

## August 22, 2022 – Wealth Planning Commentary

### The IRS increased audits on high income taxpayers, likely to accelerate

The IRS is ramping up audits on high income taxpayer. Set aside the \$80 billion of new funding from the Inflation Reduction Act (IRA), the IRS has already increased audits on high income households. According to data published by the Treasury Inspector General for Tax Administration, the percentage of 2019 tax returns audited in the 7-month period between Sept 30<sup>th</sup>, 2021, and May 1, 2022, doubled for taxpayers with income between \$500k-\$10mm and quadrupled for those with greater than \$10mm.

This is a sharp change in direction for the IRS. Audits of individual taxpayer returns decreased for all income levels from 2010 to 2019. On average, a taxpayer was three times less likely to be audited in 2019 than they were in 2010. During this time audit rates decreased the most for high income taxpayers. Even though the rate has increased the likelihood of audit is still relatively low. As of May, taxpayers making \$200k - \$1mm had less than a 1% probability of an audit and that number was 2% for income between \$1-10mm. Taxpayers with \$10mm or more of income had the highest chance, around 9%. These probabilities may increase as the IRS seeks to turn the funds from the IRA into measurable increases in audits on high-income taxpayers.

The press talks a lot about income tax... but what about estate tax returns? The chance of an audit is much higher and increases proportionally with the size of the estate. An estate tax return is 10 to 20 times more likely to be audited than an income tax return.

One red flag for the IRS is the property valuation within the estate. When a large portion of an estate is real estate or a private business, the IRS takes notice. Art, antiques, and collectibles can also draw the IRS's attention. Another target is the valuation of gifts made during the deceased's lifetime. Valuation is especially important to properly document with gifts of private company stock, property, and discounted valuation of LLC interests. Other techniques that are more likely to be challenged include gifts that are technically not gifts; sales of assets directly to children or an Intentional Defective Grantor Trust (IDGT) that are funded with intra-family loans.

Our recommendation is to ensure the valuation of gifted and inherited property or LLC discounted valuations are properly documented and to use a qualified appraiser where applicable.

### IRS raises individual overpayments and underpayments rate

The IRS announced last week that interest rates on overpayments and underpayments will increase starting in Q4 this year. The rate will increase from 5% to 6% a year, compounded daily.

### Bill to suspend 2022 RMDs

In July, Republican Congressman Warren Davidson introduced a bill to the House that would allow taxpayers to suspend RMDs for calendar year 2022. RMDs that had already been taken would be eligible for a rollover. The bill has been referred to the House Committee on Ways and Means.

We believe this bill is unlikely to pass since it benefits high income taxpayers the most. Congressional democrats have not voiced interest and currently have the most votes. We will update you with any developments.

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