



Dbriefs U presents:

Individual Taxation — A First Look at Compliance and Planning

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Agenda

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Form 1040 tax return

Individual income tax formula

Exclusions from income

Gross income

Itemized deductions

Standard deduction

Personal and dependency exemptions

Filing status

Tax credits

Introduction

- The general purpose of taxes is to raise revenues for governments, but they are also used to achieve certain economic and social goals
- Many different types of taxes are assessed at all levels of government
- Income taxes are the most significant and are levied on individuals, corporations, estates, and trusts
- This presentation will focus on **federal income** taxes for **individuals**
- A good understanding of the tax law can have a significant effect on many personal finance decisions of individuals

Form 1040 - U.S. Individual Income Tax Return

- Due date of tax return: April 15 of the following year
- Extension permitted until October 15

Form 1040 Department of the Treasury—Internal Revenue Service
U.S. Individual Income Tax Return 2010 OMB No. 1545-0047

For the year Jan. 1–Dec. 31, 2010, or other tax year beginning 2010, ending 2010

Name, Address, and SSN
 Your first name and initial Last name
 If a joint return, spouse's first name and initial Last name
 Home address (number and street), if you have a P.O. box, see instructions. Apt. no.
 City, town or post office, state, and ZIP code. If you have a foreign address, see instructions.

Your social security number
 Spouse's social security number

See separate instructions.
 ⚠ Make sure the SSN(s) above and on line 6c are correct.
 Checking a box below will not change your tax or refund.

Presidential Election Campaign Check here if you, or your spouse if filing jointly, want \$3 to go to this fund: You Spouse

Filing Status
 1 Single
 2 Married filing jointly (even if only one had income)
 3 Married filing separately. Enter spouse's SSN above and full name here.
 4 Head of household (with qualifying person). (See instructions.) If the qualifying person is a child, enter the child's name here.
 5 Qualifying widow(er) with dependent child

Exemptions
 6a Yourself. If someone can claim you as a dependent, do not check box 6a.
 b Spouse
 c Dependents:
 (f) First name Last name (g) Dependent's social security number (h) Dependent's relationship to you (i) if child under age 17 qualifies for child tax credit (see page 10)
 If more than four dependents, see instructions and check here
 d Total number of exemptions claimed Add numbers on lines above

Income
 7 Wages, salaries, tips, etc. Attach Form(s) W-2
 8a Taxable interest. Attach Schedule B if required
 b Tax-exempt interest. Do not include on line 8a
 8b
 9a Ordinary dividends. Attach Schedule B if required
 b Qualified dividends
 9b
 10 Taxable refunds, credits, or offsets of state and local income taxes
 11 Alimony received
 12 Business income or (loss). Attach Schedule C or C-EZ
 13 Capital gain or (loss). Attach Schedule D if required. If not required, check here
 14 Other gains or (losses). Attach Form 4797
 15a IRA distributions
 15a Taxable amount
 15b
 16a Pensions and annuities
 16a Taxable amount
 16b
 17 Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E
 18 Farm income or (loss). Attach Schedule F
 19 Unemployment compensation
 20a Social security benefits
 20a Taxable amount
 20b
 21 Other income. List type and amount
 22 Combine the amounts in the far right column for lines 7 through 21. This is your total income

Adjusted Gross Income
 23 Educator expenses
 24 Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ
 24
 25 Health savings account deduction. Attach Form 8899
 25
 26 Moving expenses. Attach Form 3903
 26
 27 One-half of self-employment tax. Attach Schedule SE
 27
 28 Self-employed SEP, SIMPLE, and qualified plans
 28
 29 Self-employed health insurance deduction
 29
 30 Penalty on early withdrawal of savings
 30
 31a Alimony paid b Recipient's SSN
 31a
 32 IRA deduction
 32
 33 Student loan interest deduction
 33
 34 Tuition and fees. Attach Form 8817
 34
 35 Domestic production activities deduction. Attach Form 9908
 35
 36 Add lines 23 through 31a and 32 through 35
 36
 37 Subtract line 36 from line 22. This is your adjusted gross income

Individual income tax formula

Income from whatever source derived

- Exclusions

Gross income

- Deduction “for” AGI

Adjusted gross income (AGI)

- The greater of: Itemized deductions or standard deduction

- Personal and dependency exemptions

Taxable income

- Apply tax rates

Gross income tax liability

- Credits (including federal income tax withholding and estimated tax payments)

Net tax due or refund

Exclusions from income

- §102 Gifts and inheritances
- §101 Life insurance proceeds to beneficiary
- §103 Interest on state and local bonds
- §§105, 106, 79 tax free employee fringe benefits (medical insurance, limited GTLI, higher education reimbursements, and others)
- §911 Foreign earned income up to \$91,400
- §104 State sponsored workers compensation payments compensation for physical injury
- Others to a limited extent
 - §117 Scholarships
 - §121 Gain on the sale of personal residence

Exclusions from income — Examples

- If someone were to gift you \$1,000,000 in cash or fair market value of property, you would have no gross income and he would get no deduction
- If your grandfather passed away, and you were the beneficiary of his \$100,000 life insurance policy, you would not be taxed on the \$100,000
- Similarly, if when he died, his will or living trust passed on to you \$300,000 of cash or property, that would also be income tax free to the recipient

§61 Gross income

- Gross income defined: “.....all income from whatever source derived.....”
 - Salary
 - Interest
 - Dividends
 - Rents
 - Royalties
 - Annuities
 - Income from flowthrough entities (partnerships, S corporations, trusts)
 - Alimony
 - Prizes
 - Awards
 - Capital gains, etc.

Poll question #1

Jaclyn owns stock of ABC Company which has **appreciated** significantly over what she paid for the shares 5 years ago. Her cost was \$4,000. The value of the ABC stock is currently \$10,000. She also owns stock of XYZ Company that has **depreciated** significantly over what she paid for the shares 3 years ago. Her cost was \$8,000. The value of the XYZ stock is \$2,000. She needs \$10,000 to pay her Robert Morris University tuition due December 15, 2010 and \$2,000 for living expenses. Jaclyn wants to pay as little income tax as possible on this sale in 2010. What should Jaclyn do to get the most cash and pay the least amount of income tax related to this stock in 2010?

- Sell the ABC stock and the XYZ stock and offset the capital gain with the capital loss
- Sell only the ABC stock
- Sell only the XYZ stock
- Don't sell any stock, buy a lottery ticket and hope for the best

§62 Deductions for adjusted gross income

- Trade and Business Expenses — self employed
- Certain Trade and Business Expenses — employee
- Losses from Sale or Exchange of Property
- Deductions attributable to Rents and Royalties
- Pension, Profit-sharing and Annuity plans of Self-Employed individuals
- Retirement Savings
- Alimony
- Moving Expenses
- Interest on Education Loans
- Others

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Itemized deductions — Schedule A (Form 1040)

SCHEDULE A (Form 1040)		Itemized Deductions		OMB No. 1545-0074 2010 Attachment Sequence No. 07	
Department of the Treasury Internal Revenue Service (20)		▶ Attach to Form 1040. ▶ See instructions for Schedule A (Form 1040).			
Name(s) shown on Form 1040				Your social security number	
Medical and Dental Expenses	Caution. Do not include expenses reimbursed or paid by others.				
	1	Medical and dental expenses (see instructions)	1		
	2	Enter amount from Form 1040, line 38 <input type="text" value="2"/>	2		
	3	Multiply line 2 by 7.5% (.075)	3		
	4	Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-	4		
Taxes You Paid	5 State and local (check only one box):				
	a <input type="checkbox"/> Income taxes, or				
	b <input type="checkbox"/> General sales taxes				
	6	Real estate taxes (see instructions)	6		
	7	New motor vehicle taxes from line 11 of the worksheet on back (for certain vehicles purchased in 2009). Skip this line if you checked box 5b	7		
	8	Other taxes. List type and amount ▶ _____	8		
	9	Add lines 5 through 8	9		
Interest You Paid	10 Home mortgage interest and points reported to you on Form 1098				
	11 Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see instructions and show that person's name, identifying no., and address ▶ _____				
	Note. Your mortgage interest deduction may be limited (see instructions).				
	12	Points not reported to you on Form 1098. See instructions for special rules	12		
	13	Mortgage insurance premiums (see instructions)	13		
	14	Investment interest. Attach Form 4952 if required. (See instructions.)	14		
	15	Add lines 10 through 14	15		
Gifts to Charity	16 Gifts by cash or check. If you made any gift of \$250 or more, see instructions				
	If you made a gift and got a benefit for it, see instructions.				
	17	Other than by cash or check. If any gift of \$250 or more, see instructions. You must attach Form 8283 if over \$500	17		
	18	Carryover from prior year	18		
	19	Add lines 16 through 18	19		
Casualty and Theft Losses	20	Casualty or theft loss(es). Attach Form 4684. (See instructions.)	20		
Job Expenses and Certain Miscellaneous Deductions	21	Unreimbursed employee expenses—job travel, union dues, job education, etc. Attach Form 2106 or 2106-EZ if required. (See instructions.) ▶ _____	21		
	22	Tax preparation fees	22		

Itemized deductions

- Medical and dental
 - Unreimbursed expenses are deductible to the extent that such expenses exceed 7 ½ % of AGI
- Taxes
 - State and local income, real and personal property, others
- Interest
 - Qualified residence and investment interest
- Charitable contributions
 - Cash and property contributions to qualified domestic organizations
- Casualty and theft loss
 - Unreimbursed losses are deductible to the extent that such losses exceed 10% of AGI
- Miscellaneous deductions
 - Unreimbursed expenses are deductible to the extent that such expenses (in the aggregate) exceed 2% of AGI
- Others

Standard deduction

- Taken instead of itemized deductions
- Amount depends upon the filing status of the taxpayer

Basic Standard Deduction — 2010	
Filing Status	Amount
Married Filing Joint	\$11,400
Surviving Spouse	\$11,400
Head of Household	\$8,400
Married Filing Separately	\$5,700
Single	\$5,700

Additional standard deduction

- Age (65 or older)
- Blindness

Additional Standard Deduction — 2010	
Filing Status	Amount
Married Filing Joint	\$1,100
Surviving Spouse	\$1,100
Head of Household	\$1,400
Married Filing Separately	\$1,100
Single	\$1,400

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Poll question #2

Danielle, a single filer, received a large year end bonus from her employer in 2010. She wants to minimize her income tax liability for this year. Danielle has qualifying deductions for 2010 well in excess of \$5,700, the standard deduction amount for a single filer. If Danielle wants to minimize her income tax liability for this year, she should:

- Defer any charitable contributions to 2011
- Claim the standard deduction
- Pay her fourth quarter state income tax estimate (due 1/15/11) by December 31, 2010.
- Invest her bonus check in high yield corporate bond fund

Personal and dependency exemptions

- For 2010, the personal and dependency exemption is \$3,650
- If someone is a dependent of another taxpayer, they may not take a personal exemption for themselves
- To qualify as a dependent, must be a North American resident; must not have filed a joint return (except to get a tax refund) and must be a qualifying child or qualifying relative of the taxpayer

Filing status

- Filing status is important:
 - For which tax rate schedule you use
 - For eligibility for various deductions and credits and what AGI limit might apply

Filing status (cont.)

- Single
- Married couples (Schedule Y-1)
 - Married couples will either file jointly (as one) or separately. As a general rule, jointly is more efficient tax wise.
- Surviving spouse
 - This status is permitted for the next two years after the spouse died. To qualify the widow or widower must remain unmarried and maintain a household for a dependent child during that year.
 - After two years, usually the status will revert to Head of Household or Single
- Head of household (Schedule Z)
 - A special type more favorable filing status to Single where either:
 - Pay more than half the cost of maintaining a dependent parent's home
 - Pay more than half the cost of a household that is the principal place of abode for more than half a year of a dependent qualifying child or qualifying relative

How does filing status affect tax liability?

Comparison of Income Tax Liability by Filing Status — 2010		
Filing Status	Taxable Income	Income Tax Liability
Married Filing Joint	\$373,650.00	\$101,085.50
Surviving Spouse	\$373,650.00	\$101,085.50
Head of Household	\$373,650.00	\$105,095.00
Single	\$373,650.00	\$108,421.25

Tax credits

- Credits vs. deduction
 - Credits — \$1 for \$1 reductions in tax liability
 - Provides equal benefit to taxpayers
 - Deduction — \$1 reduction in taxable income
 - Tax benefit depends on the taxpayer's marginal tax rate
- Federal tax withholding from salary, wages, and bonuses are credited against the tax liability
- Estimated tax payments are credited against the tax liability
- Examples
 - Earned income credit — refundable credit
 - Child and dependent care credit
 - Education credits

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Net tax due or refund

Poll question #3

John, age 64, and his wife Carol, age 66, are preparing their 2010 Form 1040. John was declared legally blind. They do not itemize their deductions. What should their filing status be and how much is their standard deduction for 2010?

- Married filing separately and \$13,600
- Married filing jointly and \$13,600
- Head of Household and \$9,500
- Married filing jointly and \$12,500

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