

# Tax Preparation Simplified

# So why is "simplification" such a long word?



# Simplified Tax Preparation A Three Step Process

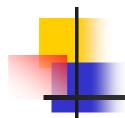
## **Step # 1**

How much did you make last year?



# Step # 2

How much do you have left?



# Step#3

Send amount in Step 2 to the IRS.



# "Federal Tax Laws with Emphasis on Senior Issues"

- Interest
- Dividends
- Capital Gains
- Retirement Income
  - IRA's
  - Pensions
  - Social Security
- Deductions
- A Credit or two



#### **Useful References**

- Form 1040 Instructions
- Form 1040
- Publications, especially pub 17
- IRS website: irs.gov



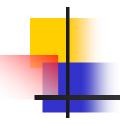
#### **New for 2008**

- Return of the ESP!
- Real Estate Taxes can be included in the Standard Deduction
- First Time Homebuyers Credit
- Some "Adjustments" extended
- Usual inflation adjustments



### Who must file?

- Everyone?
- How do you decide?
- It depends on:
  - Filing Status
  - Age
  - Income
  - Other Factors
- If in doubt file!



# Who should file?

#### Anyone wanting:

- A tax refund (excess withholding)
- Certain credits (EIC, ACTC, RRC)
- A copy of their return:
  - To get a real estate tax reduction
  - In case they hear from the IRS

#### Confused?

Unless obvious, prepare the return



<b>1040</b>		rtment of the Treasury—Internal Revenue S . Individual Income Tax Ref	. ~ //////////	08	(99)	IRS Use	Only—Don	ot write or	staple in this space.			
	For	For the year Jan. 1-Dec. 31, 2008, or other tax year beginning , 2008, ending , 20					OMB No. 1545-0074					
Label									Your social security number			
(See Instructions A B E Use the IRS L Iabel. Otherwise,	lf a	joint return, spouse's first name and initial	8pous	Spouse's social security number								
	Но	Home address (number and street). If you have a P.O. box, see page 14. Apt. no.							You must enter your SSN(s) above.			
please print R or type.	CIt	, town or post office, state, and ZIP code. If y	Checkir	Checking a box below will not								
Presidential	Ļ								your tax or refund			
Election Campaign	▶ ○	heck here if you, or your spouse if filing j	jointly, want \$	3 togoto	this fund	d (see p	age 14) I	<b>▶</b> ∟	You Spou	80		
Filing Status	1 [ 2 [											
Check only	3 [											
one box.	3 L	and full name here. ▶	h depen	dent child (see pag	je 16)							
	6a	Yourself. If someone can claim you	ı as a depend	ent, do no	ot check	box 6a		}	Boxes checked on 6a and 6b			
Exemptions	ь	Spouse					/ .	اني	No. of children on 6c who:			
	С	Dependents:	dent's	(3) Dependent's (4) √ if qu relationship to child for ch				lived with you .				
		(1) First name Last name	social security	y number	yo		credit (see p		<ul> <li>did not live with</li> </ul>			
				:					you due to divorce or separation			
If more than four				l					(see page 18)			
dependents, see page 17.				!					Dependents on 6c			
page 17.				<del> </del>			$\vdash \vdash \vdash$		not entered above.	$\overline{}$		
	d	Total number of exemptions claimed	'	<u> </u>					Add numbers on lines above >	- 1		
	7	•						7		_		
Income	/ 8a	Wages, salaries, tips, etc. Attach Form(s Taxable interest. Attach Schedule B if r						8a		$\vdash$		
	b	Tax-exempt interest. Do not include or	-	l sı	ь I		. i .			-		
Attach Form(s) W-2 here. Also	9a	Ordinary dividends. Attach Schedule B		🗠				9a				
attach Forms	b	•	ii required	91			. i .			_		
W-2G and	-	Qualified dividends (see page 21)						10				
1099-R if tax	10	Taxable refunds, credits, or offsets of st		income to	axes (see	page 2	2)			_		
was withheld.	11	Alimony received						11		<del></del>		
	12	Business income or (loss). Attach Sched	dule C or C-E	Z			<u>.</u>	12		-		
	13	Capital gain or (loss). Attach Schedule [		fnotrequ	iired, che	ck here	▶ ⊔	13		<del></del>		
If you did not	14	Other gains or (losses). Attach Form 479	97					14		<del></del>		
get a W-2, see page 21.	15a	IRA distributions 15a		bTax	able amou	ınt (see p	oage 23)	15b		<del></del>		
oce page 21.	16a	Pensions and annuities 16a		b Tax	able amou	ınt (see p	oage 24)	16b		<u> </u>		
Enclose, but do	17	Rental real estate, royalties, partnerships	, 8 corporatio	ns, trusts,	etc. Atta	ich Sch	edule E	17		<u> </u>		
not attach, any	18	Farm income or (loss). Attach Schedule	F					18				
payment. Also, please use	19	Unemployment compensation						19				
Form 1040-V.	20a	Social security benefits . 20a		b Tax	able amou	ınt (see p	age 26)	20b				
	21	Other income. List type and amount (se	e page 28)					21				
	22	Add the amounts in the far right column for	or lines 7 throu	ıgh 21. Thi	is is yourt	total inc	ome 🕨	22				
	23	Educator expenses (see page 28)		23	3							
Adjusted	24	Certain business expenses of reservists, per	forming artists.	and								
Gross		fee-basis government officials. Attach Form			4							
Income	25	Health savings account deduction. Attac			5							
	26			20	6							
	27	One-half of self-employment tax. Attach		2	7							
	28	Self-employed SEP, SIMPLE, and qualit		· ·	_							
	29	Self-employed health insurance deducti										
	30	Penalty on early withdrawal of savings		28) 3(			$\neg$					
			-,,	31	_							
	31a	Alimony paid b Recipient's SSN ▶		3	_		-					
	32	IRA deduction (see page 30)		—			-					
	33	Student loan interest deduction (see pages)		33			-					
	34	Tuition and fees deduction. Attach Form		. 34			-					
	35	Domestic production activities deduction.		903 3	0							
	36	Add lines 23 through 31a and 32 through						36		<del></del>		
	37	Subtract line 36 from line 22. This is vo	uradjusted q	ross inco	me .		🕨	37		I		



Form 1040 (2008)	)		Page 2						
Tax	38	Amount from line 37 (adjusted gross income)	38						
and	39a	Check ∫ ☐ You were born before January 2, 1944, ☐ Blind. ☐ Total boxes							
Credits		if: □ Spouse was born before January 2, 1944, □ Blind.   checked ▶ 39a □							
Oreula		( —, -,, —,							
	. •	If your spouse itemizes on a separate return or you were a dual-status alien, see page 34 and check here ▶ 39tb ☐							
Standard Deduction	ြင	Check if standard deduction includes real estate taxes or disaster loss (see page 34) ▶ 39c ☐							
for—	40	Itemized deductions (from Schedule A) or your standard deduction (see left margin) .	40						
10.	41	Subtract line 40 from line 38	41						
<ul> <li>People who checked any</li> </ul>	42	If line 38 is over \$119,975, or you provided housing to a Midwestern displaced individual, see							
box on line 39a, 39b, or		page 36. Otherwise, multiply \$3,500 by the total number of exemptions claimed on line 6d .	42						
39a, 39b, or 39c or who	42		43						
can be	43	Taxable income. Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-	44						
claimed as a	44	Tax (see page 36). Check if any tax is from: a 🗌 Form(s) 8814 b 🗎 Form 4972 .							
dependent, see page 34.	45	Alternative minimum tax (see page 39). Attach Form 6251	45						
All others:	46	Add lines 44 and 45	46						
Single or	47	Foreign tax credit. Attach Form 1116 if required 47							
Married filing	48	Credit for child and dependent care expenses. Attach Form 2441 48							
separately, \$5,450	49	Credit for the elderly or the disabled. Attach Schedule R 49							
	50	Education credits. Attach Form 8863							
Married filing jointly or	1	Education credits. Attach Form 6605							
Qualifying	51	netienent savings contributions death Attach Form 5000 .							
widow(er),	52	Child tax credit (see page 42). Attach Form 8901 if required _ 52							
\$10,900	53	Credits from Form: a □ 8396 b □ 8639 c □ 5695 . 53							
Head of	54	Other credits from Form: a 3800 b 8801 c 54							
household, \$8,000	55	Add lines 47 through 54. These are your total credits	55						
40,000	56	Subtract line 55 from line 46. If line 55 is more than line 46, enter -0	56						
	57	Self-employment tax. Attach Schedule SE	57						
Other	58	Unreported social security and Medicare tax from Form: a 4137 b 8919	58						
Taxes	59	Additional tax on IRAs, other qualified retirement plans, etc. Attach Form 5329 if required .	59						
		Additional taxes: a AEIC payments b Household employment taxes. Attach Schedule H	60						
	60 61	Additional taxes: aAEIC payments b Household employment taxes. Attach schedule H  Add lines 56 through 60. This is your total tax	61						
			01						
Payments	62	Todala income tax withing intin 1 dillo w-2 and 1000							
	63	2000 estimated tax payments and amount applied from 2007 return							
If you have a	64a	Earned income credit (EIC)							
qualifying child, attach	ь	Nontaxable combat pay election 64b							
Schedule EIC.	65	Excess social security and tier 1 RRTA tax withheld (see page 61)							
	66	Additional child tax credit. Attach Form 8812							
	67	Amount paid with request for extension to file (see page 61) 67							
	68	Credits from Form: a 2439 b 4136 c 8801 d 8885 68							
	69	First-time homebuyer credit. Attach Form 5405 69							
	70	Recovery rebate credit (see worksheet on pages 62 and 63)							
	71	Add lines 62 through 70. These are your total payments	71						
Refund	72	If line 71 is more than line 61, subtract line 61 from line 71. This is the amount you overpaid	72						
Direct deposit?	73a	Amount of line 72 you want refunded to you. If Form 8888 is attached, check here ▶ □	73a						
See page 63	<b>▶</b> b	Routing number							
and fill in 73b, 73c, and 73d,	<b>▶</b> d	Account number							
or Form 8888.	74	Amount of line 72 you want applied to your 2009 estimated tax ▶ 74							
Amount	75	Amount you owe. Subtract line 71 from line 61. For details on how to pay, see page 65 ▶	75						
You Owe	76	Estimated tax penalty (see page 65)							
Third Party	Do	you want to allow another person to discuss this return with the IRS (see page 66)?	Complete the following.   No						
Designee		elgnee's Phone Personal Identific	ation						
Designee	nar		· <b>▶</b>						
Sign	Un	der penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and	to the best of my knowledge and						
Here		bellef, they are true, comect, and complete. Declaration of preparer (other than taxipayer) is based on all information of which preparer has any knowledge.							
Joint return?	Yo	Your signature Date Your occupation Daytime phone number							
See page 15.									
Көөр а сору	80	ouse's signature. If a joint return, both must sign. Date Spouse's occupation	,						
for your records.	7								
		Date	Preparer's 96N or PTIN						
Paid		eparens Check if							
Preparer's	9	seir-emproyed 🗌	<u> </u>						
Use Only	you	urs if self-employed), D	1 .						
	adi	dress, and ZIP code Phone no.	( )						



# Filing Status

What is it?



# Filing Status Options

#### Federal (5):

- Single
- Married Filing Jointly
- Married Filing Separately
- Qualifying Widow(er)
- Head of Household

#### Virginia (3):

- Single (box for HOH)
- Married Filing Joint
- Married Filing Separate

#### Virginia Part Year (4)



# Why is Filing Status important?

It affects tax

- It determines availability of credits
- It is a common error





- Highest tax
- Lower standard deduction
- Many credits eliminated or reduced



#### Interest Income

- Reported to you on 1099-INT
- Bank deposits, savings accounts, CD's
- Bonds
- OID (reported on 1099-OID)
- Tax exempt interest- must be reported



#### **Dividends**

- Reported to you on 1099-DIV
- Two types ordinary and qualified
- Qualified taxed at lower rate
- Includes reinvested dividends DRIPS
- Mutual Bond Fund interest reported as dividends



# **Capital Gains**

- The profit you make when you sell a capital asset - basically anything you own.
- The difference between cost (called "basis") and selling price



#### **Basis**

- Very important but can be difficult to determine
- Generally, basis is the cost.
- Basis for gifted assets = the donor's basis
- Basis for inherited assets = the fair market value (FMV) on the date of death
- For a home, use Adjusted Basis
  - Original cost
  - Plus cost of "capital" improvements
  - Minus depreciation (e.g. if rented)
  - Minus postponed gains



#### Some Basis Problems

- Time bought many years ago
- Stock Splits
- Reinvested Dividends
- Identifying which shares sold
  - Specific shares
  - FIFO or LIFO
  - Average cost
- Homes don't forget postponed pre-1997 gains



# **Short vs Long Term Gains or Losses**

#### Short Term

- Held one year or less
- Taxed at regular income tax rate

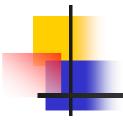
#### Long Term

- Held for more than one year
- Taxed at lower capital gains rate



# **Capital Losses**

- Can <u>sometimes</u> be used to offset gains
- Losses from sale of personal property are not reported.
- Wash sale losses cannot be used
- Long-term losses can offset long-term gains.
- Short-term losses can offset short-term gains.
- Any long-term losses left over can offset short-term gains and vice versa.
- Losses remaining can offset ordinary income but only up to \$3,000 (\$1,500 if MFS).
- Unused losses can be carried forward until used



#### **Retirement Income**

- IRA's
- Pensions & Annuities
- Social Security Benefits



### **IRA Distributions**

- Distributions reported on form 1099-R
- Most "Traditional" IRA distributions are taxable (unless non-deductible contributions made)
- Distributions up to \$100,000 direct to a qualified charity not taxable
- "Roth" IRA distributions are not taxable if "qualified"
- 10% penalty for early withdrawal (some exceptions)



### Common Distribution Codes shown on 1099-R

- Code 1 Early distribution (Traditional IRA)
- Code 4 Exception applies (Traditional IRA)
- Code 7 Normal distribution (Traditional IRA)
- Code G Direct rollover to eligible plan
- Code Q Qualified distribution (Roth IRA)
- Code T Exception applies (Roth IRA)



# Required Minimum Distribution

- First distribution by April 1 of year after the year in which taxpayer turns 70 ½.
- Second distribution by Dec. 31 of year after the year taxpayer turns 70 ½.
- Subsequent distributions by Dec. 31.
- No credit for prior years' distributions.
- 50% penalty for "excess accumulation."
- Required even if working



# **Determining RMD**

- Divide IRA balance at end of prior tax year by the applicable distribution period or life expectancy.
- Each IRA has its own RMD, but total distribution can be taken from any of them.
- RMD waived for TY 2009



#### **PENSIONS & ANNUITIES**

Reported on Forms:

1099-R Most common

RRB-1099R Railroad Benefits Tier 2

CSA-1099R Civil Service

The problem - how much is taxable?

#### CORRECTED (if checked) Distributions From OMB No. 1545-0119 PAYER'S name, street address, city, state, and ZIP code 1 Gross distribution Pensions, Annuities, Retirement or 2008 Profit-Sharing Plans, IRAs, 2a Taxable amount Insurance Contracts, etc. Form 1099-R 2b Taxable amount Total Copy B not determined Report this RECIPIENT'S identification 3 Capital gain (included 4 Federal income tax PAYER'S federal identification income on your withheld number number in box 2a) federal tax return. If this form shows federal income RECIPIENT'S name 5 Employee contributions 6 Net unrealized tax withheld in /Designated Roth appreciation in box 4, attach employer's securities contributions or this copy to insurance premiums your return. 8 Other Distribution IRA/ Street address (including apt. no.) SEP/ SMPLE code(s) This information is being furnished to the Internal 9a Your percentage of total Total employee contributions Revenue Service. City, state, and ZIP code distribution 11 State/Paver's state ps. 12 State distribution State tax withheld 1st year of desig. Roth contrib. 15 Local distribution Account number (see instructions) 13 Local tax withheld 14 Name of locality



# Determining Taxable Amount

#### Fully Taxable

- Gross Distribution (Box 1) = Taxable amount (Box 2a)
- No basis in plan (non-contributory pension)
- All distributions taxable

#### Partially Taxable

- Gross Distribution (Box 1) > Taxable amount (Box 2a)
- Or "Taxable Amount Not Determined" box 2b checked
- You have a basis or cost in the plan (shown in box 9b)
- Special rules apply



# Rules For Partially Taxable Payments

#### Simplified Method

- Most common
- Required for qualified plans after Nov 18. 1996
- Divide cost in plan by the total number of anticipated payments

#### General Rule

- Use if used previously
- More complicated
- Use Worksheets and follow instructions



### **Exceptions**

- Railroad and Civil Service retirees have different forms:
  - Forms RRB-1099 and CSA-1099
  - Similar to 1099-R but different box numbers
- Disability Pensions:
  - If below normal retirement age report as wages not pension



## **Social Security Benefits**

#### Social Security

Reported on SSA-1099

#### Railroad Retirement Tier 1

- Reported on RRB-1099
- Equivalent to Social Security
- Same rules as Social Security

#### May be taxable



### **Taxability of Social Security**

- Up to 85% of Benefit can be Taxable
- Amounts exempt from tax depend on Filing Status and income (incl. 50% of SS):
  - \$32000 MFJ
  - \$25,000 S, HOH, QW & MFS if lived apart all year
  - \$0 MFS if lived together any part of year
- Use complicated worksheet



#### **Deductions**

- Taxpayer may take:
  - The Standard Deduction or
  - Itemize Deductions
- Standard deduction based on filing status, age, and eye sight
- If itemizing, Schedule A must be prepared

### **Standard Deduction**

#### Base rates for 2008:

Married, joint return

Single

Married, separate return

Head of household

\$10,900

\$5,450

\$5,450

\$8000

#### Add-on if 65 or older

Married \$1,050

Single \$1,350

#### Add-on if Blind

Married \$1,050

Single

\$1,350

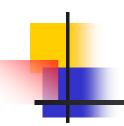
36



## **Property Tax Deduction**

#### New for 2008

- Increase in Standard Deduction for:
- Those who pay property taxes but do not itemize deductions
- Maximum increase to Standard Deduction is \$1000 MFJ or \$500 S
- Check box on 1040 line 39c and use worksheet



# Itemized Deductions Schedule A

- Medical Expenses
- Certain Taxes
- Interest
- Gifts to Charity
- Casualty & Theft Losses
- Miscellaneous Expenses





- Must be <u>paid</u> by the Taxpayer
  - Cannot be reimbursed expenses
  - Not all "medical expenses" qualify
- Must be paid during the tax year
- Only for Taxpayer, spouse or dependents





- MUST be imposed on the taxpayer
- MUST be paid by the taxpayer
- MUST be paid in the current tax year



### **Deductible Taxes**

- State and Local Income or Sales taxes
- Real Estate taxes generally reported by mortgage company on Form 1098
- Personal Property taxes (based on value of property/car)



### **Non-Deductible Taxes**

- Federal income and excise taxes
- Social Security & Medicare taxes (deducted from paycheck)
- Federal Unemployment Tax (FUTA)
- Customs duties
- Federal Estate and Gift taxes



## **Deductible Interest**

### Home Mortgage

- Interest/Points from Form 1098
- Points not reported on Form 1098
- Qualified Mortgage Insurance premiums

#### Investment Interest



- Receipts or bank records required
- Other-than-cash gifts over \$500 require Form 8283
- Over \$5000 require appraisal
- Cars require a 1098-C from recipient
- Clothing & household items must be in "good" condition
- If > 20% of AGI check the rules
- Out-of-pocket expenses like mileage @ 14¢, tolls, parking, can be included





#### To the extent they exceed 2% of AGI:

- Un-reimbursed employee expense
- Tax Preparation Fees
- Other Expenses (see 1040 Instructions)

#### Other Miscellaneous Deductions:

Gambling losses up to extent of winnings



### **Credits**

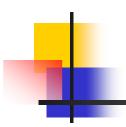
#### We will look at:

- Foreign tax credit
- Credit for the elderly or disabled
- First-time Homebuyers Credit
- Recovery Rebate Credit



# **Foreign Tax Credit**

- Take as itemized deduction or ....
- Take as credit (usually better)
- 1040 Line 47
- May need form 1116 if >\$300 (\$600 MFJ)



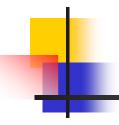
# Credit for the Elderly or Disabled

- 65 years or older, or:
- Under 65 and retired on permanent and total disability and has disability income
- Use Schedule R
- But almost no-one qualifies!
  - Max AGI \$25000 MFJ both spouses over 65
  - Max AGI \$17500 if single
  - Max SS \$7500 MFJ



# RESIDENTIAL ENERGY CREDITS

- Non-business Energy Property Credit has expired:
  - Insulation, windows, doors, etc.
- Residential Energy Efficient Property Credit is still valid:
  - Qualified Solar and Fuel Cell devices



## **Recovery Rebate Credit**

- Return of the ESP!
- Additional payment possible if filing status or income has changed since 2007
- Amount of ESP received during 2008 must be known - if in doubt call IRS
- Refundable
- Complicated worksheet

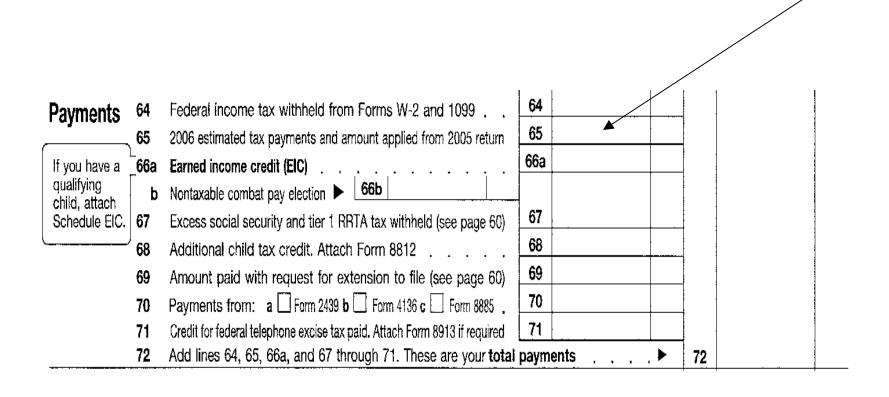


## First Time Home-buyers Credit

#### REFUNDABLE CREDIT

- New for 2008
- Must be main home
- Must be purchased after April 9 2008
- Must not have owned a home during prior 3 years
- Credit must be repaid over 15 years starting 2010
- Maximum credit is \$7500 (\$3750 MFS)
- Form 5505 required

## Don't forget estimated taxes





# **Underpayment Penalty**

- Due if taxes owed exceed \$1000
- Unless withholdings exceed:
  - 90% of current year tax liability, or
  - 100% of prior year tax liability, or
  - 110% of prior year tax liability if AGI is over \$150,000

# Finally Beware the AMT!!



- 23 million in 2007 and growing!
- Depends on:
  - Income level
  - Type of income
  - Deductions
- Requires a complicated form 6251



## **The Last Word**

The hardest thing in the world to understand is income tax!

Albert Einstein