

# **Knowing What the IRS Will Be Looking For**

The second question (the first being: "Why me?") everyone asks after they open the IRS envelope and read the "audit invitation" is: "What are they going to be looking for?" There's not a tax practitioner in this country who hasn't heard that question dozens of times.

The problem with that question is that it's often asked too late; that is, too late to be any help in preparing the tax return, and sometimes too late for the preparation of the audit. Even though an audit-proofer understands that his chances of being audited are slim, he or she still wants to prepare for that possibility.

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## **AUDIT-PROOFER'S STRATEGY RULE**

Audit-proofing your tax return means knowing what the IRS will be looking for long before your tax return is prepared, and beating the auditor to the punch.

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Tax examiners are impressed when they encounter taxpayers who are not only versed on the finer points of the tax law, but who are also totally prepared with all the substantiating documents to pack up their deductions and expenses. A tax examiner impressed with your cooperation and preparedness may be less inclined to probe deeper to find something wrong, if he sees that you are very much on top of everything. Tax examiners develop gut instincts and feelings about the taxpayer very early in the examination. Sometimes it's almost psychic the way that they perceive their subjects.

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## **AUDIT-PROOFER'S STRATEGY RULE**

Your objective should be to impress the tax examiner. Begin during the tax year with your recordkeeping program, as discussed in Step 1.

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If you have developed a system of records, or at least a document retention program (Step 1), and if you have done your best to obtain the correct information (Step 2), then you will be prepared for the third step in audit-proofing your tax returns: Knowing what the IRS will be looking for in the event you are audited.

Knowing what the IRS will be looking for involves two aspects:

- Knowing what documents are necessary to substantiate your expenses and deductions; and
- Knowing what points of law they will be checking.

### **The First Aspect: Correct Documentation**

It's not too difficult to save every scrap of paper or receipt, but it's a whole different thing to save the correct documentation that will justify your deductions and expenses. The correct documentation is what the IRS says is correct! And what the IRS says is correct is, for the most part, what you are going to need when you are audited.

The IRS has never published the list of proof taxpayers need to substantiate their deductions. Unless a taxpayer got an audit invitation letter, with a notice requesting the correct documentation, he never knew what to expect. Even most tax practitioners have had to rely on

their experience with the IRS to advise their clients what documentation was needed. And until now, no one has ever published the complete list of proof demanded by the IRS.

Turn to Exhibit 3-1. This exhibit is a compilation of the documentation that the IRS requests whenever it is challenging particular items on the tax return. Study this exhibit carefully! It will tell you what to save now so that next year, when you prepare this year's tax return you will have all the proof you need.

Realize how valuable this information can be to you. By thinking audit-proofing in all your financial transactions, and knowing what documents must be saved, you are well on your way to cutting your tax liability in ways you never dared to before, especially if you were afraid to take a deduction for expense items you weren't sure you could prove.

Ask yourself these questions. Have you been:

- Saving your itemized receipts for drugs and medicine that you got from you pharmacist, or have you been expecting you canceled checks to be sufficient?
- Claiming an exemption for a dependent who does not live with you, but haven't been saving receipts to verify amounts you spent for the dependent's support?
- Making cash contributions to qualified charitable organizations and neglecting to obtain receipts?
- Making trips to your doctor, but failing to keep a log of the mileage?
- Given a statement from your employer that your expenses for uniforms, equipment, and/or tools were required? Have you been saving receipts for such expenditures?
- Retaining copies of expense vouchers for employee business expenses you claim from your employer?
- Making records and retaining receipts related to your entertainment expenses that show such information as the names and business relationships of the persons entertained, purpose of the entertainment, place where the entertainment took place, dates, amounts, etc.?
- The fact is most people don't keep this information because, until they are audited, they don't know it's required. Without the proper supporting documentation, or receipts, the IRS will disallow the deductions, resulting in a bill for more tax. More taxes translates into out-of-pocket dollars.

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## **AUDIT-PROOFER'S STRATEGY RULE**

- As you go through the checklist, pay particular attention to the categories that pertain to your situation. If you have not been collecting the essential information, make a commitment to yourself to begin.
- Refer to this exhibit often. Put a notation in your appointment calendar, right now, on the first Monday of each month to: Read IRS proofsheets in audit-proofing book. By rereading this section every month you will begin to consider the tax ramifications of all your financial affairs during the year, rather than just on April 15th, when it's too late.

### **The Second Aspect: Correct Information**

The second aspect to the question, "What will the IRS be looking for," relates to rules of law. First you must acknowledge that the Tax Code is thousands of pages long; that the IRS instructions contain millions of words; and, that there are hundreds of thousands of court cases yielding numerous esoteric interpretations for even the most specific and obscure circumstance. With such a vast universe of laws, rules, regulations, procedures, and court cases, the question is: How does the IRS know where to draw the line? How deeply will they probe to make sure you've applied the law correctly? How do they know what's important enough to look for, and what's not?

Add to that the basic insecurity every taxpayer experiences wondering whether he or she has met all the tests from the laws, rules, regulations, procedures, and court cases. This insecurity is a basic part of every taxpayer's fear of being audited. Sometimes taxpayers aren't even sure of what it is they do know. And with all the civil and criminal penalties that the IRS can throw at taxpayers for not preparing their tax return correctly, it's no wonder that most taxpayers are afraid of being audited.

### **One Solution**

With the help of an obscure portion of the Internal Revenue Manual for auditors, I have prepared a "Checklist of What Rules and Information the IRS Will Be Verifying" in Exhibit 3-2. This checklist is a comprehensive listing of the basic rules of law and other information the IRS expects its tax examiners to check for. It has been edited so that you can use it as you prepare your tax return to see how you will do under the scrutiny of an IRS tax audit.

The checklist is not meant to be the "end-all" perfect solution to a complete 100 percent accurate tax return. But the IRS knows from experience that they don't have to test every law, rule, regulation, procedure, or court case to discover errors on tax returns. They don't have to try and trip up taxpayers on unknown exceptions or qualifying circumstances; there are enough errors made on the basic rules alone to make it worthwhile, at least initially, to only look for the basics.

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### **AUDIT-PROOFER'S STRATEGY RULE**

Use the checklist in Exhibit 3-2 after you've prepared your return but before you send it in to the IRS. Use it to determine if you have violated any of the basic items of information or rules of law.

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If you prepare your own tax return, you are well aware how easy it is to misread a rule from an IRS publication, or how easy it is to accidentally overlook something, or how easy it is to miss something because of a change in the tax laws. This checklist will help you to avoid those problems.

For example, suppose you deducted your membership dues to a country club as a business expense because your social contacts there sometimes lead to business deals and you frequently discuss business with your golf partners. Perhaps you were told by one of your associates that this was a legitimate deduction. By using the checklist you not only discover that your membership dues are not deductible because you don't use the club more than 50 percent for business purposes, but that this deduction is one of the basic items that the IRS will be looking for. As an audit-proofer you decide to delete the deduction.

By using the checklist to eliminate proven problem areas, you will create a tax return that not only will pass initial scrutiny, but will also impress the tax examiner with the thoroughness of your preparation. An examiner who finds nothing with his initial tests and basic questions, may

feel that he is wasting his time by looking for other errors. If you have other potentially troublesome items on your return, that are not on the checklist, but which may be "gray areas" that involve a subjective interpretation of the tax law, you decrease your chances of having the tax examiner find them if you can impress your tax examiner that you know the basics.

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### **AUDIT-PROOFER'S STRATEGY RULE**

Use the checklist this year if you have been called in for an audit, to find you problem areas or weaknesses before the tax examiner does.

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If you can see, beforehand, that you are going to have a problem with something, then you can focus your energies more constructively on dealing with the problem rather than spending your time in worrying about the audit.

For example, suppose you are a computer programmer and your employer asked you to take a college course in computer architecture, which you subsequently did and paid for yourself. Afterward you are notified by the IRS that your deduction is under question. You review the requirements for deducting educational expenses and discover that the expense must have been ordinary and necessary, and required as a condition of your employment. Now you know that you are going to need a statement from your employer substantiating that he required you to take the course as a condition of your employment.

Also, by knowing the basic errors you have made, later you will be able to explain them in a way that may convince the tax examiner not to assess you additional penalties for your errors. Be careful, though, not to give anything away to the tax examiner. If you come right out and show the examiner what errors you made, he may become suspicious and think you are trying to throw him off track from finding something even bigger. He may even think that if you're dumb enough to confess your sins to him, then you may be dumb enough to try and pull something bigger.

### **Special IRS Audit Targets You Should Know About**

The IRS Audit (or Examination) Division faces continuing increases in its workload each year as the number of returns filed grows, new and more difficult schemes are used to avoid taxes, and tax laws become more complex. IRS resources have not kept pace with the growing filing population and audit coverage has declined in the last 10 years from 2.4 percent to 1.31 percent of individual income tax returns. The audit activity is IRS's biggest tool for promoting voluntary compliance; it employs approximately one third of all of IRS's resources. Program priorities are provided for guidance in determining the application of resources and input of returns. These priorities represent national goals for the utilization of Examination resources and should be followed in the sequence followed below:

1. Returns involving Taxpayer Compliance Measurement Program (TCMP) audits and nationally directed compliance studies, such as unreported tips income study.
2. Returns identified as abusive tax shelters. (See Chapter 7.) Sufficient resources will be allocated so districts can timely investigate each abusive tax shelter package referred by the service centers.

3. Returns in need of examination which represent a national commitment to specific areas of abuse: tax protestors, tax havens, foreign tax credit manipulations, abusive W-4, unreported income projects, and returns with potential unreported income shown or foreign information documents.
4. Special Noncompliance Projects: to identify and examine U.S. persons who may be using foreign entities to evade U.S. taxes by concealing income and/or creating false deductions.
5. Schedule C and Revenue Initiatives: to identify noncompliant taxpayers by making in-depth probes for unreported income, and to audit corporate returns in asset class \$100 million and over.
6. Information Returns Program cases. (See Chapter 6.)
7. Locally initiated projects, such as the Unreported Income Program, involving areas of high non-compliance.

### **Areas of Emphasis**

The following programs represent areas that are to receive special emphasis from the IRS this year:

- Fraud: identify and develop cases with fraud potential by emphasizing efforts against organized crime and high-level drug traffickers, using multiple year examinations, and probing for unreported income.
- Payer compliance: ensure employers are submitting W-4s, identifying tax protestors, aggressively asserting civil penalties, ensuring informational returns such as W-2s and 1099s are provided to taxpayers.
- Computer-Assisted Audit Activity: emphasize the identification of all ADP records, especially those created and retained on data base systems- using specialists to emphasize proper recordkeeping- aggressively pursue civil penalties where taxpayers have failed to retain machine-sensible records- maximize use of computers in audits.
- Resolution of cases: to obtain a greater number of agreements to tax determinations.
- Identifying instances of misconduct by return preparers and aggressively asserting the appropriate penalties under the Return Preparers Program.
- Encouraging taxpayer compliance with the audit process.

### **Service Center Targets**

- Abusive Tax Shelter Detection Teams are established in each service center to identify potentially abusive tax shelter schemes.
- Special emphasis to detection of fraud cases.
- Tax Protestors- to identify and examine protest scheme returns- the National Illegal Tax Protestor Data Base will be implemented to stop issuance of improper refunds and for identifying new schemes.
- Information Returns Program (IRP). (See Chapter 6.)

**Examination Initiatives:**

1. The Partnership/Investor Control System (PICS) implemented to control investor returns related to TEFRA partnership/S corporation examinations.
2. TIP Income Allocations- a matching program for tax year 1983 returns to discover employees who have underreported tip income.
3. Examination of investors who have received Pre-filing Notification and Pre-refund Letters due to potentially abusive tax shelter.

**Future Examination Initiatives:**

1. Individual Retirement Arrangements- a matching program similar to IRP is being developed to verify that an IRA exists, and that IRA deductions claimed by taxpayers are not overstated. Verification of rollover amounts and excess contributions will be built into the program.
2. Expansion of IRP matching to include bartering transactions, stock and securities sales, and tip reporting.
3. Matching state and local income tax refunds.

**Special Projects**

**1. Direct Sellers of Home Products Study**

Direct sellers of home products are individuals who sell consumer products to others on a person-to-person basis, usually working out of their own home. They may sell door to door, through a sales party plan, or by appointment in someone else's home. Or they may find their customers among their co-workers, friends, relatives, or neighbors.

Subject to certain limitations and substantiation requirements, ordinary and necessary expenses incurred by an individual in carrying on a trade or business are deductible for income tax purposes (Code Section 162). The determination of whether an expense is ordinary and necessary to the operation of a business is a factual question.

Except for certain expenses allowed as itemized deductions, an individual's personal, living, or family expenditures are not deductible (Code Section 262). Certain expenditures which otherwise would be treated as personal living expenses, such as expenditures for meals, lodging, travel, or entertainment, may be deductible when incurred in a business or investment activity.

If the expenses from a business exceed the taxpayer's income from the business for the year, the net business loss may be used to offset income from other sources, such as employee wages received by the taxpayer.

This study will address the issues of taxpayers who claim a business loss from direct selling activities on their Schedule C and use such loss to offset other types of income thereby reducing their tax liability. It will be determined if expenses claimed are ordinary and necessary for carrying on the business and if income is properly reported.

The objectives of this study are:

- To determine compliance levels of taxpayers claiming a loss from direct selling activities;
- To evaluate the feasibility, practicality, costs, and revenues of a continuing compliance program in this area;
- To develop a profile that can be used to supplement current selection methods if necessary;
- To determine the need for legislative proposals to enhance voluntary compliance.

Even though this study has been completed, it was designed to produce a "supplemental return selection system." That means that very soon that IRS will be targeting direct sellers on a nationwide basis.

Direct sellers should note that the line items on their return that will be scrutinized the closest are:

\* Cost of goods sold. \* Car and truck expenses. \* Travel and Entertainment. \* Other Expenses. \* Office-in-the-home expense.

#### 2. Unreported Income DIF Scoring.

A selection system has been implemented to score returns with a high potential for unreported income.

#### 3. Lifetime Exclusion of Gain or Sale of Residence (LTEX)

This program identifies taxpayers who have claimed the lifetime exclusion of gain on sale of their personal residence, determines that the exclusion is properly claimed, and corrects returns claiming the exclusion which appears to be unallowable.

Code Section 121 now allows taxpayers age 55 and over to elect a lifetime exclusion up to \$125,000 of the gain on the sale or exchange of their residence. (\$62,500 if married filing separately.) The taxpayer must have owned and used the principal residence for a period of three or more years during the five years preceding the sale.

Because the law allows a taxpayer to make this election only once in a lifetime, the IRS will track these elections until the taxpayer's death. The law further stipulates that a taxpayer is not eligible for the election if the spouse previously elected the exclusion in another sale or exchange. In the case of a jointly filed return with an election present, the account will be tracked for the lifetime of both spouses regardless of taxpayers' subsequent marital status.

#### 4. Questionable Form W-4 Program

Employers are required to submit to the IRS any W-4 submitted to them that claims more than 14 withholding allowances, or claims exemption from withholding even though the employee is earning more than \$200 a week. The IRS reviews the W-4s for accuracy. If not accurate, the employee and the employer are notified and the employee is prohibited from claiming more allowances than the IRS allows.

### **Proof You Will Need To Substantiate Your Deductions**

#### ALIMONY PAYMENTS

\_\_\_ Copy of divorce decree, separate maintenance decree, or other instrument which specified the basis for alimony payments.

\_\_\_ Current name, address, and Social Security number of divorced or separated spouse.

\_\_\_ Canceled checks or receipts to verify payments you made. If alimony payments are not made directly by you, you may need documents showing the source. For example, insurance policy, endowment or annuity contract, etc.

#### BAD DEBTS

\_\_\_\_ Verification of the debt such as a note or contract that would establish a debtor-creditor relationship.

\_\_\_\_ Full name and last known address of the debtor.

\_\_\_\_ Evidence of your efforts to collect the debt.

\_\_\_\_ Evidence of uncollectibility of the debt in the year claimed.

#### BUSINESS USE OF HOME

\_\_\_\_ Statement from your employer if you are required to provide an office in your home or elsewhere.

\_\_\_\_ Canceled checks or receipts verifying expenses incurred.

\_\_\_\_ Verification of percentage of square footage of home used for business to total square footage of home.

#### BUSINESS VS. NONBUSINESS ACTIVITY

\_\_\_\_ Copies of tax returns for the 4 preceding years (6 years if the activity involves horses) if you were engaged in the activity during those periods.

\_\_\_\_ If this is your first year for the activity, be prepared to discuss: 1. Manner in which you carry on the activity; 2. Expertise of you or your consultants; 3. Expectations of the anticipated increase in value of business assets; 4. Success in carrying on other activities; 5. Elements of personal pleasure or recreation involved in carrying on the activity.

#### CAR AND TRUCK EXPENSES-SCHEDULE C OR F

\_\_\_\_ Repair receipts, inspection slips, or any other records to show total mileage driven for the year.

\_\_\_\_ Log books and other records verifying the business mileage claimed.

\_\_\_\_ If you did not keep a log or other formal record of your business mileage, reconstruct the business use of the vehicle. This information should include current mileage reading on the vehicle used for business purposes, mileage reading on the vehicle when you acquired it, mileage reading for January 1 and December 31, and mileage distance between your residence and your business activities during the year, if you kept one.

\_\_\_\_ If you claimed actual expenses, you may have to provide paid bills, invoices, and canceled checks for automobile expenses you incurred during the year. These include gas, oil, tires, repairs, insurance, interest, tags, and taxes.

#### CASUALTY LOSSES

\_\_\_\_ Insured Property: A copy of insurance report showing date and nature of loss or damage claimed, amount of damages claimed on insurance, amount of coverage carried and the date and amount of claim paid by insurance (or amount of claim pending);

\_\_\_\_ Uninsured Property: Any fire or police department reports on fire losses, theft losses, or losses from accidents.

\_\_\_\_ Photographs showing extent of loss, if available.

\_\_\_ Appraisal from a qualified estimator or adjuster showing fair market value of the property before and after the casualty; or an estimate of the damages.

\_\_\_ Cost or other basis of property and date acquired.

\_\_\_ Verification of actual cost of repairs.

#### COMMISSIONS OR CONTRACT LABOR

\_\_\_ Copies of Forms 1099 for commissions paid.

\_\_\_ If Forms 1099 were not issued to individuals who were paid commissions, provide the names, addresses, and Social Security numbers of the recipients.

\_\_\_ Provide canceled checks or other records to verify the amount paid to each individual.

#### CONTRIBUTIONS

\_\_\_ Canceled checks and receipts for contributions to church or charitable organizations.

\_\_\_ If the contribution was other than money, show: (a) name and address of the charitable organization; (b) items contributed; (c) appraisal of the fair market value of each item on the contribution date; (d) original cost.

\_\_\_ If you reported expenses for attending a church convention or similar activity, furnish a statement showing you were an official representative of your church.

#### COST OF LIVESTOCK OR OTHER ITEMS BOUGHT FOR RESALE

\_\_\_ Physical inventory sheets for both beginning and ending inventory for the year and copies of Federal tax returns for the year before and the year after the tax return year.

\_\_\_ Canceled checks, receipts, and purchase journal or summaries for goods purchased for resale.

\_\_\_ Information or computation concerning cost of inventory items that were withdrawn for personal use.

#### COST OF GOODS SOLD

\_\_\_ Physical inventory sheets for both beginning and ending inventory and copies of Federal tax returns for the year.

\_\_\_ Canceled checks, receipts, and purchase journal or summaries for goods purchased for resale.

\_\_\_ Information or computation concerning cost of inventory items that were withdrawn for personal use.

#### CREDIT FOR CHILD OR DEPENDENT CARE EXPENSES

\_\_\_ If you are divorced or separated parent, you will need a copy of the divorce decree or separation agreement, dates you had custody of the child and dates the other parent had custody of the child.

\_\_\_ If you paid for care of a disabled dependent, you will need a doctor's statement showing the dependent was physically or mentally unable to care for self.

\_\_\_ Names and addresses of persons or organizations you paid for child care or for care of a disabled dependent. Copies of canceled checks and receipts verifying costs.

\_\_\_ If you do not have canceled checks, obtain statement from the person or organization showing name, address, period of care, and amount paid.

#### DEPRECIATION OF RENTAL PROPERTY

\_\_\_ Evidence to verify ownership of property, date property acquired, cost or other basis showing amount allocated to land and to the building, cost of improvement, and additions to property.

#### DEPRECIATION-SCHEDULE C OR F

\_\_\_ Purchase invoices and receipts for assets

\_\_\_ Copies of Forms W-2 for employees who were paid salaries or wages.

#### LEGAL, TAX INVESTMENT COUNSEL FEES

\_\_\_ Canceled checks, receipts, or statements showing amount of payment and purpose of expense.

#### MACHINE HIRE OR CONTRACT LABOR - SCHEDULE F

\_\_\_ Copies of all Forms 1099 for machine hire expenses paid.

\_\_\_ If Forms 1099 were not issued to individuals who were paid for machine work, provide the names, addresses, and Social Security numbers of the recipients.

\_\_\_ Provide canceled checks or other records verifying the amount paid to each individual.

#### MEALS AND LODGING EXPENSES

\_\_\_ Verification of the number of days away from home overnight for business purposes.

\_\_\_ Receipts or records for meals.

\_\_\_ Receipts for lodging.

#### MEDICAL AND DENTAL EXPENSES

\_\_\_ Insurance policies on which you deducted the cost of premiums paid.

\_\_\_ Itemized receipts for drugs and medicine showing the person for whom the drugs and medicine were purchased. Canceled checks alone are not acceptable.

\_\_\_ Canceled checks, receipts, or statements for all medical and dental expenses showing the person for whom each expense was incurred.

\_\_\_ Statement from insurance company showing any expense reimbursed or paid directly by it.

\_\_\_ Statement to show cost and medical requirement for special equipment or education expense.

#### MISCELLANEOUS

You will need your records, including canceled checks, receipts, explanations, etc., as appropriate, for the following items to be covered during the examination of your return:

\_\_\_ Supplies - Schedule C or F.

\_\_\_ Utilities and Telephone Expenses.

- \_\_\_ Dues and Publications - Schedule C or F.
- \_\_\_ Legal and Professional - Schedule C or F.
- \_\_\_ Fertilizer, Lime, Chemicals - Schedule F.
- \_\_\_ Veterinary Fees, Medicine Expenses.
- \_\_\_ Advertising Expenses.
- \_\_\_ Land Clearing and Conservation Expenses.
- \_\_\_ Feed, Seed, Plant Purchased.
- \_\_\_ Earned Income Credit.
- \_\_\_ Self-Employment Tax.
- \_\_\_ Credit for Political Contribution.

#### MOVING EXPENSES

- \_\_\_ Canceled checks and receipts verifying amount of moving expenses you paid.
- \_\_\_ Names and relationships to you of members of your household who moved with you.
- \_\_\_ Computations showing number of miles by direct route from your old residence to your new place of employment and to your old place of employment.
- \_\_\_ Name and address of each employer you had since you moved to new place of employment and period of time you were employed by each.
- \_\_\_ Statement from your employer of the allowance or reimbursement paid you for moving expenses showing amounts by kinds of expense, such as plane or train fares, meals and lodging, automobile expense, transportation of household and personal property.
- \_\_\_ Closing statements on purchase and sale of personal residence. Copies of lease agreement where applicable.

#### PENSION OF ANNUITY INCOME

- \_\_\_ Furnish records of the amount received for the year and what part is excludable.

#### PENSION OR PROFIT SHARING PLANS-SCHEDULE C OR F

- \_\_\_ Canceled checks and other documents verifying contributions to the plan for the year.
- \_\_\_ Copy of Form 5500-C or 5500-R, whichever is appropriate.

#### REAL ESTATE AND PERSONAL PROPERTY TAXES

- \_\_\_ Verification of legal ownership of the property.
- \_\_\_ Canceled checks and receipts for taxes paid; for example, statement from mortgage company.
- \_\_\_ Identification of any special assessments deducted as taxes, and an explanation of their purpose.

#### RENT ON FARM, PASTURE

- \_\_\_ Copies of leases or rental agreements, canceled checks, and statements for rent paid or owed during the year.

#### RENT ON BUSINESS PROPERTY-SCHEDULE C OR F

\_\_\_\_ Copies of leases or rental agreements, canceled checks, and statements for rent paid or owed during the year.

#### RENTAL-VACATION HOME

\_\_\_\_ If you own and rent a home or other dwelling unit that you also use as a residence in the tax year, supply the following: 1. A diary reflecting the number of days for personal use and the number of days for business use. 2. Records to verify rental income and rental expenses as well as depreciation claimed.

#### RENTAL INCOME AND EXPENSES

\_\_\_\_ Records showing total of rent you received.

\_\_\_\_ Canceled checks and receipts to verify all expenses claimed.

\_\_\_\_ If any units were occupied rent free or below rental value during the year, an explanation of the reason.

\_\_\_\_ If the unit was used for personal reason, show the total number of days rented and number of days used for personal purposes.

\_\_\_\_ Evidence to verify ownership of property, date property was acquired, cost or other basis showing amount allocated to land and to buildings, cost of improvements and additions to property. Include escrow papers and property tax bill for the year of purchase.

\_\_\_\_ If property was converted from a personal residence to rental property, show date converted, and appraisal of fair market value when converted.

#### REPAIRS-SCHEDULE C OR F

\_\_\_\_ Canceled checks, receipts, and invoices for repairs.

\_\_\_\_ For large repairs, description of the nature of the repair.

#### SALARY AND WAGES-SCHEDULE C

\_\_\_\_ All four quarterly employment tax returns (Forms 940 and 941) filed to support your deduction for salaries and wages paid to your employees.

\_\_\_\_ Copies of Forms W-4 for all your employees.

\_\_\_\_ Copies of Forms W-2 for employees who were paid salaries or wages.

#### SALE OF PERSONAL RESIDENCE

\_\_\_\_ Closing statements for sales of the residence and for cost of this residence when purchased.

\_\_\_\_ Canceled checks and receipts for improvements made to the residence sold.

\_\_\_\_ Canceled checks and receipts for fixing-up expenses incurred within 90 days of selling your residence (these expenses must have been paid within 30 days after the sale).

\_\_\_\_ If you replaced the residence that was sold, provide the closing statement on purchase of the new residence.

\_\_\_\_ If any part of your residence was used for business use prior to the sale, you should have a copy of your income tax return for the last year the home was used for business before the sale.

#### SALES OF PROPERTY OTHER THAN STOCK

- \_\_\_ Closing statements on purchase of property.
- \_\_\_ Verification of capital improvements to property (receipts, bills, contract).
- \_\_\_ You will need records showing terms and expenses of sale, and copy of closing or settlement sheet.
- \_\_\_ If sale involved rental or business property, you should have copies of your income tax returns for the 2 years before the year of sale.
- \_\_\_ If you reported gain or loss from repossession you should have a copy of your income tax return for the year or the original sale, all contracts or legal documents involved, and verification of repossession costs.

#### SALES TAXES

- \_\_\_ Receipts for sales taxes paid on a car, motorcycle, motor home, truck, boat, airplane, home (including mobile or prefabricated), or building materials you bought to build a new home.
- \_\_\_ If you used actual receipts to compute your sales tax, you will need verification of all purchases on which sales tax was paid.

#### SCHEDULE C (OR F)-GENERAL

- \_\_\_ All books, journals, ledgers, and worships used in preparing your return.
- \_\_\_ All bank statements and canceled checks (both business and personal) for the 14-month period from December through January of the following tax year.
- \_\_\_ Records of all savings and invested funds for the year.
- \_\_\_ Records of all business and personal loan activity (proceeds and payments).
- \_\_\_ Purchase invoices or closing statements covering acquisition and disposition of capital items (business and personal). This includes real estate, automobiles, machinery, and equipment.
- \_\_\_ Information on any nontaxable income received, including but not limited to Social Security benefits, gifts, and inheritances.
- \_\_\_ Copies of your four most recent Forms 941 and related W-4's.

#### SCHOLARSHIP OR FELLOWSHIP GRANT

- \_\_\_ A statement from the grantor of your scholarship or grant showing the following: 1. Funds from which grant was paid. 2. Amount of grant and period covered. 3. Requirements of grant including any present, past, or future obligations or services. (Are all candidates for the degree you're working toward required to perform these services?) 4. Fringe benefits you derived (medial insurance, awards, bonuses, etc.). 5. Benefits derived by grantor. 6. Selection criteria for recipients.
- \_\_\_ Current transcript of credits for degree.
- \_\_\_ University bulletin outlining degree requirements.
- \_\_\_ A copy of the official instrument establishing the scholarship or fellowship program.

#### STATE AND LOCAL INCOME TAXES

- \_\_\_ Copies of state and local income tax returns for any of the 3 previous years.
- \_\_\_ Copy of Federal income tax return for any of the 3 previous years.
- \_\_\_ Canceled checks and receipts showing taxes paid.

STATE INCOME TAX REFUND

\_\_\_\_ Furnish a copy of your Federal income tax return for any of the 3 previous years.

\_\_\_\_ Furnish a copy of your state income tax return for any of the 3 previous years.

STOCK SALES

\_\_\_\_ Brokerage vouchers establishing the purchase price, sales price, and dates of transactions.

\_\_\_\_ If you sold securities on which you had a return of capital you will need records showing the nontaxable distributions received during the holding period.

\_\_\_\_ If you claim worthless securities, you will need verification of dissolution or liquidation and liquidation distribution.

TRAVEL-EMPLOYEE BUSINESS EXPENSES

\_\_\_\_ Furnish a log or diary for travel costs incurred while away from home on business. This information should include transportation tickets, receipts, and canceled checks, etc.

TRAVEL AND ENTERTAINMENT EXPENSES

\_\_\_\_ A log or diary for travel costs incurred while away from home on business. This information should include transportation tickets, receipts, and canceled checks.

\_\_\_\_ Records and receipts for entertainment expenses you claimed. These records must show the names and business relationship of the person(s) entertained, purpose of the entertainment, place where the entertainment took place, date of the entertainment, and amount of the expenditure.

\_\_\_\_ If you claimed expenses for maintaining an entertainment facility, provide records showing the total use and business use of the facility, and expenses incurred, in addition to the information required above.

\_\_\_\_ If you claimed expenses for business gifts, provide records and receipts showing cost of the gifts, persons to whom the business gifts were made, and their business relationship.

TRAVEL EXPENSES-MISCELLANEOUS DEDUCTIONS

\_\_\_\_ Furnish a log diary for travel costs incurred while away from home on business. This information should include transportation tickets, receipts, and canceled checks, etc.

UNIFORMS, EQUIPMENT, AND TOOLS

\_\_\_\_ Explanation of how expense related to your employment including a description of the uniform.

\_\_\_\_ Statement from your employer that the expense was required, reimbursement policy, and amount reimbursed or allowance paid.

\_\_\_\_ Canceled checks and receipts verifying the expense.