

Tax Law Basics



Income Overview

- Taxable income versus nontaxable income (including excluded income)
- Earned income versus unearned income



Taxable Versus Nontaxable Income



- Basic tenet of the income tax code:
Income or gain, from whatever source derived, is taxable...
unless the code says it is not taxable
- Table B on D-1 in **Pub 4012** has examples of income that is not taxable

Pub 4012, Page D-1

Taxable Versus Nontaxable Income



- Even though not taxable, must input certain nontaxable income
 - Exempt interest income
 - Exempt interest income dividends
- May affect other calculations
e.g., taxable portion of social security benefits

Earned Versus Unearned Income

Pub 4012, Page I-1

- Definition differs – must check rules for particular benefit
- Example:
 - For earned income credit
 - ✱ Earned income does not include penal income
 - For dependent care credit
 - ✱ Earned income does include penal income

Earned Versus Unearned Income



- Earned income usually includes
(for in-scope returns):
 - Wages – Normally reported on Form W-2
 - Business Income – Reported on Schedule C
- (there are more types of earned income)

Earned Versus Unearned Income

- **Investment income is unearned income for in-scope returns – examples:**
 - Interest
 - Dividends
 - Capital gains or losses
 - Royalties

Earned Versus Unearned Income

- **Other types of unearned income for in-scope returns**
 - Land rents
 - Unemployment
 - Retirement income
 - Social security benefits

(there are more types of unearned income)

Deductions and Credits



- A grace of the law
- If there is not a provision to allow the deduction, it is not deductible
- To claim any credit, must satisfy all requirements

Deductions

- Reduce income otherwise subject to tax
- Types:
 - Adjustments to gross income
 - Itemized or standard deduction
 - Personal exemption deduction
 - Dependent exemption deduction

Credits

- **Reduce tax liability dollar for dollar**
 - **Nonrefundable**
 - ✱ Limited to amount of tax
 - ✱ No cash back
 - **Refundable**
 - ✱ Cash back if exceed tax liability

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Comments?



Questions?