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Two Easy Ways To Avoid IRS Problems

Keeping business and personal affairs separate is smart if you want to steer clear of the IRS.

You might do things with a dual motive, like 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.

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.

Keeping good records is another big rule that many people have trouble with. In fact, most of us violate this edict at one time or another. 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.

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