2011

Getting the Tax Relief You Need

Understanding taxes, deductions, credits, refunds

– and what to do if you can’t pay your tax bill.

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Introduction

Taxes!

We know … the very word can strike fear into anyone's heart. And that fear, worry and concern can be much worse when you know you can't pay your tax bill – because of an error you might not even understand, because you've experienced unusually hard times or because you've been avoiding a problem for a while.

Freedom Tax Relief (FTR) understands those reactions, because we work every day to help people eliminate their tax debt problems. FTR provides tax representation and resolution services. Our experts have helped almost 9,000 people resolve tax debt issues since 2002. And now we want to help you.

Fortunately, you can avoid some tax problems ahead of time instead of managing them later. If you are in that situation, you'll find tips in this guide for you. You can learn the basics of tax credits and deductions, find out how to plan ahead for your taxes, and understand what life situations can impact your taxes.

If you are worried about your taxes, we'll also tell you about all of your options if you can't pay. And if you decide you need expert help, we've provided a list of tough questions you should ask a tax relief company before you entrust them with your situation.

Nobody likes to think about a tax bill – but with the right information, you'll have the tools to make good decisions.

Planning for the tax year

Before you can pay your taxes, you have to plan. If your situation is very simple, you might be able to use the most basic tax form, the 1040-EZ. But before long, most adults need to file the full 1040 form to take advantage of credits and deductions that can save them money.

To prepare yourself for filling out your annual tax form, follow this tax planning checklist. It's a good idea to go through this process in November or early December so you can make the best choices for the tax year. (Mark your calendar for next year!) Some people like to do a mid-year checkup, too.

1. **Know the facts.** Before year's end, organize your receipts and records. Planning early helps you save time when you file your tax return. Pre-planning also helps you to maximize your deductions while you have time.

2. **Do a test run.** Hang onto a copy of last year's tax form, either on your computer software, in hard copy or by downloading it from the IRS website. Fill it out using this year's numbers to estimate whether the current tax filing season will bring a refund or a bill. (Some tax laws will change, but you'll at least get a general idea.)

3. **Plan donations to get deductions.** When you donate household items and clothing to a charity, be sure to get a receipt. Free online tools like It's Deductible (www.itsdeductible.com), or your tax advisor, can help calculate the value of your donations. Give money donations by Dec. 31 to get credit on the current year's taxes. You also can donate unneeded vehicles, stocks and investments.

4. **Spend FSA dollars before they expire.** Many employers offer flexible spending accounts (FSAs). FSAs cut tax bills by letting you use pre-tax dollars for medical care and/or child care. Workers who do not use the money in their accounts by the end of the FSA year lose that money. Some FSAs expire at year-end, others at a different time during the year. Check your FSA balance. If you are not on track to spend it all, use up your funds by buying needed medications or contact lenses, seeing the dentist, getting a checkup, or arranging other needed care. The IRS' website has a full list of FSA-qualifying expenses. Then be sure to submit all your receipts for reimbursement before your FSA deadline.

5. **Add up medical bills.** If medical and dental expenses for the year add up to more than 7.5 percent of household adjusted gross income (AGI), they might be tax-deductible. After that cutoff, all of your medical expenses can reduce your tax bill. Another factor to consider: Some expensive procedures might cost enough to put you over your health insurance deductible. If that's the case for you, you might want to schedule a procedure this year to minimize out-of-pocket costs.

6. **Save for retirement.** Many retirement contributions are tax-deductible. Check with a tax planner for details on making the most of a tax-deductible investment for the future.

7. **Pay ahead on student loans.** Many people with student loan debt are eligible to deduct up to $2,500 that they have paid in interest. This deduction is “above the line.” That means it lowers adjusted gross income, which can help taxpayers qualify for other deductions or benefits.

8. **Estimate next year’s taxes.** It is a good idea to estimate next year’s taxes and plan based on the estimate. This year’s income tax debate in Washington demonstrated how important this is, because income tax rates can change periodically.

The ABCs of tax credits and deductions

We all know the adage that taxes are one of the things nobody can avoid (the other, of course, being death). But you *can* make your tax bill less painful by making sure you don't pay taxes on money the government has decided you can spend tax-free.

Income tax returns offer two ways to reduce your tax bill: credits and deductions. A tax *credit* is like a rebate on some of the tax you would otherwise pay. It actually cuts down the amount of tax you pay by subtracting part of that tax. A tax *deduction* lets you reduce the amount of income you report, so that you pay your set percentage of income tax on a smaller total amount. Credits tend to be more valuable because they knock dollars right off your bill, but deductions can add up too.

Some credits and deductions apply to everyone, whether you itemize deductions or not. To receive others, you must itemize deductions. Itemizing generally involves filling out a separate tax form or forms (most commonly Schedule A) that includes detailed information on every deduction you are claiming. See a tax advisor for more details on how deductions and credits apply to your situation.

Most-overlooked credits and deductions

Each year, the Internal Revenue Service publishes a list of income tax credits and deductions that taxpayers frequently miss out on. Check your tax return carefully to be sure you're keeping every penny of your income that doesn't need to go to taxes. This list incorporates the IRS's suggestions and a few more you might not be thinking about.

1. **Earned income tax credit.** People who earn only a modest income benefit from this credit. Calculate your tax carefully to see if you qualify. The cutoff is around $40,000 for working families and $14,000 for childless individuals.

2. **Child tax credit.** If you have children, do not forget to claim your child tax credit. The credit is up to $1,000 per child. It is *in addition to* the exemption of up to $3,400 per dependent that you can claim.

3. **Dependent-care credit.** If you have children, you might have child-care bills. If so, you are eligible for as much as $6,000 in child-care tax credits. Even after-school care can qualify. If you use a job-based reimbursement account (such as an FSA), you might easily miss this credit. The deduction also applies if you pay someone to take care of a spouse or other dependent while you work. You will need to file with the tax ID number of your child-care provider.

4. **Credits for education expenses.** These include several categories. The *Hope credit* is usually available for the first two years of college. The *American Opportunity Credit* lets college juniors and seniors claim up to $2,500 per student (based on modified adjusted gross income). You can deduct interest paid on *student loans*, too. And for young adults whose parents pay their student loan bills, the former student can still deduct the interest, as long as the parents do not claim him or her as a dependent.

5. **State sales taxes.** Taxpayers can choose to deduct either state and local income taxes, or state and local sales taxes. The credit works mostly for taxpayers in states with no income tax, because income tax generally is a greater burden than sales tax in income-tax states. If you bought a vehicle or boat, or made another big purchase such as homebuilding materials, you may find that the sales tax you paid makes the sales-tax deduction a better deal. This can be true even if your state does have income tax. Check the IRS website for a calculator to help figure the deduction. Also be aware that depending on your adjusted gross income, you can usually deduct sales tax paid on the purchase of a new car, truck, motorcycle or motor home.

6. **Reinvested mutual fund dividends.** If you have a mutual fund account, you might be able to save with this deduction. When you sign up for a mutual fund account, check a box to have dividends (or what the fund earns) automatically reinvested. “Reinvesting” means any interest, earnings or other payments from the mutual fund automatically go to buy additional shares in the fund. Essentially, it means the investor doesn’t take any profit in their pocket, but keeps earned from the fund in the fund, being continually used to buy more shares in the fund. The money that is reinvested increases the tax basis in the fund – a term for the amount you’ve contributed to the fund to buy the shares you own. If and when you sell your shares, you can choose between a couple of tax options, but either way, you will benefit from including reinvested dividends in your tax basis (or cost basis). A higher cost basis means you will have a lower capital gain, which is the difference between how much you paid for the shares and how much you made at their sale – or a greater loss – when you sell your shares. Taxpayers who do not include the reinvested dividends in the basis have to pay taxes twice on dividends: First, when they receive the dividend, and second, when they receive proceeds of selling the shares.

7. **Out-of-pocket charitable contributions.** Keep receipts for gifts to nonprofits, and check your last pay stub of the year for contributions deducted at work. And don’t overlook all charity gifts, no matter how small. For instance, if you buy ingredients for a fundraising bake sale or stamps to mail notes to raise money for charity, those are charitable contributions. Also keep track of the miles you drive for charitable causes – they are deductible, too.

8. **Moving expenses for a first job.** Your job-hunting expenses while looking for your first job are not deductible. But if you pay your own moving costs to get to the location (at least 50 miles away), those are – including a deduction for mileage, fees and tolls. The same applies to moving costs for any job in a new city.

9. **Military reservists’ travel expenses.** Members of the National Guard or military reserve can deduct travel expenses to get to some drills or meetings. These must be more than 100 miles from home and involve an overnight stay.

10. **Estate tax on income in respect of a decedent.** For anyone who inherited an IRA from someone with an estate subject to the federal estate tax, there is a tax deduction for the amount of estate tax paid on the IRA assets received.

11. **Retirement savings credit.** Low- or moderate-income earners can take this credit to help them save for retirement. If your income is below certain limits and you contribute to a retirement plan through work or to an IRA, you probably qualify.

12. **State tax paid last year.** If you owed tax when you filed your state tax return last year, include that amount in this year's return. Also include any state income taxes withheld from paychecks or paid via quarterly estimated payments.

13. **Points paid on a mortgage.** If you bought a house this year, you can deduct all the points you paid. If you refinanced a mortgage, you can deduct those points, but only over the life of the loan. While it's a small amount each year – just 1/30th of the points paid each year over the term of a 30-year mortgage – it still belongs to you. In the year you pay off the loan, you also generally can deduct all points not yet deducted.

14. **Jury pay returned to your employer.** Some employers continue to pay employees' full salary while they serve jury duty. But sometimes, they require employees to turn over their jury pay. The IRS requires citizens to report jury pay as taxable income, and so you can deduct any amount you pay back to your employer.

15. **Property tax – even with the standard deduction.** Even if you do not itemize deductions, you can deduct property tax. The IRS allows you to add $500 to $1,000 to the standard deduction if you paid property taxes.

16. **Casualty losses in disaster areas.** Taxpayers who claim the standard deduction can add in casualty losses if the loss occurred in a presidentially designated disaster area. Check the IRS website to learn about rules year by year.

17. **Energy-saving home improvements.** New windows or doors, insulation or high-efficiency heating or cooling in 2009 or 2010 might qualify for a credit. The tax credit for these energy-saving home improvements is 30 percent of the cost. The maximum credit is $1,500 in the 2009-2010 period. Check the IRS website for details.

Changes to existing credits and deductions

Following is a list of the major tax code changes for 2011. The 2010 Tax Relief Act extended most existing tax structures for two years. It's always smart to check current tax laws to stay up to date.

1. **Repay 2008 home buyer tax credit.** Many people purchased homes in the past few years and received credits. Those who bought in 2008 must repay the credit over 15 years. In 2011, you will begin paying $500 per year in additional tax if you received the maximum $7,500 credit. This amounts to a 15-year interest-free loan to help buy your home.

2. **Changes to adjusted gross income (AGI) limits.** AGI limitations will no longer affect personal exemptions and itemized deductions.

3. **Losses can be claimed.** Taxpayers will be able to claim personal casualty and theft losses that exceed $100.

4. **New IRA rules.** More taxpayers will qualify for deductions for payments to individual retirement accounts (IRAs). The IRS calculates how much you can deduct based on your AGI. The limits are slightly higher for 2011 than in 2010.

5. **Higher AGI for Earned Income Credit.** The maximum AGI allowed in the Earned Income Credit calculation will increase.

6. **Changes to AMT.** Taxpayers will be able to take more credits against alternative minimum tax (AMT). The AMT exemption also will decrease.

7. **More money in paychecks.** For 2011, workers will pay 2 percent less in Social Security deductions from their paychecks. This could amount to more than $2,000 for a worker earning the maximum subject to FICA tax (just below $107,000 per year).

8. **Mileage deduction:** If you are self-employed and drive your car for business, or if you use your car to travel to medical appointments or for charitable causes, you might be able to deduct your mileage. You will need to track the total miles you drive in a year and the specific miles you drive for each tax-deductible purpose. Some people write down the number of miles or starting and ending mileage in a small notebook they keep in their vehicle. Others use their calendar, a cell phone app or a spreadsheet. For 2011, the IRS has established deductible mileage amounts at 51 cents per mile for business miles driven, 19 cents per mile for medical miles, and 14 cents per mile for charitable purposes. Mileage also might be deductible (at 19 cents per mile) for some moving purposes.

9. **Ability to roll over to a Roth IRA.** In 2010, people could convert an IRA to a Roth IRA and report the income from that transaction over two years. This particular transaction can be amended this year, if you like. For example, if your assets drop by a large amount in 2011, you can recharacterize the entire conversion back to an IRA before Oct. 15, 2011.

10. **Unlimited deductions.** For 2011, deductions can be itemized no matter what percentage of income they comprise. This should allow more taxpayers to claim deductions.

11. **Estate and gift taxes have big breaks.** The 2010 Tax Relief Act makes estate and gift tax limits "portable" between couples – meaning that if one spouse does not use his or her limit, the other spouse can use it. Gift-givers pay no tax on gifts of $13,000 or less ($26,000 for married couples) to any one person, with a lifetime limit of $5 million, up from $1 million last year.

Many of these credits and deductions are subject to income limitations or other restrictions. To learn more, visit www.irs.gov and/or consult your tax preparer.

The 5 best ways to use a tax refund

Are you getting a tax refund from the Internal Revenue Service, or a refund from your state? Congratulations!

Some money experts suggest that if you get a refund, you should work with a tax advisor to change your income tax withholding so that you keep more of your cash – instead of lending it to the IRS, interest-free. But some people love to get a tax refund. To them, having a little too much tax withheld is like a forced savings plan.

If you agree with the first group, look into your tax withholding. But whichever group you're in, if you're getting money back, spend it wisely. Here are some suggestions on the most effective ways to spend an income tax refund:

1. **Pay down credit card bills or other high-interest debts – including payday loans.** Getting rid of debt is an excellent investment, with a better return than almost anything else. For example, if you pay off credit card debt that carries an average interest rate, you'll effectively earn 14 percent to 20 percent – or more – per year. Ready to pay down your debt? First, make required payments on secured debts (mortgage, car). Mortgage payments should take absolute priority. Next, list unsecured debts (credit cards, loans) in order of highest interest rates. If you have payday loans, those will probably be at the top of the list. On all but the *highest-rate card*, pay the minimum payment. (You can find the interest rate on your billing statement, or call customer service and ask.) Then use every cent you have available to pay toward your debt with the highest interest rate.

2. **Create an emergency fund**. The Great Recession has pointed out how important it is to have money set aside for emergencies. If you do not yet have enough money set aside to cover several months' worth of expenses, think about saving your tax refund. In the long run, you want to aim for a fund with enough to pay 6 to 9 months of basic living expenses. Remember that this figure doesn't have to equal salary. Instead, it would include only what your household would need in a dire situation – enough to cover basic expenses. Keep these savings in a money market fund or rolling CDs so that the money earns interest and you can't easily spend it – but you can access it in an emergency.

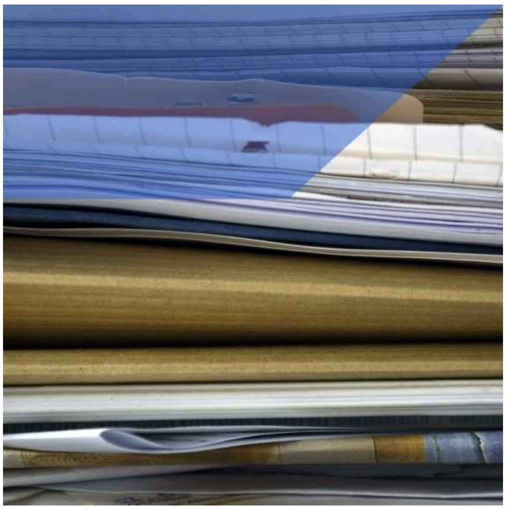
3. **Make sure you have enough insurance**. Everyone should have health, auto, and home or renters' insurance. If your family's breadwinner supports other people, you might need life insurance, too. An "umbrella" insurance policy can help protect you from additional liability. And if every bit of income is essential to your household's survival, look into disability coverage. With insurance, understand that the cost won't pay you back unless you need it – but just one trip to the emergency room or one theft can end up costing thousands of dollars.

4. **Fund the future**. Contribute to a retirement savings account, whether you choose an individual or Roth IRA, 401(k) or other plan. Talk to your financial advisor about the best choice for you. Or contribute to a college savings fund for a child.

5. **Invest in your home**. If you are a homeowner, consider using a refund to pay for major or minor maintenance. A small investment now can help prevent bigger (and more expensive) problems down the road. In addition, fixing up your home can increase its value – as well as your enjoyment.

Whatever you do, be sure you keep a frugal mindset. For instance, if you pay off debts, but you charge up the credit cards or sign for a new car loan a few months later, you have ultimately gained nothing. Make a smart choice, though, and your tax refund can be a gift from Uncle Sam that keeps on giving.

Life changes that affect your tax bill



Sometimes it seems like your tax bill is a moving target. Almost everything you do affects it, and it's hard to know the impact before you make the choice. If you are planning or experiencing life changes, review this list to get an idea of how those changes might affect your income taxes.

1. **Marriage.** A new marriage has several tax implications. No matter when during the year a couple marries, they will file as married, either jointly or separately, for that tax year. A tax professional can help couples choose the best filing method. Current tax law has eliminated the *marriage penalty*. That means the standard deduction and tax brackets for married couples are about the same as those for two singles. (After 2012, that might change, unless Congress extends the current provisions.) Marriage also has some tax benefits, such as a larger exclusion on taxes on profits when you sell a home.

2. **Graduation.** A child's high school or college graduation might have a big impact on parents' taxes. When a child becomes independent, the parents can no longer claim the child tax credit. If a child enrolls in college, parents should keep careful records of the educational expenses they pay. Also, parents should know that some interest paid on student loans is tax-deductible. Additionally, if parents begin to repay loans (such as PLUS loans) taken for a child's education, the interest might be tax-deductible. And health care premiums paid for a child (who can stay on a parent's policy until age 26) might be deductible, too. Check with a tax advisor.

3. **Job bonus/commission.** The economy is recovering slowly. Some workers might earn a little more this year from bonuses or higher commissions. People who are self-employed or hold contract positions (such as some sales professionals) should carefully review their income and how much self-employment tax they owe. Be sure you pay enough in quarterly income tax payments to avoid IRS penalties. The IRS provides a worksheet to calculate payments.

4. **Job hunting.** People who are looking for a job might find that tax deductions can soften the blow of unemployment, as some job-search expenses are tax-deductible. These might include employment agency fees, resume-printing costs, and travel expenses for interviews (even mileage to drive to a local interview). The job-seeker must be looking for work in his or her current profession, not changing fields. (See our lists for ideas if you get or lose a job.)

5. **Buying or selling a house.** Tax credits for buying a home are no longer in effect. But home-buyers can deduct other costs of home ownership. Some common deductions are points paid (or a loan origination fee recorded as points), mortgage interest and property taxes paid.

6. **Moving.** People who move to another location because of a job can usually deduct moving expenses. You do have to meet certain conditions. Keep detailed records of moving expenses and keep all moving-related receipts.

7. **Becoming self-employed.** Self-employment can be a good choice for some people in a tough economy. But it does have major implications for your taxes. Be sure to talk to a tax advisor. You'll need to be especially careful that you are paying enough in self-employment taxes, which include the employer portion of Social Security tax. If you do not pay enough, you can face penalties.

8. **Taking a part-time or contract job.** Odd jobs can affect income tax obligations, whether you are a student or an adult. All U.S. workers are required to pay income taxes if they earn enough money. Tips, babysitting income, lawn-mowing money or sporadic consulting might generate income that requires you to pay income taxes. Check to see if your employer has you complete a W-4 form and withholds taxes. If not, learn about what self-employment taxes the IRS might require you to pay.

9. **Yard sale income.** As with income from a summer job, remember that money earned on that summer garage sale could be considered income. However, the IRS provides an exception. If items are sold for less than was paid for them, the income is not taxable. (The same rule applies to income from items sold occasionally on eBay or similar sites.) People who sell items regularly for profit, whether at yard sales or online, should consider the money they make to be business income and pay taxes accordingly.

10. **Retirement.** Retirement can affect your taxes a great deal. When you retire, your income will likely decrease, and some of it may be untaxed. In some places, retired people or those on a fixed income have different local tax responsibilities (such as no longer paying property tax). Work with a tax advisor to be sure you understand the rules as they affect your specific situation.

11. **Hiring household help.** It's in the headlines frequently: A well-known person has tax trouble because of their household help. You don't have to be a millionaire to have this problem, though. If you hire someone who performs more than occasional babysitting, housecleaning or yard/gardening services, you need to acknowledge and understand your employment tax obligations.

12. **Death of a spouse.** When a spouse dies, it can affect your taxes. While estate taxes usually do not apply if the estate passes to a spouse, your income might change, and the balance of your retirement plans and insurance might shift. As you are working through the many challenges during this time, make sure you take taxes into account.

Any of these activities might affect your income taxes. In fact, any time you have a major life change, you might see that change reflected in your taxes. All taxpayers should keep good financial records and consult help if needed to pay what you owe.

What to know: If you get a new job …

Were you hired for a new job this year? Congratulations! The good news is that jobs earn money. But the bad news is that you must pay taxes on that income. Make the best of your tax situation by reviewing this checklist when you're going through your hiring paperwork.

1. **Fill out your W-4 properly.** You will need to establish how much income tax your employer takes out of your paycheck. You can count one exemption for yourself and for each dependent. Some single people put "0." This means more is taken from their check, and they usually get a tax refund – but meanwhile, the IRS has been holding some of their money. If you are married, talk with your spouse to be sure you don't withhold too little – if you do, you'll wind up owing taxes. If your new job is a second job, you might want to take zero exemptions to be sure enough tax is withheld. If you need more help, see the IRS Withholding Calculator.

2. **Choose your benefits.** If your employer offers health insurance coverage, that's great. You cannot deduct most health insurance premiums your employer pays, because these are usually subtracted from your paycheck pre-tax. Health insurance premiums that you pay might be deductible. Check with a tax advisor to be sure.

3. **Choose flex spending benefits.** Choosing flex spending, qualified expense plan or "cafeteria plan" allocations might seem like a hassle, but they can save a lot of money. These plans let workers set aside money to pay for medical costs or child care. The money will be taken out of your paycheck each month, before your taxable income is calculated. That means you can pay for these essentials with pre-tax income, depending on your employer's limits. Be aware, though, that what you don't spend, you lose. Calculate costs carefully to be sure you will spend everything you set aside.

4. **Choose child care carefully.** Of course, you want your little one to be well taken care of. Remember that child care expenses that you pay so that you can work are usually tax deductible. Be sure your child care provider is willing to give you their tax identification number so you can report (and deduct) this significant expense.

5. **Pay attention to retirement options.** It's always smart to take advantage of any employer-sponsored retirement plans, such as a 401(k), 403(b) or IRA. If your employer matches your contributions, it's like additional salary. Make your account allocations thoughtfully, and take advantage of any financial counseling sessions your employer offers.

6. **Roll over your old 401(k).** While it might be tempting to cash out your retirement account from your old job, don't do it. Instead, roll it over so that it can continue growing for your retirement. You won't miss it now, but you'll appreciate it later.

7. **Don't take pay under the table.** Being paid in cash might avoid taxes now, but you're also breaking the law. If the IRS discovers your fraud, you could face legal action and penalties. And untaxed income won't qualify toward Social Security or other benefits you'll eventually receive in older age.

What to know: If you lose a job …

Unfortunately, losing a job is all too common in the last few years. If you have recently lost work, review this list of things you should consider about taxes and unemployment.

1. **Negotiate for good severance.** If you are laid off, negotiate for a layoff package just as you would for a salary. Ask if you can cash in vacation, sick or personal days; determine how long insurance will run; and look into extension of any other benefits. Do be aware that the IRS considers unemployment and severance pay as taxable income.

2. **Job search expenses are tax-deductible.** If you are seeking a new job in your field, you can deduct the expenses of job hunting. These might include printing resumes, fees paid to a hiring consultant, or travel costs to interview for jobs.

3. **Volunteering can have tax benefits, too.** Volunteering is a great way to keep yourself busy and network, too. Any monetary or item donations to nonprofit organizations might also be tax-deductible. Mileage you travel for volunteer work also can be deducted, so keep track of the miles you drive.

4. **Leave retirement alone.** Many people think of cashing in their retirement fund when they are laid off. But early withdrawals come with income tax and penalties. It is best to leave retirement funds to grow while you look for a new job.

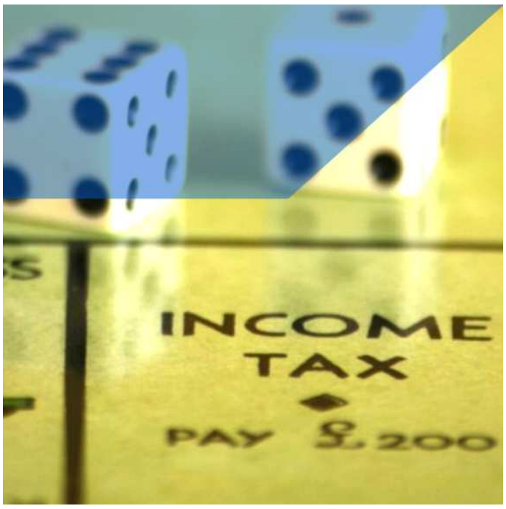
5. **Moving costs can be tax-deductible.** If you move to a new city to accept a new job, your moving expenses might be tax-deductible. Check with the IRS or a tax advisor to find out if your situation qualifies.

6. **Gifts will not cost you in tax.** If a relative or friend gives you gifts of cash or property, you do not owe taxes on that income. Certain gifts might incur gift tax for the giver.

7. **Losing or selling your home can have tax implications.** If you sell your home, you might be eligible for capital gains tax if you make more than $250,000 in profit on the home ($500,000 for a married couple filing jointly). If you lose your home to foreclosure, the amount written off might be taxable to you. Check with a tax advisor to learn more.

8. **If you start a business, get tax help.** Many people start a part-time or full-time business after they lose a job. Self-employment has special tax implications. Be sure you understand how to manage your taxes if you become an entrepreneur.

Options if you can't pay your tax bill



For at least two years, many Americans have felt the effects of the recession. As they pinch pennies in many areas, some people may not be able to save enough to pay their tax bills. Some people have a nagging knowledge that they owe the IRS. Others owe many thousands of dollars accumulated over years. They might have intentionally avoided taxes, been busy with life and not gotten around to paying, or just made a mistake.

According to the Internal Revenue Service, in 2009 and 2010, U.S. residents filed more than 141 million federal income tax returns each year.[1] In 2009, 9.7 million accounts were delinquent -- 7 percent of all accounts. These taxpayers owed more than $103 billion in taxes, penalties and interest. The number of levies (a key enforcement tool in which the IRS takes possession of assets to collect on unpaid taxes) rose to nearly 3.5 million during 2009, a 32 percent increase over the number in 2008.[2]

It can be frightening to owe money to the IRS. If you owe, the IRS might be sending you worrisome letters, calling you or even garnishing your wages. It is, however, possible to negotiate with the IRS and get a tax bill reduced. If you believe you may not be able to pay your tax bill, review the following pointers to see what your next steps should be.

1. **File a return:** Even if you cannot pay your tax bill, file a return. Not filing is the single biggest mistake people can make. If you file late, you will ring up penalties and interest, which make a bad situation worse. The penalty for filing late is 5 percent of the tax due on a return – *per month*. Penalties max out at 25 percent for returns that are one year late. In addition, a taxpayer paying late will pay monthly interest at 0.5 percent of the unpaid amount each month. Interest also accrues on the balance owed. The bottom line: *Filing a return one year late can result in penalties and interest that add as much as 38 percent to the tax owed on a tax return.*

2. **Get an extension:** If you can't complete your return on time, file an extension (IRS Form 4868). You might still have to pay penalties, but they will be less than if you do not file.

[1] http://www.irs.gov/newsroom/article/0,,id=231381,00.html
[2] http://www.irs.gov/taxstats/article/0,,id=207457,00.html

3. **Contact the IRS:** Taxpayers who cannot pay taxes should contact the IRS. If you avoid the situation, it will only get worse, as the IRS has many tools to find tax evaders and get the money they owe. Recognize that some IRS policies limit penalties for taxpayers who contact the IRS or pay a late bill voluntarily. For very serious offenders, the IRS might even reduce or eliminate jail time if you go to them first. The IRS also provides a "reasonable cause" designation for individuals who cannot pay for reasons such as a death in the family, serious illness, or financial records lost in a natural disaster. If the IRS decides you have cause, contacting them might eliminate your penalties.

4. **Work with the IRS directly**: Taxpayers with tax debts of less than $10,000 often can figure out a way to pay on their own. If not, some taxpayers have success working with the IRS to arrange an installment plan.

5. **Apply for an installment agreement:** If you owe up to $25,000 at tax filing time, you might be eligible to pay in monthly installments. Along with your tax return, attach Form 9465 (Installment Agreement Request), or complete the Online Payment Agreement application. Setting up the agreement costs $105, or $52 if the taxpayer signs up for direct withdrawal from a bank account. When you apply, you'll state the amount you plan to pay each month and when you will pay. You will pay interest plus a late payment penalty on the unpaid taxes for each period after the due date that the tax is not paid.

6. **Don't count on bankruptcy:** Historically, consumers with severe tax debt might file Chapter 7 bankruptcy protection. However, the 2005 bankruptcy reform law significantly limited the ability to obtain Chapter 7 filings. The bill's new "means test" requires many consumers to file Chapter 13 bankruptcy, which establishes a repayment plan rather than wiping out all debt. If serious tax debt is the primary problem, taxpayers might be better off consulting a tax relief specialist for help in negotiating with the IRS (see next point).

7. **Get professional help:** When individuals cannot pay tax liabilities of $10,000 or more, specialists can help. These specialists negotiate with the IRS on behalf of these consumers to help them arrange a settlement. Tax relief specialists usually are attorneys, enrolled agents or certified public accountants with special training and experience. They know the ins and outs of IRS forms and calculations. The experts can help consumers understand IRS rules and get back into good standing.

   Depending on how serious a person's situation is, there are two types of IRS settlement:

   - An **offer in compromise** reduces the principal, interest and penalties owed to the IRS.
   - An **installment agreement** is a payment plan for the amount due. It often includes reduced penalties.

If you owe too much on state taxes: If you are far behind in tax payments to your state (for states that collect income tax), you also should take action to resolve the situation. State income tax laws vary by state. You may need to contact a tax professional for help in resolving state income tax debt.

No matter how much you owe in taxes, the key is to take action. Do not let overdue taxes languish. Tax agencies are serious -- and increasingly aggressive -- about tax collection and evasion. Tax debt can result in a lien on a house or garnished wages.

How to choose a tax relief company

If you decide you need help with your tax debt, it's important to know what to look for. Ask these questions of a tax debt resolution firm or tax relief company before you sign an agreement with them.

1. **Promises, promises** - Beware of companies that make specific promises before they review an individual's situation. It's also a red flag if a company pressures you to sign up immediately or send money before an agreement is created. A trustworthy company will be honest and communicative with prospective clients.

2. **Background** – What is the background of the company's management team? Look for good, relevant education and experience. Never accept a management team that jumps from opportunity to opportunity to make its fortunes.

3. **History** – How long has the company been in business? How many customers has it served? Find out if the company and its own employees will actually provide service through the life of the program, or if they contract out to others once they have enrolled a client. Will they let you speak to the tax professional who will be handling your matter?

4. **Success** – What is the company's success rate on obtaining resolutions with the IRS? What is the company's savings rate on IRS-accepted offers?

5. **Fees** – Make sure the company can clearly explain, and document, their fees and how they charge them.

6. **Services** – Be sure the company can represent you in an audit, if need be. Also ask if they can directly intercede on your behalf with the IRS as needed. In its initial consultation, did the company ask about your assets, income and expenses before suggesting a way to resolve the tax debt? If they jumped into offering suggestions without understanding your individual situation, they might not be a solid help.

7. **Staff** – Does the company have licensed agents (attorneys or enrolled agents) working on your case? Tax debt relief is serious business. Tax law is complex. You want real experts on your side.

About Freedom Tax Relief

www.freedomtaxrelief.com

Based in San Mateo, Calif., Freedom Tax Relief (FTR) provides tax representation services. Working directly with the IRS, FTR helps individuals and businesses prepare back tax returns, become compliant with the IRS, determine the optimal IRS tax resolution program and resolve tax problems. Since its inception, FTR has achieved a savings rate of 87 percent on IRS-accepted offers in compromise. The company, which has served nearly 9,000 consumers since 2002, is a wholly owned subsidiary of Freedom Financial Network LLC.

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