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STATUTE OF LIMITATIONS 101 – HOW LONG MUST YOU KEEP RECORDS?

By Victor Sy, CPA, MBA

How long do you need to keep tax records? How long can the IRS audit your tax returns? How long can the IRS collect unpaid taxes? Let's discuss IRS statute of limitations so you can clean your garage for 2012.

Statute of limitations provides final dates after which neither you nor the IRS can be disturbed by the other. From an IRS perspective, the agency can no longer audit your tax return or collect what you owe. From your perspective, you can no longer claim a refund on an overpaid tax.

1. The general statute to audit you is three years after the return is filed.
2. The statute is extended to six years if you omit 25% of your gross income.
3. The statute to collect what has been established to be your tax liability is 10 years.
4. A tax return that is filed earlier than April 15 is considered filed on that deadline. A 2010 return filed on February 15, 2011 is considered filed on April 18, 2011 with a statute expiration of April 15, 2014.
5. A 2010 tax return that was extended and filed on October 15, 2011 is considered filed on that date with statute expiring on October 15, 2014. (TIP: If you have some sensitive issues that you don't want disturbed, file on time so as not to give the IRS an extra six months to snoop around).
6. There is no protection from the statute if the IRS does not receive your tax return. There is no protection even if you filed a return but the IRS did not receive (or claims not to have received) your return!
TIP: Mail certified with return receipt especially if your return contains some critical income or deductions.
7. There is no statute if you do not file a return. They can audit you anytime.
8. There is no statute for false or fraudulent returns. Nada.
9. If you want statutes to protect you but your records are incomplete, file anyway. TIP: File a signed processible return. Provide sufficient data for IRS to assess your liability. That return does not need to be perfect. Show an honest attempt to comply with the law.
10. If the IRS identifies you as a non-filer, they can file a substitute return for you. Believe me, that return will be estimated on the high side, pardon me, on the very high side, resulting on a very high tax of about 200% of what you actually owe. Add penalties and interests and, Houston, you have a problem.
11. Filing a gift tax return is advisable even if not required. It starts the running of the statute of limitations.
12. An estate or decedent's estate may also request for a prompt assessment within 18 months.
13. The executor of an estate can request for discharge from personal liability within nine months after the request is filed. It does not shorten the three-year statute but relieves the executor of personal liability.
14. Here's another tip so we don't end our discussion with an unlucky 13. What if you are under examination and the agent wants you to extend the statute? Should you extend or not? Well, if you do, you are just giving the IRS more time to get you. If you don't, they will bypass appeals and go straight to Tax Court with a notice of deficiency. Going to Tax Court could get very expensive. TIP: Extend and go to Appeals. You will be asked to sign either Form 872 or Form 872-A. Go with Form 872 that expires at a specific future date. Avoid 872-A which is open-ended meaning it has no expiration period.

In summary, by 4/17/12:

- Keep records for 2007, 2008, 2009, 2010, 2011 (4th year is for California)
- Dispose records for 2006 and prior years.
- But keep an additional 2 years for 2005 and 2006 if you omitted 25% of your income.

This concludes our Statute of Limitations Course 101. Good day!