Forbes

Robert W. Wood

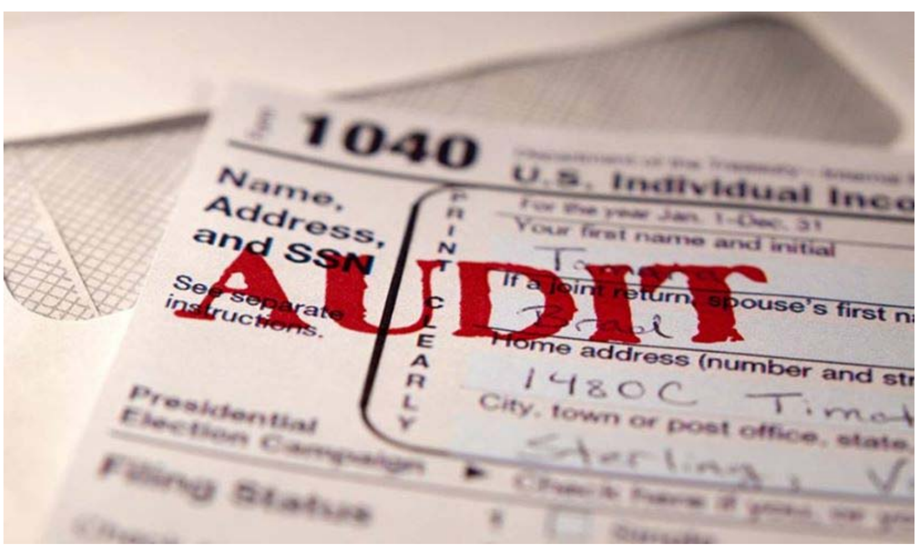
THE TAX LAWYER

TAXES 1/15/2016

Beware: IRS Now Has Six Years To Audit Your Taxes, Up From Three

No one wants to be audited, so knowing how long your tax return can be attacked is important. The statute of limitations on taxes is a fundamental rule allowing taxpayers to eventually cut off their exposure. It can be pretty satisfying to say to the IRS, “sorry, you’re too late.” But this year, that will be a little harder due to an expansion of the IRS’s power to audit for extra years.

Traditionally, the primary IRS statute of limitations was three years. But there are many exceptions that give the IRS six years or longer. Several of those exceptions are more prevalent today, and one of them has gotten bigger, despite a decision by the U.S. Supreme Court.



The three years is doubled to six if you omitted more than 25% of your income. For years, there was a debate over what it *means* to *omit* income from your return. 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 a piece of property for $3M, claiming that your basis (what you invested in the property) was $1.5M. In fact, your basis was only $500,000. The effect of your basis overstatement was that you paid tax on $1.5M of gain, when you should have paid tax on $2.5M.

In *U.S. v. Home Concrete & Supply, LLC*, the Supreme Court slapped down the IRS, holding that overstating your basis is *not* the same as *omitting* income. The Court said 3 years was plenty for the IRS to audit. But Congress recently *overruled* the Supreme Court and gave the IRS six years in such a case.

Six years can be a long time. Filing your return early won't help either. The time periods can be even longer than six years in some cases. 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. In some cases, the IRS can go back 30 years. In *Beeler v. Commissioner*, the Tax Court held Mr. Beeler responsible for 30 year-old payroll tax penalties.

These waiting periods can be nerve wracking. Even if you do your best with your taxes, taxes are horribly complex. Even innocent mistakes can sometimes be interpreted as suspect. For all these reasons, 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, usually for a year. 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 these days 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.