

The Mysteries of Income Tax Returns

MFSRC – September 25, 2012
 Amy A. Anderson J. D., C.P.A.
 Assistant Ramsey County Attorney

Where to start

- Gross income minus above the line deductions, minus personal exemptions, itemized or standard deductions and then times what tax rate. After that there are credits, payments and penalties.
- Total income...adjusted gross income...taxable income...ordinary income...capital gains.
- IRS Publication 17 is a primer on many issues, but even the primer is over 300 pages and there are many references to other in-depth IRS publications on the issues.

Form 1040 Department of the Treasury—Internal Revenue Service (99)		2011		OMB No. 1545-0074	IRS Use Only—Do not write or staple in this space.																									
For the year Jan. 1–Dec. 31, 2011, or other tax year beginning , 2011, ending , 20				See separate instructions.																										
Your first name and initial		Last name		Your social security number																										
If a joint return, spouse's first name and initial		Last name		Spouse's social security number																										
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, also complete spaces below (see instructions).				Presidential Election Campaign Check here if you, or your spouse if filing jointly, want \$3 to go to this fund. Checking a box below will not change your tax or refund. <input type="checkbox"/> You <input type="checkbox"/> Spouse																										
Foreign country name		Foreign province/county		Foreign postal code																										
Filing Status 1 <input type="checkbox"/> Single 2 <input type="checkbox"/> Married filing jointly (even if only one had income) 3 <input type="checkbox"/> Married filing separately. Enter spouse's SSN above and full name here. ▶ 4 <input type="checkbox"/> Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶ 5 <input type="checkbox"/> Qualifying widow(er) with dependent child																														
Exemptions 6a <input type="checkbox"/> Yourself. If someone can claim you as a dependent, do not check box 6a b <input type="checkbox"/> Spouse c Dependents: <table border="1"> <thead> <tr> <th>(1) First name</th> <th>Last name</th> <th>(2) Dependent's social security number</th> <th>(3) Dependent's relationship to you</th> <th>(4) <input checked="" type="checkbox"/> if child under age 17 qualifying for child tax credit (see instructions)</th> </tr> </thead> <tbody> <tr><td> </td><td> </td><td> </td><td> </td><td><input type="checkbox"/></td></tr> <tr><td> </td><td> </td><td> </td><td> </td><td><input type="checkbox"/></td></tr> <tr><td> </td><td> </td><td> </td><td> </td><td><input type="checkbox"/></td></tr> <tr><td> </td><td> </td><td> </td><td> </td><td><input type="checkbox"/></td></tr> </tbody> </table> If more than four dependents, see instructions and check here ▶ <input type="checkbox"/> d Total number of exemptions claimed						(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) <input checked="" type="checkbox"/> if child under age 17 qualifying for child tax credit (see instructions)					<input type="checkbox"/>					<input type="checkbox"/>					<input type="checkbox"/>					<input type="checkbox"/>
(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) <input checked="" type="checkbox"/> if child under age 17 qualifying for child tax credit (see instructions)																										
				<input type="checkbox"/>																										
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				<input type="checkbox"/>																										
				<input type="checkbox"/>																										
				Boxes checked on 6a and 6b No. of children on 6c who: • lived with you • did not live with you due to divorce or separation (see instructions) Dependents on 6c not entered above Add numbers on lines above ▶ <input type="checkbox"/>																										

Filing Status

There are 5 choices of filing status – Single, Married filing joint, Married filing separately, Head of Household and Qualifying widow(er).

One thing you might see is splitting the exemption deductions when there is more than one child and then both parents claim head of household.

Exemptions

First are the exemptions for you and spouse and then exemptions for the children.

To take an exemption for a child, the child must be living with you and your home must be their main home for more the 6 months of the year.

Child's exemption

Here are the 6 things that go together with the exemption for a child;

1. Dependency exemption
2. Child tax credits
3. Head of household filing
4. Credit for child and dependent care expenses
5. Exclusion for dependent care benefits
6. Earned income credit

All of these items are for the custodial parent unless there is something in the decree that give the non-custodial parent the exemption or the custodial parent signs form 8332.

What if non-custodial has exemption?

If the non-custodial receives the exemption, they are entitled to:

1. Dependency exemption
2. Child tax credit

In order for a non-custodial parent to claim the exemption and child tax credit they need to include portions of their judgment and decree with their return or form 8332 signed by the custodial parent.

What can tax returns tell you?

Then the custodial parent retains the last four.

3. Head of household filing
4. Credit for child and dependent care expenses
5. Exclusion for dependent care benefits
6. Earned income credit

This means the custodial parent can still file as head of household, still get the earned income credit and the non-custodial parent may not.

- Current income of parents
- Clues to assets held
- Income trend (if several years of returns)
- Self employed status of parent
 - Entries on lines 12, 17, 18, and 21 on page 1 of 1040 (Schedule C, S Corporation, Rental income, Farm income)

Income

Line 7. Wages, salaries, tips, etc. Attach Form(s) W-2

“Income” in the W-2 is not the total income we would look at for child support as there may be deductions coming out of paycheck that are not taxable. W-2 income on a return may not be the same as what shows up in DEED on PRISM. DEED is usually larger if employer allows pretax deductions and is doing things correctly.

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

Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.

If you did not get a W-2, see instructions.

Enclose, but do not attach, any payment. Also, please use Form 1040-V.

An employer can't give employees things without tax consequences unless there is a specific exception, for instance a day care expense account or medical insurance that is deducted pre tax. Some items are not taxable for income tax purposes but are for FICA and Medicare taxes.

Line 8a – Taxable Interest

- Reported on 1099-INT
- Bank or credit union interest
- Sell your house on a contract for deed
- Invest in business that has investments

Line 8b – Tax-exempt interest

This income is reported in summary form, usually at the bottom of the 1099 from a broker.

Line 9a – Ordinary Dividends

- Reported on 1099-DIV
- Dividends from stock holdings

Line 9b – Qualified Dividends

- Reported as part of 1099-DIV – some of the dividends received above are entitled to preferential tax treatment i.e. reduced rates.

Line 10 – Taxable Refunds, credits, or offsets of state and local income taxes.

- Reported on 1099 - G
- Not all of this is necessarily taxable.
- If you did not itemize deductions in the prior year return, your state refund is not taxable.

Line 11 – Alimony received

There is no document on which this is reported to the IRS. Theoretically the amount reported should match up to the deduction on the payor's return line 31.

Line 12 – Business Income or (loss). Attach Schedule C or C-EZ.

This is a self-reported number and increases not only the income tax, but the self-employment taxes paid. Some figures on the income side of the Schedule C may be reported specifically for independent contractors who receive a 1099 – Misc but generally all the income here is self-reported.

Self-employed tax returns may need adjustments

- Some deductions allowed by IRS should not be allowed for child support
- Expenses are exaggerated or include personal expenses
- The opportunity for a self-employed person to support himself and yet report negligible income is too well known to require exposition. Ferguson v. Ferguson 357 N.W.2d 104, 108 (Minn. App. 1984)

Line 13 – Capital gain or (loss) Attach Schedule D if required. If not required, check here

If you sell any stocks or bonds, this is where income is reported. If a business you owned sold anything it will also be reported here as a “flow-through” item. This is another type of income that has favorable tax treatment in that the maximum rate currently 15%.

Capital Losses also flow through this line but are limited to a \$3,000 loss. This number has been in place for over 30 years and never been adjusted for inflation.

Line 14 – Other gains or (losses) Attach Form 4797

Income from the sale of non-capital assets is reported here.

Line 15a – IRA distribution Line 15b Taxable amount

Reported on 1099-R

Any Individual Retirement Account distribution you receive is included on line 15a even if you have rolled over the IRA into another investment. The form you receive should include the total distribution as well as the taxable portion.

Important to include the type of IRA distribution as some may be subject to an early withdrawal penalty.

Line 16 a – Pension and annuities 16b taxable amount

Reported on 1099-R

Pension distributions are reported on this line. If you receive a pension distribution and it's rolled over into a different retirement account, like an IRA, it may not be taxable.

Line 17 – Rental Real Estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E.

Page 1 - Most rental income reported on Schedule E is self reported, that is income received from a private renter. If taxpayer is renting property to a business, they should receive a 1099-MISC with an entry in Box 1.

Page 1 also includes Royalty income which is reported on a 1099-MISC.

Rental Expenses

The expenses claimed on the Schedule E are self-reported except for mortgage interest and real estate taxes. The others; repairs, insurance, advertising, cleaning would require back up from the taxpayer to be verified. All of these expenses reduce the income reported. There is also depreciation which is not an out-of-pocket expense.

Schedule E, Page 2 – The income on the top of this page is from businesses the taxpayer has an ownership interest in. There is a corresponding partnership, or corporate return that reports the income to the shareholder or partner via a K-1. Near the bottom is the income that beneficiaries receive from any trusts or estates.

Line 18 - Farm income of (loss). Attach Schedule F

This form is similar to a Schedule C, but with categories of deductions related to the operation of a farm.

Line 19 Unemployment compensation

This income is reported on Form 1099-G (for government payments)

Line 20a - Social security benefits

The gross amount is reported on SSA-1099.

Line 20b – Taxable amount (of social security benefits)

The result here is a calculation of how much of the social security is taxable and it all depends on the rest of the income reported on the return.

Line 21 – Other income. List type and amount

What goes here – any other taxable income not listed above. Common examples would be jury duty pay, gambling winnings, prizes and awards, state property tax refunds, income from activity not engaged in for profit, net operating loss carryovers. Most income reported here is not of a reoccurring nature.

Line 22 Combine the amounts in the far right column for lines 7 through 21.

This is your total income.

If there are any losses above, they should be in parentheses above and subtracted from the other amounts.

Adjusted Gross Income	23	Educator expenses	23			
	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 8889	25			
	26	Moving expenses. Attach Form 3903	26			
	27	Deductible part 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 8917	34			
	35	Domestic production activities deduction. Attach Form 8903	35			
	36	Add lines 23 through 35	36			
	37	Subtract line 36 from line 22. This is your adjusted gross income ▶	37			

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form **1040** (2011)

Items used to arrive at Adjusted Gross Income – Line 23-36

Not going to list them all. Significant are Line 27 where the business portion of self-employment taxes are deducted and Line 31a where alimony that is deducted goes.

All these items are referred to as “above the line deductions” because they come off before you get to adjusted gross income.

Adjusted Gross Income

This figure is relevant because there are other itemized deductions and credits that are limited or eliminated as this goes higher.

Other issues

- Which Form – 1040, 1040A, 1040 EZ?
- When to file?
- How long do you have to keep records?
- Innocent spouse questions.

1040, Page 2

Line 40 – Itemized deductions (from Schedule A) or your standard deduction

Line 42 – Exemptions

These are the last items deducted to arrive at Taxable Income. The deductions included in itemized deductions are referred to as below the line deductions.

Questions?

Amy A. Anderson

Assistant Ramsey County Attorney

Amy.Anderson@Co.Ramsey.MN.US

(651) 266-3069