How Do I Avoid Penalties and Maximize My Tax Refund?

For many people, taxes are intimidating. After all, slip-ups can have serious consequences. Take this week's guest, a 40-year-old public service worker based in Washington, DC, who wound up with a massive bill from the IRS after adjusting her tax withholding to pay down debt quicker and not filing taxes for two years. To help you avoid tax mistakes and maximize benefits–and ensure you're up to date on all that changed for 2021–host Stefanie O'Connell Rodriguez turns to Kristin Myers, editor-in-chief of The Balance, and Caleb Silver, editor-in-chief of Investopedia.

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Jada: Let me tell you, it was very hard seeing that tax bill being added and seeing that I'm in $211,000 of debt. It was a gut punch.

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 40-year-old public service worker based in Washington DC-who we're calling Jada, not her real name.

[MUSIC FADE UNDER & OUT]

Stefanie O'Connell Rodriguez: In September 2018 Jada was $189,000 in debt. Hoping to pay down her debt faster, Jada, adjusted her tax withholding to increase her take home pay on each paycheck**.**

Jada: I did that because a coworker of mine was doing it, but she even said, "Hey, you know, you should probably only do it for a few months and then adjust your allowances back the way they're supposed to be so that you can not have to owe the IRS."

Stefanie O'Connell Rodriguez: But that's not what happened.

Jada: I got really comfortable with having this quote unquote, extra money on my paycheck.

Stefanie O'Connell Rodriguez: And in addition to under withholding, Jada didn't file her Federal or State tax returns for two years.

Jada: And I didn't file because, like the other debt I had been ignoring, I was avoiding it.

Stefanie O'Connell Rodriguez: While Jada may have been avoiding filing her taxes, she was making real progress on her debt pay off journey. By June of 2019, she'd paid off around $16,000. So she decided to hire a tax professional to help her file her outstanding tax returns.

Jada: When I got the actual tax bills in the mail, it turned out to be $21,946 with penalty and interest.

Stefanie O'Connell Rodriguez: Jada's tax bill brought her total debt balance to even more than where she'd started.

Jada: It was the first time since I got serious about my debt that I felt like I was going to give up. I felt like it was the universe just telling me, "Nah, this isn't for you. Debt freedom is an illusion. This is not something that you can obtain." And I almost quit.

Stefanie O'Connell Rodriguez: But she didn't. To manage the emotional burden of her financial situation, Jada started seeing a therapist. And eventually, she got back on track with her debt repayment plan and paid off the last of her outstanding $21,946 tax bill in March of 2021.

But here we are in 2022, taking on yet another tax season. And while, like Jada, many of us have learned lessons the hard way—what can make tax season especially tricky is that the rules and laws are constantly changing.

Caleb Silver: It's hard enough for people just to stay on top of their own personal finances, but when it comes time to reporting all of that to the government, it's even more complicated and it's pretty daunting.

Stefanie O'Connell Rodriguez: That's Caleb Silver, personal finance expert and editor-in-chief of Investopedia. He and Kristin Myers, editor-in-chief of The Balance, are back this week to help us break down what's new this tax season and the changes we can expect to see when filing our tax returns.

Kristin Myers: So many changes have been happening in the tax code. One of the first things would be those standard deductions. They jumped up to $12,550, if you were a single filer, over $25,000 if you're married, and it was over $18,000, almost $19,000, if you were filing as a head of household.

Now income tax brackets also did change but you're going to want to check out what those new income tax brackets are, because it might mean that you actually aren't in the tax bracket that you thought you were. Perhaps you might be paying a little bit more in taxes. You might also be paying a little bit less. And then that child tax credit, that also got a nice bump.

Stefanie O'Connell Rodriguez: Caleb, I want to take a deeper dive on this child tax credit. So can you kind of break that down for us?

Caleb Silver: Yeah. For qualifying families, if you did get that childcare tax credit payment you gotta make sure that you compare that with what you can actually claim on your tax return. So, if you see less than you're eligible [for], you can claim a credit on your 2021 return. And eligible families who didn't get the monthly advanced payments in 2021 for some reason, they can get the lump sum payment on that childcare tax credit when they filed their return this year.

The question is, will it stick around in 2022? That's a very big question, but you should make sure you get the eligible money you deserved for last year.

Stefanie O'Connell Rodriguez: And what does that look like? How do I figure out my eligibility?

Caleb Silver: Well, if you earn under $150,000 as a married couple you get a certain amount per child. Again, that's up to $4,000 per qualifying child. But, if you earn over that amount, you won't get a tax credit payment, so you should not be expecting it.

Stefanie O'Connell Rodriguez: Another major thing in the last couple of years were unemployment benefits. Kristin, what are the tax implications there?

Kristin Myers: So, in 2020, if you were receiving unemployment because of the pandemic, you actually got a tax break. Typically you have to pay tax for those unemployment benefits that you received. Unfortunately, in 2021, that tax break was essentially taken away. So, you are going to have to pay taxes on those unemployment benefits again.

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Stefanie O’Connell Rodriguez: After the break, we’ll be back with Caleb and Kristin to talk about what the latest changes to the tax code mean for how we should be managing our money today.

[MUSIC OUT]

Stefanie O’Connell Rodriguez: Are there any other things that we need to be aware of in terms of what's new this season or next season that should inform how we're financially planning today?

Caleb Silver: Yeah. Keep an eye on the standard deduction amounts for 2022—Kristin was talking about it earlier. The standard deduction amounts are going to increase to $12,950 from the $12,550 for individuals and married couples filing separately and $19,400 for heads of households.

So that's a significant amount. That's to combat inflation, but you also have a cost-of-living increase—two things you should keep an eye on. The other thing, again, is that child care tax credit, is that going to stay in place? It is sort of caught in the Build Back Better plan negotiations right now.

I also think if you've made a life change in the past year or you're planning one this year, you're changing jobs, you're retiring. Maybe you're getting a divorce. Maybe you're getting married. Each one of those has tax implications, but you got to familiarize yourself with what those are before you make those steps, because those should be factored into any decision you're making.

There are a lot of tax breaks out there that a lot of people don't know about. And there are a lot of tax burdens out there that folks don't know about. So, every time you're about to make that significant change, always consider what that might mean from a tax standpoint.

So irs.gov, you can probably find some simple answers there, but it can get pretty complicated. And if you use a tax preparer software, a lot of those have good educational, glossaries and explainers that could help you as well.

Stefanie O’Connell Rodriguez: There's also a lot of paperwork that comes with that stuff. So, what do I need to hold on to so that I have the right thing in hand when it comes time to file my taxes?

Kristin Myers: The IRS actually recommends you keep these records for up to three years. So, you don't actually have to keep it in an ever-increasing box, and the records that you're going to want to keep hold of are essentially records of your income. So that might be the W2. That's that form that your job is going to send you that says how much you earned in that calendar year, or your 1099s if you're more of a gig worker. You're going to want to keep records of all of your expenses. So if you own a home, that's going to be your property records and taxes that you're paying on the property, or even on the interest that you're paying on your mortgage. If you have a business you're going to want to keep records, recording your business income, and also your business expenses. If you've given charitably, you're going to want to start keeping records of that, at least for that filing year, and then two more years after that.

Caleb Silver: There was a change in the year 2021 where taxpayers, who don't itemize their deductions, they can qualify to take a charitable deduction of up to $600 for married taxpayers filing joint returns, and up to $300 for other filers. So that's important. You can take a bigger chunk for a deduction in the year 2021. The government was trying to incentivize some contributions. If you do itemize, there is the Tax Relief Act of 2020 that lets you apply an increased limit of up to a hundred percent of your adjusted gross income for cash contributions made to charities during 2021.

[BEAT DROPS]

Stefanie O’Connell Rodriguez: For more on what’s new this tax season, like the changes to the standard deduction, the child tax credit, and deductions for charitable giving, join us again next week. We’ll also break down what you need to know before you decide whether to do your own taxes or consider hiring a tax professional to help you file your return.

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