TAX POLICY

Your Burning Tax Season FAQs, Answered

By Martha C. White | April 9, 2012 | +

Tax preparers toil in obscurity for most of the year, trying to keep track of the ever-changing kaleidoscope that is our federal tax code. But when crunch time comes for taxpayers to get their returns filed to the Internal Revenue Service's satisfaction, everybody wants an expert in their corner willing to dispense advice and explain the often byzantine process. Here are five common Q&As the pros field regularly.

1. Should I do my own taxes or pay somebody — and should I bother itemizing?

If you're an employee who receives a W-2 and you don't own a home, you probably won't have any challenges doing your own taxes, says Craig Wild, partner at Wild, Maney, and Resnick LLP. If you have a major life change — marriage, divorce, the birth of a child, a move, a job change across state lines, the purchase or sale of a home — you could benefit from professional help. Itemizing will work in your favor if you have more than the standard deduction — that's $5,800 for singles, $11,600 if you're married filing jointly — in mortgage interest, real estate taxes, state income tax payments and charitable donations, says Dana Levit, owner of Paragon Financial Advisors.

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2. What's the difference between a credit and a deduction?

A deduction reduces your taxable income by the amount of the deduction. If your taxable income is $30,000 and you have a $1,000 deduction, your taxable income becomes $29,000. A credit is a benefit you subtract from the amount of taxes you owe. If you owe $2,500 to the IRS and you have a $500 credit, that bill drops to $2,000. "Credits are the holy grail," says Mark Steber, chief tax officer at Jackson Hewitt Tax Service. If you have a choice between a credit and a deduction, all other things being equal, take the credit. "It's typically much more valuable than a deduction," he says.

3. Will I have to pay taxes on debt canceled in a foreclosure or short sale?

Unlike forgiven credit card debt, which is treated as taxable income for IRS purposes, you won't have to pay taxes on debt canceled by a foreclosure if the home was your primary residence, says Jackie Perlman, tax analyst with the H&R Block Tax Institute. The rules are different if the house was a vacation home or investment property, though, so you'll need to check out IRS publication 4681 to figure out if you'll owe taxes in your situation.

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4. Why am I getting taxed on unemployment benefits?

A lot of people don't realize unemployment benefits are taxable and are shocked when they find out they owe even though they spent part or all of last year out of work, Craig Wild says. Unemployment is considered income by the IRS, which means it's taxable. Although there is an option when applying for unemployment to have taxes automatically withheld, many people eschew it because the benefits are already so much smaller than the paycheck they had been receiving. This year the government is offering out-of-work taxpayers some breathing room, though. The following applies to people who were out of work for at least 30 days between January 1, 2011 and April 17th of this year. Include with your return the new IRS form 1127A, which gives you a six-month extension to pay any taxes you owe.

5. What if I don't have the money to pay my taxes?

Tax pros are unanimous in what *not* to do: Don't fail to file a return and hope the IRS won't notice. They will, and since the agency charges penalties for both failure to file as well as failure to pay, not filing means you'll be hit with two fines instead of one. File on time and pay whatever you can, even if it's a fraction of what's due. The IRS will let taxpayers with outstanding balances up to 120 additional days to pay, although you will still have to pay interest and late payment penalties. If you need more time than that, you can set up an installment plan; there's a one-time set-up fee of $105, or $52 if the payments are deducted directly from your bank account.