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Did You 'Disclose' On Your Taxes? Here's Why IRS Cares

Disclosure can sometimes have a negative connotation, and that's true in taxes too. Without knowing exactly why, most people do not want to ‘‘disclose'' unless there is a clear legal requirement. Discretion and privacy sound so much better—take the President's tax returns, for example. Most taxpayers may not know what disclosure means or why you may want to do it.

It just sounds like extra work, or extra risk, something you do not want to consider unless it is required somehow. We all fear IRS audits, and we all want to steer clear of them, so any extra audit attention is the last thing anyone wants. Ironically, though, disclosure can actually reduce risk in some cases. What is disclosure anyway?

Disclosure is more than the usual listing of income or expenses. It is simply a type of extra explanation. How much extra explanation a disclosure involves varies considerably, not only in legal requirements but also in practice. Sometimes the IRS says it is *required*. The circumstances and tax issues can be extremely varied.

There are almost infinite circumstances in which disclosure could be required. Some of it is about how strong or weak your tax position is on your facts and under the law. The IRS wants disclosure if you do not have at least ‘‘substantial authority'' for your tax position. I'm sure that sounds a little like you are asking for the IRS to audit you or to disallow the deduction.

But huge numbers of disclosures actually do not trigger audits, and in that sense the fear that disclosing enhances audit risk is often overblown. Technically, you do not *have* to disclose. But disclosing has a big silver lining: it is a way to get out of penalties. What's more, it can also prevent the IRS from extending the usual three-year limitations period for assessment of income tax.

For example, if you omit more than 25 percent of the gross income from your tax return, the normal IRS three-year statute of limitations is extended to six years. However, in determining whether you omitted income from your return, the IRS counts what you disclosed too, even if you say it isn't taxable. So, you help yourself by disclosing. There is also a penalty for a substantial understatement of income tax. It is notable that the threshold is not high. An individual who understates his tax by more than 10 percent or

$5,000, whichever is greater, can end up with this penalty. One way to avoid the penalty is to adequately disclose the item.

All you need is disclosure plus a reasonable basis for your tax position. Once again, disclosure helps you. How do you disclose a tax position, for example to be sure you aren't hit with a substantial understatement penalty? The classic way, which the IRS clearly prefers, is by form. There are two disclosure forms, Form 8275 and Form 8275-R. We can dispense with Form 8275-R because that form is for positions that contradict the law.

Form 8275 (*without* the R) is another matter. This is a very *common* form, and it is commonly filed. It bears underscoring that most tax returns attaching Form 8275 are not audited, so the form does not automatically trigger an audit. But how much detail to provide is another matter. Be concise. Some people go on for pages on Form 8275, and even include attachments with letters or documents. That is inappropriate and exposes you to additional risk.

Besides, the IRS doesn't want or need all that. If the IRS wants more detail, they will ask for it. You are required to disclose enough detail to tell the IRS what you are doing. Be thorough and don't hide the ball, but keep it short and succinct.

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