

Dodging Tax Penalties

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Most taxpayers don't intentionally incur tax penalties, but many who are penalized are simply not aware of the penalties or the impact they can have on their wallet. As tax season approaches, let's look at some of the more commonly encountered penalties and how they may be avoided.

Underpayment of Estimated Taxes and Withholding – Taxpayers are required to pay their tax liability as they go during the year, either through withholding or by making estimated tax payments. If the taxpayer owes more than \$1,000 when filing his or her return for the year, the IRS will assess the underpayment of estimated tax penalty, which is currently 4% of the underpayment computed quarterly. There are "safe harbor" payments that can protect you from this penalty, which include payments in the following amounts: 90% of the current year's tax liability or 100% (110% for high-income taxpayers) of the prior year's tax liability. Farmers and fishermen need only prepay 66-2/3% of the current liability or 100% of the prior year's liability.

Late Paying Penalty – When the tax owed on a return is paid after the unextended due date of the tax return (usually April 15), the taxpayer is subject to a penalty of 1/2% per month (maximum 25%) on the unpaid balance. Taxpayers are frequently caught by this penalty when they need an extension to file their tax return. Many fail to realize that the extension does not include an extension to pay. The only way to avoid or minimize this penalty is to have no or little balance due on the return when it is finally filed. The extension form includes a provision to pay the projected balance owed when filing the extension.

Late Filing Penalty – If the return is filed after the due date, including extensions, a late filing penalty of 4.5% per month (maximum 22.5%) applies. The automatic extended due date for 2016 returns is October 18, 2017, but an extension request form must be filed by the April 2017 due date to qualify. Thus, the penalty would generally apply to 2016 returns filed after October 18, 2017. If the return is over 60 days late, the minimum penalty for failure to file is the lesser of \$205 or 100% of the tax shown on the return. While the obvious way to avoid a late filing penalty is to file in a timely fashion, the IRS will consider abating the penalty if it can be proven that there was reasonable cause and no willful neglect for filing late.

Negligence – When underpayment is due to negligence on the part of the taxpayer or when there are errors in tax valuations, 20% of the tax underpayment is charged. This penalty is frequently encountered when the IRS adjusts a filed return due to unreported income or overstated deductions. To reduce the chance that you may be subject to this penalty, be sure you provide all of your W-2s, 1099s, K-1s, etc. for the preparation of your return, complete any organizer that have been requested and ensure that you can substantiate all of the deductions you claim.

Dishonored Check – The penalty for dishonored checks is 2% of the check amount, but if the amount is \$1,250 or less, the penalty is the amount of the check or \$25, whichever is

less. If you don't have sufficient funds to pay your tax when you file your return, rather than writing a check that you know will bounce, you may be able to arrange an installment payment plan with the IRS. You may still incur late payment charges, but the penalty rate is lower if you are on a payment plan.

Missing ID Number – This penalty of \$50 for each missing number is charged when a taxpayer doesn't provide a required Social Security number (SSN) for him or herself, a dependent or another person on his or her tax return or doesn't. It is also charged when the taxpayer doesn't provide his or her SSN to another person or entity when required.

There are more severe penalties not mentioned here that apply to fraudulent actions or claims. In addition to the late filing penalty, it is possible to have some of the other penalties abated for reasonable causes. If you have questions related to the application of any of these penalties, please give this office a call.