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IRS Statute Of Limitations — Is Your Return Safe?

In the 1976 movie *Marathon Man* a Nazi war criminal—and dentist—played by Laurence Olivier comes out of hiding to retrieve a cache of diamonds, continually repeating "is it safe?" If you're squeamish about dentistry, I would skip this thriller, since the Olivier character's preferred method of torture is drilling and pulling teeth without anesthetic. Besides, dental pain and taxes have something in common, and this time of year one pain is enough.

"Is it safe?" is a good question to ask about your tax returns. The IRS is pushing not only to audit you for the customary three years but to extend it to six. The proof of this putsch is a pile of tax cases and controversial IRS Regulations. See IRS Temporary Regs., T.D. 9466. Although the IRS has lost most of these cases, the IRS recently won a six year look-see in court. See *Beard v. Commissioner*.

The IRS normally has three years to question your taxes but that time is **doubled** if you omitted 25% or more of your income. For decades now, tax lawyers assumed—as the tax code section says on its face—you must "omit" the income from your return to trigger the six year wait. Should the IRS get double time if you achieve the same effect by a higher basis—say by claiming you paid $2 million for a house you actually bought for $1 million?

That may sound like a subtle distinction, but it isn't, and it's prompting lots of concern about how long the IRS can keep you guessing whether

you owe more tax. It turns out many people are flummoxed by IRS statute of limitations questions. We all want to know when we can throw receipts away and legitimately point to the statute of limitations rather than finding receipts and making substantive tax arguments why a deduction was proper. Regarding the need for receipts, see What If A Taxpayer Doesn't Have Receipts?

Fraud? Who Me? One good question is how the statute of limitations on fraud fits into this puzzle. The IRS has *no* time limit if you *never* file a return (the three years never starts to run) and no time limit on fraud. See IRC § 6501(c)(2). The fraud rule is confusing. You might think the IRS would assert fraud to get unlimited time.

Fortunately, though, the IRS has a high burden to carry to show fraud. The IRS handbook on fraud makes interesting reading. The result of the high burden of proof is that the IRS doesn't often try to use the unlimited fraud statute.

Extending the Time? Another common glitch is what happens if the IRS asks you to extend the statute. The IRS may contact you (usually about two and a half years after you file), asking you to *extend* the statute. The IRS may want to examine an issue, but has not had time to complete its analysis to determine if you do or don't deserve a tax bill.

As a result, the IRS will send you a form asking you to sign and return it consenting to extend the statute. Some taxpayers say "no" or ignore the request. Either way, that usually leads the IRS to send a notice assessing extra taxes based on whatever information the IRS has.

Consequently, most tax advisers say you should usually grant a requested extension. However, you may be able to limit the scope of the extension to certain tax issues or to limit the additional time (for example, to an extra year). In most cases, you should seek professional help. Indeed, although you should generally give the IRS an extension of time, saying no makes sense in some circumstances.

For more, see Even The IRS Has Time Limits.

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