

The Financial Planning Newsletter

Wesling Financial Planning Services

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Direct Deposit of Tax Refund to an IRA: Many Chances for Errors. Filing a paper return near the deadline could result in your IRA contribution being credited to the wrong year. If your return arrives too late and the IRS doesn't process your return before April 17th, the refund will likely be applied to tax year 2007 even if you wanted the refund applied to 2006. Electronic filers are being cautioned to file as many as three weeks before April 17th and paper filers as many as 6 weeks early.

If your check arrives at your IRA custodian after the 17th, you may need to contact your custodian to ensure they use the correct tax year for your IRA contribution. Another area to check with your custodian about is whether they will accept a tax refund payable to you and your spouse as an IRA deposit for an individual. Also, not all custodians accept direct deposit for IRA contributions, and often, those that do use a different routing number for direct deposits than the routing number on their bank forms (such as checks).

Other considerations for direct deposit include ensuring your account number is correct, and be sure the account is open if you're establishing a new IRA. Also, avoid an over-contribution by depositing no more than \$4,000.00 (or \$5,000.00 if over age 50).

If there is an error in your return, the amount of the IRA contribution and even its tax deductibility could be impacted. Many of these situations may require an amended return resulting in costs and headaches to you, the taxpayer.

As odd as this may seem, if you cross out or use white out on the account or routing numbers on the IRS form for direct deposit of your refund, the IRS will reject your direct deposit request and send you a refund check. All this means you should file early and consider using the direct deposit only for current year IRA contributions.

IRS Announces Long-Distance Excise Tax Credit. There is a one-time credit to all telephone customers who paid excise tax on long-distance service after Feb. 28, 2003, and before Aug. 1, 2006. The credit is the result of recent federal court rulings that the 3-percent tax is no longer applicable to long-distance service as it is billed today. Generally, anyone who paid for long-distance service during this time is eligible to receive this credit.

You can request the credit on your regular tax return. If you don't have to file a tax return, you can use a newly created form to request this credit and receive a refund, even if you owe no federal income tax. In addition, the IRS is providing a fast and simple option for any long-distance customer by offering a standard credit amount, between \$30 and \$60, based on the number of exemptions they claim. Credits and refunds can be requested using Forms 1040, 1040A, 1040 EZ or 1040 NR, or by using



new Form 1040EZ-T. These forms can be downloaded at IRS.gov or can be obtained by calling 1-800-TAX-FORM.

Long-distance telephone customers for whom it is more advantageous to request a credit using the actual amount of tax paid may use Form 8913 and attach it to your tax returns or Form 1040EZ-T. Be careful if you claim the actual amount. Keep your records for at least three years until the statute of limitations expires, if you claim the actual amount. The IRS is receiving individual claims of actual amounts in the tens of thousands of dollars. These returns are almost certain to become audit targets.

Your Visit With Your Tax Auditor: Why You? The IRS selects returns to audit in three ways: random check, mismatch of information provided from different sources, and a computerized scoring system targeting returns with the highest likelihood of underpaid taxes. The mechanics of the computer scoring are one of the best kept secrets of the IRS.

Audit likelihood is least for incomes between \$25k and \$50k, with no Schedule C or Schedule F. Less than 0.25% of these returns were audited. Incomes below \$25k and above \$100k were three times as likely as other income brackets to have returns audited. Further, including a Schedule C with your return greatly increases the chances of an audit. Income over \$100k with a Schedule C resulted in an audit rate of 1.2%. Worse yet, income under \$25k with a Schedule C resulted in an audit rate of 2.67%. This data is for the latest year available, 2002.

The under \$25k returns are often chosen because the returns show a level of income that is incompatible with the deductions for mortgage interest and property taxes paid. Other items of interest to the IRS include deductions for your home office, tax shelter activity, travel and entertainment expenses, casualty losses, hobby losses, barter income, and substantial automobile expenses.

Certain industries also attract the attention of auditors. Hair salons and the construction trades are some of the favorites of IRS auditors.

If you are invited to an audit, be sure to have adequate legal and tax representation at all meetings with the IRS. Usually, an attorney, CPA, enrolled agent or the person who prepared your return should be present in these meetings. Also, if you ask someone to represent you in your absence, the IRS requires a power of attorney from you. IRS Form 2848 can be used for this purpose.

The statute of limitations usually extends only for three years. If the tax was underpaid by more than 25%, then the time period is six years. If fraud was committed, then there is no statute of limitations.

*The art of life is to show your hand. There is no diplomacy like candor.
You may lose by it now and then, but it will be a loss well gained if you do.
Nothing is so boring as having to keep up a deception.
-E. V. Lucas (1868-1938)*