

# CHALLENGES OF THE 2021 TAX-FILING SEASON

## Overview

This year, the season for filing 2021 income tax returns began Jan. 24 and ends on April 18, unless you file for an extension. The IRS reports that refunds are typically issued within three weeks.<sup>1</sup>

There are several issues that are relatively unique to 2021 tax returns. These include reporting income earned outside of one's home state, reconciling last year's stimulus checks and figuring out whether any advance child tax credit payments must be repaid.

## Remote Income

Many people still worked from home in 2021, our second year into the pandemic. However, for some, "home" was wherever they could access Wi-Fi on their laptop. A number of employees took the opportunity to do some traveling while still holding down their daily job. The problem is that when you earn income from outside of your home state, you may, in fact, owe taxes on that income in both states. If you traveled all over the country, you may have to file taxes in states where you worked for the money you earned during the time you were there.

Each state has different rules related to how long you were there and how much you earned. Some have temporary waivers or reciprocal agreements with other states, but only six states tax you strictly on where your employer's office is located.<sup>2</sup> Note, too, that not all tax advisors are licensed to file taxes in every state. You could enlist a tax advisor in each state, but it may be cheaper to hunker down and file all those taxes online yourself.

The situation can be even more complicated if you lived at least half the year in a state other than your home state. In this situation, earned income and investment income may be taxable in both states. Moving forward, it's important for remote workers to request that their employer make the proper state withholding and perhaps even establish an office at that teleworking location to avoid paying double taxes.

***"U.S. citizens owe U.S. taxes no matter where they live."<sup>3</sup>***

### **Income From Abroad**

American citizens who took advantage of the opportunity to work from home by living abroad are still required to file a U.S. tax return. In some cases, new rules between the U.S. and foreign countries may require additional reporting obligations, such as Foreign Bank and Financial Accounts (FBARs).<sup>4</sup>

Learn about the unique challenges of this year's tax-filing season and gauge your chances of being audited.



However, if you live and work outside of the U.S. for a year or more in 2022, you may qualify for an exclusion of up to \$112,000 in foreign earnings on next year's federal income tax return. Bear in mind that if you maintain a U.S. residence, that state also may levy taxes on your income.<sup>5</sup>

### **Foreign Retirement Income**

Also, be aware that U.S. citizens who participate in foreign workplace retirement plans are required to report this income on their tax returns. While the IRS hasn't published clear guidance on how to report these savings, the agency considers many foreign retirement accounts as "foreign trusts" for the purposes of tax reporting.<sup>6</sup> People who receive this type of income should consult with an experienced tax professional for advice on their situation.

## The Chances of Getting Audited

The chances of getting a tax audit are likely to rise going forward. That's because the current administration is focused on investigating wealthy taxpayers and corporations who under-report their income and/or deploy illegal strategies. This crackdown is viewed as a way to increase government revenues without having to raise tax rates.<sup>7</sup>

Until recently, IRS audits had been declining for years. During 2017, the chance of being audited fell to its lowest rate since 2002. Even now, three out of four audits are conducted via mail correspondence, in which the IRS requests information about one or two issues. The reason there have been fewer audits in recent years is largely due to reductions in the IRS budget and enforcement personnel, an increase in its workload, a greater emphasis on taxpayer service rather than enforcement and legal changes that made it more difficult for the IRS to pursue taxpayer offenses.<sup>8</sup>

Indeed, the Taxpayer First Act of 2019 included provisions to strengthen taxpayer rights and transform the IRS into a more taxpayer-friendly agency, as well as enhance its cyber security.<sup>9</sup>

While pursuing strategies that minimize your tax bill is a good idea, false reporting and fraudulent shortcuts are not. The last thing you want is to be audited by the IRS. One thing to note is that the likelihood of getting audited rises significantly as your income increases. However, the IRS purposely spreads out its auditing activities across all income brackets to ensure fairness.

With that said, the IRS reports that people who earn more than \$10 million a year tend to have higher audit rates (8.16% between 2010 and 2016) than those in lower income categories. Also, taxpayers with high incomes and extremely complex returns are audited by the most highly trained and experienced IRS agents.



As a general rule, among taxpayers who earn less than \$1 million, less than 1% get audited each year. However, one of the most common mistakes that triggers an audit involves the refundable Earned Income Tax Credit (EITC), which is claimed by lower-income filers. Out of the 25 million taxpayers who claim the credit, the IRS audits about 300,000 each year. About 50% of EITC claims are incorrect, which results in up to \$17 billion in improper payments each year.<sup>10</sup>

## Challenging IRS Penalties

If a taxpayer believes she has been penalized unfairly, she can formally request an abatement by completing Form 843, getting it notarized and sending it to the IRS with a copy of the penalty notice. The IRS is willing to abate penalties for what it deems as “reasonable causes,” such as:

- Death or serious illness of the taxpayer or someone in her immediate family
- The unavoidable absence of the taxpayer
- If the taxpayer’s place of business or business records are destroyed by fire or some other casualty
- If it is deemed the taxpayer was unable to determine the amount of her refund or tax due for reasons beyond her control

If the IRS denies an abatement request, the taxpayer may still have the option to appeal the decision. This process puts the onus on the taxpayer to convince an appeals board that the penalty is improper. If she fails, the taxpayer has no option but to pay the tax deficiency and subsequent penalty.<sup>11</sup>

## Taxpayer Tips

Tax filing is a little easier these days thanks to online programs that walk you through the process. However, electronic filings are just as subject to fraud and security hacks as mail-in tax returns were in the past. When filing your taxes, bear in mind the following tips:

- Taxpayers who received advance child tax credit payouts do not have to report them as income. However, if their 2021 tax-filing eligibility resulted in excess payouts, they may have to be repaid.<sup>12</sup>
- When reconciling the 2021 economic stimulus payment on your tax return, be aware that any overpayment of stimulus checks does not have to be repaid.<sup>13</sup>
- Taxpayers who do not itemize may deduct up to \$300 (individual) in cash donations made to charities in 2021; married couples filing a joint return may deduct up to \$600.<sup>14</sup>
- The quickest way to get your refund is to file electronically and provide your direct-deposit information.



- Any revenues earned from stolen goods and illegal activities should be reported on your tax return. While that rarely happens, people who are being investigated or indicted for illegal activities may want to do so in order to avoid also being prosecuted and fined for tax evasion. In fact, if a convicted felon is required to pay restitution for his crimes, those amounts qualify as a deduction.<sup>15</sup>

## Final Thoughts

When it comes to tax season, we are often stuck with many of the decisions we made (or didn't make) in 2021. That's why it's important to analyze your return this year to see how you might better position your finances, income, payouts and investment trade activity to minimize your tax burden for next year. Consult with your financial professional to discuss strategies tailored for your circumstances.





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- <sup>3</sup> Emma Patch. Kiplinger. Dec. 20, 2021. "Strategies for Working Remotely." <https://www.msn.com/en-us/money/personalfinance/strategies-for-working-remotely/ar-AAS028V>. Accessed Dec. 23, 2021.
- <sup>4</sup> Matthew Roberts. JD Supra. Jan. 6, 2022. "Is My Foreign Retirement Account Subject to IRS Information Return Reporting (FBAR, 3520, etc.?)" <https://www.jdsupra.com/legalnews/is-my-foreign-retirement-account-3643156/>. Accessed Jan. 18, 2022.
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- <sup>6</sup> Matthew Roberts. JD Supra. Jan. 6, 2022. "Is My Foreign Retirement Account Subject to IRS Information Return Reporting (FBAR, 3520, etc.?)" <https://www.jdsupra.com/legalnews/is-my-foreign-retirement-account-3643156/>. Accessed Jan. 18, 2022.
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- <sup>9</sup> IRS. July 28, 2021. "Topics in the News." <https://www.irs.gov/newsroom/whats-hot>. Accessed Jan. 18, 2022.
- <sup>10</sup> Sunita Lough. IRS. Nov. 2, 2021. "IRS audit rates significantly increase as income rises." <https://www.irs.gov/about-irs/irs-audit-rates-significantly-increase-as-income-rises>. Accessed Jan. 11, 2022.
- <sup>11</sup> Larry Jones and Joshua Smeltzer. JD Supra. Jan. 6, 2022. "Asking the IRS to Abate Penalties." <https://www.jdsupra.com/legalnews/asking-the-irs-to-abate-penalties-1705783/>. Accessed Jan. 18, 2022.
- <sup>12</sup> IRS. Sept. 10, 2021. "Common questions about the advance Child Tax Credit payments." <https://www.irs.gov/newsroom/common-questions-about-the-advance-child-tax-credit-payments>. Accessed Jan. 11, 2022.
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