Stetzer Accounting Service, LLC

Since 1965

21 things every taxpayer should know

income

1 All income, generally speaking, is subject to income tax. But not all money you receive is considered taxable income. Examples of what's not taxable: inheritances, life insurance proceeds, borrowed money, gifts, and child support payments.

2 Your tax bracket. Think of tax brackets as a row of buckets with one bucket for each bracket. Your income fills the lowest-rate bucket first, then the next bucket, then the next. Each bucket of income is taxed at its own specific rate. Entering the next bucket does not cause all your income to be taxed at the new rate, only the amount that flows over from the previous bucket. Your "top tax bracket" is the last bucket that has income in it, and that's the rate at which the next dollar you earn will be taxed.

3 When you sell anything for a profit, the gain is generally taxable, but when you sell at a loss, you're not necessarily entitled to a deduction. A loss on a home sale, for example, isn't deductible, and net capital losses have an annual limit (though you can deduct the excess loss in future years).

4 You're required to keep records to substantiate the income and deductions you report on your tax return. Organized records will make tax filing easier, and they'll be a help in tax planning to cut your tax bill.

deductions & credits

5 Even if you don't itemize deductions on your tax return, you may be entitled to certain "above-the-line" deductions (those that are subtracted from your income to arrive at your adjusted gross income). They include such things as IRA contributions, student loan interest, moving expenses, health insurance if you're self-employed, and alimony paid.

6 In taxes, a credit is better than a deduction. A credit reduces your taxes dollar for dollar (i.e., a $1,000 credit cuts your taxes by $1,000). A deduction reduces your taxes by your tax rate percentage (i.e., a $1,000 deduction for someone in a 15% tax bracket cuts taxes by $150).

7 Many deductions and credits disappear once income reaches certain levels. By knowing what tax deductions and credits you might qualify for, you may be able to do tax planning that will preserve your eligibility for these income-sensitive tax breaks.

8 Age matters in taxes. After the birthday candles are blown out, check the ever-changing tax law to see if your tax situation has changed. Many tax provisions are linked to age, so whenever there's a birthday in your family, check for changes your tax planning should take into account.

Here's a list of some of the provisions in the tax law that are age-sensitive.

- The child care tax credit for the cost of child care while you work or attend school.
- The kiddie tax on a child's unearned income.
- The child tax credit (different from the child care tax credit above).
- Contributing to a child's education savings account.
- The dependency exemption for a child.
- Required withdrawal or rollover of funds in a child's education savings account.
- Penalty-free withdrawals from retirement accounts.
- Higher standard deduction for older taxpayers.
- Required withdrawals from retirement accounts (except for Roth IRAs).

9 **Making contributions to a retirement fund** is one of the best tax shelters around.

10 **A traditional IRA** can provide deductible contributions and tax-deferred growth. Roth contributions are not deductible, but qualified withdrawals are completely tax-free.

11 **Where you hold investments matters.** Hold investments that produce taxable income in tax-deferred accounts. Hold those that produce tax-free or tax-favored income in your regular accounts.

12 Dealing with the IRS

- **File tax returns on time.** If you can't meet a filing deadline, request an extension.
- **Notify the IRS** when you have an address change.
- **Amend a return** if you discover that you've missed income or a deduction after filing. You have up to three years from the original filing date to amend.
- **Don't ignore communications** from the IRS; if you do, things will only get worse.
- **Don't fall for tax scams.** There is no secret way to avoid paying taxes.

13 **You can't give money or property to individuals tax-free.** There's an annual limit on the amount you can give to any one individual and a lifetime limit on other gifts. However, there is no limit on certain kinds of gifts: gifts to your spouse and payments for the medical or educational expenses of another person made directly to the medical or educational institution.

14 **Your marital status can have a major impact on your taxes.** Sometimes changing the date for a wedding or the timing of a divorce can be a major tax saver. A divorce certainly requires some tax planning. How you structure support payments, who gets to claim the tax exemptions for dependent children, and how you split up assets can make a huge tax difference to both parties.

15 **Home is where the tax savings are.** You can deduct mortgage interest and property taxes, and you can sell your home without paying taxes on the appreciation in value (up to certain limits), as long as you meet the ownership and use requirements.

16 **The alternative minimum tax (AMT)** was created to ensure that the wealthy paid at least some tax, despite their use of deductions, credits, and other tax breaks. Now the AMT sometimes hits middle-income taxpayers – so check your exposure to it.

17 **Withholding too much tax** from your wages isn't a smart financial move. Match your withholding to your actual tax liability for the year, and invest the extra money for yourself, not the IRS.

18 **If you're in business, engage an accountant.** The assistance and advice you get will save you more than it costs.

19 **New tax legislation has been passed almost every year** for the past 30 years. Changing rules create both traps and opportunities, a fact that makes tax planning worthwhile.

20 **Don't let the tax tail wag the economic dog.** Don't do things solely for tax reasons; every transaction should have economic merit apart from taxes.

21 strategy

The six basic tax strategies

- **Splitting income** among family members or legal entities to get more income taxed in lower brackets.
- **Shifting income** from one year to another to have it fall where it will be taxed at lower rates.
- **Shifting deductions** from one year to another to have them fall where the most tax will be saved.
- **Deferring taxes** with retirement plans and certain investments.
- **Making choices** that give a tax deduction for things you enjoy (a vacation home, for example).
- **Choosing** investments that earn tax-free, tax-favored, or lower-tax-rate income.

This brochure provides general information that should not be acted upon without further details and/or professional assistance.

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