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ONLINE TAXES

Barbara Weltman



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*This book is dedicated
with loving thanks
to my family*

Contents

Introduction	xi
Acknowledgments	xv
PART 1 Preparing and Filing Your Federal Income Tax Return	1
1. The Basics of Online Filing	3
Advantages of Online Filing	4
Scope of Online Filing	8
Privacy Concerns	10
2. Preparing Your Return	13
Return Preparation Options	14
Selecting Tax Software	15
Using Tax Software	18
Preparing Returns Online	23
Returns by Telephone	27
Avoiding Common Mistakes in Online Return Preparation	29
3. Filing Electronically	35
Electronic Filing Alternatives	36
Mechanics of Online Filing	42
Getting Refunds	45
Paying Taxes Owed	48

4. Preparing and Filing Other Federal Tax Forms	55
Filing Extensions	55
Estimated Taxes	63
Other Forms	67
PART 2 Preparing and Filing Your State Income Tax Return	69
5. Preparing Your State Return	71
Return Preparation Options for State Returns	72
Selecting Tax Software for State Returns	72
Using Software for State Returns	75
Preparing State Returns Online	77
State Returns by Telephone	77
Getting State Tax Information	78
6. Filing State Returns Electronically	81
Electronic Filing Alternatives	82
Mechanics of Online Filing	82
Getting Refunds	85
Paying Taxes Owed	86
State-by-State Survey of Filing Options	86
7. Preparing and Filing Other State Tax Forms	95
Filing Extensions for State Income Tax Returns	95
State Estimated Taxes	101
Property Taxes	101
Other Taxes	101
PART 3 Small Business Owner's Guide to Taxes Online	103
8. Filing Business Income Tax Returns	105
Benefits of <i>E-Filing</i> Business Income Tax Returns	106
Selecting Software for Business Income Tax Returns	108
Filing Electronically	113
Getting Refunds	113
Paying Taxes Owed	114
9. Filing Employment Taxes and Other Returns	119
Employment Taxes	120
Information Returns	129
Other Taxes and Returns	134
10. Getting Business Information and Help Online	139
IRS Assistance for Small Business	139
Online Accounting Options	140

Offering Electronic Filing as a Tax-Free Employee Benefit	143
Tax-Related Information Online	144
PART 4 Using the Internet for Tax Planning	149
11. What the IRS Web Site Can Offer You	151
Finding Materials for Tax Preparation	152
Doing Tax Research at the IRS Site	156
Solving Your Tax Questions Online	157
Keeping Up to Date	162
12. Online Tax Research	165
Using Tax Web Browsers	166
Online Chats and Other Tax Forums	166
Doing Tax Research Online	167
Learning from Online Tax Guides	169
Learning from Major Accounting Firms	169
Locating Tax Professionals Online	171
Other Online Resources	174
13. Online Tax Planning	175
Income Tax Planning	176
Investment Planning	180
College Savings Planning	185
Retirement Planning	188
Estate Planning	194
Glossary	197
Appendixes	201
A: Directory of Online Tax Web Sites	201
B: Directory of State Revenue Departments	215
Index	219

Introduction

In the mid-1990s the IRS started its *e-file* program—the IRS term for electronic filing—to enable taxpayers to file their returns in a new way. In 1997, Congress directed the IRS to increase electronic filing of individual income tax returns to 80% by 2007. It's expected that by that time more than 100 million returns will be filed in this manner each year.

Today nearly 40 million Americans already use *e-file* for their returns. That's more than one-third of all personal returns. Some use their home computers for *e-filing* but the majority of taxpayers work with tax professionals who submit returns electronically for them. These people have already discovered the ease, convenience, and other advantages of online filing.

With the advent of *e-filing* comes new ways to pay taxes and obtain refunds. Today you can charge your taxes as you would a new coat or a washing machine. You can authorize payment from your bank account. Complimentarily, you can direct that refunds be deposited directly into your bank account.

And the use of *e-filing* isn't limited to individuals. Business owners

can use *e-filing* to meet their employment tax obligations as well as filing certain other tax returns. Various online options can help them simplify their tax filings, payment responsibilities, and more. Tax deposits can be made electronically with the use of a computer at an owner's direction. And audit protection can be gained by reviewing IRS audit guides online.

But online filing and tax payments aren't the only ways in which the computer has changed the way we operate. The Internet has opened up a vast array of resources on taxes and tax planning for the average individual. These resources can assist you in preparing your own return so that you'll pay the least taxes required while avoiding problems with the IRS. These resources can also help you take control of your money—by helping you not only with tax planning but also with financial, retirement, and estate planning. The number of web sites that provide tax information and assistance are well into the thousands. This book only highlights several dozen sites that have proved particularly useful—but don't feel limited by what has been presented here. By all means explore the Internet for new tax-related sites that are continually added. Of course, web sites can always change or cease operation so this book makes no warranty that sites discussed here will continue to provide the information currently available there.

This book is designed to help the novice move to online filing for individual income tax returns. This step-by-step guide shows you

CAUTION

Please note that the information contained in this book reflects the options available for filing 2000 returns. It is expected that many things will change for filing 2001 returns. You need to check web sites of the IRS, your state, and other sites for information relating to your 2001 return.

how to decide between using the telephone or a home computer to prepare and file a return. It tells you how to select software and use it to your best advantage—in preparing your returns effortlessly and filing online in a snap. It also explains how you can prepare your return yourself and then work with professionals to *e-file* if you don't have an Internet connection—even how to find professionals to both prepare and file your return for you.

But this book can also help those who have already *e-filed* do it even better—using additional resources available online to learn the ins and outs of tax rules, stay abreast of tax changes, and simplify required bookkeeping tasks. It can also help small

business owners meet some of their tax filing obligations online—to save their business both time and money. Finally, this book can help with long-range tax planning—not only for income taxes but also for investments, college savings, retirement, and estate planning.

How to Use This Book

Taxes are a complex subject, but using this book is not. This book covers four general areas of concern:

- Preparing and filing your federal income tax return—from the nuts and bolts of preparing returns with the help of software or online sites to the basics of filing them with the IRS electronically.
- Preparing and filing your state income tax return—which, much like the federal tax return, can be prepared and filed electronically with your state. You'll see the different filing options available to you on a state-by-state basis.
- Small business owner's guide to taxes online—coverage of electronic filing for business, employment, and other returns as well as using the Internet for help to save the business owner time and money. Both federal and state tax issues are addressed here.
- Using the Internet for tax planning—getting tax forms, publications, and other information online, researching tax questions—and getting answers—and planning resources available through the Internet.

The information contained in this book is designed to guide you on how to prepare and file your return online and how to use the Internet for other tax-related matters. It is not intended to be construed as legal, tax, or accounting advice. If you have specific questions or issues not addressed here that you can't resolve on your own, even using the resources noted in this book, it is advisable to seek professional tax assistance.

In the appendixes you'll find a directory of all the tax-related web sites mentioned throughout the book. These sites contain information, tax materials, or other tax help for you. You'll also find a listing of state revenue departments to help you with your state tax obligations.

Throughout the book you'll see three types of highlighted information to pay special attention to:

- **Caution:** A word of caution to help you avoid trouble.
- **Do It Better . . .** Some added guidance to make things easier and help you do things better.
- **Did You Know?** Some extra information you'll find interesting and helpful.

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Preparing and Filing Your Federal Income Tax Return

The Basics of Online Filing

Just as e-mail has eclipsed snail mail as the communication method of choice by millions of Americans, filing taxes electronically is growing in popularity over the old-fashioned mailing of returns. The IRS's *e-file* system allows you to file your return without having to mail it in. There are several sound reasons for this trend toward online filing—convenience being just one of those reasons. The IRS has simplified online filing by eliminating the need to follow up with signature forms and W-2 forms—allowing for totally paperless returns. Also, advancements in privacy protection have served to enhance consumer confidence in using online filing.

If you're an *e-filer* or about to become one—for your personal tax return or for business returns—you should understand why this method of filing makes good sense. You stand to win in several ways—most importantly by making tax filing just a little less of a hassle.

In this chapter you will learn about:

- The advantages of online filing.
- The scope of online filing.
- Privacy concerns.

Advantages of Online Filing

You don't have to file your return electronically. There's no law mandating electronic filing. You can still file a paper return—through the U.S. Postal Service or by means of a private carrier such as FedEx. But using *e-file* to submit individual income tax returns electronically offers several unique advantages over traditional paper returns sent through the mail or by private carriers.

Ease of Filing

Those using their home computers can file returns with the IRS 24-hours a day, seven days a week. No more long lines at the post office on April 15th. Those who lack transportation don't have to leave home to file their returns.

Filing electronically is simple to do yourself—once you know how. Alternatively, if you don't have Internet access or still feel intimidated by doing it yourself or just don't want to do it yourself, you can use the services of a paid preparer who will submit your return for you—for a fee (generally between \$25 and \$50, depending on your location and the complexity of your return).

There are now combination tax return preparation and electronic filing sites on the Internet that allow you both to prepare and file at one location. The great thing about this arrangement is that there's no software to purchase or to download—you work directly through the Web. And the process may be entirely free in some circumstances. Even if you're required to pay, you only do so at the end of the process—when you file your return. For example, at TurboTax for the Web, your return can practically prepare itself. This site can automatically retrieve your W-2 information about your wages and 1099 information about certain investments if your employer and financial institutions participate in the TurboTax program. Other on-line preparation/filing sites boast that it can take under an hour to

Did You Know?

Nearly 40 million individuals filed their 2000 returns electronically. This accounts for more than one-third of all individual taxpayers—but still a long way from Congress' goal of 80% by 2007. But 81% of those asked said they were so satisfied with *e-filing* that they'd do it again next year.

Did You Know?

***E-filing* can be used whether you owe taxes or are due a refund. Two electronic payment options—automatic withdrawal from a bank account or credit card—enable payments to be made without the need for sending a personal check.**

prepare and file your return—something that used to take hours doing the old-fashioned way.

And you can file your federal and state income tax returns in one step—*both* returns are usually *e-filed* with the IRS who, acting as an “electronic postman,” then forwards the state return on to the appropriate state agency. In some states the transmitter routes the state return directly to the state agency instead of through the IRS. From the consumer’s perspective, regardless of the technical way in which the state receives its return, the two returns—federal and state—are filed together, simplifying the filing process.

Accuracy

Filing electronically assures that the return you submit to the IRS contains all essential information necessary for processing. If something is missing or incorrect—for example, a dependent’s Social Security number—the return is immediately rejected. This allows you to promptly correct the error and resubmit the return.

Software companies continually monitor their products for errors. You can download program updates to avoid any problems. TurboTax stands behind its product 100% by agreeing to pay any penalty charged as a result of calculation errors in its program. Other software companies have similar guarantees.

Of course, assurance of accuracy on your return depends on the

Did You Know?

The number one reason that a return is audited is a mathematical error picked up by IRS computers. Even worse, math errors can result in overpaying income taxes. About 21% of all returns prepared manually contain errors, compared with less than 2% on those returns prepared by computer—and less than 1% of computer-generated returns filed electronically have any math errors.

information you provide. For example, if you fail to include dividend income you received, the math on your return will be accurate, but the information is not correct. Only you, and not a computer program, can make sure that the information reported on the return is complete and correct.

Quicker Refunds

If you've overpaid your income taxes—because there was too much withholding from your wages or overly generous estimated tax payments—you can receive a refund more rapidly by *e-filing*. It's estimated that refunds on paper returns take an average of six to eight weeks—even longer for returns filed around April 15th. But refunds on *e-filed* returns typically are made as quickly as two weeks from the date on which the return has been accepted by the IRS.

You can receive your refund even quicker—a couple of days instead of a couple of weeks—through a refund anticipation loan. This may be called a “Refund Advance” or some other term. But whatever it's called, it's really just a short-term loan that's being made to you. Intuit (TurboTax), H&R Block (TaxCut), and other companies work with banks to provide taxpayer refund anticipation loans up to \$5,000 that put the funds into taxpayer bank accounts within two or three days of filing. There are no up-front costs for this loan—the loan origination fees are subtracted from the loan proceeds (your refund) that are deposited in your account.

While there are no up-front costs, there are fees for this quick refund method and these fees can be relatively sizable. Except in unusual circumstances, you should not use this method of receiving your refund because of the costs involved. By simply waiting a few weeks, you receive all of your money from the U.S. Treasury and you don't incur any loan origination fees in the process.

Did You Know?

There were about 80 million refunds on 2000 returns. The average refund to individuals for the 2000 tax year was \$1,728. And nearly half of all individual filers received refunds.

Do It Better . . .

Instead of receiving a refund check by mail and then having to deposit it in your bank account, you can shortcut the process by requesting that your refund be directly deposited in your account. Simply provide the necessary routing information on your return (your account number and other information) and the refund will be automatically deposited in your account.

Acknowledgment

Proof of filing is important for several reasons. It assures you that any refund due you is in progress—you can anticipate its receipt to pay your bills, plan a vacation, or make an investment.

Proof that a return has been filed is also important in establishing a statute of limitations—the time in which the IRS can audit your return. If the IRS says that no return has been filed and you lack proof to the contrary, then the IRS has an unlimited time to question your return and claim you owe back taxes—whether or not you agree.

When filing a paper return, you can have proof that your return was filed by obtaining a registered or certified receipt from the U.S. Postal Service showing when the return was mailed. Proof of filing can also be a receipt from an authorized private delivery carrier providing the following services:

- Airborne Express (Overnight Air Express Service, Next Afternoon Service, and Second Day Service).
- DHL Worldwide Express (DHL “Same Day” Service and DHL USA Overnight).
- Federal Express (FedEx Priority Overnight, FedEx Standard Overnight, and FedEx 2Day).
- United Parcel Service (UPS Next Day Air, UPS Next Day Air Saver, UPS 2nd Day Air, and UPS 2nd Day A.M.)

Did You Know?

The IRS has three years after your return is filed to assess additional taxes. When you file a return before the due date, however, the three-year period starts from the due date, generally April 15th for individuals.