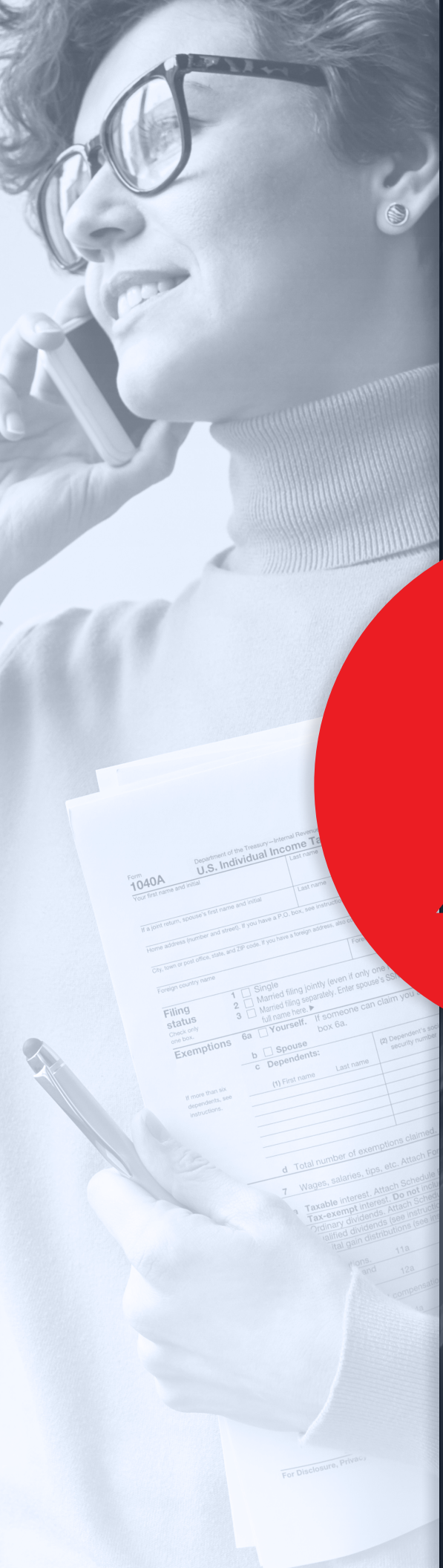

COMMON tax errors TO AVOID

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Our extended tax season is coming to a close, bringing a time of paperwork and planning to millions of Americans. In 2017, the Tax Cuts and Jobs Act (TCJA) became law, vastly changing the U.S. tax system.[1] In addition to navigating how the landscape may affect you financially, another tax priority to keep on your radar is attempting to avoid errors when filing.

Navigating the U.S. tax system can be challenging. Knowing how you need to file depends on your income and filing status as well as which tax breaks you can claim.[2] Your taxes are your responsibility, even if someone assists you in filing them.

As you prepare your taxes, here are some common filing errors to avoid. Keep in mind, this white paper is for informational purposes only. It's not a replacement for real-life advice, so make sure to consult your tax, legal, and accounting professionals before modifying your strategy. But remember, tax rules are constantly changing, and there is no guarantee that the treatment of certain existing rules will remain the same.

Error 1
Overlooked Side Income

Taxpayers must claim any income they received in a tax year. One area that some taxpayers overlook is claiming side money that is in addition to their normal salary. If you receive income from efforts outside your regular wages or self-employment, then you are obligated to report what you received.

This money usually isn't reported on a 1099 or W-2 and can include income from the following sources (and more)[3]:

- Activity that won't yield a profit, such as a hobby
- Barters for services or property
- Forgone interest from below-market loans
- Canceled debt, including discounts on mortgage loans
- Social Security benefits to spouses and dependents (subject to filing status and income)
- Unemployment compensation

But not all side money you receive is considered taxable. If you receive a financial gift from someone, like a family member, you may not have to claim this money as taxable income.[4]

SOME REASONS FOR
IRS tax penalties

- Not filing by the tax deadline
- Not paying owed taxes on time
- Not paying quarterly taxes, when needed
- Your bank doesn't honor your check or other form of payment

Source: IRS.gov, 2020

Error 2
Unrealized Tax Breaks

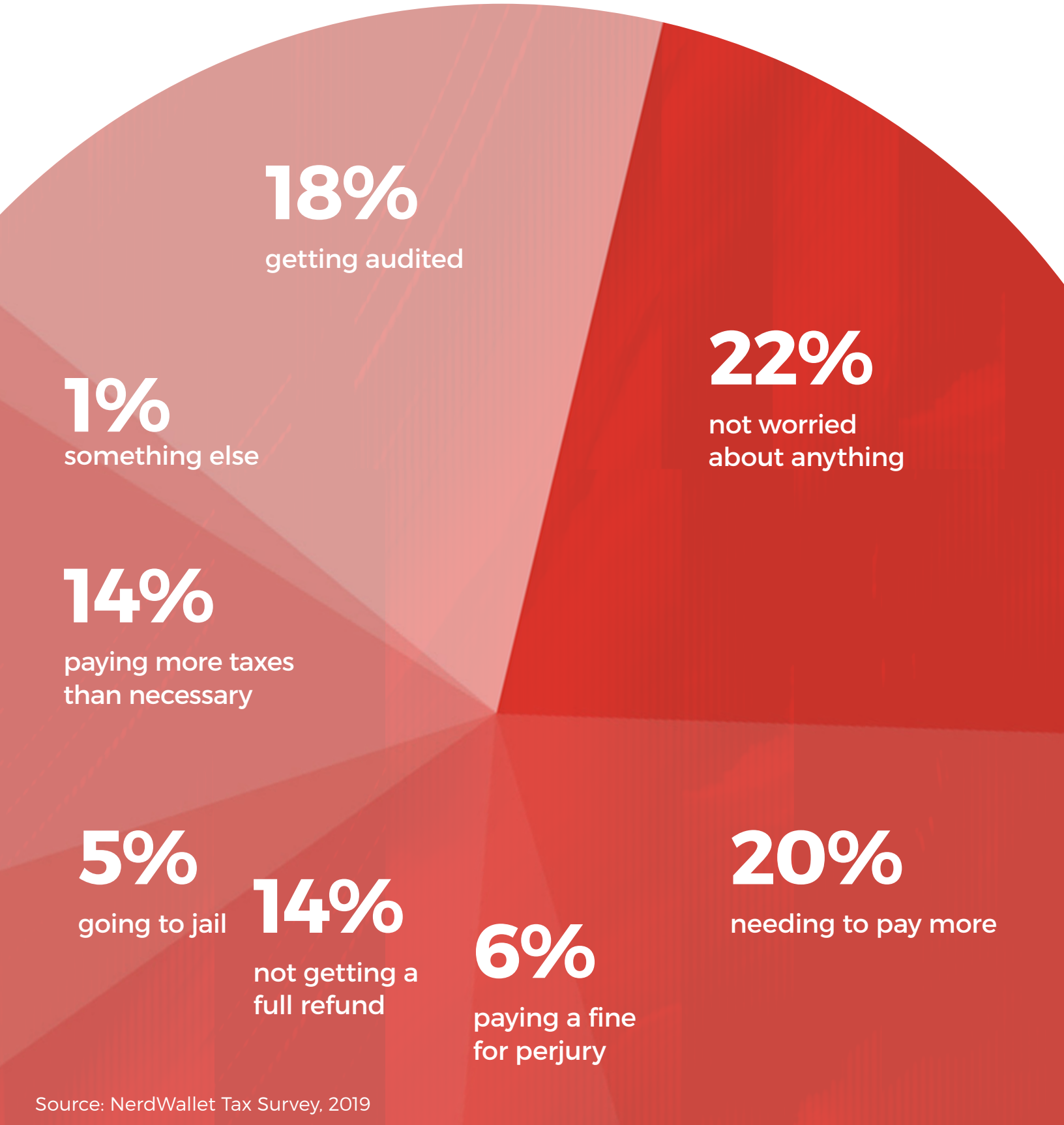
Tax breaks can manage the taxes you owe or change your liability, resulting in greater benefits for you. While deductions are one form of tax breaks, others include tax credits, exemptions, and certain tools designed to manage your tax burden.[5]

Here are some tax breaks worth keeping on your radar:

- Child and Dependent Care Tax Credit: This credit allows you to claim the childcare costs you have for children younger than 13. You can also claim expenses related to caring for a spouse or dependent who cannot physically or mentally care for themselves.[6]
- Reinvested Dividends: This tax break could help you save money by not double-taxing dividends that you reinvested to buy more shares.[7]
- Appreciated Stock Donations: Donating stocks to nonprofits that you wish to support can financially help the organization while potentially lowering your tax responsibilities.[8]

TOP TAXPAYER CONCERNS ABOUT

filing taxes incorrectly



Source: NerdWallet Tax Survey, 2019

Error 3
Wrong Filing Status

Your filing status can greatly impact your taxes because it defines your standard deduction and tax brackets. A common reason people choose an incorrect status is because it has changed during the tax year. Before filing your taxes, be sure that you've updated your tax paperwork to reflect any changes to your filing status.

The Five different tax filing statuses are:

- **Single:** Taxpayers who aren't married, are divorced, or are legally separated (as state law dictates).
- **Married Filing Jointly:** Taxpayers who are married and will file a combined joint return. Widow(er)s can typically file a joint return within the first tax year of losing their spouse.
- **Married Filing Separately:** Taxpayers who are married and choose to file separate tax returns, which may or may not decrease their tax liabilities.
- **Head of Household:** Taxpayers who are typically single and pay at least half of home expenses for themselves and a qualified person.
- **Qualifying Widow(er) with a Dependent Child:** Taxpayers whose spouse has died within the past two years and have a dependent child, assuming other qualifications are met.[9]

Changes to Filing Status

As your life changes, you can revise your filing status to match. However, if you're amending previous years' tax returns, you have limitations. For example, if your status is married filing separately, you can amend your previous returns to be married filed jointly, but not the other way around.[10]

Error 4
Incorrectly Claimed Dependents

As stated earlier, taxpayers can claim dependents they are financially responsible for during a tax year. The IRS defines dependents as a "qualifying child" or "qualifying relative."[11] As part of the 2017 Tax Cuts and Jobs Act, taxpayers can no longer claim personal exemptions for each dependent, and they can miss out on other tax benefits by incorrectly claiming or forgetting a dependent. Be aware that if you have a blended family, in which you share children with another taxpayer, you could end up accidentally claiming children when only one parent would be able to do so.[12]

Here are some tips to help you claim dependents[11, 13]:

- Age Cap: Dependents must be under the age of 19 (or for full-time students under the age of 24) at the end of the tax year.
- Claims Cap: Only one taxpayer at a time can typically claim a dependent.
- Same Residence: The claimed dependent must live with the taxpayer for more than six months of the same year.
- Proof of Records: Having school and medical records on hand will help prove you live at the same address.

New Credit for Dependents

One new tax credit available is referred to as the Credit for Other Dependents. To claim this credit, taxpayers must support dependents who are either:

- Their children, aged 17 years or older (at end of the tax year)
- Their parents
- Other qualifying relatives

However, this credit is only for taxpayers not claiming dependents under the Child Tax Credit, so be sure to correctly file this detail.[14]

Error 5
Not Having Proof of Purchases

Your paperwork is crucial for filing taxes correctly and includes everything from your pay slips to receipts. Beyond helping you file taxes, your documents also serve as proof for the claims you make on your return. Should the IRS find any errors or choose to audit you, you'll need these records to back up the numbers.

Here is a partial list of items to have on hand for verifying your financial records[15, 16]:

- Receipts: You'll need receipts to prove any tax breaks you're claiming, including transportation and any volunteer work.
- Mileage: Keep track of the miles you spend driving for things like volunteering, business meetings, or medical appointments. You also want to document any parking fees, bus or taxi fares, and tolls that you had to pay for those efforts.
- Documents on Life Events: Store important documents that relate to any life events you're including in your tax claims, such as:
    - Adoption
    - Child custody arrangement
    - Divorce
    - Marriage
    - Spousal death
- Medical Records for Home Improvements: If you renovated your home due to medical reasons, such as installing a wheelchair ramp, be sure to keep these medical and expense records.

The suggested timeframe for storing your records (and corresponding tax returns) is between 7 and 10 years. We suggest consulting your tax professional for additional perspectives.[17]

Error 6
Not Accounting for Income Changes

Your or your family's income is the key determinant of how much you'll pay in federal taxes. The IRS will tax you at a different rate depending on the total you're reporting.

The TCJA redefined the income brackets people claim when filling[18]:

2021 rate	single filers	married filed jointly
10%	$0 – $9,950	$0 – $19,900
12%	$9,951 – $40,525	$19,901 – $81,050
22%	$40,526 – $86,375	$81,051 – $172,750
24%	$86,376 – $164,925	$172,751 – $329,850
32%	$164,926 – $209,425	$329,851 – $418,850
35%	$209,426 – $523,600	$418,851 – $628,300
37%	$523,600+	$628,300+

To know your tax bracket, it helps to do calculations before you file. You'll need to identify your taxable income by[19]:

1. Adding together your earned and investment incomes
2. Subtracting from that total any adjustments and deductions

In Conclusion

Filing your taxes can be a complex responsibility, and accidental errors can be easy to make. By being diligent, carefully strategizing, and keeping tight records, you can improve your ability to file taxes without mistakes. Even if you're choosing to work with a tax professional, you are responsible for making sure you correctly file your financial details.

Remember, if you have any questions about your financial life, we're here to help you navigate this complicated landscape. We always welcome collaborating with your tax professionals to align the strategies you take across your financial priorities.

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