THE TAX PICTURE

Five Nasty Tax Surprises And How To Avoid Them

by MSN Money expert, Jeff Schnepper

(NAPSA)—The Internal Revenue Code can be full of nasty surprises.

Here are five to watch out for.

1. The responsible party surprise: Congratulations! You've been invited to serve on a prestigious nonprofit's board of directors. Surprise! You've just exposed yourself to potential taxes that can't even be discharged in bankruptcy. It's called the "responsible party" rule. If your charity has employees, taxes have to be withheld on their pay. If not, the IRS can go after the charity and anybody serving that organization who qualifies as a "responsible party."

Fortunately, there's a special exemption for unpaid volunteer board members of charities not involved in the day-to-day financial activities of the organization, and with no knowledge of the failure to fork over the taxes.

2. The debt-discharge surprise: You told your credit card companies that, unless they reduce your debt, you're going to file for bankruptcy. They lowered your liability by $5,000 so you can pay off the balance over 24 months. Surprise: That reduction is now ordinary income to you and could cost you as much as $1,750 in additional income tax. Unless sheltered by the umbrella of bankruptcy, debt reduction represents accession to wealth and is considered taxable income.

3. The Social Security surprise: Depending on your income, as much as 85 percent of what Social Security pays you may be subject to income tax. The government says you're getting your contributions returned tax-free in the 15 percent not taxed.

4. The unemployment surprise: Like many others, you lost your job. At least you have unemployment. Here's the surprise. Unemployment is taxed like any other income.

You may be a responsible taxpayer, but the U.S. tax code is filled with complexities that can blindside you and cost you money.

5. The marriage surprise: Joint and several liability. Most married couples file joint returns which normally provide a lower total tax for the couple than they would pay if they filed separately. Filing jointly, however, creates "joint and several" liability: both, or either spouse, is responsible for the full tax.

Let's say two years ago, you filed a joint return. Last year, you divorced and have no idea where your "ex" is. The IRS audits your joint return and discovers he had a job and didn't report $20,000 in cash income. The IRS now wants all of the taxes owed from you. You signed the joint return—you're liable for the taxes.

You can ask the IRS for relief as an "innocent spouse" if: You did not and had no reason to know about the understatement and it would be inequitable to hold you responsible for the deficiency.

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