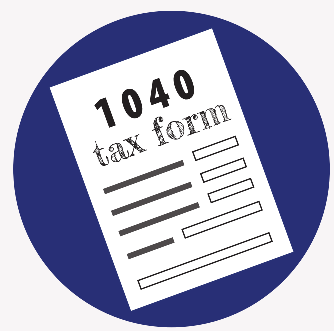
How to Tackle Your Taxes

A beginner's guide to understanding your federal individual income taxes

As Illustrated by Terry the Tax T-rex



Graphic compilations by Kristen Clark, using assets from Vecteezy.com.
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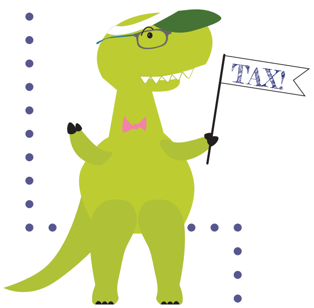


what are taxes?

The government collects income tax from U.S. residents each year. Personal income tax revenues help fund programs and services like Social Security, Medicare, schools, roads, national security, and the welfare system. If employed, an individual's employer will withhold income taxes. Because self-employed individuals do not have taxes withheld, they will generally pay estimated taxes throughout the year.

section

i.

tax basics

Taxes are based on income. Certain deductions and credits can reduce a taxpayer's overall tax liability.

Additionally, payments made throughout the year will reduce the amount of tax due at return time, sometimes even resulting in a refund.

The following section will help you undertand tax basics as well as filing requirements.

the tax equation

Your final taxes due are based on an equation that accounts for certain deductions, credits, and payments made during the tax year.

+ income

wages • salaries • tips • bonuses • interest • dividends

− deductions

specific expenses incurred that you can subtract from income

= taxable income

the amount of income subject to tax

× tax rate

Use the tax bracket based on your filing status to determine tax as not all of your income is taxed at the same rate.

= tax liability

the amount of tax that must be paid

− credits

a dollar for dollar reduction in tax liability

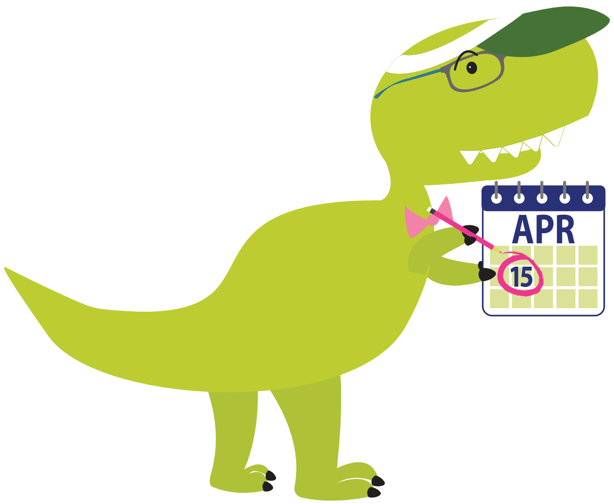
− payments

Money withheld from paychecks, or paid throughout the year to cover estimated liabilty

= tax due or refunded

If the total is positive, you owe additional tax with your return but if negative, you are due a refund of overpaid tax

due dates



Returns are due on the 15th day of the 4th month following the close of a taxable year. So for a reporting period of January 1, 2020 through December 31, 2020, a return's original due date would be due April 15, 2021.

April 15

If the **15th** falls on a weekend or holiday, the due date will be next business day.

need more time?

You can request an automatic **6-month** extension by filing Form 4868, by the original return due date.

October 15

An extension grants you until October 15th to file if on a normal calendar year. Note that an **extension** of time **to file** is **not an extension of time to pay**. You may be subject to a late payment penalty on any tax not paid by the original due date of your return.

filing status

You must determine your filing status before you can determine whether you must file a tax return, your standard deduction (discussed on pages 11 - 12), and your tax. You also use your filing status to determine whether you are eligible to claim certain other deductions and credits.

There are five filing statuses. If more than one filing status applies to you, choose the one that will give you the lowest tax liability.

To help you **determine your filing status**, visit the link below and answer questions about your living situation:

https://www.irs.gov/help/ita/what-is-my-filing-status

are you a dependent or can you claim one?

Dependent status effects tax deductions and filing status in certain cases.

If you have provided over half the support and a qualifying child or relative has lived with you for over six months, you may be able to claim them as a dependent.

Note that if someone else can claim you as a dependent, you cannot claim anyone else as a dependent.

Single.
Your filing status is single if you are considered unmarried and you don't qualify for another filing status

Married Filing Jointly.
If you are considered married at year-end and both you and your spouse agree to file jointly you qualify for this status. A joint tax return combines your incomes and deductions on one return.

Married Filing Separate.
Use this if you want to have separate tax liabilities from your spouse or your spouse doesn't want to file joint. Generally this status is least beneficial and you lose the ability to take certain credits.

Head of Household.
You may be able to file as head of household if you meet certain requirements including being unmarried on the last day of the tax year and taking **care of a dependent** for over 6 months of the year.

Qualifying Widow(er).
You may be eligible to use qualifying widow(er) as your filing status for two years following the year your spouse died.

tax brackets

The United States has a progressive tax system. That means people with higher taxable incomes are subject to higher tax rates and those with lower taxable incomes are subject to lower tax rates.

There are seven federal income tax brackets: 10%, 12%, 22%, 24%, 32%, 35% and 37%. No matter which bracket you're in, you probably won't pay that rate on your entire income. There are two reasons:

1. You get to subtract tax deductions to determine your taxable income (that's why your taxable income usually isn't the same as your salary or total income).
2. You don't just multiply your tax bracket by your taxable income. Instead, the government divides your taxable income into chunks and then taxes each chunk at the corresponding rate.

Your tax **bracket depends on** your **filing status** (see page 7). See below for two examples of the tax tables and ranges for 2020 tax year.

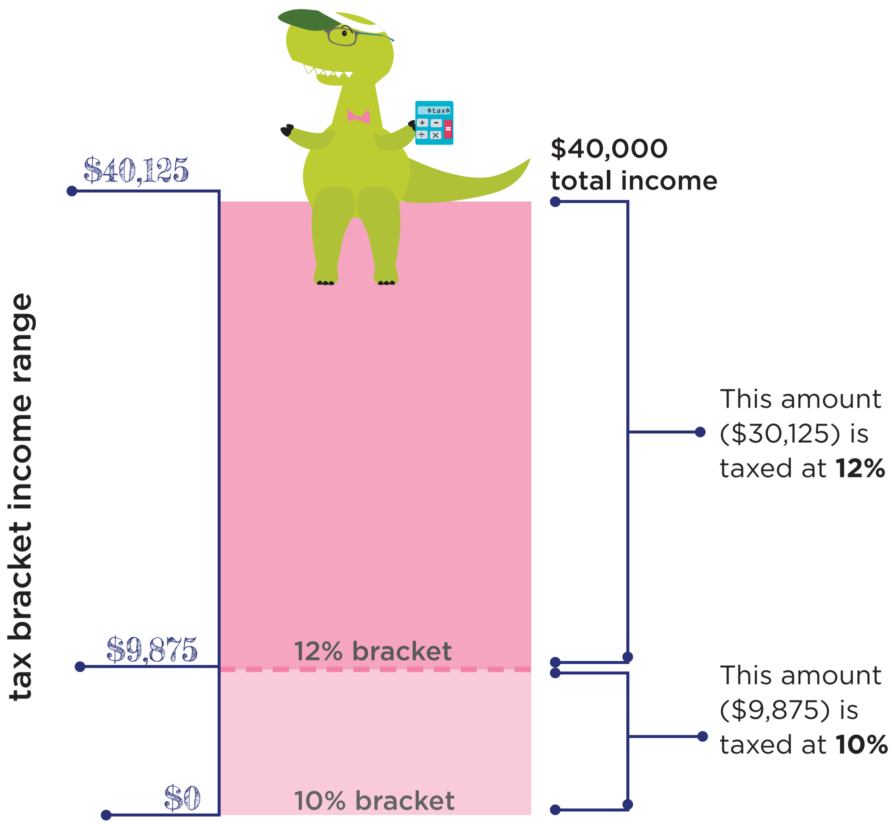
Single Filers

Tax Rate	Income Ranges
10%	$0 to $9,875
12%	$9,876 to $40,125
22%	$40,126 to $85,525
24%	$85,526 to $163,300
32%	$163,301 to $207,350
35%	$207,351 to $518,400
37%	$518,401 or more

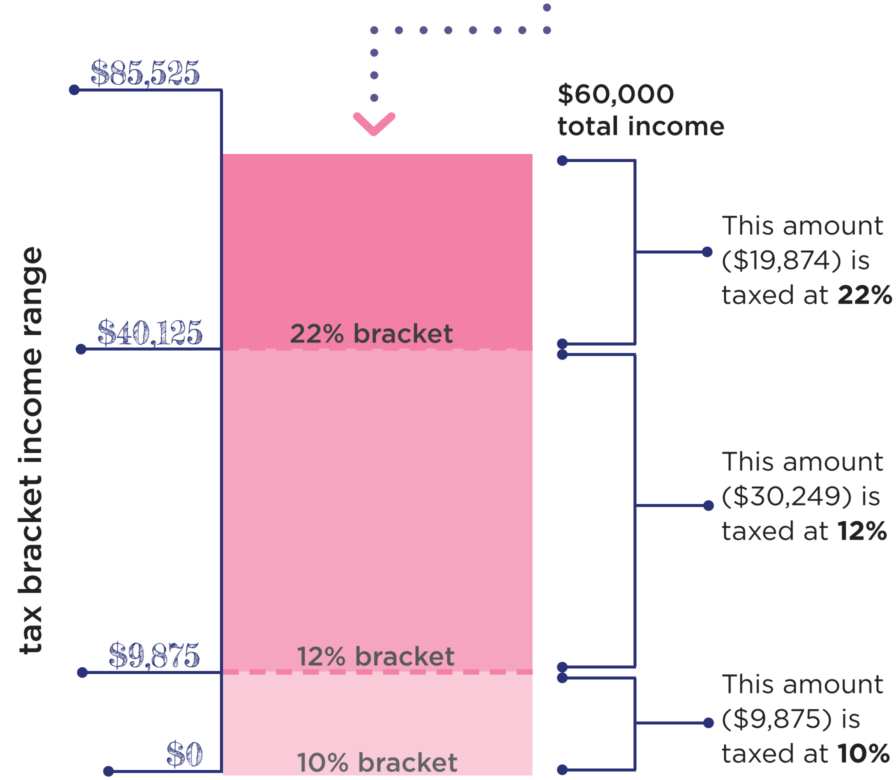
Married Filing Jointly

Tax Rate	Income Ranges
10%	$0 to $19,750
12%	$19,751 to $80,250
22%	$80,251 to $171,050
24%	$171,051 to $326,600
32%	$326,601 to $414,700
35%	$414,701 to $622,050
37%	$622,051 or more

For example, a single filer with **$40,000** in taxable income would be in the **12% bracket**. However, not all of the $40,000 is taxed at 12%. Per the table, $9,875 is taxed at 10% and the remaining $30,125 ($40,000 less $9,875) is taxed at 12%.



A single filer with **$60,000** in taxable income would be in the **22% bracket**. $9,875 is taxed at 10% in bracked 1, $30,249 is taxed at 12% in bracket 2, ($40,125 less $9,875) and the remaining $19,874 ($60,000 less $40,126) is taxed at 22% in bracket 3.



deductions vs. credits, what's the difference?

deductions

are **subtracted** from taxable income before tax liability is calculated

taxable income	$50,000
less: deductions	($10,000)
amount to be taxed	$40,000

Deductions cannot reduce your liability below zero.

Taxpayers are entitled to either the standard deduction or itemized deductions depending on the type of expenses they incur. See the next page for more info. XX

Additional deductions include IRA and 401(k) contributions, and heath savings accounts contributions.

credits

reduce tax liability owed, **dollar for dollar**

tax due	$6,500
less: credits	($1,000)
final tax due	$5,500

Some credits are refundable. For example if your tax liability is $1,000 but you are entitled to a $1,500 refundable credit, you can get a $500 refund.

Some **popular credits** include:

- Earned Income Tax Credit
- Child Tax Credit
- Child and Dependent Care Credit
- Lifetime Learning
- American Opportunity Tax Credit

do I take the standard deduction or do I itemize?

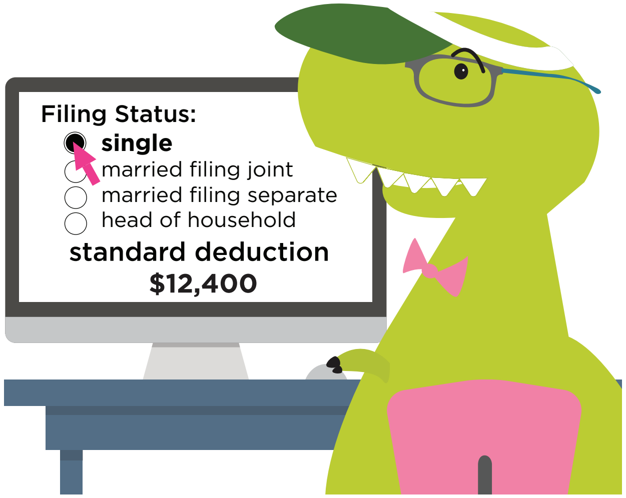
The tax code allows taxpayers one of two deductions - the standard deduction or itemized deductions. Generally, people are allowed to take whichever deduction is larger.

standard deduction

The standard deduction is basically a **flat-dollar**, no-questions-asked tax **deduction**. Claiming the standard deduction is easier, as you just check a box on your tax return. Many taxpayers find that it amounts to more than their combined itemized deductions.

The standard deduction varies based on filing status, and those 65 and older or blind are entitield to additional deduction.

Filing Status	Standard Deduction (2020)
Single	$12,400
Married, filing jointly	$24,800
Married, filing separately	$12,400
Head of Household	$18,650
Qualifying Widow(er)	$24,800



itemized deductions

Instead of taking the standard deduction, you can itemize your deductions, which means **adding up** and taking **all the individual tax deductions you qualify for**. You should itemize if this total is more than the standard deduction you are allowed based on your filing status.

Note that you should be tracking deductions throughout the tax year, and keep this documentation to prove you qualified for your deductions. Use IRS Schedule A to claim your itemized deductions.

Medical Expenses
Most taxpayers can claim medical expenses that exceed a percentage of their adjusted gross income (AGI - gross income less deductions before calculating tax liability), subject to certain rules. You can claim the deduction for **medical expenses that exceed 7.5% of your AGI**. For example, if your AGI was $100,000 and your medical expenses were $10,000 you would be able to deduct $2,500 ($10,000 less 7.5% of your AGI).

Home Mortgage Interest
You can deduct all interest paid on your home loan for the year as long as the loan doesn't exceed $750,000.

You should receive **Form 1098**, a mortgage interest statement, from your mortgage lender at the beginning of each new tax year. This form reports the total interest you paid during the previous year. The amount you input on Schedule A should tie to this schedule.

State and Local Taxes Paid
All income taxes that are imposed by a state, local, or foreign jurisdiction can be deducted, subject to a few rules. You might consider deducting sales tax instead of the state income tax as an alternative strategy—it's an either/or option. You can **claim income taxes or sales taxes**, but not both, up to $10,000.

Real Estate Taxes Paid
You can deduct the amount of real estate taxes paid on property that you own. However, the total deduction of real estate taxes and state and local taxes paid is **limited to $10,000**.

Charitable Donations
Donations to qualified charities are tax-deductible expenses that are reportable on Schedule A. Donations of items as well as cash can be deducted on your return if made to a qaulified tax-exempt organiation. You must **meet several record-keeping requirements** including saving canceled checks, acknowledgment letters from the charity or charities, and sometimes appraisals that confirm the value of donated property.

terms to know

adjusted gross income (AGI) AGI is gross income minus tax deductions that are allowable whether or not you itemize deductions when you file your tax returns.

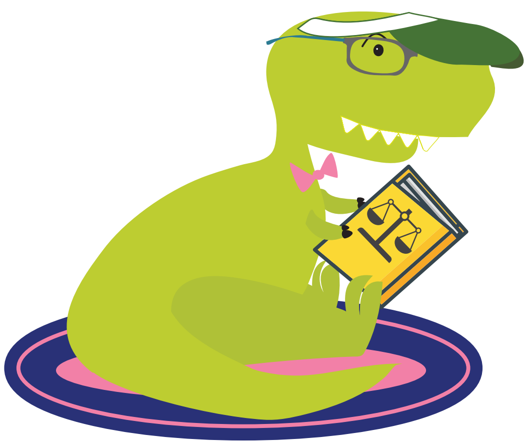
amount due Money that taxpayers must pay to the government when the total tax is greater than their total tax payments.

deductions An amount (often a personal or business expense) that reduces income subject to tax.

dependent A qualifying child or qualifying relative, other than the taxpayer or spouse, who entitles the taxpayer to claim a dependency exemption.

earned income Includes wages, salaries, tips, includible in gross income, and net earnings from self-employment earnings.

federal income tax The federal government levies a tax on personal income. The federal income tax provides for national programs such as defense, foreign affairs, law enforcement, and interest on the national debt.



filing status Determines the rate at which income is taxed. The five filing statuses are: single, married filing a joint return, married filing a separate return, head of household, and qualifying widow(er) with dependent child.

gross income Money, goods, services, and property a person receives that must be reported on a tax return. Includes unemployment compensation and certain scholarships. It does not include welfare benefits and nontaxable Social Security benefits.

interest income The income a person receives from certain bank accounts or from lending money to someone else.

itemized deductions Instead of taking the standard deduction, taxpayers can itemize actual expenses for various types of allowable deductions, by adding them all together and entering that total on their tax return. This is done if the total exceeds the standard deduction they are entitled to.

property taxes Taxes on property, especially real estate, but also can be on boats, automobiles (often paid along with license fees), recreational vehicles, and business inventories.

refund Money owed to taxpayers when their total tax payments are greater than the total tax.

standard deduction Reduces the income subject to tax and varies depending on filing status, age, blindness, and dependency.

tax credit A dollar-for-dollar reduction in the tax. Can be deducted directly from taxes owed.

taxes Required payments of money to governments that are used to provide public goods and services for the benefit of the community as a whole.

tax liability The amount of tax that must be paid. Taxpayers meet (or pay) their federal income tax liability through withholding, estimated tax payments, and payments made with the tax forms they file with the government.

tax preparation software Computer software designed to complete tax returns. The tax preparation software works with the IRS electronic filing system.

unearned income Includes income from investments such as interest from savings accounts and dividends.

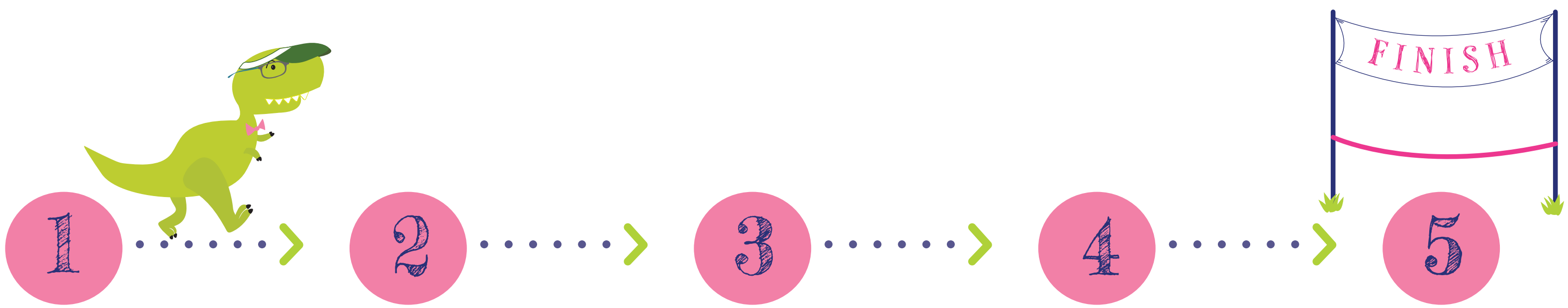
volunteer income tax assistance (VITA) This provides free income tax return preparation for certain taxpayers. The VITA program assists taxpayers who have limited or moderate incomes, have limited English skills, or are elderly or disabled. Many VITA sites offer electronic preparation and transmission of income tax returns.

withholding Money, for example, that employers withhold from employees paychecks. This money is deposited for the government. (It will be credited against the employees' tax liability when they file their returns.) Employers withhold money for federal income taxes, Social Security taxes and state and local income taxes in some states and localities.

section ii.

the tax return process

Now that you know the main elements of a return, let's get down to business and start the return process.



1. **Determine** if you have to file
2. **Gather** relevant information
3. **Organize** for easy reference
4. **Decide** how to prepare your return
5. **Review + File** your completed return

1 determine if you have to file

Not everyone needs to file a tax return. People are required to **file returns** when they **owe additional taxes** that weren't covered by estimated payments or salary withholdings.

As discussed in further detail in the previous sections several factors determine whether you must file a return including:

filing status

income totals

taxes paid or due

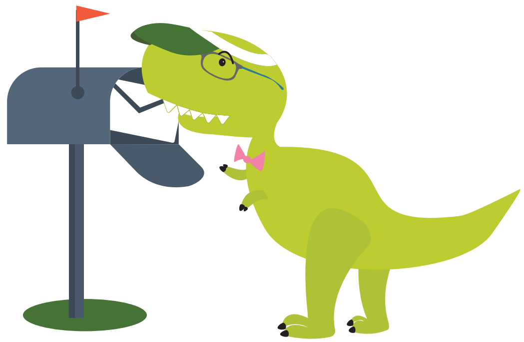
The IRS has a handy questionnaire available which incorporates these factors to determine if you should be filing a return. Visit the link below to start the questionnaire:

https://www.irs.gov/help/ita/do-i-need-to-file-a-tax-return

2 gather relevant information

Once you've determined that you need to file a tax return, start collecting information from the prior year.

An **April 15th deadline** includes information from the previous January 1 through December 31 period. So a tax return due April 15, 2021 would include all relevant information from January 1, 2020 through December 31, 2020.



+ Most forms needed for your return are available late January to early February of the year your return is due.

+ Check your mailbox as well as online financial accounts for your documents during this time.

Common forms to look for include:

- W-2 (wages)
- 1099-INT (interest income)
- 1099-DIV (dividends)
- 1098-T (tuition expenses)
- 1098-E (student loan interest)

3 organize your info for easy reference

Sort and store information in an organized manner, by tax year, so it's easier to find during return preparation or if you ever need to refer back.

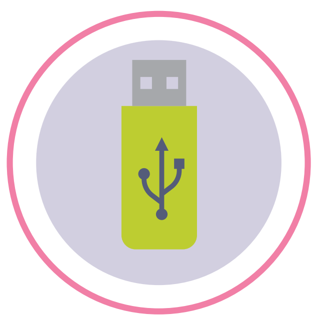
It's recommended that information be stored in **at least two places** for safekeeping for **at least 3 years**.

Try organizing info by return category:

- Income
- Deductions
- Credits
- Payments made to the IRS

Storage methods include:

computer harddrive



thumbdrive

secure file cabinet

the online cloud

4 decide how to prepare your return

Do It Yourself

Prepare your return with **tax software**. You can purchase either in-store or online.

Once installed, you will be guided step-by-step through the input process.

Turbotax, H&R Block, and TaxAct are some of the most popular tax preparation softwares.

Get Assistance

Hire a tax professional to take care of the process for you.

Meet with the tax professional to go over your financial documents.

You may qualify for **free** tax help through the **Volunteer Income Tax Assistance** program.

For more information visit: ***https://www.irs.gov/individuals/free-tax-return-preparation-for-you-by-volunteers***

5 review + file your completed return

Once your return is complete, **review** and ensure the return input matches your tax documents, whether you have prepared the return yourself or had a tax professional do so.

In most cases, **electronic filing** of your return is required. You can either do this through your preparation software or sign a form from your tax advisor and authorize them to file it on your behalf.

Make sure your return is filed by the original due date (usually April 15th) or by the extended due date (usually October 15th) if extension Form 4868 was filed.

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