

Chapter 04

Planning Your _____

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Chapter 4
Learning Objectives

1. Describe the importance of _____ for personal financial planning
2. Calculate taxable income and the amount owed for federal _____ tax
3. Prepare a federal income tax return
4. Identify tax assistance sources
5. Select appropriate tax strategies for different financial and personal situations

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Taxes and Financial Planning

Objective 1: Describe the importance of taxes for personal financial planning

- About _____ of each dollar you earn goes to pay taxes

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Taxes and Financial Planning

Objective 1: Describe the _____ of taxes for personal financial planning

- An effective tax strategy is vital for successful financial planning
- Understanding tax rules and regulations can help you reduce your tax liability

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Taxes and Financial Planning

(continued)

- To help you cope with the many types of taxes you should...
 - Know current tax laws as they affect you
 - _____ complete tax records
 - Plan purchases and investments to reduce your tax liability
- Tax planning – Take advantage of tax benefits while _____ of taxes

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Four Types of _____

- ❶ Taxes on _____
 - Sales tax & excise tax
- ❷ Taxes on _____
 - Real estate property tax
 - Personal property tax
- ❸ Taxes on _____
 - Federal estate tax, state inheritance taxes
- ❹ Taxes on _____
 - Income, Social Security taxes

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Income Tax Fundamentals

Objective 2: Calculate taxable income and the amount owed for federal income tax

Step 1: Determining _____

- ◆ Identify taxable income - net income, after deductions, on which income tax is computed

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Income Tax Fundamentals

Objective 2: Calculate taxable income and the amount owed for federal income tax

Step 1: Determining adjusted gross income

- ◆ Types of income subject to taxation include:
 - _____ *income* - includes wages, salary, commissions, fees, tips or bonuses
 - _____ *income* is money from dividends, interest, or rent from investments
 - _____ *income* is from business activities - you do not directly participate - limited partnership
 - _____ *income* includes: alimony, awards, lottery winnings, and prizes

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Computing Your Tax Liability

– Total income is affected by _____

- Exclusions are amounts not included in gross income.
- Exclusions can also be _____ **income**, which is income not subject to federal income tax. An example is interest on most state and city bonds.

– Total income is also affected by _____ **income**. This is income that will be taxed at a later date, such as earnings from a traditional individual retirement account (IRA).

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Computing Your Tax Liability (continued)

– **Adjusted gross income** is gross income after certain reductions have been made. These reductions are called adjustments to income, and include the following:

- Contributions to a traditional IRA or Keogh
- _____ payments
- _____ loan interest, tuition & fee deductions
- _____ retirement plans, such as a 401(k) or a 403(b)(7) are a type of tax shelter

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Computing Your Tax Liability (continued)

Step 2: Computing Taxable Income

– A tax _____ is an amount subtracted from adjusted gross income (AGI) to arrive at taxable income

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Computing Your Tax Liability (continued)

Step 2: Computing Taxable Income

– You can subtract the standard deduction from AGI or itemize your deductions

– _____ deductions can include items such as...

- Medical, dental expenses >7.5% of AGI
- Taxes, mortgage interest, contributions
- Miscellaneous expenses > 2% of AGI

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Computing Your Tax Liability (continued)

- Next subtract _____ from AGI
 - An exemption is a deduction for yourself, your spouse and qualified dependents
 - The amount of the exemption increases each year
- After deducting exemptions you have your taxable income.

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Computing Your Tax Liability (continued)

Step 3: Calculating taxes owed

- The percent rates are the _____ **tax rates** on the last dollars of taxable income
 - For example, after deductions and exemptions, a person in the ____ tax bracket pays 28 cents in taxes for every dollar of taxable income in that bracket

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Computing Your Tax Liability (continued)

- A person's _____ **tax rate** is based on the total tax due divided by taxable income. This rate is less than a person's marginal tax rate
 - For example, if a person with a taxable income of \$30,000 has a total tax bill of \$3,000, their _____ tax rate is 10%

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Tax Credits

- A tax credit is an amount subtracted directly from the amount of taxes owed, such as the earned income, child, and dependent care credits

- Tax Credit vs. Tax _____
 - \$100 Tax Credit reduces your taxes by \$100
 - \$100 Tax Deduction reduces taxes by \$28 if you are in the 28% bracket

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Recent Tax Credits

- Foreign tax
- Retirement savings
- Adoption expenses
- American opportunity/Lifetime Learning
- Mortgage interest
- Energy savings
- Elderly and disabled

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Making Tax Payments - Withholding

W-2 Form

<small>1</small> Control number	<small>3</small> Employer's identification number	<small>4</small> Employer's State number	<small>Copy B to be filed with employee's Federal tax return. This information is being furnished to the Internal Revenue Service.</small>	
<small>2</small> Employer's name, address, and ZIP code Information Data, Inc. 9834 Collins Blvd. Benton, NJ 08734		W-2 Wage and Tax Statement		
		<small>5</small> Statutory rate <small>6a</small> Legal emp. <small>6b</small> Sub-emp. <small>6c</small> Void total Employee ceased rep. emp. total		
<small>8</small> Employer's social sec. number 123-45-6789	<small>9</small> Federal income tax withheld 2,678.93	<small>10</small> Wages, tips, other comp 23,972.09	<small>11</small> Soc. sec. tax withheld 1,725.99	
<small>12</small> Employer's name, address, and ZIP code Barbara Victor 124 Harper Lane Parmont, NJ 07819		<small>13</small> Social security wages 23,972.09	<small>14</small> Social security tips	
		<small>16</small>	<small>16a</small> Fr ben. incl in Box 10	
		<small>17</small> State income tax	<small>18</small> St wages, tips, etc	<small>19</small> Name of State
		<small>20</small> Local income tax	<small>21</small> Loc wgs, tips, etc	<small>22</small> Name of locality

Department of the Treasury Internal Revenue Service OMB No. 1545-0046 16-0311690

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Filing Your Federal Income Tax Return

Objective 3: Prepare a federal income tax return

- There are five filing _____ categories
 - Single or legally separated
 - Married, filing jointly
 - Married, filing separately
 - Head of household
 - Unmarried individual who maintains a household for a child or dependent relative
 - Qualifying widow or widower (2 years)

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Filing Your Federal Income Tax Return (continued)

Which Tax Form Should You Use?

- Least complicated; quick and easy to file
- Single or married filing jointly, under age 65 and with no dependents
- Income consisted of wages, salaries, and tips, and no more than \$1,500 of taxable interest
- Your taxable income is less than \$100,000
- You do not itemize deductions, claim any adjustments to income or tax credits

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Deciding Which Tax Form to Use (continued)

1040A

- Taxable income less than \$100,000
- Adjustments to income are allowed
- Tax credits for child care and dependent care are allowed

- Required to use this form if income is over \$50,000; use if you itemize deductions

1040X

- Used to amend a previously filed return

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Completing Your Federal Income Tax Return

- Summary of tax calculation:

- ❶ Filing status and exemptions
- ❷ Income
- ❸ Adjustments to income
- ❹ Tax computation
- ❺ Tax credits

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Completing Your Federal Income Tax Return

(continued)

- ❻ Other taxes
(such as from self-employment)
- ❼ Payments
(total withholding, estimated payments, etc.)
- ❽ Determine if you are due a refund or owe taxes
Refunds can be sent directly to your bank account
- ❾ _____

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Tax Assistance and the Audit Process

Objective 4: Identify tax assistance sources

Tax Information Sources

- The IRS has methods of assistance
 - Publications and forms 1-800-TAX-FORM
 - www.irs.gov
 - Recorded messages 1-800-829-4477
 - Phone hot line 1-800-829-1040
 - Walk-in service at an IRS office
 - CD-ROMs the IRS sells that has forms and pubs
- Tax publications e.g. *Ernst and Young Tax Guide*
- The Internet
- Tax preparation software companies.

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Tax Assistance and the Audit Process (continued)

Electronic filing

- Free File Alliance offers free tax preparation, e-filing for some taxpayers
- Refunds are generally received within three weeks
- Tax preparers charge a fee for electronic filing
- Telefile is a way to file by phone if you are using form 1040EZ

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Tax Assistance and the Audit Process (continued)

- Tax preparation services
 - Range from a one-person office to large firms such as H & R Block
 - Government-approved tax experts are called enrolled agents
 - Accountants
 - Attorneys
 - If your professional tax preparer makes a mistake, you are still responsible for paying the correct amount, plus any interest and penalties

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Tax Assistance and the Audit Process (continued)

What if Your Return is Audited?

- About _____ of all returns are audited
- If you claim large or _____ deductions you are more likely to be audited
- There are three types of audits
 1. Correspondence for minor questions
 2. Office audit takes place at an IRS office
 3. Field is the most complex, with an IRS agent visiting you at home, business or your accountant's office
- You have audit rights, including time to prepare for the audit, and clarification

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Tax-Planning Strategies

Objective 5: Select appropriate tax strategies for different financial and personal situations

- Practice **tax** _____....
 - Legitimate methods to reduce your tax obligation to your fair share but no more
 - Financial decisions related to purchasing, investing, and retirement planning are the most heavily affected by tax laws
- ...not **Tax** _____
 - Illegally not paying all the taxes you owe, such as not reporting all income

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Tax-Planning Strategies (continued)

- To _____ taxes owed...

Accelerate deductions

- If you expect to have the same or a lower tax rate next year.

Delay the receipt of income

- If you expect to have the same or a lower tax rate next year.

Delay deductions

- If you expect to have a higher tax rate next year.

Accelerate the receipt of income

- If you expect to have a higher tax rate next year.

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Tax-Planning Strategies (continued)

- Homeowners—mortgage _____ and property taxes are deductible when you itemize. This reduces your taxable income.
- Use your home equity line of credit to buy a car or consolidate debt. Interest can be deductible when you itemize.
- Job-related expenses may be allowed as itemized _____.
- Using tax-exempt investments, such as municipal bonds can help reduce your taxes.

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Tax-Planning Strategies (continued)

- Tax-exempt investments
 - Interest income from municipal bonds is not subject to federal income taxes
- Put money in tax-deferred investments
 - Series EE U.S. Treasury bonds interest is exempt if used for tuition
 - Tax-deferred annuities
 - Take advantage of _____ retirement plans
 - IRA, 401(k) plans
 - Establish a Keogh plan if self-employed

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Tax-Planning Strategies (continued)

- Long-term capital gains on the sale of a home are excluded from taxes up to a certain amount
- Self-Employment - tax advantages, such as deducting health/life insurance costs, but have to pay self-employment tax (Social Security)
- Children's investments and income shifting (<\$1500)
- Education IRA savings - earnings are tax free

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Tax-Planning Strategies (continued)

- Retirement Planning
 - Traditional IRA
 - Roth IRA
 - Keogh Plan

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