CLIENT ALERT - Small Tax Mistakes Can Lead to Big Financial Consequences

Many of the most expensive tax problems do not come from aggressive tax strategies or intentional mistakes. More often, they stem from simple oversights: a missed deadline, an unfiled form, an election that was never submitted, or documentation that was never gathered.

Unfortunately, the IRS can impose substantial penalties even when the error was accidental. That is why careful tax planning, proactive communication, and strong compliance systems are so important. Below are several common issues we help clients monitor and avoid throughout the year.

Late Tax Returns and IRS Penalties

One of the most common misunderstandings taxpayers have is assuming that if a tax preparer misses a filing deadline, the IRS will hold the preparer responsible for the penalties. In reality, the IRS places the legal responsibility for timely filing on the taxpayer. Late filing penalties can add up quickly. In many cases, the IRS imposes:

- A failure-to-file penalty of 5% of the unpaid tax per month
- A failure-to-pay penalty of 0.5% per month
- Interest charges on top of both penalties

These costs can become substantial in a very short period of time.

Even courts have consistently ruled that relying on a tax professional to submit a return on time does not automatically excuse penalties. Because of this, careful deadline tracking and timely extension filings are essential parts of effective tax compliance.

Our office helps clients stay ahead of these issues by monitoring filing deadlines, coordinating extensions when necessary, and confirming filings whenever possible.

Retirement Account Rollovers: The 60-Day Rule

Retirement account rollovers can create unexpected tax problems when handled incorrectly. If funds from a retirement account are paid directly to the taxpayer instead of transferred between custodians, strict timing rules apply. In most cases, the funds must be redeposited into another eligible retirement account within 60 days. Missing that deadline can result in:

- The entire distribution becoming taxable income
- Potential early withdrawal penalties
- Unexpected withholding complications

Another common issue occurs when taxpayers receive a 401(k) distribution subject to mandatory withholding. Many individuals mistakenly redeposit only the net amount received instead of the full gross distribution, unintentionally creating a taxable shortfall.

Whenever possible, direct trustee-to-trustee transfers are generally the safest option. We work closely with clients to help coordinate rollovers properly and reduce the risk of avoidable taxes and penalties.

S Corporation Elections That Were Never Filed

It is surprisingly common for business owners to believe they elected S corporation tax treatment when the required election was never actually filed with the IRS. This often happens when:

- A new LLC is formed
- Multiple advisors are involved
- Everyone assumes someone else submitted Form 2553

The result can be years of unnecessary self-employment taxes. In some cases, the IRS allows late-election relief, but the correction process becomes more difficult and expensive as time passes. Part of our role is helping verify that critical business elections are not only discussed, but properly filed and acknowledged by the IRS.

Foreign Bank Account Reporting (FBAR)

Taxpayers with foreign financial accounts may have additional reporting obligations that are easy to overlook. Under current rules, U.S. taxpayers with foreign financial accounts exceeding certain thresholds may be required to file an FBAR (Foreign Bank Account Report), even if:

- The account generates little income
- The account is located in the taxpayer's country of origin
- The taxpayer already reports the income on their tax return

The penalties for failing to file can be severe, even when the violation was unintentional.

This is why we ask detailed questions each year regarding foreign accounts, foreign assets, and overseas financial activity. Proper disclosure and timely reporting can help clients avoid costly penalties and unnecessary IRS scrutiny.

Inherited Property and Stepped-Up Basis

Inherited property often receives a "stepped-up" tax basis equal to the property's fair market value on the date of death. This rule can significantly reduce capital gains taxes when inherited assets are eventually sold.

However, problems arise when taxpayers fail to document the value of inherited assets at the time they receive them. Without proper records or appraisals, taxpayers may later overpay taxes by reporting much larger gains than necessary.

We strongly encourage clients who inherit real estate, investment accounts, closely held business interests, or other valuable assets to obtain date-of-death valuations and preserve those records for future tax reporting.

The Importance of Proactive Tax Guidance

Many tax problems are preventable when issues are identified early. Small administrative oversights can lead to substantial financial consequences if they are not caught in time. Our role extends beyond preparing returns. We help clients:

- Monitor important deadlines
- Evaluate filing requirements
- Coordinate business elections
- Navigate retirement transactions
- Address foreign reporting obligations
- Preserve important tax documentation

The tax code is complex, and small details matter. Careful planning and proactive communication can often prevent costly surprises later. If you have questions about any of these issues or would like to review your current filing and compliance situation, please contact our office.