PERSPECTIVE
8 Los Angeles | Daily Journal MONDAY, FEBRUARY 13, 2012

At Tax Time, Remember To Consider Audit Risk

By Robert W. Wood

It's time to think taxes. Most business entity tax returns are due March 15 and individual returns are due April 15. You can go on extension, but that is only an extension to *file* your return, not an extension to *pay*. Besides, if you file by the normal due date the statute of limitations for audits starts to run sooner. But whenever you file, you should consider when your returns are safe from audit.

We all want our tax returns to slide through easily and without a fuss. We also want to know when we can truly breathe a sigh of relief that the Internal Revenue Service can no longer audit our return. Usually that is three years after filing. Unfortunately, sometimes the statute is six years.

The IRS gets an extra three years if you omit 25 percent or more of your income. Exactly what that 25 percent income omission standard means has proven controversial. For a time, the IRS argued that *anything* having the *effect* of understating your income would give it six years. The law is now clear that overstating your deductions is not the same as omitting income.

A case pending in the U.S. Supreme Court, however, will decide whether the IRS gets six years if you overstate your *basis* in assets, which has the effect of omitting 25 percent of your income. The case involves basis in tax shelter partnerships. That tax shelter taint could influence the decision.

Robert W. Wood is a tax lawyer at Wood LLP in San Francisco (www.WoodLLP.com). The author of more than 30 books including "Taxation of Damage Awards & Settlement Payments" (4th Ed. 2009 www.taxinstitute.com), he can be reached at Wood@WoodLLP.com.

Basis comes up frequently in taxes with real estate and equipment. For example, suppose you bought your house for $400,000 and sell it for $800,000. Your tax return reports the sale but erroneously claims you paid $600,000. If that has the effect of omitting 25 percent or more of your income, the IRS may get six years to audit. This is the question before the Supreme Court.

The statute of limitations usually starts to run on the later of the filing due date or the actual filing date. If you file early (say March 1 for an April 15 due date), the three-year statute starts running April 15. If you file late, say April 30, the statute starts running April 30.

The timely mailing of a return is treated as timely filing. A return is considered delivered to the IRS on the date postmarked by the U.S. Postal Service, or delivered to FedEx, DHL or UPS. But what if the return goes missing and the IRS claims never to have received it?

The timely mailing rule does not apply if the IRS fails to receive it. To avoid an open-ended statute of limitations, many advisors recommend that all returns and other important forms be sent to the IRS via certified mail, return receipt requested. That provides prima facie evidence the return was actually delivered to the IRS.

But even with certified mail, you still have the burden of proving your return was in the envelope. To avoid this problem, you can include a cover letter stating that the tax return is enclosed with an extra copy of the cover letter and tax return, and a stamped self-addressed envelope. These should be sent by certified mail and the cover letter should ask the IRS to return a stamped copy of the letter and the tax return in the enclosed envelope.

This may sound paranoid. Still, with a true belt-and-suspenders approach, it can give you three documents to prove the IRS received the return: the return receipt, the stamped copy of the cover letter, and the stamped copy of the tax return. If either the cover letter or tax return is returned, the IRS will have a very difficult time proving it did not receive the tax return. Of course, it's unlikely that you'll ever need as these safeguards. However, you'll be quite happy you have it if things turn out badly.

Some returns are judged "not a tax return" and therefore insufficient to trigger the statute of limitations. Perhaps most importantly, the return must be signed and must be verified under the penalty of perjury. Don't try to alter the penalties of perjury language on the tax return!

What about missing data, unchecked boxes, and omitted details? Missing items on your tax return isn't good practice but many such problems won't cause the return to fail to start the statute of limitations. The Supreme Court has identified the basic elements of a tax return sufficient to start the statute running. Perfect accuracy is not necessary if the taxpayer purports to file a return, signs it under penalty of perjury, and shows an honest and genuine attempt to satisfy the law. See *Zellerbach Paper Co. v. Helvering*, 293 U.S. 172 (1934).

The IRS' own manual says that a tax return must only meet two requirements to be processed. It must be signed, so failing to sign it (or altering the penalty of perjury statement) is fatal. Plus, you must provide sufficient information to enable the IRS to ascertain and assess your tax liability. That's it, so get started today!

This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.