

4D – Income Taxes

_____ – there are 5 different categories

- Single – You must be unmarried at the end of the year.
- Married filing jointly – this is how most married people will file.
- Married filing separately – occasionally, but rarely, it is better to file separately if you are married.
- Head of Household – you are single but have a dependent (such as a child or your parent that you support).
- Widow or Widower with a Dependent Child – can use this filing status for 2 years after your spouse dies if you still have a dependent child.

_____ - all the money you receive in a year - money from wages, tips, interest you earn, dividends, capital gains, etc.

_____ - some gross income is not taxed (i.e. IRA contributions or other tax deferred savings plans)

AGI = _____

_____ - fixed amount per person that is subtracted from your AGI
_____ calculating your taxes. In 2003, the amount was _____ per person. (In 2004 it was \$3,100.)

Unless someone else is able to claim you as a dependent (such as your parents), you can count yourself, your spouse (if you are married) and each of your dependents (usually your children).

_____ - *varied* amount that is subtracted from your AGI before calculating your taxes. Two options:

1) _____ - fixed amount based on your filing status:

	2003	2004
• Single	\$4,750	\$4,850
• Married, filing jointly	\$9,500	\$9,700
• Married, filing separately	\$4,750	\$9,700
• Head of Household	\$7,000	\$7,150

2) _____ - use this amount if it is _____ than your standard deduction. Must complete Schedule A.

_____ - The U.S. has a _____ - people with higher taxable incomes pay a higher tax *rate*.

Different _____ are assigned to different income ranges or *margins*. (The 1040 tax form instructions contain tax tables that show the taxes you owe based on your taxable income and filing status.) We are going to use the tax rates.

2003 Marginal Tax Rates

Tax rate	Single	Married filing jointly	Married filing separately	Head of household
10%	Up to \$7000	Up to \$14,000	Up to \$7000	Up to \$10,000
15%	\$7001 to \$28,400	\$14,001 to \$56,800	\$7001 to \$28,400	\$10,001 to \$38,050
25%	\$28,401 to \$68,800	\$56,801 to \$114,650	\$28,401 to \$57,325	\$38,051 to \$98,250
28%	\$68,801 to \$143,500	\$114,651 to \$174,700	\$57,326 to \$87,350	\$98,251 to \$159,100
33%	\$143,501 to \$311,950	\$174,701 to \$311,950	\$87,351 to \$155,975	\$159,101 to \$311,950
35%	\$311,951 or more	\$311,951 or more	\$155,976 or more	\$311,951 or more

Example 3) Suppose you are single and have a taxable income of \$18,500. How much are your taxes? (Use 2003 Tax Rate Table)

Example 4) Suppose you are married and file a joint return. If you and your spouse have a taxable income of \$105,000, how much are your taxes? (Use 2003 Tax Rate Table)

_____ - these reduce your overall taxes by their full amount.
Some examples are:

- Earned Income Credit (EIC)
- Child and Dependent Care Credit
- Credit for the Elderly or the Disabled
- Advance Earned Income Credit
- Education Credits
- Child Tax Credits
- Adoption Credit
- Excess Social Security and RRTA Tax Withheld
- Retirement Savings Contributions Credit

Tax _____ are really better than tax _____ because tax credits reduce your tax bill by their full amount. For instance, if you qualify to get a \$1,000 child tax credit, your tax bill will be reduced by \$1,000. However, if you give \$1,000 to the church, you are in the 25% tax bracket, and you itemize deductions, this \$1,000 donation will only reduce your tax bill by 25% of \$1,000 or \$250.

Example 5) Suppose you are single, in the 25% tax bracket, and itemize your deductions. How much will your tax bill be reduced if

- a) you donate \$2,500 to charities.
- b) you qualify for a \$2,500 education credit.
- c) same as above a) except you do not itemize your deductions.

_____ - subtract any tax credits from the computation with the tax rates

_____ - money withheld each pay check and sent to the IRS. Totaled amount is what you've already paid on your tax bill.

_____ - The difference between your total tax bill and the amount of payments or withholdings.

Example 6) Suppose you are single and make \$42,000 from your job and earn \$385 interest from your savings account. You contribute \$3,800 to your retirement fund. During the year you pay \$2,700 interest on your mortgage and donate \$1,600 to charities. Find your gross income, your adjusted gross income, your taxable income and your taxes. If you had \$4,250 withheld from your paychecks, how much is your refund or the amount you owe? (Use 2003 data)

Example 7) You are now married and file a joint return with your spouse. You have 3 dependent children. You earn \$52,000 and your spouse earns \$32,000. You also earn \$1,200 interest from savings accounts and certificates of deposit. You deposit \$4,800 into your retirement fund and your spouse deposits \$2,500 into his/her retirement account. You have \$3,265 in medical and dental expenses, pay \$3,800 in real estate taxes, pay \$9,560 interest on your home mortgage, and donate \$1,750 to charities. Also, you qualify for \$3,000 in child tax credits. Find your gross income, your adjusted gross income, your taxable income, and the total taxes. If you and your spouse had \$10,805 withheld collectively, how much will you get back or how much do you owe? (Use 2003 Tax data)

_____ – these are collected under the name of FICA (Federal Insurance Contribution Act). Social Security and Medicare go primarily to people who have retired. FICA applies only to income from wages. That is, if you earn \$40,000 from your job and \$800 interest from savings, FICA only taxes the \$40,000. (The IRS taxes both.)

In 2003, the FICA tax rates for individuals who were not self-employed were

- 7.65% on the first \$87,000 of income from wages
- 1.45% on any income from wages in excess of \$87,000

Example 8) Suppose you earn \$45,000 from your job, \$3,200 interest from savings and \$880 in dividends. Also, suppose you sell some stock and have a capital gain of \$5,250. How much do you pay in FICA taxes?

Example 9) Suppose you earn \$124,650 in wages. How much goes to FICA?

_____ - profit from sale of item such as property or stock.

Short term – profits on items sold within 12 months of purchase.

Long term – profits on items held for more than 12 months before being sold.

Long term capital gains are taxed at lower rates than ordinary income.

As of 2003, the rates were:

- maximum of 5% for income in the 10% and 15% tax brackets
- a maximum of 15% for income in all higher tax brackets.

Example 10) (#54, pg 281) Calculate the total tax owed for each (FICA and income). Compare the overall tax rates. Assume both individuals are single and take the standard deductions. (Use 2003 Tax Rate Table)

Deion earned \$60,000 in wages. Josephine earned \$60,000, all in dividends and long-term capital gains.

Be sure you know/can:

- Calculate gross income, adjusted gross income, and taxable income.
- Calculate taxes, including FICA.
- The effect on total tax bill of tax deductions and tax credits.
- Whether it is better to use standard deductions or itemized deductions.
- How to do any of the operations noted in Figure 4.8. (Table 4-10 will be provided on the test.)

