Checklist of Common Tax Blunders

Here is what not to do. Tax professionals report that their clients often make these mistakes in handling their finances and taxes. If you are not using a tax professional to prepare your return, and especially if you are not using computer software to prepare your taxes, be sure to read this list carefully to make sure you are avoiding these pitfalls.

Not Planning for the Alternative Minimum Tax (AMT)

State taxes, car licenses, real estate taxes, certain home equity interest paid, a portion of your medical expenses, and most miscellaneous itemized deductions (such as tax preparation fees and employee business expenses) are not deductible for AMT purposes.

- If a significant portion of your miscellaneous itemized deductions happens to be employee expenses you’re not reimbursed for, check with your employer to see if you can be reimbursed directly for your costs.
- Don’t assume that it’s always best to prepay your state income taxes or your property taxes before the end of the year! If you are subject to the AMT, neither of these taxes will garner you any tax benefit.

Not Using a Computer to Plan for and Prepare Your Income Taxes

There are so many interrelationships in the tax law that even if you have a very simple tax return, you can miss something very important by doing your return or tax planning by hand.

Overusing a Home Equity Loan

It can be a good idea to convert otherwise non-deductible personal interest into tax-deductible home loan interest. But don’t get carried away and take 15 years to pay off a three-year car loan – you’ll pay a fortune in interest!

Taking the Home Office Deduction Without Considering the Tax Effects When You Sell Your Home

The part of your home that is used for business may not qualify for the (maximum) $250,000 ($500,000 if Married Filing Joint) exclusion of gain from tax on the sale of your home; you could end up paying taxes on the home office portion of the gain!

Not Claiming all of the Deductions You are Legally Entitled to

Take charitable contributions into consideration. You may not think the clothes you give to charity are worth much, but consider using valuation software, such as It’s Deductible, and see how much items actually sell for when determining how much to claim. You may be surprised!

Not Accounting for Mutual Fund Dividend Reinvestments

Reinvested dividends generate tax *basis*. Be sure to add them to your cost basis when you calculate your taxable gain from the sale. It is best to update your records annually.

Not Tracking Your Year-to-Year Carryover Items

State and local taxes paid for the prior year in the current year, capital loss carryovers from prior years, and charitable contribution carryovers can get lost in the shuffle.

Not Setting up a Qualified Retirement Plan in Time

Most qualified plans must be established (but not necessarily funded) by December 31 of the tax year in which you want to take the deduction. Many IRAs can be set up through April 15th of the following year, and SEP plans can be set up as late as October 15th of the following year.

Failing to Name (or Naming the Wrong) Beneficiary to an IRA, 401(K), or Other Retirement Plan

Upon death, IRA accounts pass tax-free to your spouse. If you designate no beneficiary for your retirement accounts, many plans name your estate as the beneficiary — which can be the most costly to your estate. Naming grandkids may subject the account to the generation-skipping transfer tax.

Not Maximizing Your 401(k) Contributions, Particularly if Your Employer's Plan Provides for Matching Contributions

Current tax law provides annual increases in the maximum amount contributable; be sure to take this into consideration when planning for your financial future.

Not Making Your Quarterly Estimated Tax Payments When You're Self-employed or Have Significant Investment Income

Some taxpayers who have the ability to pay their estimated taxes quarterly either don't find the time to do so or prefer to wait to pay their taxes when they file their income tax returns. This is a mistake: you'll pay underpayment penalties to the tune of about 6% per annum for each quarter that the taxes aren't paid.

Not Planning Correctly for Stock Option Exercise and Selling Activities

Many employees who exercise options and sell stock in same-day transactions find that the gains they realize from such a sale push them into a higher tax bracket than they'd otherwise be in. If this happens to you, and if your employer simply withholds taxes at a fixed rate from your sale transaction, be sure to determine just what your actual income tax liability will be so that you're not surprised at the amount of tax you owe come April 15th.

Changing Jobs and not Adjusting Your Withholding Allowances on Form W-4 to Account for Increased Wages or Signing Bonuses

Further, not considering your state income tax withholding allowances once you've adjusted your federal numbers. You may be just fine federal-withholding-wise, but forgetting to adjust your state withholding as well may set you up for an unpleasant surprise.

Contributing to a Roth IRA When You're not Qualified to do so Because Your Income is too High

Individuals whose modified adjusted gross income is over $110,000 ($160,000 for married couples filing a joint return) may not contribute to a Roth IRA; doing so will subject you to a 6% penalty assessed on the amount you contributed.

Making a Federal Estimated Tax Payment Right After a Big Income Event Rather than Waiting Until April 15th

Why is this a mistake? If you're *otherwise protected* from the application of underpayment penalties (because, perhaps, you are paying through withholding and estimates an amount equal to last year's tax – or for higher income taxpayers, 110% of last year's tax), there's really no reason to pay your federal taxes early. Let that money earn interest for you until it's time to pay Uncle Sam.