Section 10.2 (Income and Payroll Taxes)

- 16th Amendment to US constitution grants congress the power to collect taxes on incomes

- There are innumerable special exceptions and rules, this is just an overview.
  - Adoption Credits, Special Rules for foreign income, different rules for interest on educational loans, Medical savings accounts, etc.

- Numbers and rates change from year to year. Numbers here are current (for your 2015 taxes you’ll file before/in April of 2016), the ones in the text are a few years old.

- There are different filing statuses for taxes:
  - Single
  - Married couple filing Jointly
  - Married filing separately
  - Head of household
• **Taxable Income** is the portion of income subject to tax.
  
  – Income from ever source is (potentially) taxable.
  – Not all income is subject to income tax (there will be deductions)
  – *Tax Exemptions* and *deductions* are subtracted from your total income to get your Taxable Income.

• **Exemptions and Dependents**
  
  – An **Exemption** is an amount of nontaxable income for each person who can be claimed as a dependent
  – The exemption amount is $4,000 (per person) in 2015.
    
    * Dependents are most commonly children (including stepchildren, foster children, etc), but there are cases when other relatives can count as dependents.
    
    * Each human person can only be claimed as an exemption once

      · You’re not allowed to take this exemption yourself if someone else (like a parent) claims you as a dependent, but you still have to file taxes.
      · If parents file taxes separately (whether they are married or divorced/separated), each child can only be claimed as a dependent for one parent or the other, not both.

• **Examples:**

  1. Wanda and Walter are married with no children (but they have 3 dogs). They are filing taxes jointly. How many exemptions can they claim?
  2. Xavier is a single parent with 1 child, his filing status is ‘single’. How many exemptions can he claim?
  3. Yuri and Yolanda are divorced with 2 children (Yusef and Yasmeen). The children live with Yuri and he supports them financially. Yuri and Yolanda are each filing taxes as single.
     - How many exemptions can Yuti claim?
     - How many exceptions can Yolanda claim?
• There are many other expenses that are **Tax Deductible** (can be excluded from taxable income)
  - Mortgage Interest
  - Some student loan interest
  - State/Local Taxes
  - Charitable Contributions
  - Medical Expenses (above a certain threshold)
  - Some Education Expenses
  - Some Job Search Expenses
  - etc

• **How to find Tax Deduction**
  - Find the Exemption Amount ($4000 in 2015) for each person (tax payer(s) and dependents)
  - *Then pick whichever is larger:*
    * **Itemized Deductions:**
      Add all deductions (state and local taxes, charitable giving, mortgage interest, etc)
    * **Standard Deduction:** For 2015....
      - is $6,300 for a single taxpayer
      - is $12,600 for married couple filing jointly

  - You’ll subtract both the *Exemption Amounts* and *One of the Deductions* from Total Income to get *Taxable Income*

• **Examples:**

  1. Wanda and Walter are married with no children (but they have 3 dogs). They are filing taxes jointly. Their combined taxable income in 2014 was $99,796. They paid $5,703 in state and local taxes, gave $2,950 to charity and paid $941 in interest on student loans that is tax deductible. They have no other tax deductible expenses and no other special adjustments to their taxable income. What was their taxable income for 2015?
• Tax Rates

– In the US we have *progressive tax rates*, so lower incomes pay lower tax rates and higher incomes pay higher tax rates.

– So to find the appropriate tax rate for an individual (or married couple) you need to know their Taxable Income, and look up their tax on a table.

– 2015 Tax Rates for ‘Single’ Filing

<table>
<thead>
<tr>
<th>If Taxable Income is:</th>
<th>The Tax Is:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not over $9,225</td>
<td>10% of the taxable income</td>
</tr>
<tr>
<td>Over $9,225 but not over $37,450</td>
<td>$922.50 plus 15% of the excess over $922.50</td>
</tr>
<tr>
<td>Over $37,450 but not over $90,750</td>
<td>$5,156.25 plus 25% of the excess over $37,450</td>
</tr>
<tr>
<td>Over $90,750 but not over $189,300</td>
<td>$18,481.25 plus 28% of the excess over $90,750</td>
</tr>
<tr>
<td>Over $189,300 but not over $411,500</td>
<td>$46,075.25 plus 33% of the excess over $189,300</td>
</tr>
<tr>
<td>Over $411,500 but not over $413,200</td>
<td>$119,401.25 plus 35% of the excess over $411,500</td>
</tr>
<tr>
<td>Over $4413,200</td>
<td>$119,996.25 plus 39.6% of the excess over $413,200</td>
</tr>
</tbody>
</table>

– 2015 Tax Rates for ‘Married Filing Jointly’

<table>
<thead>
<tr>
<th>If Taxable Income is:</th>
<th>The Tax Is:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not over $18,450</td>
<td>10% of the taxable income</td>
</tr>
<tr>
<td>Over $18,450 but not over $74,900</td>
<td>$1,845 plus 15% of the excess over $18,450</td>
</tr>
<tr>
<td>Over $74,900 but not over $151,200</td>
<td>$10,312.50 plus 25% of the excess over $74,900</td>
</tr>
<tr>
<td>Over $151,200 but not over $230,450</td>
<td>$29,387.50 plus 28% of the excess over $151,200</td>
</tr>
<tr>
<td>Over $230,450 but not over $411,500</td>
<td>$51,577.50 plus 33% of the excess over $230,450</td>
</tr>
<tr>
<td>Over $4411,500 but not over $464,850</td>
<td>$111,324.00 plus 35% of the excess over $411,500</td>
</tr>
<tr>
<td>Over $464,850</td>
<td>$129,996.50 plus 39.6% of the excess over $4464,850</td>
</tr>
</tbody>
</table>

• Example:

1. Calculate the 2015 income tax for Wanda and Walter (in the previous examples).
Real Life Concerns:

• Marriage Penalty
  – Sometimes 2 married people who work would be better off if they were unmarried (thus legally allowed to file as single).
    e.g. if Ann and Alex each have (separate) taxable incomes of $150,000. If they were unmarried, they would each be in the 28% bracket. But since they are married, their combined taxable income is $300,000, so they are in the 33% bracket.
  – Filing jointly is can be beneficial (lower taxes paid) if one partner earns income and the other does not (or if there is a very large disparity in their incomes).
  – ‘Marriage Penalty’ only happens in higher tax brackets

• Other Considerations
  – Everything we’re covering is ordinary income.
    Things like profits from selling stocks are considered capital gains, and have different (lower) tax rates in most cases.
  – Alternative Minimum Tax
    Uses different rates and doesn’t allow for as many deductions. If ATM is larger, that is the amount of tax you pay. It’s purpose is to unsure those with very high incomes didn’t take too many deductions.
Income Tax Withholding

- Employers are responsible for withholding money from employees paychecks and sending it directly to the Internal Revenue Service IRS (or local tax authorities).
- The rates apply to wages after subtracting withholding allowances (roughly equal to deductions for dependents). The pay that’s eligible to be taxed is called taxable pay.
- You fill out a W-2 Form at each job so your employer can get your withholdings sent to the correct tax authorities, in the correct amounts.

- 2015 Withholding for BIWEEKLY paid Single Filer

<table>
<thead>
<tr>
<th>Amount of wages after subtracting withholding allowances</th>
<th>Amount of income tax to withhold is...</th>
</tr>
</thead>
<tbody>
<tr>
<td>Over but not over</td>
<td>of excess over</td>
</tr>
<tr>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>$88</td>
<td>$0.00 plus 10% $88</td>
</tr>
<tr>
<td>$443</td>
<td>$35.50 plus 15% $443</td>
</tr>
<tr>
<td>$1,529</td>
<td>$198.40 plus 25% $1,529</td>
</tr>
<tr>
<td>$3,579</td>
<td>$710.90 plus 28% $3,579</td>
</tr>
<tr>
<td>$7,369</td>
<td>$1,772.10 plus 33% $7,369</td>
</tr>
<tr>
<td>$15,915</td>
<td>$4,592.28 plus 35% $15,915</td>
</tr>
<tr>
<td>$15,981</td>
<td>$4,615.38 plus 39.6% $15,981</td>
</tr>
</tbody>
</table>

- 2015 Withholding for BIWEEKLY paid Married Filing Jointly

<table>
<thead>
<tr>
<th>Amount of wages after subtracting withholding allowances</th>
<th>Amount of income tax to withhold is...</th>
</tr>
</thead>
<tbody>
<tr>
<td>Over but not over</td>
<td>of excess over</td>
</tr>
<tr>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>$331</td>
<td>$0.00 plus 10% $331</td>
</tr>
<tr>
<td>$1,040</td>
<td>$70.90 plus 15% $1,040</td>
</tr>
<tr>
<td>$3,212</td>
<td>$396.70 plus 25% $3,212</td>
</tr>
<tr>
<td>$6,146</td>
<td>$1,130.20 plus 28% $6,146</td>
</tr>
<tr>
<td>$9,194</td>
<td>$1,983.64 plus 33% $9,194</td>
</tr>
<tr>
<td>$16,158</td>
<td>$4,281.76 plus 35% $16,158</td>
</tr>
<tr>
<td>$18,210</td>
<td>$4,999.96 plus 39.6% $18,210</td>
</tr>
</tbody>
</table>

Example:

1. Vivienne is married, and claims 3 exemptions (one each for her and her spouse, and one for their child). After contributions to health insurance and her 401(k) her taxable pay is $3,082 every 2 weeks. How much should her employer withhold for federal income taxes?
• Taxes Owed and Refunds

- The amount withheld from your taxes isn’t the end of the story, it’s an estimation, and doesn’t take into account deductions (and other info). You still need to file an income tax return (with the IRS, and possibly state and or local tax agencies as well)
- Once you calculate your income tax, you add up the total amount withheld.
  * If the total amount withheld is HIGHER than your income tax you get a refund (for the amount of the different)
  * If the total amount withheld is LOWER than your income tax you owe the different (and could be subject to interest payments on the underpayment amount)

• Example:

  1. Suppose Wanda and Walter (together) had a total of $10,982.50 withheld from their paychecks in 2015. Do they get a refund or do they owe taxes? How much?
  2. Suppose Vivienne’s taxes for 2015 were $7,366.83. Determine the amount of her refund or the amount of taxes she owes.

• FICA (Federal Insurance Contributions Act)

- These are taxes that fund Social Security and Medicare, employers are also responsible to withholding these taxes (and passing the money along to the appropriate agencies)
- e.g. In 2014, the Social Security portion of FICA is 6.2% of taxes up to $117,000 in wages.
  Your employer also pays a 6.2% Social security tax on your wages.
Calculating Taxes Summary:

- Determine if filing Married or Single, consult appropriate table.

- Determine how many Exemptions the filer can claim
  - 1 for themselves (or 2 for married filing jointly)
  - 1 for each additional dependent (child, qualifying relative, etc)
  - Exemption Amount is $4000 × number of exemptions.

- Find Deductions
  - Check amount of itemized deductions and standard deduction, chose whichever is larger
  - Add the larger one to the exemption amount, this is total deductions.

- Calculate Taxable Income:
  Take the filer's total income, and subtract their total deductions.

- Determine which tax bracket the filer is in.
  (look at the appropriate table and compare their taxable income)

- Calculate the Income Tax for the filer using the formula from the table.

- Determine Withholdings:
  Check appropriate table, and deterring withholding amount per pay period.

- Determine Taxes Owed/Refund: Compare the total withholdings: amount withheld per pay period × number of pay periods and income tax owed.
  - If the amount withheld is HIGHER, the filer gets a refund (withholding - tax)
  - If the amount withheld is LOWER, the filer owes taxes (tax-withholding)

• Yuri and Yolanda are divorced with 2 children (Yusef and Yasmeen). The children live with Yuri and he supports them financially. Yuri and Yolanda are each filing taxes as single. Yuri’s 2014 income was $120,414. He paid $6,089 in state and local taxes in 2015, he donated $1,000 to one charity and $400 to another (both of which qualify as tax deductions) and paid $3,463 in mortgage insurance. Yuri had no other tax deductions and no other special adjustments to his taxes.

1. How many exemptions can Yuri claim?
2. What are Yuri’s total deductions?
3. What is Yuri’s taxable income for 2015?
4. What Tax bracket is Yuri in?
5. What is Yuri’s federal income tax for 2015?
6. If Yuri had $595.39 withheld from his paycheck (every 2 weeks), does he get a refund or does he owe taxes?
7. What is the amount of the refund/taxes owed?