



## CH. 3 | PREPARING YOUR TAXES

1

### IMPACT OF INCOME TAX

- Typical American family pays more than one-third of its gross income in taxes including federal income tax, Social Security and Medicare tax, and state income, property, and sales tax.
- About half of taxpayers pay no income tax, but all pay Social and Medicare Tax [total rate of 7.65% of wages is paid by employee].
- Taxpayers with income over \$250,000 filed 2.4% of tax returns and paid 48.9% of the income tax.

2

## CORPORATE AND PERSONAL TAXES

- Tax Cuts and Jobs Act (TCJA): The GOP tax bill signed into law by President Trump on Dec. 22, 2017. Many tax brackets, thresholds, and rates changed in 2018 including elimination of personal exemptions and the expansion of the Child Tax Credit.
- Individuals: Rates begin at 10% and rise to 37% for individuals with income over \$500,000 and for married couples filing jointly with income over \$600,000. May be subject to state tax.
- Corporations: Starting 2018, the effective rate is a flat 21%. Also subject to state tax (around 5%).

3

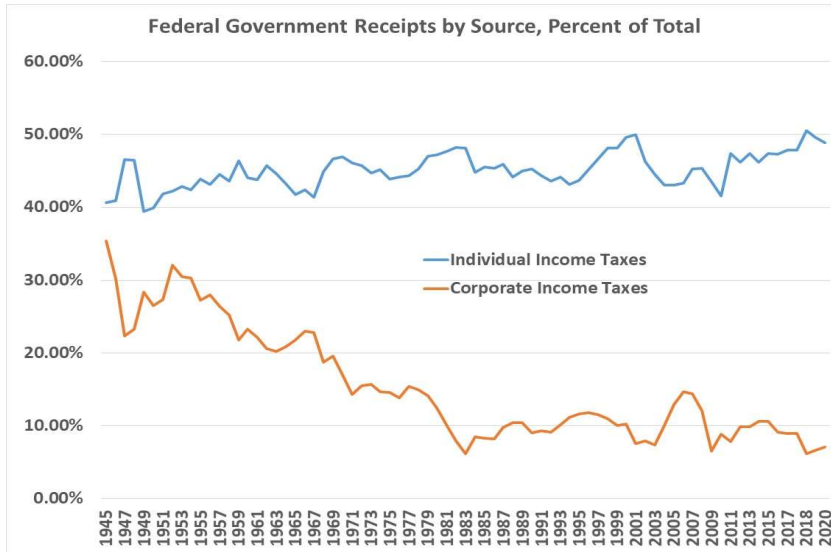
[Money amounts are in thousands of dollars]

Type of tax	Gross collections [1]			Refunds [2]	Net collections	
	2019	2020	Percentage of 2020 total	2020	2020	Percentage of 2020 total
	(1)	(2)	(3)	(4)	(5)	(6)
<b>United States, total</b>	<b>3,564,583,961</b>	<b>3,493,067,956</b>	<b>100.0</b>	<b>736,154,793</b>	<b>2,756,913,163</b>	<b>100.0</b>
<b>Business income taxes</b>	<b>277,057,735</b>	<b>263,563,107</b>	<b>7.5</b>	<b>59,425,105</b>	<b>204,138,002</b>	<b>7.4</b>
Corporation income tax	275,863,125	262,619,583	7.5	n.a.	n.a.	n.a.
Tax-exempt organization unrelated business income tax	1,194,610	943,524	[3]	n.a.	n.a.	n.a.
<b>Individual and estate and trust income taxes [4]</b>	<b>1,981,650,716</b>	<b>1,871,170,827</b>	<b>53.6</b>	<b>[5] 667,491,102</b>	<b>1,203,679,725</b>	<b>43.7</b>
Individual income tax withheld	1,351,036,063	1,269,498,820	36.3	n.a.	n.a.	n.a.
Individual income tax payments [6]	591,146,138	567,944,758	16.3	n.a.	n.a.	n.a.
Estate and trust income tax [7]	39,468,515	33,727,249	1.0	3,302,732	30,424,517	1.1
<b>Employment taxes</b>	<b>1,207,553,842</b>	<b>1,268,076,594</b>	<b>36.3</b>	<b>6,171,683</b>	<b>1,261,904,911</b>	<b>45.8</b>
Old-Age, Survivors, Disability, and Hospital Insurance (OASDHI), total [4]	1,194,896,783	1,256,622,090	36.0	5,901,209	1,250,720,881	45.4
Federal Insurance Contributions Act (FICA)	1,129,053,644	1,186,906,549	34.0	n.a.	n.a.	n.a.
Self-Employment Insurance Contributions Act (SECA)	65,843,139	69,715,541	2.0	n.a.	n.a.	n.a.
Unemployment insurance	6,437,704	6,281,575	0.2	130,329	6,151,246	0.2
Railroad retirement	6,219,355	5,172,929	0.1	140,146	5,032,783	0.2
<b>Estate and gift taxes</b>	<b>17,565,044</b>	<b>18,197,587</b>	<b>0.5</b>	<b>609,686</b>	<b>17,587,901</b>	<b>0.6</b>
Estate	16,001,974	17,115,476	0.5	567,689	16,547,787	0.6
Gift	1,563,070	1,082,111	[3]	41,997	1,040,114	[3]
<b>Excise taxes [8]</b>	<b>80,756,624</b>	<b>72,059,841</b>	<b>2.1</b>	<b>2,457,217</b>	<b>69,602,624</b>	<b>2.5</b>

Source: IRS

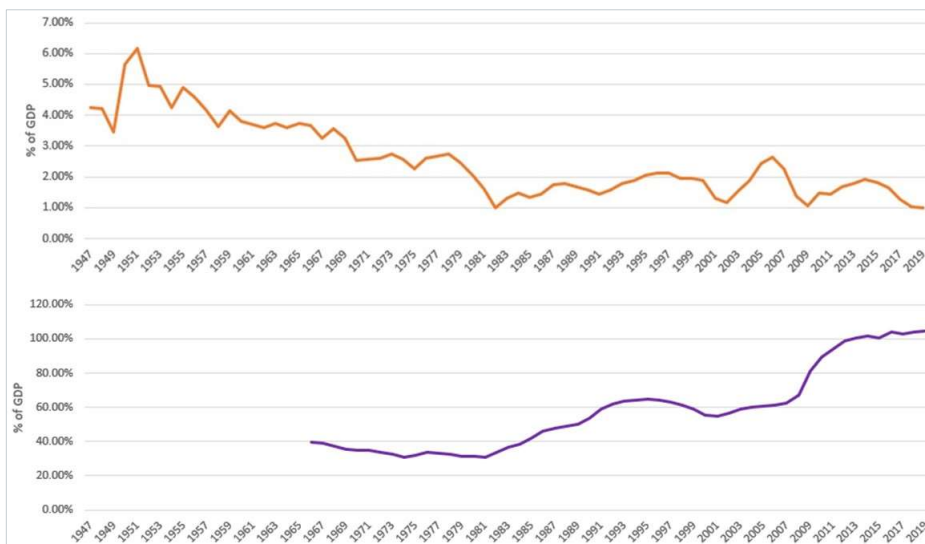
4

## INDIVIDUAL VS. CORPORATE TAXES



5

## FEDERAL DEBT LEVEL INCREASING RAPIDLY



6

## CALCULATING TAXES

- **Tax = Tax Rate \* Tax Base**
  - ✓ Name of tax indicates the tax base: Property tax has value of property as the tax base while sales tax has sales amount as the tax base.
  - ✓ Lower tax by lowering tax rate or lower tax base
  - ✓ Lower tax rate by nature of income:
    - Capital gains and dividends are taxed at maximum of 20%.
    - Gain up to \$250,000 single [\$500,000 joint] from sale of personal residence is taxed at 0% rate.
  - ✓ Lower tax base by deductions, exclusions, and exemptions

7

## INCOME VS. SALES TAX

- The federal income tax is referred to as a progressive tax rate, as income increases, the tax rate also increases.
- Most sales taxes have a flat tax rate. However, since the higher income taxpayer spends less of their income on items subject to the sales tax, the sales tax paid as a percent of income actually decreases as the income increases.
- Thus, the sales tax is referred to as a regressive tax rate.

8

## INCOME TAX RATES

- For planning purposes, tax rates are identified as
  - ✓ Average tax rate = Total tax / Taxable income
  - ✓ Marginal tax rate = Tax on the last or next dollar of taxable income (the rate from the tax bracket that applies to the taxpayer)
- The average tax rate is used for long range planning; the marginal tax rate, for short-term planning.

9

## INCOME TAX RATES

- The filing status determines which tax rates a taxpayer uses. There are five filing statuses:
  - ✓ Single: Unmarried taxpayers
  - ✓ Married filing jointly: Taxpayers are married on the last day of the year and elect to file joint return. When a joint return is filed, both taxpayers are liable for the tax.
  - ✓ Married filing separate: Each spouse files their own return and they are only liable for their tax.
  - ✓ Head of Household: Single taxpayers who provide a household for a qualifying person (a dependent or a relative other than cousins)
  - ✓ Surviving Spouse: For two years after the death of a spouse, the surviving spouse may use the joint rates if they have a dependent child living with them.

10

## PERSONAL TAX RATES IN 2021

Rate	For Single Individuals	For Married Individuals Filing Joint Returns	For Heads of Households
10%	Up to \$9,950	Up to \$19,900	Up to \$14,200
12%	\$9,951 to \$40,525	\$19,901 to \$81,050	\$14,201 to \$54,200
22%	\$40,526 to \$86,375	\$81,051 to \$172,750	\$54,201 to \$86,350
24%	\$86,376 to \$164,925	\$172,751 to \$329,850	\$86,351 to \$164,900
32%	\$164,926 to \$209,425	\$329,851 to \$418,850	\$164,901 to \$209,400
35%	\$209,426 to \$523,600	\$418,851 to \$628,300	\$209,401 to \$523,600
37%	\$523,601 or more	\$628,301 or more	\$523,601 or more
Source: Internal Revenue Service			

11

## CAPITAL GAINS

- Capital Gains: Profits from the sale of assets not normally transacted in the normal course of business
- Capital gains for individuals are generally taxed as ordinary income if held for less than a year, and at the capital gains rate if held for more than a year.

### 2021 Capital Gains Tax Rates & Brackets (Long-Term Capital Gains)

	For Unmarried Individuals, Taxable Income Over	For Married Individuals Filing Joint Returns, Taxable Income Over	For Heads of Households, Taxable Income Over
0%	\$0	\$0	\$0
15%	\$40,400	\$80,800	\$54,100
20%	\$445,850	\$501,600	\$473,750

Source: Internal Revenue Source

12

## TAXABLE INCOME

- Taxable income is computed as follows:
  - ✓ Gross Income: All income from whatever source derived less amounts excluded by the Congress such as proceeds from life insurance, scholarships, gifts, interest on state and local bonds, and other.
  - ✓ Subtract adjustments to income including business expenses, contributions to retirement funds, and other tax deductions.
  - ✓ Adjusted Gross Income [AGI]

13

## STANDARD DEDUCTIONS

- Deductions reduce Taxable Income:  
 $\text{Value} = \text{Deduction} \times \text{Tax rate}$
- You deduct greater of Standard Deduction or Itemized Deductions.
- Standard deduction amount depends upon filing status:
  - ✓ Single or Married filing separately: \$12,550 in 2021
  - ✓ Married filing jointly: \$25,100 in 2021
  - ✓ Head of household: \$18,800 in 2021

14

## ITEMIZED DEDUCTIONS

- Itemized deductions include deductions for:
  - ✓ Taxpayers who incur qualified out-of-pocket medical and/or dental expenses that are not covered by insurance can deduct expenses that exceed 7.5% of their adjusted gross incomes (AGI).
  - ✓ Long-term care insurance premiums are tax deductible to the extent that the premiums exceed 10% of an individual's AGI.
  - ✓ Home mortgage interest is deductible on the first \$750,000 in loans.
  - ✓ Home-equity loan/line of credit interest is deductible provided that the borrowed funds are used to buy, build, or substantially improve the home that secures the loan.
  - ✓ Charitable contributions to a 501(c)(3) organization
  - ✓ Miscellaneous includes gambling losses, losses from partnerships or subchapter S corporations, employee business expenses over 2% of AGI, etc.

15

## TAX CREDITS

- Credits are dollar for dollar reduction in tax.
- Common credits:
  - ✓ **Nonrefundable tax credits:** These are items directly deducted from the tax liability until the tax due equals \$0 (e.g. Credits for adoption, the Lifetime Learning Credit, the Child and Dependent Care Credit, the Saver's Tax Credit for funding retirement accounts, and the mortgage interest credit). Any amount greater than the tax owed, resulting in a refund for the taxpayer, is not paid out.
  - ✓ **Refundable tax credits:** If the refundable tax credit reduces the tax liability to below \$0, the taxpayer is still due a refund (e.g. Earned Income Tax Credit).

16



## WITHHOLDING TAX

- Withholding Tax: Employer is required to withhold income tax from employee salary before paying the employee.
- For employees, withholding is the amount of federal income tax withheld from your paycheck. The amount of income tax your employer withholds from your regular pay depends on two things: The amount you earn & the information you give your employer on Form W-4.
- Self-employed or taxpayers having income that is not subject to withholding, must pay estimated tax on a quarterly basis.
- Take Home Pay: Taxpayer's gross pay is reduced by income tax withholding, Social Security and Medicare taxes, and cost of benefits (such as health and life insurance, and retirement contributions).

17

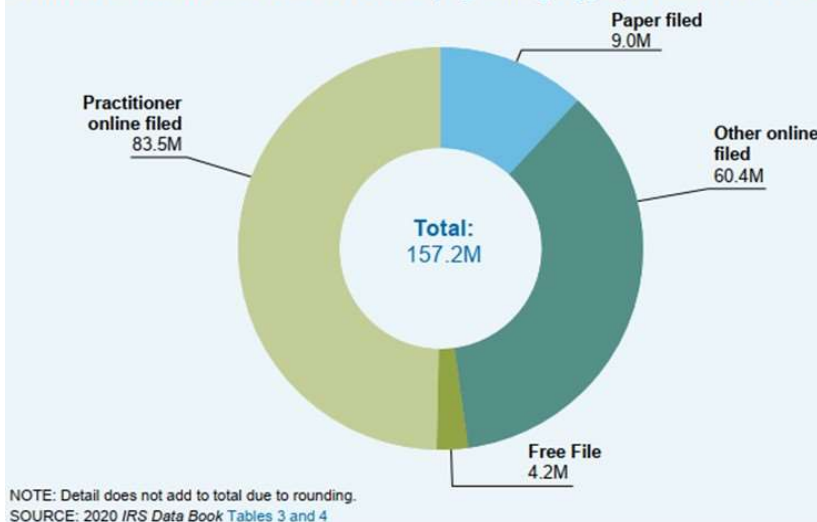
## FILING TAXES

- Individual Income Tax Filing: Form 1040
  - ✓ Form 1040-EZ is a short-version tax form for annual income tax returns filed by single filers with no dependents.
  - ✓ Form 1040-SR is a version of the 1040 tax return that was created specifically for use by senior citizens.
- Calendar Year Filers (Most Common) File on: April 15
- Using tax preparation software or tax preparer reduces time and effort in filing but increases filing costs.
- IRS has responsibility to enforce tax laws.
  - ✓ Returns are selected for audit both because of high probability of error and on a random basis to judge level of compliance.

18

## FILING TAXES

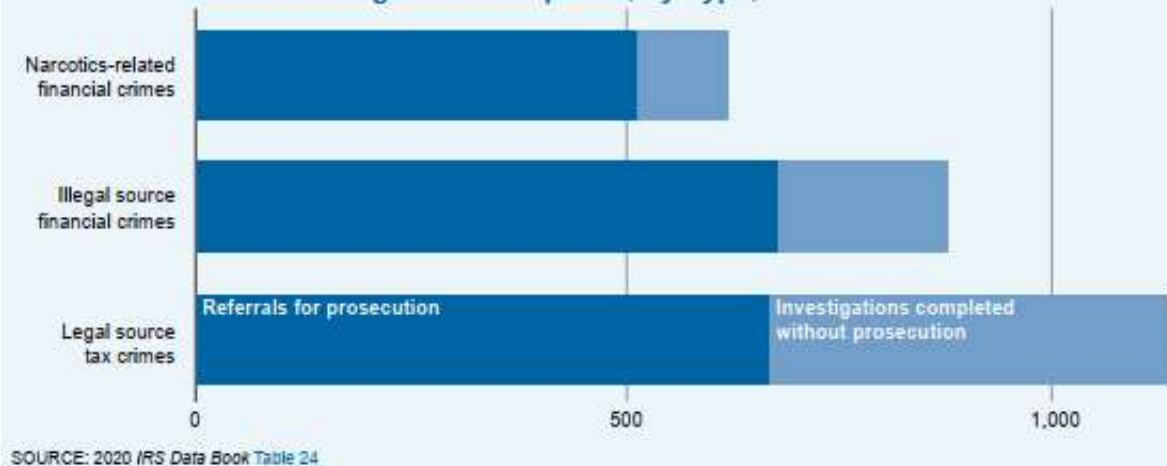
Number of Individual Returns Filed, by Filing Type, Fiscal Year 2020



19

## IRS INVESTIGATIONS

Number of Criminal Investigations Completed, by Type, Fiscal Year 2020



20