

# 5 Tax Mistakes You Can't Afford to Make



Tax errors can snowball into a financial nightmare for your business. Misfiling business taxes can lead to thousands of dollars in back payments, penalties, and interest, not to mention the threat of a state or federal tax audit. Even an innocent mistake in payroll data or expense claims can result in long-term financial and reputational damages for your company.

But as stressful as managing business taxes can be, there's no reason filing should feel like a ticking time bomb. To help, we've gathered the most common tax mistakes to avoid, so you can get through tax season without breaking a sweat.

## Free Download: Payroll Checklist

Nothing squashes employee morale like a botched payday. That's why we've wrangled all the important payroll to-dos you need to ensure accurate, on-time payroll runs for your company.

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# 5 Common Tax Filing Mistakes to Avoid

## 1. UNDERPAYING ESTIMATED TAXES

The IRS requires **quarterly payments** if you expect to owe the following amounts in income tax:

- **For individuals, sole proprietors, partnerships, and S corporation shareholders:** \$1,000
- **For C corporations:** \$500

If you fail to pay estimated taxes on time, or underpay estimated taxes, you can get hit with some hefty penalty fees. Not only can the IRS add on extra penalties to what a business may already owe in taxes, but it also charges interest. By the time your business files taxes in the spring, you could be looking at a massively inflated tax liability.

For sole proprietorships, partnerships, and shareholders of S corporations, you can calculate estimated tax payments using **IRS Form 1040-ES**. C corporations may choose to use Form 1120-W as a calculation tool for estimated taxes, but since the IRS has discontinued updates for this form, companies filing as a C corporation should consult with their financial advisors on the best way to calculate estimated taxes.

To make sure your business pays its quarterly estimated taxes on time, follow the **IRS schedule of deadlines**:

- April 15: Q1 estimated taxes due (tax on income earned January 1–March 31)
- June 15: Q2 estimated taxes due (tax on income earned April 1–May 31)
- September 15: Q3 estimated taxes due (tax on income earned Jun 1–August 31)
- January 15: Q4 estimated taxes due (tax on income earned September 1–December 31)

## WHAT ABOUT EMPLOYMENT TAX PAYMENTS?

Be sure not to confuse estimated tax with **employment tax**. Employers must pay employment taxes to cover their share of employees' Social Security and Medicare taxes, and to make a contribution to the **unemployment fund**. These **payroll taxes** must be paid monthly or semimonthly, depending on your payroll size, and are separate from the quarterly estimated taxes that go toward a business's income tax liability.



## 2. MISSING OR INCORRECTLY CLAIMING DEDUCTIONS

Accurately claiming **deductions** is crucial to surviving tax season. Deductions are eligible business expenses that you can claim on your tax return to reduce your total taxable business income for the year. The more expenses a business claims, the lower the tax liability. Missing out on legitimate deductions means paying more taxes than necessary, while claiming incorrect deductions can trigger IRS scrutiny and penalties.

Claiming deductions can be overwhelming—there are dozens of qualified business expenses, each with their own set of requirements. But as tricky as it can be, navigating through all those expense claims can save your business thousands of dollars in taxes.

Here are some eligible—and often overlooked—business expenses:

- **Home office:** If the business owner has workspace in their home used exclusively for managing the company, the cost of using that space is a deductible business expense.
- **Business travel:** If a company has done any business travel in the last year, associated costs for transportation, food, and lodging could be eligible for a tax write-off.
- **Startup costs:** Is your company a **new startup**? Review any business costs incurred before the company officially launched—they might qualify for a deduction.

Deductions help your business save money, but incorrectly claiming expenses costs you big time. Getting a little too creative with business expenses and claiming deductions that don't actually qualify can spell serious trouble with the IRS. Whether an accident or not, incorrectly claiming business deductions can lead to an IRS **audit** and crushing penalties for unpaid taxes.

Some common deductions errors to avoid include:

- **Personal expenses:** Maintaining **boundaries between your personal life and work** isn't just good life advice—it's also required by the IRS! A business owner's personal expenses, such as buying a new refrigerator for their home kitchen or going on a family vacation, do not count as business expense deductions.
- **Excessive gifts or entertainment:** While the IRS will allow businesses to deduct some expenses related to giving gifts or providing entertainment to clients, there are strict limits on how much a business can claim.
- **Big purchases:** If you spend a lot of capital on something that will serve your business in the long run, like equipment, the IRS won't let you claim it all in one fell swoop. Instead, the business can claim the **gradual depreciation** in the purchase's value on each annual tax return.
  - For example: if a newspaper company buys a new printing press, they can't legally claim the full cost of the press as an expense. Rather, every year when the printing press becomes worth a little less than the amount it was originally purchased for, the newspaper company can claim that loss as a deduction.

### 3. MISCLASSIFYING EMPLOYEES

**Misclassifying employees** is a major legal and financial liability for companies. Misclassification occurs when a company pays an individual as an independent contractor but treats them like an employee. In addition to exposing the business to costly lawsuits under the **Fair Labor Standards Act**, employee misclassification also runs the risk of racking up a big tax bill with the IRS.

Employers pay taxes for W-2 employees, including Social Security, Medicare, and unemployment taxes. When an employee is given a 1099-NEC instead of a W-2, the employer isn't paying any of those employment taxes.

If it's determined that an employee should have been **classified as a W-2 employee** and wasn't, the IRS will require the company to pay those missing employment taxes, plus penalties and interest. The company will probably also face late taxes and penalties for state unemployment and any other state-level employment taxes.

The IRS uses the following **common-law standards** to define an employee:

- **Behavior:** How much control does the company have over how the individual does their work?
- **Finances:** Does the company manage all the operational aspects and costs of the individual's work?
- **Relationship:** What's the nature of the contract? Is the individual's work an ongoing and essential part of the company's business?

If the company supervises and controls the individual's work, manages all the finances related to the work, and expects the individual to work for them indefinitely, the company is treating that individual like an employee, not a contractor. To avoid penalties and lawsuits, make sure any contributor at your business that meets this criteria is issued a W-2 and that their paychecks are factored into your payroll tax payments.

If your company has already misclassified employees, you may be eligible to apply for the **Voluntary Classification Settlement Program (VCSP)** to help lower your unpaid tax liability and properly classify your employees going forward.

### 4. FILING AS THE WRONG ENTITY TYPE

If your business files taxes as the wrong entity classification, you could be unnecessarily increasing your tax liability. After all, a small business with a few shareholders has a very different financial structure than a huge corporation, and your tax obligations should reflect that.

The IRS recognizes **several types of businesses**, each with their own tax implications:

- **Sole Proprietorship**
  - An unincorporated business owned by one individual.
  - Profits and losses are reported on the owner's personal income tax return (**Form 1040**, Schedule C).
  - The owner is subject to self-employment tax.
- **Partnership**
  - An unincorporated business owned by two or more individuals.
  - Profits and losses are passed through to the partners' personal income tax returns (**Form 1065**).
  - Partners are subject to self-employment tax.

- **S Corporation**

- A small business corporation that elects to pass through profits and losses to shareholders' personal income tax returns (**Form 1120-S**).
- Shareholders pay income tax on their share of profits, and only pay self-employment tax on the wages they draw as employees of the S corp.

- **C Corporation**

- A separate legal entity that is taxed separately from its owners (**Form 1120**).
- Double taxation—corporate income tax and individual income tax on shareholder dividends—sometimes applies.

If your business is a limited liability company (LLC), your entity classification for federal taxes is a little complicated. The IRS doesn't use LLC as a classification—LLCs were created by state laws, with each state having slightly different definitions and requirements. For federal tax purposes, an LLC will need to elect its entity classification as one of the types recognized by the IRS, using **Form 8832**.



## 5. PAYROLL ERRORS AND RECORD DISCREPANCIES

If you have payroll mistakes, you'll likely have tax mistakes, too. **Payroll errors** can lead to significant discrepancies between reported and actual tax liabilities, resulting in penalties, interest on late tax payments, and even an IRS or state audit.

Some common payroll problems that lead to tax mistakes include:

- Pay miscalculations: An error in an employee's pay, such as miscalculating overtime, will have a ripple effect on taxes, causing incorrect payments for employment taxes and issues on W-2 and W-3 forms.

- Withholding errors: If your payroll system isn't withholding the proper amount in federal and state taxes from employee paychecks, you could face problems with underpaying taxes.
- W-2 and 1099 problems: Employers are responsible for issuing accurate W-2s to their employees and 1099-NECs to contractors. Employers also need accurate W-2 information to properly complete **Form W-3**. If payroll data is inaccurate, or there's issues transferring payroll data into the necessary forms, you'll have some major headaches come tax season.
- Poor record-keeping: Good records are essential to filing taxes correctly and avoiding problematic audits. The IRS recommends keeping all tax records for at least four years, but ideally, you should preserve all your **payroll and tax records** indefinitely. Without the proper records, your business will struggle to verify deduction claims, manage tax payments, and make data-informed financial decisions.

### Are You Making These 5 Common Payroll Mistakes?

When payroll mistakes crop up, the impact can ripple across your entire company. Fortunately, the most common payroll errors are avoidable. Learn how to identify—and prevent—the most common errors.

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## Understand the Difference Between Evasion and Avoidance

Whether you're planning an overall financial strategy for your business or managing the day-to-day of payroll operations, understanding the **difference between evasion and avoidance** is key to preventing some of the most serious tax errors.

**Tax evasion** is the illegal nonpayment or underpayment of taxes and can result in severe financial penalties and, in extreme cases, imprisonment. Generally, if any information on a business's tax return is inaccurate or dishonest, and results in lower taxes, then the business has committed illegal tax evasion.

Examples of tax evasion include:

- Failing to accurately report total income
- Claiming false deductions
- Concealing taxable assets

On the other hand, tax avoidance refers to any legal strategy to reduce your tax liability. Tax avoidance strategies might save a lot of money, but they won't involve any misrepresentations or lies about a company's finances.

Examples of possible avoidance strategies include:

- Claiming legitimate deductions
- Utilizing tax-advantaged investments and retirement accounts
- Using legal offshore tax haven accounts

Choosing how to strategically reduce tax liability is your business's prerogative, but always make sure your tax process falls on the side of avoidance, never evasion. It's a good idea to consult with a tax law expert before filing your tax return, especially if you have doubts or concerns.

## Choose the Right Payroll System

No matter how prepared you are to navigate business taxes, you'll still face challenges if you don't have the **right payroll system**. With an inefficient or confusing payroll software, you run the risk of serious data errors and technical difficulties that can cause tax inaccuracies, missing records, and processing delays. Meanwhile, a centralized, easy-to-use payroll ensures accurate and seamless data management that simplifies your tax process.

When **reviewing payroll options**, look for a connected platform that brings your payroll, benefits and people data together, so you can easily get the full picture of your tax information. And don't forget to look at the services a vendor provides beyond the tech itself—your payroll platform should come with comprehensive tax services that can help your company audit data, manage tax calculations, and comply with updated tax laws year-round.

## Pay Your People Confidently

From easy-to-understand pay stubs to seamless payroll runs and reporting, everything works effortlessly together to give payroll admins and employees happier paydays.

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