions on how to do so can be found in the Form 4868 instructions.

Due Dates for 2022 Tax Returns

April 18, 2023

To Do:
Most taxpayers must file tax return and pay tax or file for 6-month extension and pay estimated tax

June 15, 2023*

To Do:
Taxpayers living (or serving in the military) outside the U.S. on April 18, 2023, must file tax return and pay tax or file for 6-month extension and pay estimated tax

*Interest is due on taxes paid after the April filing date

October 16, 2023

To Do:
Taxpayers who filed for an extension must file tax return and pay any additional tax

Filing for an automatic extension does not provide any additional time to pay your tax. When you file for an extension, you have to estimate the amount of tax you will owe and pay this amount by the April filing due date. If you don't pay the amount you've estimated, you may owe interest and penalties. In fact, if the IRS believes that your estimate was not reasonable, it may void your extension.

Note: *Special rules apply if you're living outside the country or serving in the military and on duty outside the United States. In these circumstances, you are generally allowed an automatic two-month extension (to June 15, 2023) without filing Form 4868, though interest will be owed on any taxes due that are paid after the April filing due date. If you served in a combat zone or qualified hazardous duty area, you may be eligible for a longer extension of time to file.*

What If You Owe?

One of the biggest mistakes you can make is not filing your return because you owe money. If your return shows a balance due, file and pay the amount due in full by the due date if possible.

If there's no way that you can pay what you owe, file the return and pay as much as you can afford. You'll owe interest and possibly penalties on the unpaid tax, but you'll limit the penalties assessed by filing your return on time, and you may be able to work with the IRS to pay the remaining balance (options can include paying the unpaid balance in installments).

Expecting a Refund?

The IRS has stepped up efforts to combat identity theft and tax refund fraud. More aggressive filters that are intended to curtail fraudulent refunds may inadvertently delay some legitimate refund requests. In fact, the IRS is required to hold refunds on all tax returns claiming the earned income tax credit or the additional child tax credit until at least February 15.

Most filers, though, can expect a refund check to be issued within 21 days of the IRS receiving a tax return. However, note that in recent years the IRS has experienced delays in processing paper tax returns.

So if you are expecting a refund on your 2022 tax return, consider filing as soon as possible and filing electronically.

Key Retirement and Tax Numbers for 2023

Every year, the Internal Revenue Service announces cost-of-living adjustments that affect contribution limits for retirement plans and various tax deduction, exclusion, exemption, and threshold amounts. Here are a few of the key adjustments for 2023.

Estate, Gift, and Generation-Skipping Transfer Tax

- The annual gift tax exclusion (and annual generation-skipping transfer tax exclusion) for 2023 is $17,000, up from $16,000 in 2022.
- The gift and estate tax basic exclusion amount (and generation-skipping transfer tax exemption) for 2023 is $12,920,000, up from $12,060,000 in 2022.

Standard Deduction

A taxpayer can generally choose to itemize certain deductions or claim a standard deduction on the federal income tax return. In 2023, the standard deduction is:

- $13,850 (up from $12,950 in 2022) for single filers or married individuals filing separate returns
- $27,700 (up from $25,900 in 2022) for married joint filers
- $20,800 (up from $19,400 in 2022) for heads of household

The additional standard deduction amount for the blind and those age 65 or older in 2023 is:

- $1,850 (up from $1,750 in 2022) for single filers and heads of household
- $1,500 (up from $1,400 in 2022) for all other filing statuses

Special rules apply for those who can be claimed as a dependent by another taxpayer.

IRAs

The combined annual limit on contributions to traditional and Roth IRAs is $6,500 in 2023 (up from $6,000 in 2022), with individuals age 50 or older able to contribute an additional $1,000. The limit on contributions to a Roth IRA phases out for certain modified adjusted gross income (MAGI) ranges *(see chart).* For individuals who are active participants in an employer-sponsored retirement plan, the deduction for contributions to a traditional IRA also phases out for certain MAGI ranges *(see chart).* The limit on nondeductible contributions to a traditional IRA is not subject to phaseout based on MAGI.

MAGI Ranges: Contributions to a Roth IRA

	2022	2023
Single/Head of household	$129,000–$144,000	$138,000–$153,000
Married filing jointly	$204,000–$214,000	$218,000–$228,000
Married filing separately	$0–$10,000	$0–$10,000

MAGI Ranges: Deductible Contributions to a Traditional IRA

	2022	2023
Single/Head of household	$68,000–$78,000	$73,000–$83,000
Married filing jointly	$109,000–$129,000	$116,000–$136,000

Note: The 2023 phaseout range is $218,000-$228,000 (up from $204,000-$214,000 in 2022) when the individual making the IRA contribution is not covered by a workplace retirement plan but is filing jointly with a spouse who is covered. The phaseout range is $0-$10,000 when the individual is married filing separately and either spouse is covered by a workplace plan.

Employer-Sponsored Retirement Plans

- Employees who participate in 401(k), 403(b), and most 457 plans can defer up to $22,500 in compensation in 2023 (up from $20,500 in 2022); employees age 50 or older can defer up to an additional $7,500 in 2023 (up from $6,500 in 2022).
- Employees participating in a SIMPLE retirement plan can defer up to $15,500 in 2023 (up from $14,000 in 2022), and employees age 50 or older can defer up to an additional $3,500 in 2023 (up from $3,000 in 2022).

Kiddie Tax: Child's Unearned Income

Under the kiddie tax, a child's unearned income above $2,500 in 2023 (up from $2,300 in 2022) is taxed using the parents' tax rates.

Business Owners Should Prepare for Stronger Tax Enforcement

The Inflation Reduction Act of 2022 is providing the IRS with an influx of about $80 billion to modernize outdated technology and rebuild a depleted workforce, which is expected to improve enforcement to the tune of about $200 billion over a decade. Treasury Secretary Janet Yellen directed the agency not to use additional resources to increase audit rates for taxpayers making under $400,000 a year, but the tax returns of high-earning business owners are likely to face more scrutiny than they have in years past.[1]

IRS audit rates for individual, partnership, and S corporation income tax returns have fallen since 2010, a trend that could reverse as the IRS ramps up enforcement. Higher audit rates won't appear overnight, but large investments to upgrade technology could eventually help the IRS develop more advanced enforcement methods.

With that in mind, here are some tips to help you avoid unwanted attention from the IRS.

Understand the process. Tax returns are randomly selected, which means you might be audited even if you do everything by the book. However, when your tax return is processed, a computer program screens for anomalies and compares deductions to those of taxpayers with similar incomes. Your return is more likely to be chosen if there's a higher chance that it would result in the collection of additional taxes, but an audit can also be triggered by a red flag on your return or a simple mistake that leads to additional questions. If selected for a correspondence audit, you may be asked to mail specific information to the IRS. A comprehensive field audit would be conducted at your home, place of business, or accountant's office.

Avoid common traps. Filing an incomplete tax return (with missing forms or schedules) and not making tax payments on time are surefire ways to attract unwanted attention from the IRS. Taking business deductions that are not in line with industry norms, not categorizing transactions consistently from year to year, having a high number of independent contractors relative to full-time employees, and reporting continuous losses are all situations that can look suspicious, even if they are valid.

Step up your record-keeping. Taxpayers are required to keep tax records for at least three years from the date the tax return was filed. Organizing and possibly digitizing your records could make it easier to respond to any requests for information that may come from the IRS — and not being able to provide a requested document could negatively impact your audit results.

A heightened focus on compliance means it may be more important than ever to consult an experienced tax professional for personalized guidance, especially if you receive any type of communication from the IRS.

1) U.S. Treasury Department, 2022