Robert W. Wood

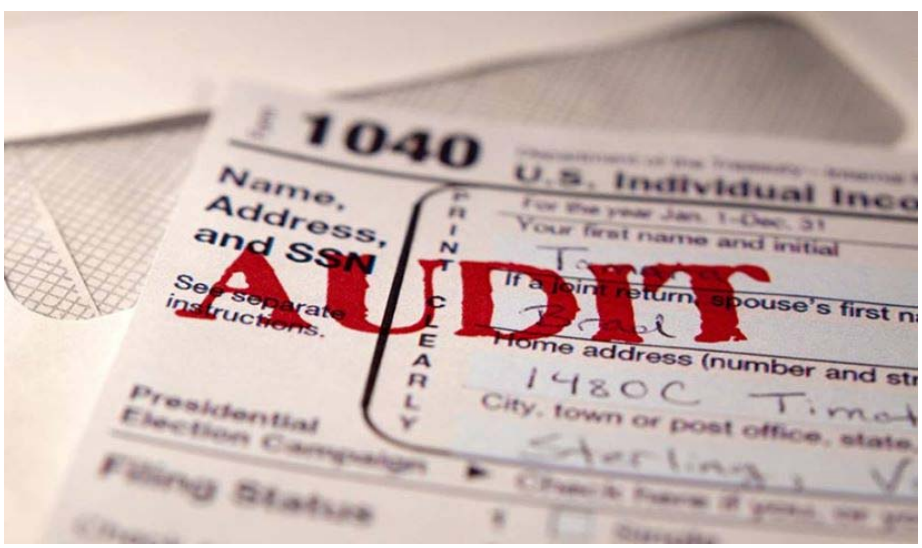
THE TAX LAWYER

TAXES 1/30/2016

IRS Tax Audits Can Go Back Six Years

The statute of limitations on taxes is a fundamental rule allowing taxpayers to eventually cut off their exposure. You can finally throw out records and breathe a sigh of relief. You can even say to the IRS, “sorry, you’re too late.” But this year, that will be a little harder, and the wait will be longer. Traditionally, the main IRS statute of limitations was three years.

But the three years is doubled to six in many cases. One big category is if you *omitted* more than 25% of your income. For years, there was a debate over what that meant. Taxpayers and some courts said “omit” means leave off, as in don’t report. But the IRS said it was much broader.



Example: You sell real estate for $3M, claiming that your basis (what you had invested) was $1.5M. In fact, your basis was only $500,000. Your basis overstatement means you paid tax on $1.5M of gain, when you *should* have paid tax on $2.5M.

That was the situation in *U.S. v. Home Concrete & Supply, LLC*, and the Supreme Court ruled that overstating basis is *not* the same as omitting income. The Court said 3 years was plenty for the IRS to audit. But Congress *overruled* the Supreme Court and gave the IRS six years. Six years is a long time.

Filing your return early won't help either. The time periods can be even longer than six years in some cases. For example, the IRS has no time limit if you never file a return. For unfiled tax returns, criminal violations or fraud, though, the practical limit is usually six years. Another scary rule is that the IRS can audit forever if you omit certain tax forms.

Plus, once an assessment is made, the IRS *collection* statute is typically 10 years. All of these waiting periods can be nerve wracking. It pays to know how far back you can be asked to prove your income, expenses, bank deposits and more. Frequently, the IRS says it needs more time to audit. The IRS will ask you to sign a form extending the statute of limitations. Most tax advisers tell clients to agree, but get some professional advice about your own situation. You may be able to limit the time or scope of the extension.

Another hot button involves offshore accounts. The IRS is going after offshore income and assets in a big way, and that dovetails with another IRS audit rule. The IRS also gets six years to audit if you omitted more than $5,000 of foreign income (say, interest on an overseas account). That matches the audit period for FBARs, offshore bank account reports that can carry civil and even criminal penalties far worse than those for tax evasion.

For all these reasons, be careful and keep good records. You should keep copies of your old tax returns forever. But after a time–many people say seven years–you *should* be able to throw out records and receipts. Yet some records such as improvements to property that go into your basis, are exceptions. If you remodel your kitchen and sell your house 20 years later, the receipts for your remodeling job are still relevant to your tax return.

Statutes of limitation are important. Always check them carefully, including all exceptions. Being able to tell the IRS it is too late to audit can be worth the wait.

For alerts to future tax articles, email me at Wood@WoodLLP.com. This discussion is not legal advice.