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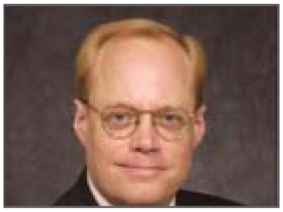

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IRS Can Audit You Forever, But Key Steps Can Prevent It

Even a routine tax audit can be expensive and nerve-wracking. So if the IRS statute of limitations has expired, it can be a trump card. The IRS normally has three years to audit, measured from the return due date or filing date, whichever is later.

But watch out: the three years is ***doubled*** if you omitted 25% or more of your income. Even worse, the IRS has ***no*** time limit if you ***never*** file a return. What's more, the IRS also has no time limit on fraud. As a result, you might think the IRS would always assert fraud to get unlimited time.

It's a chicken or egg issue, since the IRS has to show you were fraudulent to keep the time limit open. Fortunately, though, the IRS has a high burden to show fraud. Here are other timing rules you should know.

Many people *voluntarily* give the IRS more time. Why would anyone do that? It works like this. The IRS contacts you (usually about two and a half years after you file), asking you to *extend* the statute. Most tax advisers say you should usually agree. If you say "no" or ignore the request, the IRS will assess extra taxes.

There are also time limits to amending a tax return. Do it within three years of your original. But here's a timing trick. If your amended return has an increase in tax, and you submit the amended return within 60 days before the three-year statute runs, the IRS will only have 60 days after it receives the amended return to make an assessment.

An amended return that does *not* report a net increase in tax doesn't extend the statute. Timing on refunds can be tricky too. If you have too much tax withheld but fail to file a return, you usually only have ***two*** years (not three) to get it back.

Statute of limitation issues come up frequently with partnerships, LLCs and S corporations. The partners or shareholders pay tax, but the return is filed by the entity. And the entity might agree to extend the statute. Also, a tax notice may be sent to a partnership, but not to partners. Professional advice may be needed to untangle it.

Also, watch for cases where the statute may be "tolled" (held in abeyance). That can occur with an IRS John Doe summons, even though you have no notice of it! For example, suppose a promoter sold you on a tax shelter. The IRS may issue the accountant a summons asking for the names of all his clients. While he fights turning those names over, the statute of limitations clock for his clients is stopped.

Finally, consider state taxes too. Some states have three- and six-year statutes like the IRS. But some states set their own time clocks, giving them even more time to assess taxes. In California, for example, the basic statute of limitations is four years. However, if the IRS adjusts your federal return you are ***obligated*** to file an amended return in California. If you don't, the California statute ***never*** runs out.

Timing is everything in tax matters, and that's certainly true with the statute of limitations. The statute usually begins to run when a return is ***filed***, so keep certified mail or courier confirmation. If you file electronically, keep all the electronic data, plus a hard copy of your return. Monitor the timing carefully and know when you're clear. It can mean the difference between winning and losing.

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.