How to Avoid and Correct Tax Issues

Nobody likes unexpected tax bills or IRS penalties. So how can you minimize the possibility of errors on your return? And if an error does still slip through, what then? In both cases, it's often a matter of paying close attention to documentation.

Avoiding tax errors. Audrey Young, a tax attorney and senior manager at accounting, tax, and consulting firm RSM US, says one of the basic things that everyone should do is pay attention to what their tax preparer sends them. "Most clients who work with professionals get a tax organizer," Young says. The organizer is a document outlining a series of questions for people to answer. It helps taxpayers think through all the big and small items from the past year that could impact their taxes.

Big life changes in particular should be called out in the organizer, as they're a common cause of tax filing errors:

- Selling a business
- Selling interest in a building or shares in a closely held business
- Inheriting money or an IRA
- Turning 70½ and triggering mandatory IRA distribution requirements

"Most people do a very good job except when an extraordinary transaction comes along," Young says. In these cases, good record keeping is crucial — as is sharing that information with your advisor. For example, a problem that can attract unwanted IRS interest is when someone fails to note an extraordinary gift, such as land, to a university or charitable organization. The value of that property has to be properly documented.

When gifts of stock or other property (like a vacation home) are made during one's life, good records are essential to avoiding tax problems down the road — especially for the recipient. That's because the gift's "cost basis" — the purchase price — also transfers to the gift recipient. Say mom and dad give their vacation home to their adult child. If, later on, that child sells that house, the cost basis used to determine how much profit was made on the sale is the purchase price of the home when the child's parents originally bought it.

Correcting tax errors. If you do make a mistake, don't panic. With some common mistakes, such as math errors, IRS computers will often detect the error and send you a bill. You'll be required to pay interest on the unpaid tax, but unless the IRS thinks it's a deliberate or particularly large omission, you probably won't owe a penalty.

If you or your preparer discover an error after filing, Young recommends filing an amended return as soon as possible. “I think it’s always better to report your error before the IRS finds it,” Young says. Remember, your preparer will need to correct all the errors in the return — not the just the ones that are favorable for you.

It’s important to note that your preparer must file amended returns on paper (rather than e-filing) and they can take longer for the IRS to process. So, the sooner you correct any mistakes, the sooner you can resolve any potential conflicts.

Our firm does not provide tax or legal advice

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