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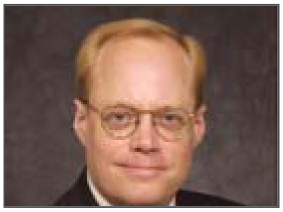

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# IRS Pushes For 6 Years To Audit!

Yes, this headline is meant to sound frightening. The good news is that most of the time, the IRS has only three years after you file your tax return to audit you and that rule is not changing. See Even The IRS Has Time Limits.

With your tax return due April 15, the statute of limitations should normally run three years later. If you file early, the statute runs exactly three years after the due date. If you file late and do not have an extension, the statute runs three years following your actual (late) filing date.

It's good to monitor when the statute expires so you can determine when a particular tax year is in the clear. This is especially true if you've taken controversial or aggressive tax positions. You may want to maintain a cash reserve to handle a tax controversy or pay additional taxes if the IRS comes along.

**Six Year Risk.** But sometimes the IRS can take ***up to six years*** to audit. The circumstances in which the IRS gets this double time have become controversial. The IRS gets six years if your return includes a "substantial understatement of income."

Generally this means you've omitted 25% or more of your gross income, but exactly what that means is currently the subject of litigation. The IRS argues that anything that has the ***effect*** of a 25% understatement of gross income triggers the extra three years. The IRS has pushed especially hard for six years to go after basis over-statements.

> **Example:** Suppose you sell a piece of property for $3 million, claiming that your basis (what you've invested in the property) was $1.5 million. In fact, your basis was only $500,000. The effect of your basis overstatement was that you paid tax on $1.5 million of gain when you *should* have paid tax on $2.5 million. Your basis overstatement probably means a six-year statute applies.

There have been several court cases on just this point. For a summary, see Capital Gain: Three-Year Or Six-Year Statute Of Limitations? In fact, the IRS just earned a major victory in the Seventh Circuit Court of Appeals. In *Beard v. Commissioner*, the appellate court reversed the Tax Court and said the IRS was correct that it had six years.

But despite the big IRS victory in the Seventh Circuit, the IRS is losing elsewhere. In *Home Concrete & Supply LLC v. United States*, the Fourth Circuit sided with the Ninth Circuit's decision in *Bakersfield Energy Partners LP v. Commissioner*, and the Federal Circuit in *Salman Ranch Ltd. v. United States*. Finally, the Fifth Circuit weighed in, also holding for the taxpayer. See *Burks v. United States*. All four of these appellate courts said no to the IRS attempt to apply the six-year statute of limitations to omissions of more than 25% of gross income caused by an overstatement of basis.

With the IRS victory in *Beard v. Commissioner*, here's how the circuits stack up:

| CIRCUIT | RESULT |
|---|---|
| Seventh | IRS wins and six-year statute of limitations applies |
| Fourth, Fifth, Ninth, Federal | IRS loses so is limited to three-year statute |
| Other | We'll see |

**Amending Tax Returns Too.** If you want to amend a tax return, you must do it within three years of the original filing date. How does amending your tax return affect the statute of limitations? Most people assume that once you amend, the three year clock starts ticking anew. Nope.

If your amended return shows an increase in tax, and you submit the amended return within 60 days before the three-year statute runs, the IRS has 60 days after it receives the amended return to make an assessment. This narrow window can present planning opportunities. An amended return that does ***not*** report a net increase in tax does ***not*** trigger an extension of the statute.

For more, see:

Even The IRS Has Time Limits

Capital Gain: Three-Year Or Six-Year Statute Of Limitations?

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