

The Disciplined Investor Podcast – Guest Interview Summary

Guest: Dan Pilla

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Quick recap

Andrew and Dan discussed their personal experiences with weather conditions in South Florida and Minnesota, as well as the complexities of tax season, particularly for self-employed individuals. They also touched on tax strategies, IRS insights, and common mistakes that could lead to an audit, emphasizing the importance of maintaining accurate and original source records for income and expenses. The conversation also covered the challenges of organizing and maintaining financial records for tax purposes, the importance of keeping receipts and records for business expenses, and the ongoing compliance responsibility of tax filing.

Tax Season and Estimated Payments

Dan and Andrew discussed the complexities of tax season, particularly for self-employed individuals. They highlighted the importance of making estimated payments based on previous year's tax liability to avoid penalties. Dan explained that the IRS requires these payments to be made quarterly, and the amount should be 100% of the previous year's tax liability or 90% of the current year's. Andrew raised a question about the interest on overpaid taxes, to which Dan confirmed that interest is always charged. They also touched on the possibility of getting an extension of time to pay taxes, but warned that this must be filed before the due date to be effective.

Adjusting Withholding for Tax Liability

Dan and Andrew discussed the importance of adjusting withholding to match tax liability, rather than relying on the withholding system as a savings account. They emphasized the need for discipline in saving or investing the increased

paycheck amount. They also highlighted the benefits of contributing to a 401(k) on a pre-tax basis, which provides an additional tax deduction and can lead to a more secure financial future.

Tax Strategies and Audit Risks

Andrew and Dan discussed tax strategies, IRS insights, and common mistakes that could lead to an audit. Dan emphasized the importance of understanding how the IRS selects returns for audit and keeping proper records to support deduction items or income items. He also highlighted that two-thirds of audit adjustments are due to lack of records, not cheating.

Maintaining Accurate Source Records for Expenses

Dan discussed the importance of maintaining accurate and original source records for income and expenses, particularly for self-employed individuals. He emphasized the need for these records to support business-related expenses, such as travel and mileage, and to avoid disallowance by the IRS. Andrew raised concerns about the practicality of maintaining such records for expenses like Lyft or Uber rides, to which Dan suggested that these companies might provide receipts or logs that could be used to support business-related expenses.

Tax Record Management Challenges

Dan and Andrew discussed the challenges of organizing and maintaining financial records for tax purposes. Dan emphasized the importance of understanding the numbers in a tax return and having the necessary documentation to support them. He recommended keeping records for at least three years from the date the return is filed. Andrew acknowledged the overwhelming nature of this task for some people. They agreed that the compliance burden of the Internal Revenue Code is excessive and should not coexist with freedom in society.

Business Expense Record Keeping

Andrew and Dan discussed the importance of keeping receipts and records for business expenses, particularly for travel and meals. Dan emphasized the need to prove business travel and expenses to the IRS, and suggested using a separate credit card and bank accounts for business and personal expenses. They also touched on the topic of a continuing legal education seminar for tax professionals.

IRS Funding and Workforce Changes

Dan discussed the recent changes in the Internal Revenue Service (IRS) due to the Inflation Reduction Act. He clarified that the IRS received an additional \$80 billion over 10 years, not all at once, to hire about 87,000 additional workers. However, Congress later reduced this to \$60 billion. Dan also pointed out that the IRS was experiencing a mass retirement level, with about 30% of the workforce eligible to retire in the next two years. He suggested that the IRS's problems were not due to losing employees, but rather the non-core responsibilities Congress had given them, such as enforcing the Affordable Care Act and administering Covid-era programs. Dan concluded that the IRS should focus on its core job rather than being overwhelmed with these tasks.

Voluntary Compliance vs. Tax Enforcement

Dan emphasized the importance of voluntary compliance with the tax code, stating that 98% of tax revenue is collected through voluntary means, while only 2% is collected through enforcement. He argued that the IRS would benefit more from assisting taxpayers in understanding and complying with the increasingly complex tax law rather than relying on enforcement. Andrew agreed, suggesting that simplifying the tax code would lead to more voluntary compliance and reduce the need for enforcement.

Tax Compliance and Economic Waste

Dan and Andrew discussed the ongoing compliance responsibility of tax filing, which is an annual process that starts over every year. They also touched on the issue of the IRS not having a Presidentially nominated and Senate confirmed Commissioner, which remains to be seen. Andrew suggested that the time spent on record keeping and documentation should be a deductible item, but Dan clarified that it's not currently recognized as such. They also discussed the economic waste of time spent on tax compliance, which is estimated to be equivalent to the entire productive component of the workforce in Michigan, Ohio, and Indiana.