

Tax Time

How long can the IRS audit? It depends.

BY ROBERT W. WOOD

An IRS audit can involve targeted questions and requests of proof of particular items only. Alternatively, audits can cover the waterfront, asking for proof of virtually every line item. Even if you do your best with your taxes, they are horribly complex.

Thus, if you face an IRS tax audit and can point to the statute of limitations as a bar, you should. But figuring out exactly how long the IRS has can sometimes be challenging. The basic rule is simple. The primary IRS statute of limitations generally runs three years after you file.

However, there are many exceptions

that give the IRS six years or longer. The statute of limitations is six years if your return includes a substantial understatement of income. Generally, this means omitting more than 25 percent of your gross income. But the six-year statute does not apply if you overstated your deductions or credits rather than actually omitting income.

The IRS has argued in court that other items on your tax return that have the effect of more than a 25 percent understatement of gross income should give it the full six years. After bitter lower court litigation, even the U.S. Supreme Court got involved. In *U.S. v. Home Concrete & Supply, LLC*,¹ the Supreme Court held against the IRS, holding that overstating your basis in an asset is not the same as omitting income.

However, Congress then overruled the Supreme Court and gave the IRS six years. So, if you overstate your basis in an asset you sell and cross that 25 percent income mark, the IRS can audit you for six years. The IRS gets six years in many other cases too.

The three years is also doubled if you omitted more than \$5,000 of foreign income (say, interest on an overseas account). Moreover, if you receive a gift or inheritance of over \$100,000 from a non-U.S. person, you must file IRS Form 3520. If you fail to file it, your statute of limitations never starts to run. (Forever is a lot longer than six years.)

Another foreign asset form is IRS Form 8938. If you are required to file and skip it, the IRS clock never runs. If you own part of a foreign corporation, there is IRS Form 5471. If you fail to file a required Form 5471, your return remains open indefinitely.

More generally, what if you never file a return or file a fraudulent one? The IRS has no time limit if you never file a return, or if it can prove civil or

criminal fraud. The same is true if you alter the penalties of perjury language on your return.

With all the ways that the IRS gets extra time to audit, it may surprise you to learn that the IRS may ask for more time. The IRS may contact you, asking you to extend the statute of limitations. If you say no, the IRS will usually make a tax assessment, usually one that is based on unfavorable assumptions. Most tax advisers tell clients to agree to the requested extension, but consult one about your situation.

Another trap involves an IRS John Doe summons, which can extend the statute. So can being outside the country. If you are outside the country for years and return, the IRS statute of limitations does not run while you were away.

Innocent mistakes can sometimes be interpreted as suspect, and digging into the past is rarely pleasant. Records that were at your fingertips when you filed might be buried or gone even a few years later. So the stakes with these kinds of issues can be large.

Tax lawyers and accountants are used to monitoring the duration of their clients' audit exposure, and you should be too. It pays to know how far back you can be asked to prove your income, expenses, bank deposits, and more. Watch the calendar until you are clear of audit.

Once a tax assessment is made, the IRS collection statute is typically 10 years. This is the basic collection statute, but in some cases that can be renewed. Trying to keep all these rules straight can be maddening. But there are few things more satisfying than being able to show the IRS that it is too late to come after you. **TBJ**

NOTES

1. *U.S. v. Home Concrete & Supply*, 132 S. Ct. 1836 (2012).



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