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## Cutting Corners on Your Taxes Is Still a Bad Idea

TAX REPORT |

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Yes, the IRS is shrinking. But it is far from toothless, and the cost of getting caught is rising

If you're thinking about cheating a little— or a lot—on your taxes due April 15, think again. It's easy to see why Americans may be tempted to cut corners. Since President Trump took office and Elon Musk's Department of Government Efficiency began its work, the Internal Revenue Service has shed thousands of workers, including key executives, and reduced tax enforcement. More disruptions are likely on the way.

Tax preparers are feeling a shift. "Clients are putting more emphasis on pushing the envelope, because they see what's going on at the IRS," says Dan Herron, a CPA in San Luis Obispo, Calif., who will prepare about 400 returns this year.

He says some have asked about taking larger deductions for "business" expenses that seem suspiciously personal. "Then I have to quiz them about whether a meal was *really* for business and explain why the return has to be correct," Herron adds.

To be sure, he and other tax professionals have a good way to rein in would-be tax cheats. They can—and often do—refuse to sign inaccurate returns, because doing so could cost them their licenses. Just over half of individual filers, or about 85 million, use professional preparers.

That leaves nearly 80 million or so who prepare their own returns, whether it's with commercial software, a tax clinic or pencil and paper. For them, it's far easier to omit income, inflate deductions, or even skip filing altogether.

If you're feeling tempted to push the envelope this year, remember the IRS is far from toothless— even now.

First, the agency has lots of information alerting it to omitted income. By law many companies, financial institutions and others have to notify the IRS when they make payments to individuals.

For employees, W-2 forms show wages and other information, and the IRS expects more than 250 million of them for this filing season.

The IRS also gets a blizzard of 1099 and similar forms reporting other income that Americans receive for everything from gig work and capital gains to gambling winnings and unemployment benefits. According to the latest data available, the IRS got 5.4 billion of these forms in 2023.

Then the agency's computers match the information on these forms with what's on taxpayers' returns and generate bills for discrepancies that the taxpayer can challenge. This process will begin late this year and continue for at least a year, according to an agency spokesman—and it's not labor-intensive.

Matching forms can also "out" taxpayers who haven't filed a return, if they received income that was reported on a 1099 or similar form. For filers who don't respond to requests about the missing return, the IRS is allowed to make up a substitute tax return in the non-filer's name using the information it has.

For example, agency staffers could include income reported by employers or brokerage firms while omitting a \$2,000 tax credit for a young child.

The IRS often detects tax crimes like money laundering by mining data on other types of forms. Recently, the agency's criminal division said it has been using cash transaction reports filed by banks and other financial institutions to find criminal activity. For the three-year period ended last Sept. 30, nearly 90% of cases the division recommended for prosecution involved someone who was the subject of these filings.

Beyond forms, the IRS has the supersecret DIF score to discover potential tax cheating. DIF stands for discriminant function, and for decades DIF formulas have compared a filer's return data with that of similar returns to find unusual patterns, like outsize deductions for the amount of income reported.

When the IRS finds unpaid taxes due, it has a toolbox with dozens of penalties provided by Congress.

"The penalties mount up, because interest rates are higher than they used to be. Interest runs on penalties as well as the tax," says Jeffrey Porter, a CPA practicing in Huntington, W.Va.

A sampling of these penalties starts with interest charges, which are due on nearly all underpayments. Currently the rate is 7%, far above the 3% of a few years ago.

Next are penalties for failure to file a return and failure to pay taxes, if applicable. Failure to file is 5% of the tax due a month, with a maximum of 25%. Failure to pay is 0.5% of the tax due a month, also with a maximum of 25%. There are some offsets between these two.

Of other penalties, one of the most feared is the accuracy penalty for substantial underpayment of tax. It has variations, but it often applies when unpaid taxes are 10% of the total due or \$5,000, whichever is greater.

For individuals, the penalty is at least 20% of the relevant underpayment. And if income is substantially understated, the statute of limitations can be six years rather than the usual three.

Less common is the civil-fraud penalty for willfully dodging taxes. But it's a whopper: 75% of the understated amount, and there's no statute of limitations for it.

Finally, don't forget the penalty for filing a frivolous tax return. This one applies when your return doesn't include enough information to compute the tax or else has information showing your tax is clearly incorrect.

In practice it could apply to a protester who files a return saying the Constitution prohibits federal income taxes, or to a filer who uses a paper return as a coloring book rather than filling in the numbers. Penalty: \$5,000.

The bottom line is that the IRS has plenty of ways to find tax misdeeds and penalize Americans who commit them. So here's the best reason to play it straight this year: You want to sleep at night.

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