Tax Tips You Can Use

Bank account basics
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This article discusses the importance of bank accounts to your tax situation. Many people decide not to receive a tax refund by direct deposit. They believe that if they allow bank information to be added on their return, the IRS will know about the account. While that is true, their mistake is thinking that the IRS does not already know about their bank account.

This article is not intended to frighten people. IRS agents are not allowed to look up information on anyone they choose. An agent who sneaks a look at information on her boyfriend's ex-wife would be terminated immediately. However, if an agent has a need-to-know, then all of the accounts for a taxpayer can easily be obtained. Examples of a need to know do not include payments or refunds on tax returns, but do include information to aid in collection of a tax debt and information to complete an audit.

Many people get simple letter audits suggesting that an error was made on a tax return and provides steps to correct the error or pay the increase in tax. In these cases, bank statements are not requested. In my experience, every other audit has required that bank statements be provided for the year in question. The reason for wanting bank statements is to look at the record of deposits. The auditor adds up all of the deposits for the year and then compares that to the total gross income included on the tax return. If the deposits are about equal to the gross income on the return, then the return has a great probability of being correct. If the amount of money deposited in the account(s) is more than the amount represented on the return, the auditor will want to know where the excess money came from and will suspect unreported income or possible illegal activities. If the amount deposited is a lot less than the income reported, the auditor will ask about other accounts or cash transactions, because that is also unusual in today's world. Think of your bank statements as a day-to-day history of your financial life.

Think back two years ago and all of deposits you made that year. That is the most common audit year right now. If you had to outline and explain all of those deposits, could you do so? If you have deposits that combine different items or have business and personal items in the same account, it might be very difficult to go back and explain discrepancies. Also, if you have sources of non-taxable income like money gifts from Aunt Sarah, an inheritance from mom, or loan repayments from Uncle Fred, your bank deposits will look different from your tax return.

I recommend to clients that if they have unusual income, they make a note or copy of the check and add it to their tax file. That way, if they are audited in a future year, it would be easy to find and explain the unusual deposit. I also recommend that different kinds of income be deposited separately. Deposit slips are cheap and that way a taxpayer can easily see the different income types. The good news is that only a small percentage of taxpayers are audited.

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