Survey - How Did Consumers Pay Last Year's Tax Bills?

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MoneyRates.com surveyed 500 consumers about the results of their 2018 tax preparation.

More than half (51%) of the respondents surveyed owed money on their 2018 taxes, catching many off guard.

The reason?

Even though nearly 75% of Americans, historically, have received refunds, the White House tax law changes resulted in under-withholding for millions of Americans. The Government Accounting Office (GAO) sounded a warning about this in early 2018; but most consumers, unsurprisingly, don't get regular reports from the GAO.

>> MoneyRates covered the topic here: Why You May Owe the IRS for 2018 Taxes

Owing the IRS is not necessarily a bad thing. From a financial-management perspective, owing the IRS means you received an interest-free loan from the government, while those who get refunds actually *give* the government an interest-free loan.

The survey results suggest that most of those who did owe seem to grasp this. While 51% owed money, only 11% of the respondents said they increased their withholdings for 2019.

15% Unable to Pay Tax Debt

Most taxpayers who owed were prepared to pay their 2018 balances from their income (58%) or savings (27%). Here's what the rest who owed did to handle their tax debt:

- 10% borrowed with credit card or personal loan
- 2% liquidated retirement assets
- 1% set up an installment plan with the IRS

Finally, 2% who owed chose "other," which could mean that they borrowed from family and friends, pawn shops, title loans and such - or perhaps they are among those who refused to pay as a protest against government-spending policies.

More Taxpayers Don't Expect to Owe for 2019

From the survey responses, it appears that those who were caught off guard by tax changes in 2018 took action and changed their withholding:

- 51% said they do not expect to owe when they file their 2019 tax returns
- 49% indicated that they will probably owe money to the IRS

Of those who expect to owe, here's how they plan to make that tax payment:

- Pay from regular income (write a check or electronic transfer): 62%
- Withdraw from savings: 23%
- Pay with a credit card: 5%
- Take out a personal loan: 5%
- Liquidate retirement investment: 4%
- Other: 2% (IRS installment plan, personal borrowing, not paying, etc.)

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Avoid Penalties: File Even if You Can't Pay

The one thing you don't want to do, even if you can't pay what you owe, is ignore the problem. File your return even if you can't pay your taxes to avoid the non-filing penalty. There is also a penalty for failing to pay the taxes due, but it's one-tenth as much as the failure-to-file penalty.

How failure-to-file penalties work

Per the IRS, a failure-to-file penalty applies to returns filed after the due date or extended due date if there is no reasonable cause for filing late.

- The penalty is 5% of the unpaid taxes for each month or part of a month that a tax return is late
- The penalty won't exceed 25% of your unpaid taxes
- The late filing penalty is calculated from balance due
- If after five months you still haven't paid, the failure-to-file penalty will max out - but the failure-to-pay penalty continues until the tax is paid, up to 25% of the balance due
- The maximum total penalty for failure to file and pay is 47.5% (22.5% late filing and 25% late payment) of the tax
- If your return was over 60 days late, the minimum failure-to-file penalty is the smaller of $210 (for tax returns required to be filed in 2019) or 100% of the tax required to be shown on the return

What Interest Rate Does the IRS Charge?

As of 2019, the interest rate charged by the IRS for unpaid balances (in addition to the .5% per month failure-to-pay charge) is the federal short-term rate plus 3%. As of this writing, that's 4.69%. But you also pay the failure-to-pay penalty of .5% per month.

> **If you owe $5,000, for example, and paid it off in a year with a payment plan, your monthly payment would be $427 and your total interest would be $128. But if you fail to file on time, your penalty would be $1,250, plus the $128 interest.**

Best Payment Options for Paying Your Tax Bill

If a non-filing penalty applies to you, you'll want to repay your tax bill as soon as possible to reduce that penalty. There are several ways to do this.

Credit card

For smaller amounts that you can pay off in a month or two, credit cards are certainly convenient. Fees apply, but they are small and don't go to the IRS. The actual "convenience charge" depends on the payment processor, but most only charge about 2% of the tax payment amount.

The downside, in addition to the interest charges, is the fact that increasing your credit-card balance almost always lowers your credit score. If you have a large purchase like a home or car coming up, you might want to avoid adding to your credit-card balance.

And if your repayment will take longer than a month or two, and you don't have a low-interest card, you could save money by paying off the credit card balance with cheaper financing, like a personal loan.

Personal loan

A personal loan has a few advantages over a credit card.

- You don't increase your credit utilization and decrease your credit score.
- Personal loans have fixed interest rates and terms. (You can budget for the payment and you'll know exactly when you'll clear your debt.)
- The interest rate is usually lower (about 7%) than that of a credit card.
- If you have other credit card debt you would like to consolidate, you can roll that into your personal loan as well. This can help you become debt-free faster.

Personal loans don't take long to process. You can apply and have your money in days or even hours. And you can compare multiple offers fast by completing a single online form.

Try to take a loan for the shortest possible term. Ideally, you'll repay your IRS bill in one year so you won't be dealing with this year's tax bill when you get next year's.

Personal Loan for $5,000 Tax Debt					
Interest Rate	1-Year Payment	2-Year Payment	3-Year Payment	4-Year Payment	5-Year Payment
6%	$430	$222	$152	$117	$97
9%	$437	$228	$159	$124	$104
12%	$444	$235	$166	$132	$111
15%	$451	$242	$173	$139	$119
18%	$458	$250	$181	$147	$127

>> Compare personal loan offers now

Home-equity financing

If you owe a very large amount, home-equity financing may be the option with the lowest interest rate. However, home-equity loans usually require home appraisals and have higher setup costs. It might be a good option though if you also need money for home improvements, to consolidate debts or have another big-ticket purchase in mind.

Liquidating retirement savings

Liquidating retirement savings can have bigger consequences than you may think. If you don't qualify to withdraw from your retirement accounts without penalty, you'll take a 10% hit right off the top. And even if you do qualify to withdraw money, your withdrawal could be taxable.

So if you had to pay 25% taxes plus a penalty on a $5,000 tax bill, you'll have to withdraw $6,750 to pay off a $5,000 balance. If you're old enough to avoid an early-withdrawal penalty and withdraw after-tax dollars from a Roth IRA, you'll pay no penalty or tax.

IRS installment agreement

If you owe more than you can pay when you file, you can propose an installment agreement (also called a payment plan) to the IRS. You can apply for one online.

A short-term (120 days or fewer) plan costs nothing to set up. For a long-term plan, the IRS does charge a fee of $31 to $225, depending on whether you apply online, by phone or mail and how you choose to pay (automatic debit from your bank account, check, card, etc.)

The IRS will contact you and let you know if your application has been approved and what the terms of your agreement are.

If You Can't Afford Your Tax Bill at All…

Sometimes, there is no possible way to pay your taxes. Your company may be out of business. Your health may be poor. You may have just survived a natural disaster, but your possessions and home did not.

In that case, you won't be borrowing to pay your tax debt. You need to throw yourself on the mercy of the IRS and request an offer in compromise.

IRS offers in compromise are agreements between taxpayers and the IRS in which the agency accepts less than the full amount due. You won't qualify if you could reasonably afford to pay off your debt through an installment agreement. You apply by completing Form 656-L.

You'll probably qualify if the IRS deems the full amount noncollectable. That means your assets and income are less than the amount you owe. In addition, you might qualify if collecting the entire debt would, according to the IRS, "create an economic hardship or would be unfair and inequitable because of exceptional circumstances."

You may be able to discharge your obligation with a lump sum or series of payments.

When to Increase Your Withholding

While interest-free loans from the IRS are a good thing, managing them requires a level of financial literacy that many consumers just don't have - or wish to have.

For those who are not tax experts or financial gurus, a tax refund is an important way to save, and they count on a windfall at tax time to pay bills, bulk up retirement accounts or just treat themselves to vacation or holiday extravagance.

If that describes you, consider adjusting your withholding if you want to avoid owing the IRS or increase your tax refund.

You should also take a look at your withholding if you were unable to pay the full amount due, or if you incurred penalties for under-withholding.

You can usually avoid under-withholding penalties if any of the following apply:

- Your tax bill was less than $1,000
- You withheld (or paid estimated tax) of at least 90% of the tax for the current year
- You withheld (or paid estimated tax) of at least 100% of the previous year's tax

There are special rules for farmers and fishermen, some household employers and eligible high-income taxpayers. There are other exemptions for those who underpaid because of catastrophic events or retirement.

How to Adjust Your Withholding

The IRS has a helpful online tool you can use to determine how much you should withhold and how many exemptions you should claim on your Form W-4.

It's called the Tax Withholding Estimator.

Just fill in the form and then use the results to complete a new W-4 with your employer or to adjust your quarterly estimated taxes if you are self-employed or have investment income.

Remember, as long as you pay enough to cover 100% of the previous year's liability, you won't have an under-withholding penalty.

If you don't want to owe at all, withhold enough to cover your expected liability plus a refund if you desire.

A little advance tax planning goes a long way on April 15.

>> Need help to prepare your taxes? Read Tax Prep Costs: What It Costs to Get Your Taxes Done