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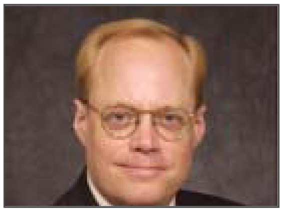

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Five Ways To Audit Proof Your Tax Return Against The IRS

Except for tax protestors, no one wants to fight with the IRS. That's why there's such a mystique about avoiding an audit. While what-triggers-an-audit theories abound, there are some basic things you can do to reduce your chances of being picked for an audit or at least to make any interactions with the IRS less traumatic. My advice doesn't come with a guarantee, but it's better than a Ouija board.

1. Don't claim flaky deductions. Uttered by Judge Learned Hand in 1934, this may be the most famous iteration of the taxpayer's role:

"Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes." Helvering v. Gregory, 69 F.2d 809, 810 (2d Cir. 1934).

So don't be scared to take deductions and losses you're entitled to, but don't take tax positions you aren't comfortable defending. If you take reasonable tax positions, you'll likely find you won't end up needing to defend them. And if you do face an audit, it will likely be far easier.

There are many old wives tales saying that certain items trigger an audit: home office deductions, passive losses, schedule C (sole proprietorship) activities, etc. You can't predict the trigger (and you can drive yourself crazy trying), but you can adopt the "be reasonable" mantra about every item on your return, including these. So if you don't have a decent claim for a home office, don't claim it. If your money-losing sole proprietorship is really more a fun hobby, treat it as such.

2. Use a pro, or use software. Some argue a return prepared by a professional is less likely to be audited, but there's little reliable data to support it. Nevertheless, having a professional prepare your return–or at least advise on anything quirky–is a good idea.

If you do your own return, using a commercially available software package, such as Intuit's Turbotax or H&R Block's Taxcut will make it easier and more reliable. If the software produces some result you consider wrong, don't simply override it. (Or, at least investigate before you do.)

Example: You're not rich and can't understand why the software has spit out a Form 6251 showing you owe the alternative minimum tax. Sad to say, you probably do, particularly if you live in a high tax state or have a large family.

3. Disclose just enough. You'd be surprised how many 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 to by the IRS.

Disclosures can be made on regular paper or special IRS forms. Tax return preparers distinguish "white paper" disclosures from those on IRS Forms 8275 and 8275-R. A Form 8275 "Disclosure Statement" on plain paper can be used any time you need to disclose something that can't be adequately disclosed on the forms. 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.

4. Check your math. Make sure you add, subtract and multiply accurately. Check your numbers through each step and do some simple math checks when you finish. This is another reason to use a software program. Remember, even if you use a software program, you don't have to file electronically. You can print out your returns and mail them in. If you do make a math mistake, you are likely to get a math correction notice from the IRS. This isn't an audit. But your goal is to minimize such interaction with the IRS bureaucracy, which isn't known for the best mail handling practices.

5. Account for every Form 1099. Form 1099 comes in many varieties, including 1099-INT for interest, 1099-DIV for dividends, 1099-G for tax refunds, 1099-R for pensions and 1099-MISC for miscellaneous income. These forms are sent by payers of such funds to both you and the IRS. So regardless of how many 1099s you receive, make sure they all are accounted for on your return. There are also Forms 1098 which lenders send (to you and the IRS) recording how much interest you paid. The IRS matches your return against the 1098s and 1099s. So one way to guarantee an IRS query is to fail to account for something. If a Form 1099 is wrong–say it reports more income than you had–you can explain or deduct it on the return, but you need to first report it.

A last word: No matter how careful you are, there's no way to guarantee you'll never have a tax controversy. Sometimes your number just comes up. While audit rates for most types of tax returns are low, there is always a chance you will be examined. Try to be ready.

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