SMALL CHANGE

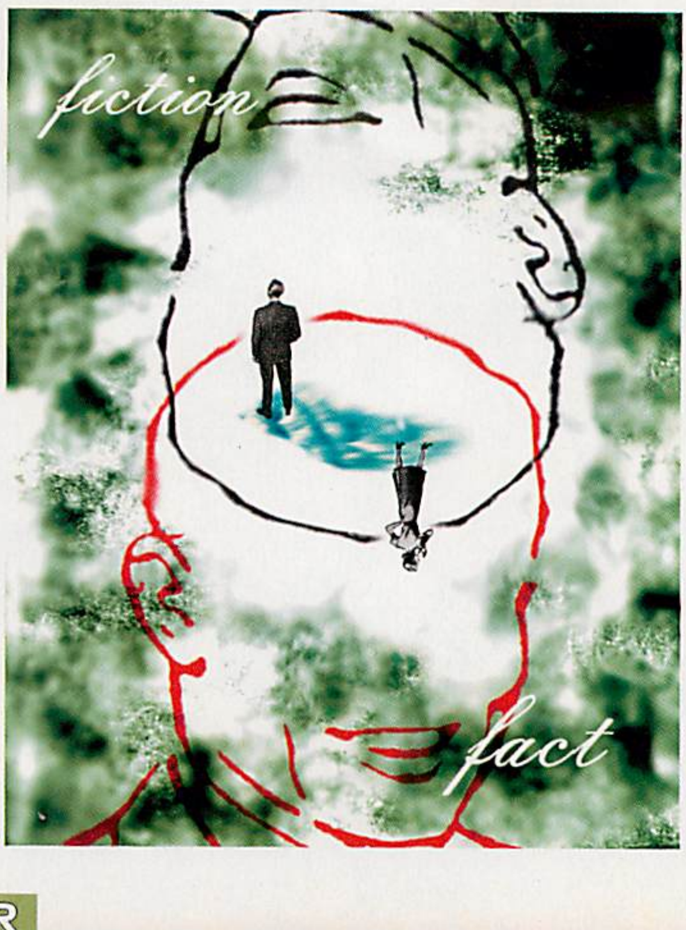
Here's what's new for taxpayers come this April 15.

BY DAVID J. SILVERMAN

Not a lot has changed for the 1996 tax year, in keeping with a trend that began back in 1994, but here are the six new twists that are most likely to affect SmartMoney readers this tax season.

1. Direct Deposit of Your Refund. If you're owed money this year, you'll be happy to know that getting it faster is getting easier. You don't even have to fill out a special form anymore. Just enter the routing number of your bank and your account number on the line below the refund line on your tax return. (Your routing number is the nine-digit number to the left of your account number at the bottom of your check.) Curiously, a number of my clients are reluctant to take the IRS up on this offer. "The IRS knows too much about me already" seems to be their rationale. While I can understand their fear, believe me, the IRS can figure out your bank account number on its own if it wants to. The fact is, direct deposit is the best way I know to make sure your refund isn't among the 96,000 refund checks returned to the IRS by the post office every year—and that number doesn't even include the checks that are lost or stolen.

2. Employer-Provided Education. Until 1995, your employer could reimburse you or pay for up to $5,250 worth of education expenses, and you didn't have to pay tax on that benefit. That provision was stripped away, but now it has been reinstated retroactively to 1995. So if your employer paid for any education during that period and you paid tax on it, you are entitled to two refunds: one from your employer for the Social Security and Medicare taxes you paid and one from the IRS for the tax you paid. Your employer has to issue you a Form W-2c (Statement of Correct Income and Tax Amounts) showing the corrected wages. Attach it to form 1040X (Amended U.S. Income Tax Return). Get used to filing amended returns, because the $5,250 rule expires again on June 30, 1997, and Congress likes to reinstate it retroactively. One other wrinkle: After June 30, 1996, graduate-level courses no longer qualify.



3. Social Security Numbers for Newborns. Last year, kids born in November and December didn't need Social Security numbers. Now only December babies get a break. Otherwise, every dependent you claim requires one. No number, no deduction. This rule also applies to the Earned Income and Child Care credit. You can get an application for a Social Security card (Form SS-5) by calling 800-772-1213.

4. Personal Exemptions. You get to deduct $2,550 for 1996, a $50 increase from last year. That is, assuming you don't earn too much: Each of your personal exemptions decreases by $51 for every $2,500 of income above $117,950 if you're single, or $176,950 if you're married filing jointly.

5. Standard Deduction. In calculating your taxable income, you are allowed to deduct the larger of either your itemized deductions (for most people it's taxes, mortgage interest, charity and business expenses) or the standard deduction. This year inflation pushed the standard deduction for singles up $100, to $4,000, and up $150 for married couples, to $6,700. Taxpayers who are 65 or older, or are blind, get to increase their standard deduction by $1,000 if single, or $800 if married. These amounts get doubled for anyone who is both 65 or older and blind.

6. Standard Mileage Allowance. People who use the standard allowance instead of deducting all their actual auto expenses may claim 31 cents per mile, up from last year's 30 cents. For auto use to get to the doctor or to medical therapy and in connection with moving expenses, the allowance inched up a penny, to 10 cents. For unreimbursed charitable work, the IRS is not so charitable; the deduction remains at 12 cents.

Payback Time on Your Mutual Funds

Sell any mutual fund shares for a big gain last year? Congratulations. Now you get to pay the tax on your profits. The simplest way to figure out how much you owe—apart from getting your fund company to do the math for you, which many already do—is the "average-cost basis" method. Figure the average price you paid for all of your shares, including shares you bought through reinvested dividends. Subtract this number from your selling price and you've got your taxable capital gain. Still a little confused? The worksheet below will walk you through it.

1. Original cost of your fund shares (including broker's fees, transfer charges and loads) $________
2. Dividends reinvested (including tax-exempt dividends) ....$________
3. Fund's retained long-term capital gains (reported to you on Form 2439)*..........................$________
4. Add lines 1 through 3. ....$________
5. Taxes paid by fund on long-term capital gains (reported to you on Form 2439)*..........................$________
6. Subtract line 5 from line 4. (This is your aggregate tax basis.)..........................$________
7. Number of shares you owned before selling ....________
8. Divide line 6 by line 7. (This is your average-cost basis.)..........................$________
9. Number of shares you sold..................................________
10. Multiply line 8 by line 9. ....$________
11. Total sales proceeds (minus commissions and back-end fees)................$________
12. Subtract line 11 from line 10. (This is your taxable gain or loss.)..........................$________

*It's rare that a fund has retained long-term capital gains, so you probably won't have to worry about this.

BEYOND BELIEF

Debunking the tax season's most common myths.

Through the years I have found that people are as superstitious about April 15 as they are about Friday the 13th or walking under a ladder. Tax myths, like other superstitions, have a loyal following. Here are some of my personal favorites:

The IRS's Preprinted Label Is an Audit Magnet. I'm afraid not. The label is used to speed up the processing of your return, not to determine if you should be audited. If the IRS wants to investigate you, it doesn't need a gummed label. It has over 100,000 employees and a computer the size of the Pentagon at its disposal. So then, what do those numbers mean on the label? Brace yourself: It's information about whether the IRS sent you the long or short tax form and where you filed last year.

It's Best to File at the Last Minute. I agree. You shouldn't pay what you owe one second before it's due. But your return won't get lost in the crowd by being filed at the stroke of midnight on April 15. Returns are selected for audit on the basis of a DIF score, which is shorthand for Discriminant Function. DIF scores measure whether the IRS believes a return is accurate or not. Every return gets graded, no matter when it arrives.

Only People with Large Incomes or Deductions Get Audited. It's just not so. The IRS has switched its focus away from verifying deductions to checking whether you report all your income. If you are self-employed, operate a small business or receive a large portion of your income from tips, the IRS is especially interested in you.

No News Is Good News. Clients have often told me how they received a notice from the IRS, ignored it and then never heard from the agency again. Here's where no news could be bad news. After the IRS sends you a bill, it has 10 years to collect what you owe, and the interest meter is always running.

I Can Always Settle for Less. Unfortunately, in my experience the IRS's much-heralded "Offer in Compromise" program—in which you pay only part of what you owe—falls under the heading, "If it sounds too good to be true . . ." In fact, most offers are rejected. I've found that to cut a real deal with the IRS, you've got to be getting on in years, in poor health and broke.

Who Will Know? The IRS will know, that's who. Just about every transaction between you and your employer, bank, customers, stockbroker etc. is reported to the IRS and can be matched against what you report on your return. Last year the IRS sent almost 3 million extra tax bills to people who failed to report all their income.

I Can Reduce My Tax by Making Tax-Free Gifts. This is one of the most common mistakes of all. The annual $10,000 gift-tax exclusion—$20,000 if you are married—means you can give away that much money per year per person without owing *gift or estate tax* or eating into your $600,000 lifetime exemption. It does not reduce the amount of income tax you have to pay.

—D.J.S.