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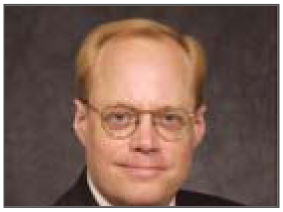

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Avoid 5 Alluring Tax Mistakes That Are Costly, Even Criminal

In Three Felonies a Day, Harvey Silverglate argues that vague laws and changing technologies cause the average American to unwittingly break the law every day. Most of us mess up tax issues every day too. Avoid these mistakes, and you'll reduce your chances of coming to grief with the IRS.

1. Forgetting That All Income is Taxable. One huge mistake is neglecting to include every bit of income. Whether you receive a Form 1099, W-2, K-1, or no report at all, include all your income. Discrepancies can trigger audits. And there are many surprising items IRS says to report. And if you end up in the IRS cross hairs, be careful.

2. Mixing Business & Personal. You may do things with a dual motive–like a pleasant lunch with a business colleague, going on vacation with your best client or buying a vacation home that's also an investment. However, you'll be better off if you can separate your tax life into business and personal. Many big, messy and expensive tax disputes come down to a violation of this fundamental divide.

The person who forgets this rule and tries to morph personal into business to get a write-off is asking for trouble, including:

- Trying to deduct the cost of your divorce because your business is at risk.
- Trying to deduct a miserable vacation with their best client.
- Claiming your hobby was really for profit. (click here for more advice.)

Many provisions in the tax law explicitly recognize dual purposes. Still, try to avoid dual-purpose goals and do your best to categorize things appropriately. Your tax life will be easier.

3. Ignoring Forms 1099. This isn't only an April 15 item. How you handle third party information returns like Forms 1099 year round can influence your risk of audit and how you'll interact with the IRS thereafter. You need a system to record and track these information returns. That's exactly what the IRS does. A lot of what goes on at the IRS is computer matching–the endless correlation of taxpayer identification numbers and payments. Even a small mismatch will be caught.

4. Failing to Keep Good Records. You might think keeping good records only helps you if you actually end up in a tax controversy. Actually, keeping good records can keep you out of tax trouble in the first place. Maybe it's karma. Does the IRS really care about record keeping? Yes. Most audits conducted on ordinary, law-abiding folks are correspondence audits.

Keep records and receipts for about six years after you file. Keep copies of your ax returns themselves forever. And remember, you may need basis records for decades. If you buy a house an improve it over a 10 year period, 20 years later when you sell it, you'll need those receipts. It's true that in a pinch, some tax receipts are optional, but you'll save money and uncertainty by keeping them.

5. Forgetting That Tax Cases Can Become Criminal. A majority of criminal tax cases still originate in normal IRS civil audits. If an IRS auditor discovers something suspicious the auditor can notify the IRS's Criminal Investigation Division. The IRS is not obligated to tell you this criminal referral is occurring. Normally, the civil auditors suspend the audit without explanation. You might assume the audit is over or will eventually resume. Meanwhile, the IRS is building a criminal case.

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