Ensure your tax return does not stick out from the pile

By Robert W. Wood

In my last column (Jan. 9), I noted five ways to help make your tax return look plain vanilla and not be audited. Although tax advisers are supposed to assume that every return is examined, there is no law against trying to make the return not stick out from the pile. Here are five more ways to help avoid an audit or ensuing tax controversy.

Disclose Just Enough

You'd be surprised how many tax professionals and amateurs alike try to submit too much information. If your return is complex, you may need to add explanations or disclosures in footnotes. Be concise, truthful and accurate, but don't provide copies of sales agreements, settlement agreements, bank statements, etc., unless you are later asked for copies by the Internal Revenue Service.

Disclosures can be made on regular paper or special IRS forms. Tax return preparers distinguish "white paper" disclosures, which clarify or explain an item in a footnote on plain paper, from those on IRS Forms 8275 and 8275-R. A Form 8275 "Disclosure Statement" can be used any time you need to disclose something that can't be adequately explained on the return. Form 8275-R "Regulation Disclosure Statement," is for disclosing positions that are contrary to IRS regulations or other authority. You shouldn't be filing a Form 8275-R — or taking a tax return position that would require it — without professional help.

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Use Care With Noncash Charitable Donations

Charitable contributions are laudable but the tax deductions get a surprising number of people in trouble. By far the largest issues are usually with noncash donations, especially the donation of clothes and household goods, vehicles, artwork, real property and conservation easements. There are special forms to use and special rules to follow when it comes to appraisals and substantiation. The IRS takes these rules seriously and so should you.

If your noncash contributions for the year exceed $500, you must complete IRS Form 8283 and attach it to your return. If you donate property (or a group of similar items) worth more than $5,000, you must also complete Section B of Form 8283 which requires a "qualified appraiser" meeting IRS criteria. Be sure to allow time for these formalities. If you donate property in kind, don't get too greedy with valuations, and expect scrutiny, especially on big numbers.

If You Receive a Small Tax Bill, Pay It

Not every IRS notice you receive means that you are being audited. In fact, notices noting that you failed to report a Form 1099 for interest or that you made a math mistake in computing deductions are usually generated by machine. In that sense, you are better off simply paying small bills from the IRS.

Nevertheless, some taxpayers believe that if they have taken reasonable tax positions, and completed their return accurately, they should fight any tax bill, especially if the IRS is wrong. The answer is more practical than principled. It usually doesn't pay to fight with the IRS, and it can sometimes lead to a full-blown audit. If the tax bill is small, don't get into the system and risk bigger problems for a few dollars. Just pay it and move on.

Of course, what is small to one person may be a major bill to someone else. There's no absolute standard here. But at least consider the possibility of paying a tax bill unless you are certain that you are better off contesting it.

Don't Amend Without Thinking

The flip side of paying a small tax bill is not amending a tax return just to get a small refund. Amended returns are reviewed much more regularly than initial returns. So if you forgot a deduction or otherwise think you can get a small amount back by amending, think twice before amending your return. Consider whether you might have bigger problems if other matters on your return, unrelated to the amendment, are reviewed.

Moreover, be aware that if you do amend a tax return, you can't cherry pick what you amend. If there are points not in your favor, you must cover those too.

Don't Ask For Your Money Back

If you are entitled to a refund, consider applying it to your next year's tax payments rather than asking for the refund in cash. If you have overpaid your estimated taxes or had excess withholding taken from your wages, you are entitled to get the money back when you file your return. Nevertheless, asking for a huge refund can be a mistake from an audit perspective.

Indeed, you'll have a lower profile if you file a return applying some or all of your whopping refund to estimated tax payments for the current or future years. This logic applies to both initial returns and to amended ones.

No matter how careful you are, there is no way to guarantee that you will never be audited or have a tax controversy. Sometimes your number just comes up. The good news is that the overwhelming majority of audits today are done by correspondence and not sitting across a desk from the IRS.

That means the process is controlled and, especially if you have representation, you need not fear the audit process. Audit rates for most types of tax returns are statistically unlikely. However, IRS enforcement efforts are on the uptick, particularly when it comes to upper income taxpayers.

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