

# The Mysteries of Income Tax Returns

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# 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.

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.

▲ Make sure the SSN(s) above and on line 6c are correct.

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.  You  Spouse

Foreign country name

Foreign province/country

Foreign postal code

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 but not your dependent, enter this 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

Table with 4 columns: (1) First name, Last name, (2) Dependent's social security number, (3) Dependent's relationship to you, (4) if child under age 17 qualifying for child tax credit (see instructions)

If more than four dependents, see instructions and check here

d Total number of exemptions claimed

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

# 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.

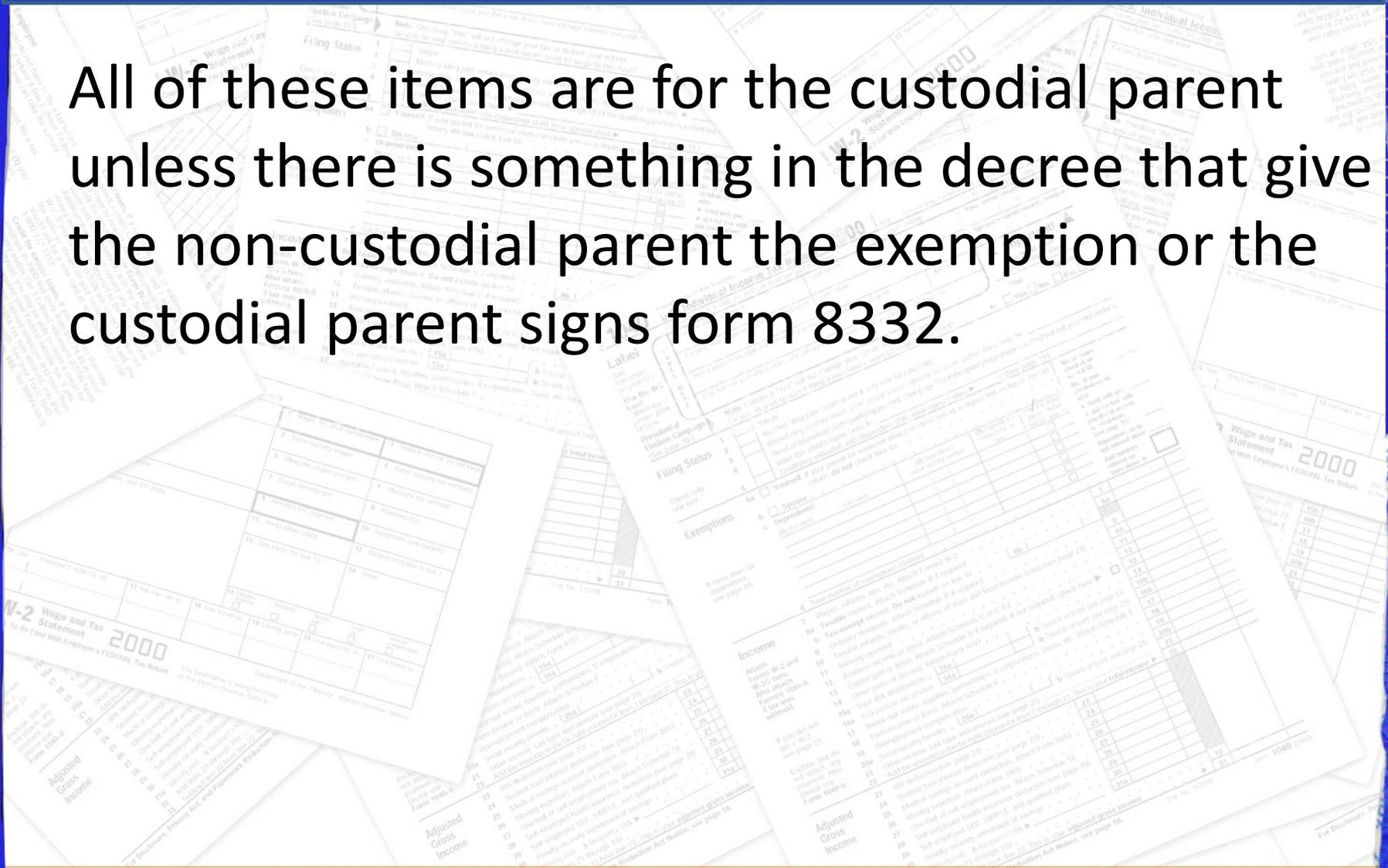
To take an exemption for a child, the child must be living with you and your home must be their main home for more the 6 months of the year.

# 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.

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.

# What can tax returns tell you?

- 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**

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.

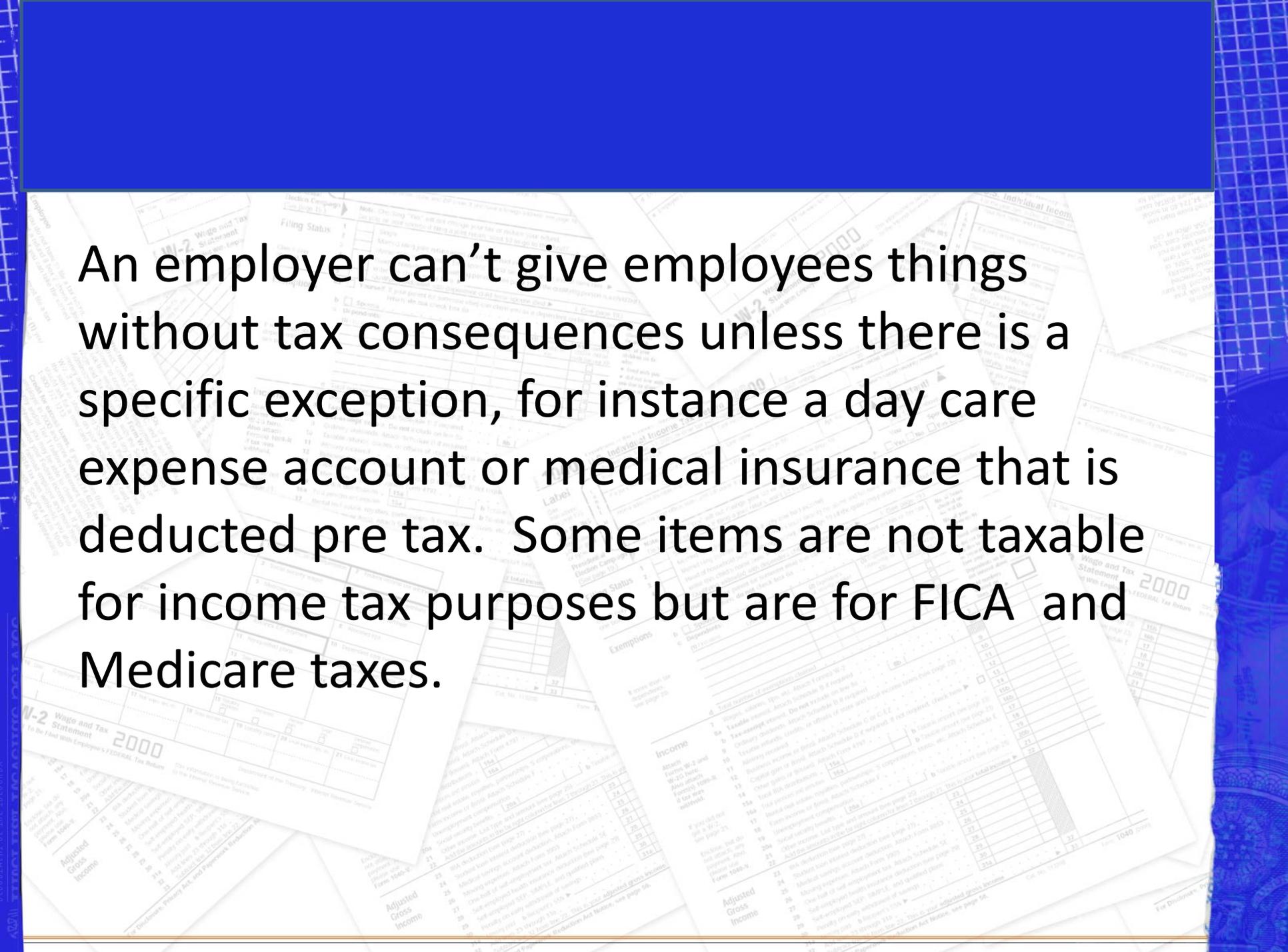
7	Wages, salaries, tips, etc. Attach Form(s) W-2 . . . . .	7		
8a	Taxable interest. Attach Schedule B if required . . . . .	8a		
b	Tax-exempt interest. Do not include on line 8a . . . . .	8b		
9a	Ordinary dividends. Attach Schedule B if required . . . . .	9a		
b	Qualified dividends . . . . .	9b		
10	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 . . . . .	15a		
		b	Taxable amount . . . . .	15b
16a	Pensions and annuities . . . . .	16a		
		b	Taxable amount . . . . .	16b
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 . . . . .	20a		
		b	Taxable amount . . . . .	20b
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 <input type="checkbox"/> . . . . .	22		



# 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.

The background of the slide consists of several overlapping, semi-transparent 2000 W-2 Wage and Tax Statements. The forms are scattered across the white central area, with some showing the 'Adjusted Gross Income' section and others showing the 'Income' section. The year '2000' is clearly visible on several forms. The text is centered over this background.

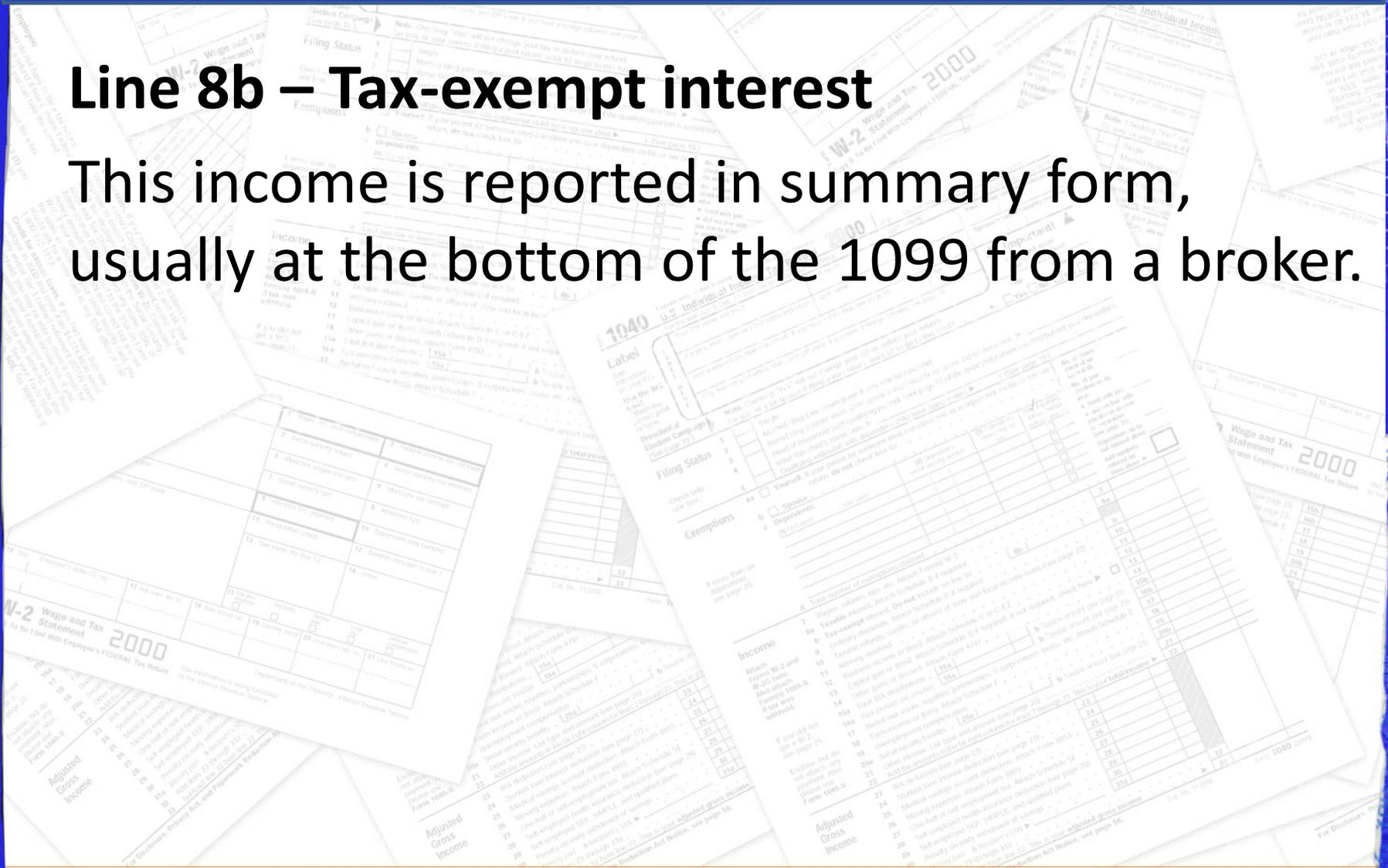
An employer can't give employees things without tax consequences unless there is a specific exception, for instance a day care expense account or medical insurance that is deducted pre tax. Some items are not taxable for income tax purposes but are for FICA and Medicare taxes.

## 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.

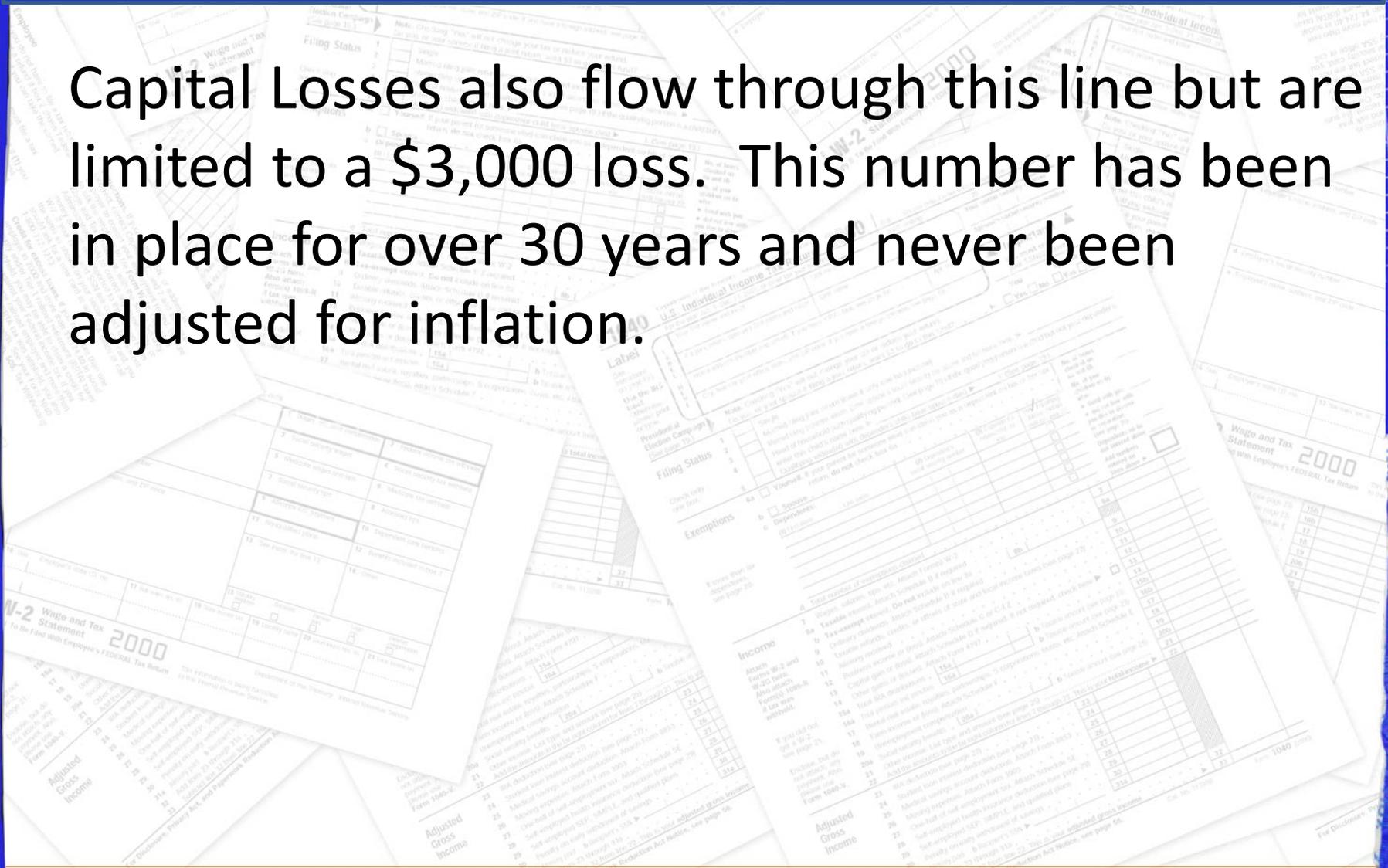
## Self-employed tax returns may need adjustments

- 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**

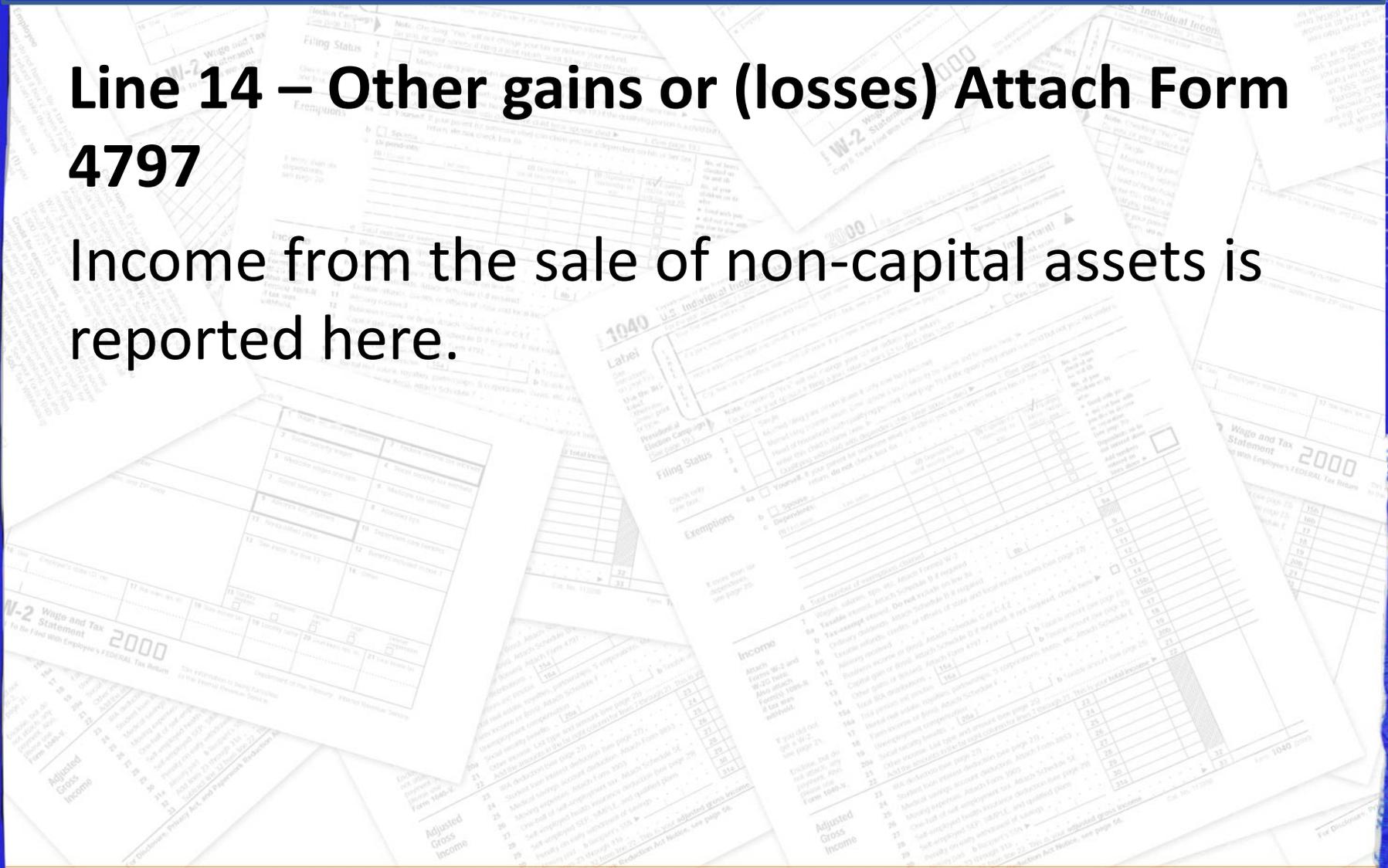
If you sell any stocks or bonds, this is where income is reported. If a business you owned sold anything it will also be reported here as a “flow-through” item. This is another type of income that has favorable tax treatment in that the maximum rate currently 15%.

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.

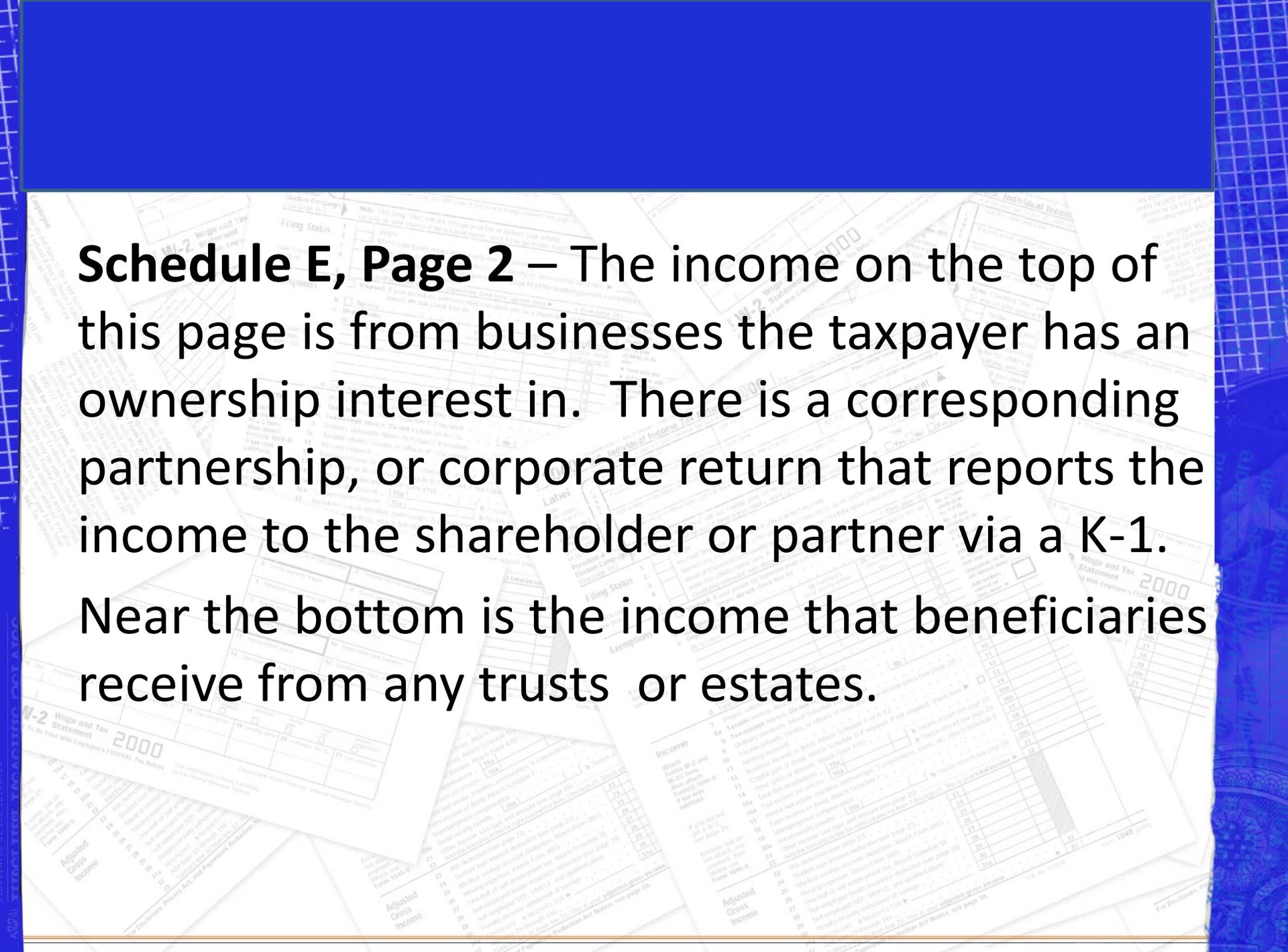
**Line 17 – Rental Real Estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E.**

**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.

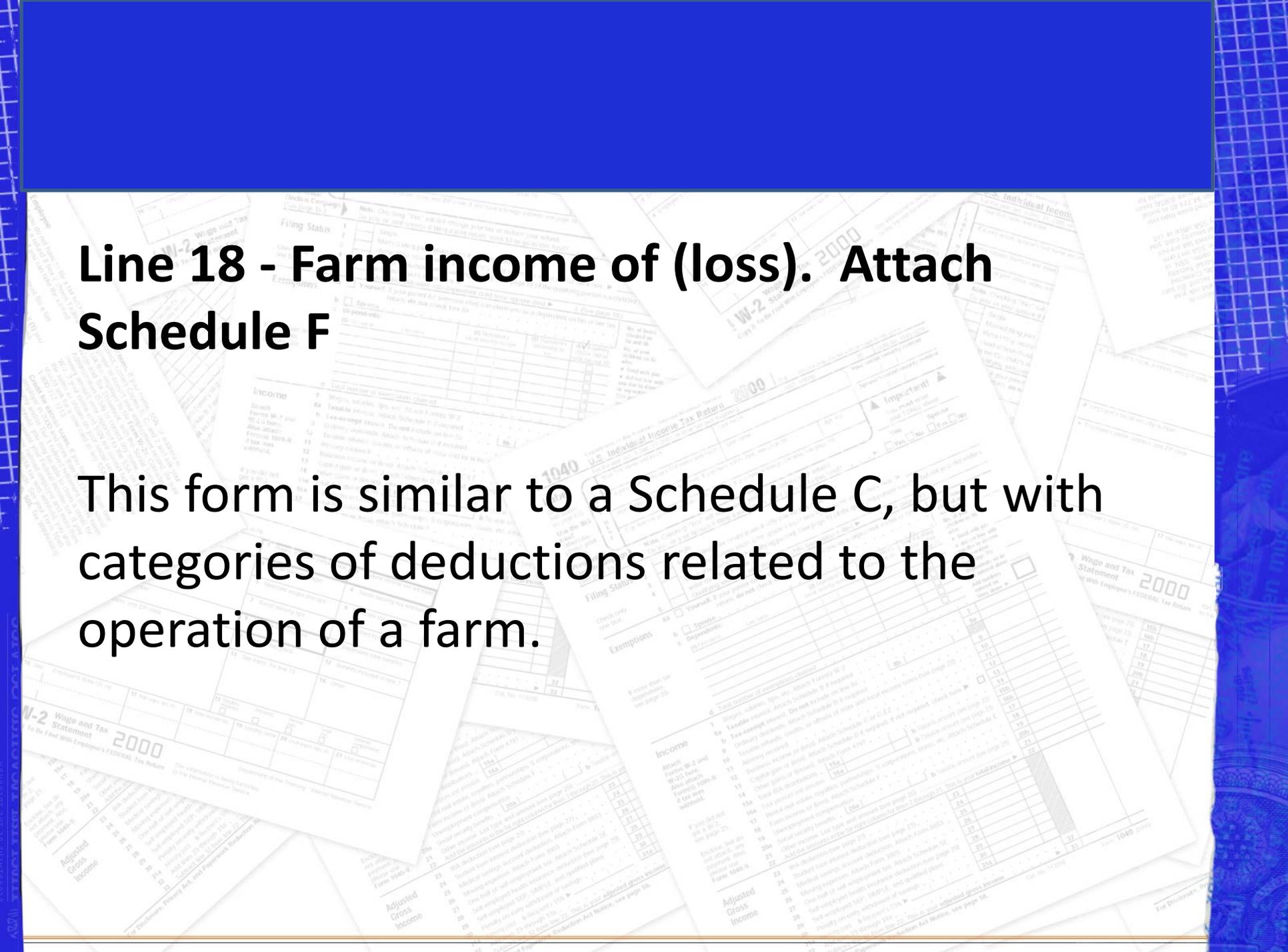
Page 1 also includes Royalty income which is reported on a 1099-MISC.

## 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.

The background of the slide features a collage of various tax forms, including W-2 Wage and Tax Statements, 1040 Individual Income Tax Returns, and Schedule E forms. The forms are layered and slightly faded, creating a textured effect. The text is overlaid on this background in a large, bold, black font.

**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.

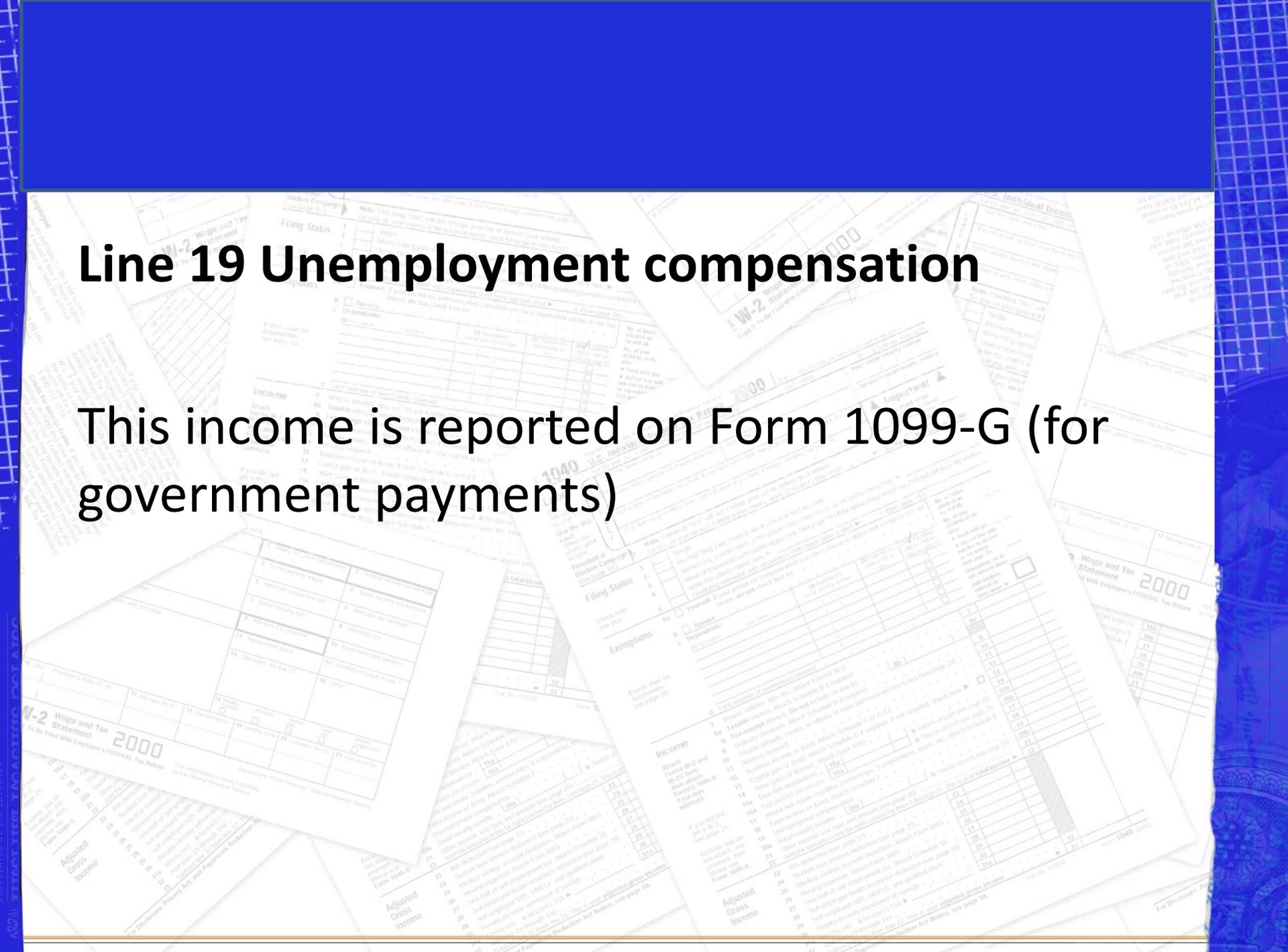


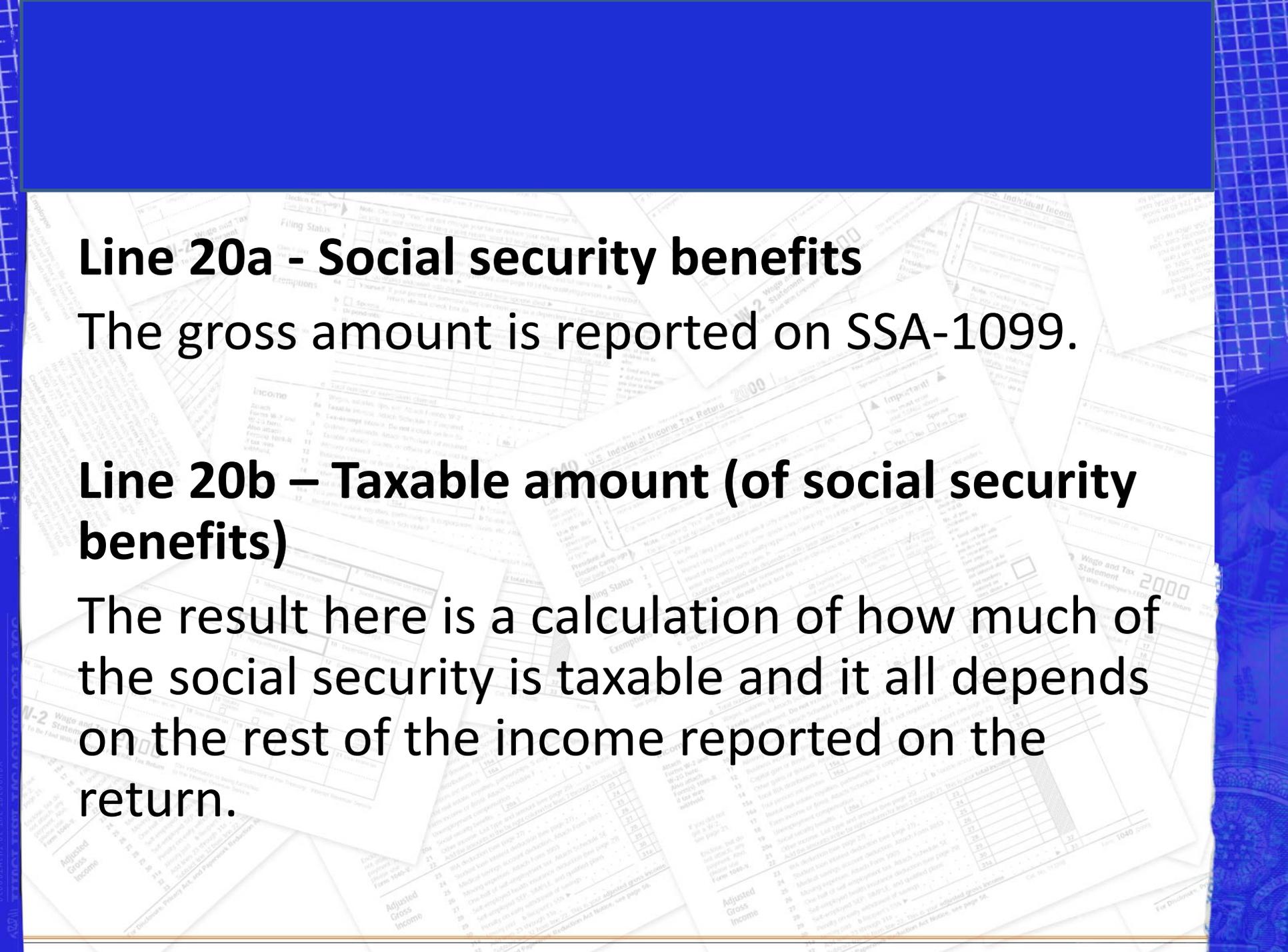
**Line 18 - Farm income of (loss). Attach Schedule F**

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>b</b> Recipient's SSN ▶ <u>          </u>   <u>          </u>   <u>          </u>	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 <b>adjusted gross income</b> . . . . . ▶	37			

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 11320B

Form **1040** (2011)

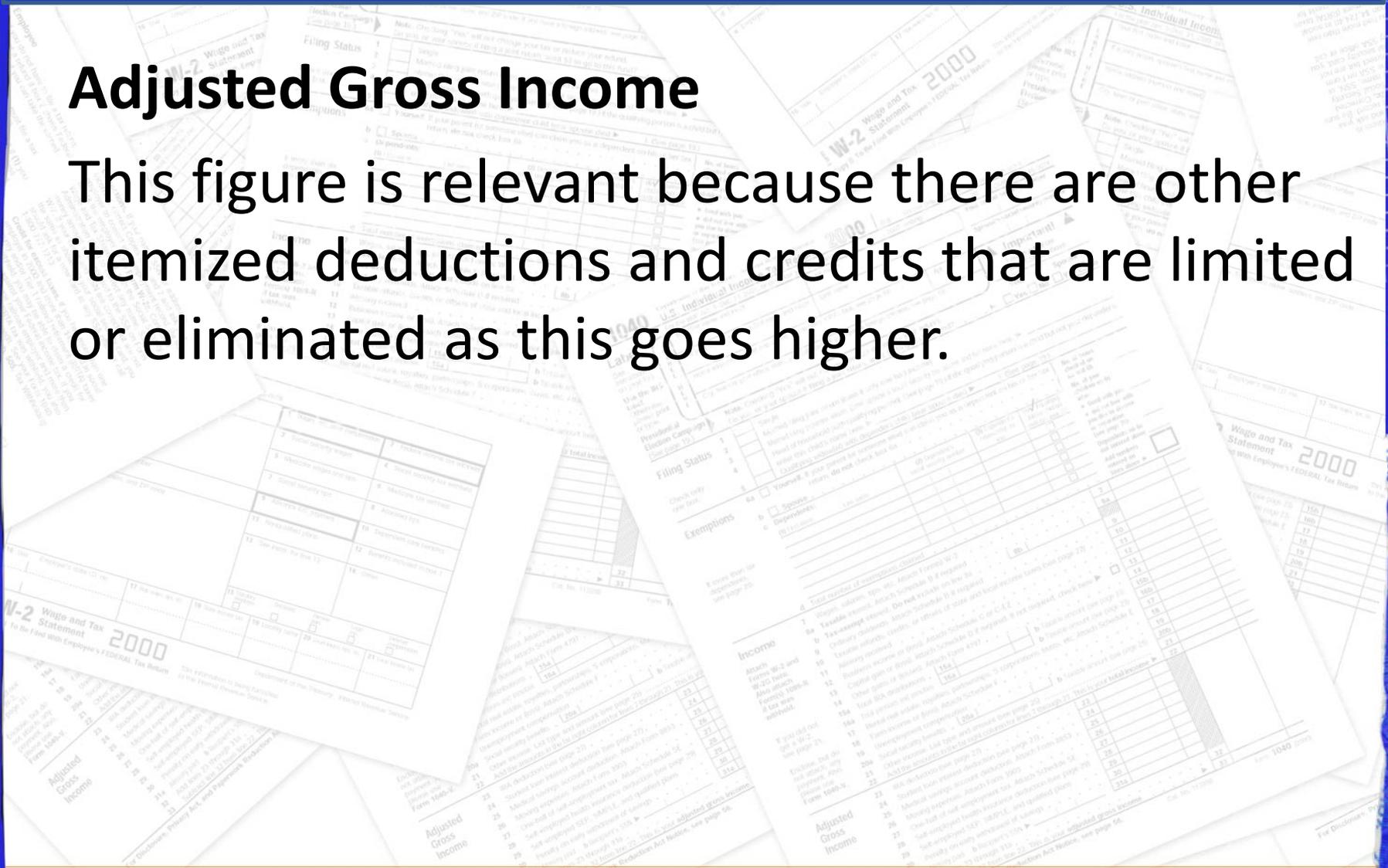
## Items used to arrive at Adjusted Gross Income – Line 23-36

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.



**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.

# Other issues

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

# Questions?

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