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Life. Investing. And Everything in Between



BEST PRACTICES TO MINIMIZE AN AUDIT

By Kelly L. Olczak, CFP®

Taxpayers invest about 13 hours preparing their tax returns, according to [the IRS's instructions for Form 1040](#).

More specifically, the IRS says that the average nonbusiness taxpayer spends nine hours preparing a tax return, which includes three hours of record keeping. For taxpayers who file a business return, expect around 24 hours, with about half of that spent keeping records.

No wonder it's easy to make a mistake. Time-consuming or not, the IRS isn't always in a forgiving mood when errors pop up.

Even if you hand your records to your accountant or CPA, forgetting important documents can delay your refund, force an amended return, or worse, trigger an audit.

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7 Ways to Minimize Audit Risks

1. You've probably heard it before, but let's start with the basics. One of the biggest mistakes folks make is **filing a return before they have all their 1099s and W-2s**.

By now, you've probably received any corrected 1099 forms. But in the future, be careful about filing by early February (gosh, I know that feels good, but...) and getting a notice in late February that your brokerage firm has adjusted your original 1099.

2. One reason taxpayers get into trouble is the **failure to report income** from:

- regular wages (W-2),
- Social Security (SSA-1099),
- pensions, IRA distributions, and annuities (1099-R),
- partnership income (K-1),
- income from an independent contractor gig (1099-NEC),
- rent or royalties (1099-MISC),
- real estate sale proceeds (1099-S), and
- income from interest (1099-INT), dividends (1099-DIV), or capital gains (1099-B).

The income above is derived from various sources, but they share a common thread: They all trigger a form. If income triggers a form, the IRS will receive a duplicate copy.

Good record-keeping and reliable tax software that reminds you of the previous year's activities can help eliminate errors.

If possible, stay consistent with the same tax software, which will remind you of the forms you used the previous year.



Good record-keeping

Did you receive the form in the mail? Put it in your “tax drawer.” Did you receive an email alerting you that your 1099 is available? Save the email in your tax year 2023 email folder. Don’t have a tax year 2023 folder or tax drawer, then create one.

We can’t overemphasize the importance of good record-keeping.

3. Watch out for business losses. Most businesses lose money in the early stages. But if your business is losing money year after year, it could raise suspicions that it is simply a hobby. You may love golf. You may even teach beginners how to play. But if your golfing business can’t turn a profit, the IRS may decide it’s a hobby.

Or it may raise suspicions that you are misreporting income or expenses. This can be especially true for cash-based businesses.

That doesn’t mean you shouldn’t report losses. Keep detailed records for at least seven years demonstrating legitimate expenses.

4. Let’s turn to deductions. Is a charitable deduction outside of what is considered “normal,” i.e., much higher than the average charitable deduction based on your income?

Be sure you keep careful records. Overall deductions for donations to [public charities](#), including donor-advised funds, are generally limited to 50% of adjusted gross income (AGI). The limit increases to 60% of AGI for cash gifts, while the limit on donating appreciated non-cash assets held more than one year is 30% of AGI.



The **home office deduction** is becoming increasingly popular, but you must be self-employed and conduct most of your business from home. If your company allows you to work from home and you are a W-2 employee, don't even consider taking the home office deduction.

Starting in tax year 2013, the IRS began allowing taxpayers to take what they call the **simplified option**. It is a standard deduction of \$5 per square foot, a maximum of 300 square feet.

It's much simpler than the standard method, and there is no recapture of depreciation upon the home's sale, but your deduction will probably be lower.

5. As a business owner, **your income may fluctuate**. But wild swings in income can put an unwanted spotlight on your tax return because it may raise suspicions that you may not be reporting all of your income.

Consider a note when filing if expenses or income changes dramatically. Most software programs will let you include documentation that sheds light on your unique circumstances.



Other deductions: How much is too much?

How much is too much? No one really knows, but if it is too far outside the norm, IRS computers may flag your tax return. Again, keep detailed records that substantiate your deductions.

6. Does the IRS suspect that you have **\$10,000 or more in foreign accounts** and have not filed a FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR), or if they believe you reported incorrectly or have misreported values on the FBAR, you may be subject to an audit, according to Bloomberg Tax.



7. Avoid abusive tax shelters. More recently, questionable transactions identified by the IRS include abusive syndicated conservation easements, abusive micro-captive insurance company arrangements, and Malta retirement plans (Bloomberg Tax).

In addition, scams involving the earned income tax credit, sick leave, family leave, and false fuel tax credit claims can trigger an audit.

Key tax filing dates

April 1, 2024 - RMD due if you turned 73 in 2023.

April 15, 2024 - Tax Day (unless extended due to local state holiday).

April 15, 2024 - Deadline to File Form 4868 and request an extension.

April 15, 2024 - Deadline to make IRA and HSA contributions for tax year 2023.

October 15, 2024 - Deadline to file your extended 2023 tax return.

Source: Intuit



Bottom line

It's impossible to bulletproof a tax return completely, and high-income taxpayers will come under more scrutiny simply because of their income. But you can reduce the risk, and if audited, you will be in a better position to quickly answer questions and put the exam in the rearview mirror.

If the IRS contacts you, you probably won't receive an invitation for an at-home audit. Instead, you will receive a letter detailing the money the IRS believes you owe, along with penalties and interest. The IRS will give you a specified amount of time to prove that your original filing is correct. Provide the documentation requested. If everything looks good, you'll be clear.

Please let us know if you have any tax-related questions. As always, feel free to reach out to your tax advisor.



BRIEF MARKET UPDATE

Election-Year Shenanigans

Investors disregarded disappointing inflation numbers last month and talk of fewer rate reductions this year. Instead, they remained fixated on robust business earnings and rising enthusiasm for AI, or artificial intelligence.

As the table illustrates, U.S. stocks are off to a good start this year.

Key Index Returns		
Index	MTD %	YTD %
Dow Jones Industrial Average	2.2	3.5
Nasdaq Composite	6.1	7.2
S&P 500 Index	5.2	6.8
Russell 2000 Index	5.5	1.4
MSCI World ex-U.S.A**	1.6	1.9
MSCI Emerging Markets**	4.6	-0.3
Bloomberg U.S. Agg Total Return	-1.4	-1.7

Source: Wall Street Journal, MSCI.com, Bloomberg, MarketWatch

MTD returns: January 31, 2024 – February 29, 2024

YTD returns: January 31, 2024 – February 29, 2024

During a presidential election year, investors often wonder about the impact on the market. Well, stocks usually appreciate during presidential election years, but an annual gain is not unusual. Historically speaking, broad-based market indexes have a long-term upward bias.

So, let's review the data for any discernable trends.



Since 1928, the S&P 500 Index has averaged an annual increase of 11% (dividends reinvested). The index finished the calendar year higher 73% of the time, according to data provided by the NYU School of Business.

Table 2: Presidential election year performance

	S&P 500 Index annual average since 1928	Presidential election year since 1928	The incumbent* runs for re-election since 1928
Average rise in the S&P 500 Index	11%	11%	15%
The S&P 500 Index rose:	73% of the time	83% of the time	93% of the time

Data Source: NYU Stern School of Business Historical Returns on Stocks, Bonds and T-Bills

The S&P 500 is an unmanaged index that cannot be invested into directly.

**1940 and 1944, when FDR sought a third and fourth term, are not included.*

The modern S&P 500 Index was first launched in 1957. Performance back to 1928 incorporates the performance of the predecessor index, the S&P 90. Data includes dividends reinvested.

Past performance is no guarantee of future results.

During a presidential election year, the S&P 500 index also advanced an average of 11%. That is to say that a presidential election appeared to have no influence on stocks. Election or no election, the S&P 500 averaged 11%; end of story, right?

Let's take it one step further and review returns when the incumbent was running for re-election.

When the incumbent sought a second term, the S&P 500 averaged an advance of 15% and finished the year in positive territory 93% of the time.

The return not only exceeded the longer-term average, but the 93% "win rate" topped the presidential "win rate" of 83% and the longer-term "win rate" of 73%.



Of course, there's no guarantee stocks will follow the historical pattern. Exercises such as these make for fascinating conversation but not much more, in our view.

Today's climate

Today's political environment is filled with acrimony and bitterness, but we caution against making investment decisions tied to political headlines. It's common to hear pundits proclaim that this election is "the most important in our lifetime." But that has more to do with hype and voter turnout.

Unquestionably, the winner will help set the course for the nation. However, investors view market performance through a very narrow lens.

Year after year, the economic fundamentals have fueled gains or losses in equities. Interest rates, economic activity, corporate profits, and inflation are the variables that have historically influenced market sentiment, not elections or the party that wins.

Investment Wisdom from the Oracle...

As legendary investor and the chairman of Berkshire Hathaway, Warren Buffett pointed out in his [annual letter to shareholders](#) last month:

"Occasionally, markets and/or the economy will cause stocks and bonds of some large and fundamentally good businesses to be strikingly mispriced. Indeed, markets can—and will—unpredictably seize up or even vanish as they did for four months in 1914 and for a few days in 2001," he said.



“If you believe that American investors are now more stable than in the past, think back to September 2008. Speed of communication and the wonders of technology facilitate instant worldwide paralysis, and we have come a long way since smoke signals. Such instant panics won’t happen often—but they will happen.”

But, as Buffett opined, “Thanks to the American tailwind and the power of compound interest, the arena in which we operate has been—and will be—rewarding if you make a couple of good decisions during a lifetime and avoid serious mistakes.”

We’ll sum up our letter to you with this final remark from him. “It’s harder than you would think to predict which (businesses) will be the winners and losers. And those who tell you they know the answer are usually either self-delusional or snake-oil salesmen.”

That’s one reason why we stress the importance of diversification, not the political headline of the month. It allows us to participate in the “American tailwind.”

Final thoughts...

I really think Warren Buffett stands out as a rock-solid investor. Learning from him has been incredibly valuable, especially his knack for navigating the ups and downs of the market with a clear "Buy Low - Sell High" strategy. It's something that has really shaped our firm's approach, keeping us focused on the long game. If you're one of our clients, you've probably seen firsthand how we stick to our guns, even when the market gets a bit wild.

If you don’t work with our firm yet, I think it’s important for you to understand our philosophy. We embrace the wisdom of investing giants like Warren Buffett and applying those insights to our modern strategies. We're excited about the possibility of guiding you through your investment journey, offering clarity and confidence in your financial decisions. Whether you're already with us or thinking about taking the first step, our commitment to your success remains unwavering. Let's navigate the future together, building a portfolio that stands the test of time and brings your financial goals within reach.



That wraps up our adventure through the world of tax audits and the latest market trends! We hope you found our tips as handy as a Swiss Army knife during tax season and our market overview as insightful as a crystal ball. Remember, we're here to help you navigate these waters with ease and confidence. So, until next time, keep your calculators close, your financial documents closer, and let's sail smoothly into financial success together! Stay savvy, stay smart, and, most importantly, stay smiling!

KELLY



Kelly L. Olczak, CFP®
Managing Partner
LynnLeigh & Company, LLC
1160 A Pittsford-Victor Rd
Pittsford, NY 14534

kelly@lynnleighco.com

(O): 585-623-5982
(M): 585-200-2320

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