I Know Nothing About Taxes. Where Do I Start?

Everyone pays taxes, yet it's a complicated process that many of us don't fully understand. As one Utah-based listener learned the hard way, one simple oversight is all it takes to get a big bill from the IRS, instead of your anticipated refund. In this episode, host Stefanie O'Connell Rodriguez tackles all the essentials with Caleb Silver, editor-in-chief of Investopedia, and Kristin Myers, editor-in-chief of The Balance, including what each tax form means, how to claim deductions (and find out what you qualify for), how to handle charitable donations, when to expect your refund, how to avoid scams, and so much more.

[MUSIC IN]

Teresa: At the time I didn't really have savings. I wasn't great with money. So just that feeling of scrambling of how am I going to pay for this and what happened? And looking at my W2 and realizing that there were no taxes withheld.

Stefanie O'Connell Rodriguez: This is Taxes in Ten, a limited series from the podcast Money Confidential at *Real Simple*. I'm your host, Stefanie O'Connell Rodriguez. And this week, we're talking to a Utah-based listener we're calling Teresa, not her real name.

[MUSIC FADE UNDER & OUT]

Stefanie O'Connell Rodriguez: A few years ago, Teresa started a new job at a public health organization. She filled out all of the paperwork, including the Employee Withholding Certificate, better known as a W4, an IRS form that essentially tells employers how much tax to withhold from each paycheck based on the employee's filing status, dependents, anticipated tax credits, and deductions.

Teresa filled out the form like she normally did and started working.

Teresa: I went on my way and I started doing my job and I never checked my pay statements to verify any of that information that HR manually entered after I filled in the paperwork.

Stefanie O’Connell Rodriguez: But when tax season rolled around and Teresa input all her income and information into the tax preparation software she was using, the estimate of the tax refund she expected, turned into a big, unexpected tax bill.

Teresa: The numbers just plummeted - went from a decent amount in the green to a few thousand dollars in the red and my stomach just dropped.

Stefanie O’Connell Rodriguez: She didn’t know what had happened. So after scrambling to come up with the money to pay her surprise tax bill, Teresa started searching for answers.

Teresa: I checked my pay statement and instead of two exemptions, like I had put on my initial HR paperwork, the HR representative entering it in accidentally put 20 exemptions.

Stefanie O’Connell Rodriguez: For almost a full year, no Federal or state taxes had been withheld from Teresa’s paycheck.

Teresa: Since that day, I have never not checked my paycheck.

Stefanie O’Connell Rodriguez: While the IRS revised the W-4 form in 2020, that doesn’t mean oversights like Teresa’s still can’t wreak havoc.

[MUSIC FADE IN]

In fact, some of the biggest tax mishaps can be avoided with the simplest steps—double checking your paperwork, your paychecks, and anything filled in or filed on your behalf.

[MUSIC FADE UNDER AND OUT]

And whether you opt to do your own taxes or work with an expert, there are some tax fundamentals and best practices we all need to know. So for the next six weeks we’re teaming up with personal finance experts, Kristin Myers, editor-in-chief of The Balance, and Caleb Silver, editor-in-chief of Investopedia, to lay out all the essentials.

Caleb Silver: The 16th amendment to the US constitution states "The Congress shall have the power to lay and collect taxes on incomes from whatever source derived, without apportionment among the several states and without regard to any census or enumeration," Everybody—students, parents, members of the military, seniors and retirees, the self-employed gig economy, workers, employees, small business owners—we all owe taxes.

Stefanie O'Connell Rodriguez: For a lot of people, their first experience is when they get their first job and they get a W4 form and they don't even know how to fill it out. And if they don't do it correctly, they could face a nasty surprise. So what do we need to know when we're filling in our paperwork to begin with?

Caleb Silver: You have to know your status, whether you have a family or whether you're filing single and you don't have a family, or you're claiming dependents. Dependents are the people who depend on you for income, and you get a deduction for those dependents. Depending on the year the number that you get for those dependents changes.

So you have to fill that out. You also have to claim any deductions that are not standard. If you have any questions about that, you could talk to your HR department or check it out on the irs.gov website as to what you should claim for yourself.

Stefanie O'Connell Rodriguez: I know for a lot of folks, they have been taking on freelance gigs, things that are not W2 income.

Caleb Silver: For those folks, mostly they're getting 1099 forms, so they're getting taxed at a different amount because they don't have the same things taken out of their check that an employee with a W2 might get. That means social security, in some cases, some Medicare in some cases. So it depends on your status. If you're working full-time for a company you're most likely going to be a W2 employee. If you're a gig worker, you're a 1099 employee, but if you're a small business owner, you could be subject to a different tax. So you have to classify yourself correctly, and that's how you pay your taxes, based on how you file and the income you make determines how much you get in taxes, or how much you have to pay in taxes, come tax time.

Kristin Myers: No matter how you get money, Uncle Sam wants his cut. So if you are taking on a side job, building up a side business or have some sort of side hustle, you are going to have to pay money, come tax time. So it's recommended that you were going to save up to 35% of the money that you're earning from that side hustle in case you need to pay some taxes back, because what you don't want is to claim that side hustle money, and then all of a sudden get hit with a huge tax bill that you don't have money to pay for.

Caleb Silver: On the flip side, you're also potentially spending money to get that side hustle going. So if you've spending money, whether it's a vehicle you use part of the time for that side hustle, or you bought some lawn mowers, cause you have a lawnmower business and you're mowing lawns. Those are business expenses you could be claiming as deductions. So you can have the side hustle and you have to pay taxes on the income, but treat it like a small business and make sure that you're filing those returns and you're filing those receipts because you could get some money back as well. So treat your side hustle like it's a small business and treat it that way at tax time. And that way you'll have everything squared away.

Stefanie O'Connell Rodriguez: And what are the important dates we need to be looking out for? And do they differ depending on our tax filing status?

Caleb Silver: They move around a little bit every year, but it's usually around the middle of the month in April. So I believe in 2022, we have to file 2021 taxes by April 18th. If you own a small business, sometimes you're on a quarterly filing schedule. You have to file every quarter, usually with your state, but sometimes with the government as well.

[MUSIC IN]

Stefanie O’Connell Rodriguez: While the deadline to file your 2021 tax returns might not exactly be something you’re looking forward to, what comes after that might be if you’re anticipating a refund. After the break, we’ll be back with when you can expect to see that money and more.

[MUSIC OUT]

Stefanie O'Connell Rodriguez: If I’m anticipating a refund, I know I'm excited to see that money in my bank account. So when, Kristin, can I expect that?

Kristin Myers: So the IRS says that you should, a huge caveat on the word should, get that refund in 21 days or less. And if you electronically file, chances are you're going to get your refund faster. However, the pandemic is still impacting the IRS. So if it has taken longer than 21 days, do not get too, too worried, it should still be on its way. Now you're going to get a refund back, generally speaking, if you overpay on your taxes. So when you're filling out that W4. Perhaps you didn't put as many deductions as you should have put. And so you've been paying more to the government than you needed to. You're going to get some money back when it comes to that refund time. You also can possibly get money back if you're owed a credit.

And a credit can happen in a variety of scenarios. If you have children and you start declaring them on your taxes, you can get a child tax credit back perhaps. If you earn less than a certain amount, you could get money back, that's that earned income tax credit. There are a lot of ways in which you can kind of claim some of these deductions —charitable giving is another.

Stefanie O'Connell Rodriguez: And can we just break down, Kristin, standard deduction versus itemizing?

Kristin Myers: Yeah. So the IRS essentially says, let's make it easy. You can just claim a standard deduction of up to $12,550. Again remember, that number did go up in 2022. And what the IRS is saying is you don't actually have to list out in other words, itemize, every single individual deduction that you're going to be needing to claim, you can just claim up to that $12,550.

Now, this is where it can sometimes get annoying because depending on your tax situation, whether you have children, if you sold property, if you bought property, if you got married et cetera, et cetera, it actually might make more sense for you to itemize those deductions. And you're going to want to do that if the itemized deductions or all the money you want to claim back from the government is more than that standard deduction. But if you're 23 years old, got your first job, don't own anything, you just go to work, pay your taxes and come home. Chances are the standard deduction is just fine for you.

Stefanie O'Connell Rodriguez: So these are a lot of things that we might be able to deduct but Caleb, tell me what other potential sources of income might we be missing that we owe taxes on?

Caleb Silver: Some of these really surprised me: scholarships and work study. If you receive a scholarship that pays for anything other than tuition fees and books, you have to pay taxes on it. If you earn more than $12,400 per year or more so that's an income level, but still you have to keep that in mind.

If you have an Airbnb and you're renting out a room in your house or an extra house, you have to pay taxes on that income. If you sell your eggs, you have to pay taxes on the amount you receive. If you have gambling winnings, you have to pay taxes on those above a certain amount. If you get canceled or discharged debt, if you owe debt to a credit card company and they discharge it, you actually have to pay taxes on some of that amount. And if you make proceeds from illegal activity, if you rob a bank, if you steal from somebody, the IRS wants you to pay taxes on that. I don't think you're going to come forth and admit it, but that's how they got Al Capone. And the last one that really surprised me. If you find treasure in your backyard, digging up the rose garden and you find a big diamond ring, you got to pay taxes on that or if you're SCUBA diving in the Caribbean and you find treasure on a ship, you gotta pay taxes on that too.

Stefanie O'Connell Rodriguez: So basically you're telling me everyone owes taxes on everything is the short summary of this episode.

Caleb Silver: That is the short title of this episode. And it's always true and it will always be true.

[BEAT DROPS]

Stefanie O'Connell Rodriguez: Next week on Taxes in Ten, we'll be back with Kristin and Caleb to talk about what's new this tax season and how these changes could impact your 2021 tax return–as well as tips for planning your finances for the year ahead.

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