**Chapter 4**

**Individual Income Tax Overview**

**Individual Income Tax Formula**

All sources of income (broadly defined) $XXX

Less: Exclusions (e.g., municipal bond interest, gifts, bequests) (XXX)

Deferrals (e.g., like-kind exchanges) (XXX)

Equals: Gross Income $XXX

Less: Deductions **FOR** AGI:

(e.g., trade or business expenses, rent/royalty

expenses, alimony paid\*, capital losses, IRA contributions, etc.) (XXX)

Equals: Adjusted Gross Income (AGI) $XXX

Less: Deductions **FROM** AGI:

(1) Greater of:

(a) Itemized deductions (e.g., medical, taxes (state/local/foreign

income, real estate, personal property), mortgage interest, investment

interest, charitable contributions, casualty/theft loses\* **OR**

(b) Standardized deduction ($12,200 – Single; $24,400 –

Married Filing Jointly; $18,350 – Head of Household) (XXX)

(2) Deduction for qualified business income (XXX)

Equals: Taxable Income (Tax Base) $XXX

Calculate Tax using Brackets/Table $XXX

Plus: Other taxes (e.g., alternative minimum tax, self- employment tax) XXX

Equals: Total Tax Liability $XXX

Less: Tax Credits (e.g., child care tax credit) (XXX)

Less: Tax Prepayments (e.g., withholding and estimated tax payments) (XXX)

Equals: Tax Due (Refund) $XXX/($XXX)

**I. Individual Income Tax Formula**

All sources of income (broadly defined) $XXX

Less: Exclusions (e.g., municipal bond interest, gifts, bequests) (XXX)

Deferrals (e.g., like-kind exchanges) (XXX)

**Equals: Gross Income $XXX**

Less: Deductions **FOR** AGI:

(e.g., trade or business expenses, rent/royalty

expenses, alimony paid\*, capital losses, IRA contributions, etc.) (XXX)

**Equals: Adjusted Gross Income (AGI) $XXX**

Less: Deductions **FROM** AGI:

Greater of (1) Itemized deductions (e.g., medical, taxes (state/local/

foreign income, real estate, personal property), mortgage interest,

investment interest, charitable contributions, casualty/theft loses\* OR

(2) Standard deduction ($12,200 – Single, $24,400 – Married Filing Jointly,

$18,350 – Head of Household) (XXX)

Deduction for qualified business income (20% of QBI) (XXX)

**Equals: Taxable Income (Tax Base) $XXX**

Calculate Tax using Brackets/Table $XXX

Plus: Other taxes (e.g., alternative minimum tax, self-employment tax) XXX

**Equals: Total Tax Liability**

**$XXX**

Less: Tax Credits (e.g., child care tax credit) (XXX)

Less: Tax Prepayments (e.g., withholding and estimated tax payments) (XXX)

**Equals: Tax Due (Refund) $XXX**

**Example: Calculating Taxable Income and Tax Due**

Janine is a single taxpayer and has the following income tax-related items in 2019: Salary of $85,000 and $7,850 FOR AGI deductions. Janine also has $25,000 for expenditures that qualify as itemized deductions and $5,000 of qualified business income (QBI). Janine does not have any tax credits, but she did have $9,000 withheld from her paychecks. In addition, Janine made $5,000 in estimated tax payments in 2019. Assume that Janine pays tax at a flat rate of 25%. What is Janine’s tax due or refund?

**Tax Return Due Dates:**

Individuals – returns are due on the 15th day of the 4th month that follows the taxable year end (April 15th for most individuals).

Corporations – returns are due on the 15th day of the 4th month that follows the taxable year end (April 15th for calendar year corporations).

Individuals and corporations are allowed to file a six month extension.

**Statute of Limitations** – A provision that requires any lawsuit to be brought within a reasonable period of time.

**Standard Deduction**

Single: $12,200; Married Filing Jointly: $24,400; Head of Household: $18,350

Standard deductions increase if the individual is over 65 and/or blind.

Claim either the standard deduction or itemized deductions.

Example: Assume Jared is a single taxpayer who makes $115,000. This year, Jared has the following expenses: Itemized deductions of $16,800. The standard deduction is $12,200. Jared wants to minimize his taxable income so should he take the standard deduction or itemize?

**SEE IN-CLASS HANDOUT PROBLEMS #1**

**II.** **Dependents of the Taxpayer**

Dependency requirements

1. Must be a citizen of the U.S. or a resident of the U.S., Canada, or Mexico.

2. Must not file a joint return with a spouse unless there is no tax liability.

3. Must be considered either a **qualifying child** of the taxpayer or a **qualifying relative** of the taxpayer.

**Qualifying Child – Four Tests** (the child must meet *all* four tests)

***1. Relationship test*** – the qualifying child must be an eligible relative of the taxpayer.

Relative = son, daughter, stepchild, eligible foster child, adopted child, brother, sister, half-brother, half-sister, stepbrother, stepsister, or a descendant of any of these

***2. Age test*** – the qualifying child must be:

1. Younger than the taxpayer; and *EITHER*

2. Under 19 years of age at the end of the year or

3. Under 24 years of age at the end of the year and a full-time student; or

4. Permanently and totally disabled.

***3. Residence test*** – must have the same principal residence as the taxpayer for more than half of the year.

***4. Support test*** – child must not have provided more than half of own support (living expenses) during the year.

Scholarships are excluded from the support calculation.

**Qualifying Relative – Three Tests** (individual must meet *all* three tests)

A qualifying relative is a person who is *not* a qualifying child and who meets all three tests.

***1. Relationship test*** – the person must be *either*:

1. A relative – a descendant or ancestor of the taxpayer, siblings, relatives through marriage (e.g., stepsiblings and in-laws) **OR**

2. A member of the household – lived with the taxpayer for the entire year.

***2. Support test*** – taxpayer must pay for more than half of the qualifying relative’s support. Scholarships are excluded from the support calculation.

(Ignore multiple support agreements)

***3. Gross income test*** – qualifying relative’s gross income for the year is *less* than $4,200.

**See Summary of Dependency Requirements at end of notes**

**Example:** Becky (age 34) and Lisa (age 36) are roommates. Becky earns $75,000 from her job, while Lisa earns $7,000 from her waitressing job (she is an aspiring painter). Because Lisa is having a hard time financially, Becky pays for Lisa’s share of rent, meals, utilities, etc. for the year ($22,000). Lisa spends all of her income on other living expenses. Can Becky claim Lisa as a qualifying relative and receive an additional dependency exemption?

**III. Filing Status**

Taxpayers determine their filing status according to their marital status at year-end and whether they have any dependents.

***1. Single*** – single as of the end of the year.

***2. Married Filing Jointly*** – married as of the last day of the year and spouses agree to file a joint tax return.

***3. Married Filing Separately*** – married as of the last day of the year and spouses do not want to file a joint tax return.

***4. Qualifying Widow or Widower (Surviving Spouse)***

a. In the year of death, married filing jointly (regardless of whether there are dependents)

b. Eligible to be a qualifying widow or widower and can file married filing jointly for the two years following the death if: (1) they remain unmarried and (2) pay over half the cost of providing a home for a dependent child or stepchild for the entire year.

c. Third year following death, head of household if the child is still living at home.

***5. Head of Household*** – unmarried taxpayer (as of the end of the year) that pays for more than half of the costs of keeping up a home for the year *and* has one of the following classifications of people living with them for over half of the year:

1. Qualifying child

2. Person that qualifies as a dependent and is related to the taxpayer

* Parents do not have to live with the taxpayer.

**SEE IN-CLASS HANDOUT PROBLEMS #2**

**Summary of Dependency Requirements**

|  |  |  |
| --- | --- | --- |
| **Test** | **Qualifying Child** | **Qualifying Relative** |
| Relationship | Taxpayer’s child, stepchild, foster child, sibling, half-brother or sister, or a descendant of any of these relatives. | Taxpayer’s descendant or ancestor, sibling, stepmother, stepfather, stepbrother or stepsister, son or daughter of taxpayer’s sibling, sibling of the taxpayer’s mother or father, in-laws, and anyone else who has the same principle place of abode as the taxpayer for the entire year (even if not otherwise related). |
| Age | Younger than the taxpayer claiming the individual as a qualifying child and under age 19 or a full-time student under age 24. Also anyone totally and permanently disabled. | N/A |
| Residence | Lives with taxpayer for more than half of the year (includes temporary absences for things such illness and education. | N/A |
| Support | The qualifying child must not provide more than half of his or her own support. | Taxpayer must have provided more than half of the support for the qualifying relative. |
| Gross Income | N/A | Gross income must be less than $4,200 (in tax year 2019). |
| Other | N/A | Not a qualifying child. |