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THE TAX LAWYER

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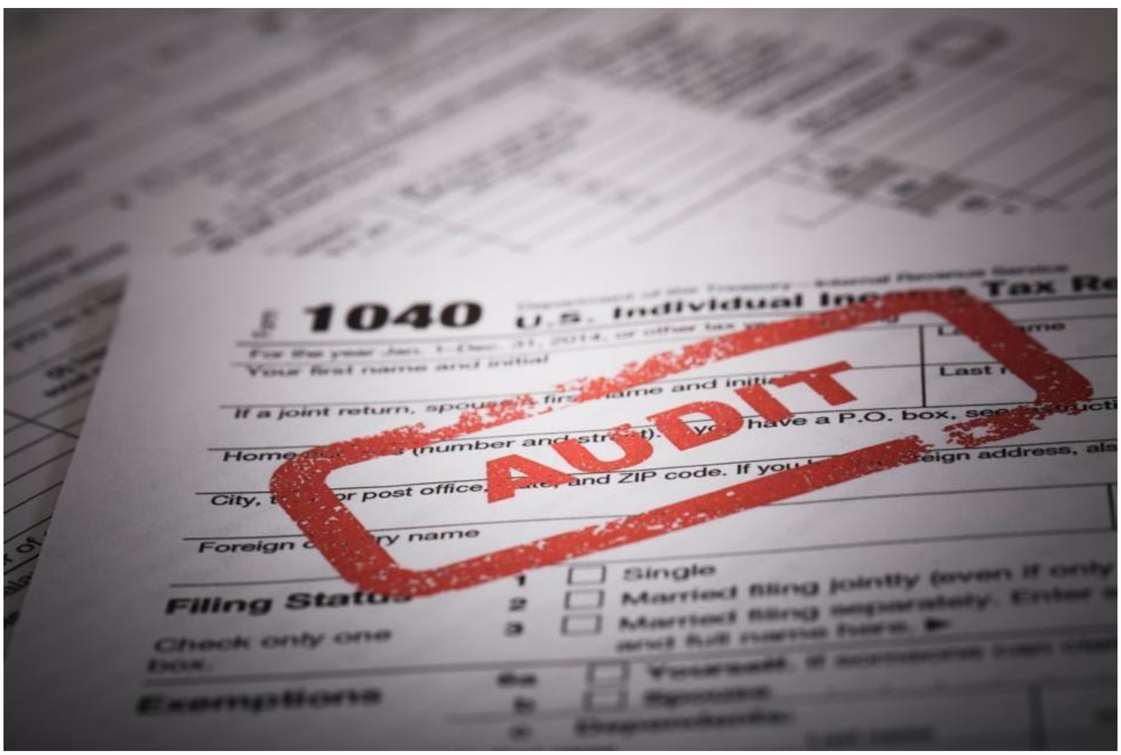
Three Tax Mistakes You Might Make Daily



You might not think about taxes until tax return time, but you should plan ahead. Many of us mess up tax issues every day. These tax mistakes aren't felonies, but you don't want to end up next April 15 having logged 365 days of tax mistakes. Here are three tax rules that many people break as often as daily.

Respect them, and you'll reduce the chance of coming to grief with the Internal Revenue Service.

1. Keep business and personal affairs separate. It may be overstated to say that these can never meet. You might do things with a dual motive—say having a pleasant lunch with a business colleague, going on vacation with your best client or buying a vacation home that you also intend as an investment. However, you'll be better off if you can separate your tax life into business and personal. That may sound radical, but it's really just following the tax code. There are many big, messy and expensive tax disputes that came down to a violation of this fundamental divide. The person who forgets this rule and tries to morph personal matters into business ones is asking for trouble. I'm thinking of people who:

- Try to deduct the cost of their divorce because their business is at risk.
- Try to deduct a miserable vacation with their best client.
- Claim their hobby activity as a gentleman farmer or horse breeder was really engaged in for profit.

Sure, there are many provisions in the tax law that explicitly recognize the dual purposes many of us have in pursuing activities and purchases. Still, try to avoid such dual-purpose goals and do your best to categorize things appropriately.

2. Keep good records. Most of us at one time or another violate this edict. You might think keeping good records is only something that can help you if you actually end up in a tax controversy. Yet believe it or not, there is something about keeping good records that can keep you out of tax trouble in the first place. Maybe it's karma. Moreover, this rule isn't just for people who run businesses. For example, recreational gamblers (even just playing the slots) need to keep a diary or other contemporaneous record of how much they bet and lose on each visit. That's because your occasional big win will be reported to the IRS by the casino. You can use gambling losses to offset your winnings. But if you don't keep good records you could end up a two-time loser—losing once at the tables and once to Uncle Sam.

Another example is charitable donations. Put a $20 check instead of a $20 bill in the collection plate. The law requires you to have paper proof of every donation you deduct. Does the IRS really care about this sort of record keeping? Yes. Most of the audits conducted on ordinary, law-abiding folks (meaning wage earners without undisclosed offshore accounts), are so-called correspondence audits. In such audits—and you might be picked for one if you deduct a lot of contributions—taxpayers are told their deductions will be disallowed unless they promptly mail back records substantiating them.

3. Respect IRS Forms 1099. This may sound like an item only for April 15, but how you handle IRS information returns such as 1099s year round influences how hard a time you have when you file your return and interact with the IRS. You need a system to record and track these information returns since that's exactly what the IRS does. A lot of what goes on at the IRS is computer matching—the endless correlation of taxpayer identification numbers and payments. Even a small mismatch between what's on these forms and what you report on your tax return will be caught and could result in months of hassles with the IRS. Much of what the IRS does when it comes to monitoring taxpayers is information return matching. There are different forms for miscellaneous income (Form 1099-MISC), nonemployee pay (Form 1099-NEC), interest (Form 1099-INT) and so on. Another common information form is a Form W-2, reporting wages. If you have a home mortgage and make mortgage payments, you should receive a Form 1098 from your lender reporting how much interest you paid during the year. When you deduct interest on your tax return, the IRS will match your return to this form to make sure you haven't overstated your deduction.

Pay attention to these little forms as they arrive. You may get a statement from your bank that looks like your regular statement, but says it is also a 1099. When you get your 1099s, don't just stick them in a drawer, look at them. Payors are required to mail all 1099s to payees no later than Jan. 31. If you receive an incorrect 1099, contact the payor who issued it as soon as you receive it. Explain the error and ask whether they have already sent a copy of the 1099 to the IRS. If not, the payor can destroy the old form and issue a corrected one. It's a good idea to keep a record of such communications, since you may end up ensnarled in a reporting mess later on. If the payor has already sent a copy of the erroneous form to the IRS, ask for a correction. In that event, the payor should issue a "corrected" 1099 (there's a special box for this).

If you are a partner in a partnership, a member of an LLC or a shareholder of an S corporation, you should receive a Form K-1, reporting how much gain, loss or income is attributed to you. Normally, it must be mailed to partners/shareholders no later then March 15, giving them one month to meet their own April 15 deadline. But some entities are notorious for being late in mailing out Forms K-1. You may find yourself unable to file your personal tax return until you receive just one more Form K-1. If it doesn't come, file a request for an extension. It's easy and the IRS will automatically grant it. Be careful out there.

Check out my website.