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10 Tax Rules To Keep You Out Of Trouble With The IRS

Taxation is complex, even if your affairs seem simple and your income is modest. And there are endless tax rules, often crossing over each other and requiring interpretation and professionals to sort them out. Still, certain tax rules seem nearly absolute. These 10 rules are important and can help keep you out of tax trouble with the IRS year-round.

Everything is Income

The IRS taxes all income from any source, whether in cash or in kind. Lottery winnings? Taxed. Gambling winnings? Taxed. You name it, it's taxed. If you find a diamond ring, you pay tax on its fair market value even if you don't sell it. And offsets or deductions are rarely as inclusive as the income.

Forms 1099 Count

Those little tax forms you get in January are keyed to your Social Security number. The IRS always gets a copy. Pay attention to each one—the IRS sure does. Yet if you are missing a Form 1099, consider not asking for it.

Pay Taxes Later

Tax planning often involves timing. Ideally, you should want to *accelerate* tax deductions, to reduce your current taxes. Conversely, when it comes to receiving payments in your income, try to *defer* them so your taxes will also be deferred. There are limits, though. Under constructive receipt rules, if you have a legal right to pay but say "pay me later," it's taxed now.

Reply to Every IRS Notice

Keeping good records is important, and so is responsiveness. Often, fighting the IRS is about attrition. Just keep replying in writing, and make sure you do it on time. Still, don't fight over small tax bills. If you get a small tax bill, pay it. Don't risk an audit or bigger dispute by fighting over small dollars.

Don't Talk To the IRS if They Visit

It is unusual for the IRS to knock on your door. But if the IRS does come to your home or business, you have the right to decline to speak with them. Ask them to talk to your lawyer. Take their card and be polite but firm. Usually you can't effectively represent yourself, and it's not worth the risk that you'll say the wrong thing.

Keep Good Records and Monitor the Statute of Limitations

The usual IRS statute of limitations is three years after you file your tax return. If you understate your income by 25% or more, though, the IRS gets double that time to audit, a whopping six years. In fact, there are 13 IRS statute of limitation rules everyone should know. You can probably throw out most tax records after six years, but keep copies of your tax returns forever.

Avoid Amending Tax Returns

Sometimes, you have to amend your tax return, but think carefully. Amended returns have a higher audit rate, especially if they request a refund. The IRS says you "should" amend your return if you discover a mistake after it's filed. However, the only time you really *must* amend is if you knew when you filed your original return that it was false. If you decide to amend, you can't cherrypick which items to fix. The amended return must correct *everything*, not just the items in your favor. So ask yourself, to amend or not to amend?

Don’t Explain or Attach Too Much

Timely file your tax returns even if you can’t pay the taxes you. Payment can come later if you can’t pay on time. In some cases, you may be able to get the IRS to agree to let you pay over time in an IRS installment agreement. Penalties will likely be smaller if you file on time. And keep your tax returns concise. If an explanation or disclosure is needed, keep it succinct. Attachments to tax returns should be limited to tax forms and, where needed, plain sheets of paper listing additional deductions, income, etc. Don’t attach other documents. If the IRS wants documents it will ask.

Be Careful With Big Refunds and Foreign Accounts

Getting a big refund can make your return stick out. Consider applying some of the refund to the current year’s tax payments rather than asking for the cash. You’ll have a lower profile with an initial or amended return. Another sensitive item is foreign bank accounts. They may generate income but you won’t receive a Form 1099. Still, reporting them is key. If balances exceed $10,000 in the aggregate any time during the year, you *also* must file FinCEN 114, also known as a Report of Foreign Bank and Financial Accounts or FBAR separate from your tax return. Penalties for failing to file, or filing inaccurately, can be quite high. If you failed to report in the past, how you transition from past reporting failures can be delicate.

Hire a Tax Professional

You can use software or hire a tax professional to prepare your tax return. But if you end up in a tax dispute, handling a tax case by yourself is usually a mistake. Hire an accountant or tax lawyer to handle it. Even simple audits can go awry, or can expand into other areas if you aren’t careful. There are many procedural issues to know if you are handling an IRS dispute, so get some professional advice. And don’t wait until the last minute.