

4 Planning: Taxes

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Activity: Tax Forms

AS YOU READ, learn the vocabulary. **AFTER YOU READ**, check your understanding through Fact and Idea Review, Critical Thinking Questions, an Extension Activity, and the Concept Application.

Understanding Taxes

Taxes pay for many services that could not be paid for by any one individual or group. The federal government uses tax dollars to support Social Security, healthcare, national defense, and social services such as Supplemental Nutrition Assistance Program (SNAP, previously called “food stamps”) and low-income housing. States, cities, and counties use tax dollars to build, operate, and maintain public schools, roads, prisons, garbage collection services, police and fire protection, and social services. By paying taxes, you are contributing to the greater good of your community and your country. If you knowingly do not file your tax returns, it is a criminal violation of the law. The Internal Revenue Service or IRS will audit your filings and compare your W-4 forms. They can collect the taxes owed, interest, and penalties. Tax policies provide benefits to families and individuals to offset certain expenses such as child care, education, and economic development. The child and dependent care tax credit gives a maximum \$3,000 credit per child for working parents. The Hope Credit provides a maximum \$2,500 tax credit for tuition costs to help pay for college. Businesses that invest in low-income communities receive tax credits to encourage them to build or start businesses and to employ more people. Most states also collect a state income tax. The states that do not collect an income tax tend to have higher sales tax or property tax rates. A tax year runs from January 1 to December 31, and you are required to file your federal income tax returns by April 15 each year.

Amount*

Gross pay \$1,923.08
Federal income tax \$191.06
Social security tax \$80.77
Medicare tax \$27.88
State income tax \$89.00
City income tax \$57.00
Final pay check \$1477.37

* Twice monthly pay based on 26 pay periods, annual income of \$50,000.00

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An employer is required to withhold federal, state and, in some cases, local income taxes from your paycheck. An employer will also have you complete a W-4 form which lets the employer know how many deductions you can take. A deduction can be a **standard deduction**, which deducts a flat rate per person claimed, or **itemized deductions** for interest on loans and charitable donations. For every deduction claimed, you deduct an amount of your income from being taxed. You can claim one deduction for yourself, one for a non-working spouse, and one for each child under the age of 18. States raise revenue in other ways, including sales taxes, excise taxes, license taxes, intangible taxes, property taxes, estate taxes, and inheritance taxes. Depending on where you live, you may end up paying all of these taxes or just a few of them. Property taxes are used to finance local schools, police, road repair, and other services. They are usually calculated by taking the assessed value of the home and multiplying that by the local tax rate. Applicable exemptions are then subtracted.

Vocabulary

Itemized deductions on a tax return, a listing of the amounts actually spent on tax deductible expenses during the year.

Standard deduction on a tax return, a set amount that the IRS allows as a tax deduction without the need to list actual expenses.

Fact and Idea Review

1. What are examples of local tax assessments?

2. Refer to the chart in the article to compute the local, state, and federal income taxes that the person in the chart pays in a year.

Critical Thinking

1. Why is it important to file a yearly income tax return? What are the consequences of not filing?

2. How do federal, state, and local government tax policies affect individuals, families, and communities?

Extension Activity

Research your local tax assessments. Create a chart or table showing how taxes collected in your community and state are allocated.

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Concept Application

Review and complete the sample W-4 form.

Form W-4 (2011)

Purpose. Complete Form W-4 so that your employer can withhold the correct federal income tax from your pay. Consider completing a new Form W-4 each year and when your personal or financial situation changes.

Exemption from withholding. If you are exempt, complete **only** lines 1, 2, 3, 4, and 7 and sign the form to validate it. Your exemption for 2011 expires February 16, 2012. See Pub. 505, Tax Withholding and Estimated Tax.

Note. If another person can claim you as a dependent on his or her tax return, you cannot claim exemption from withholding if your income exceeds \$950 and includes more than \$300 of unearned income (for example, interest and dividends).

Basic instructions. If you are not exempt, complete the **Personal Allowances Worksheet** below. The worksheets on page 2 further adjust your withholding allowances based on itemized deductions, certain credits, adjustments to income, or two-earners/multiple jobs situations. Complete all worksheets that apply. However, you

may claim fewer (or zero) allowances. For regular wages, withholding must be based on allowances you claimed and may not be a flat amount or percentage of wages.

Head of household. Generally, you may claim head of household filing status on your tax return only if you are unmarried and pay more than 50% of the costs of keeping up a home for yourself and your dependent(s) or other qualifying individuals. See Pub. 501, Exemptions, Standard Deduction, and Filing Information, for information.

Tax credits. You can take projected tax credits into account in figuring your allowable number of withholding allowances. Credits for child or dependent care expenses and the child tax credit may be claimed using the **Personal Allowances Worksheet** below. See Pub. 919, How Do I Adjust My Tax Withholding, for information on converting your other credits into withholding allowances.

Nonwage income. If you have a large amount of nonwage income, such as interest or dividends, consider making estimated tax payments using Form

1040-ES, Estimated Tax for Individuals. Otherwise, you may owe additional tax. If you have pension or annuity income, see Pub. 919 to find out if you should adjust your withholding on Form W-4 or W-4P.

Two earners or multiple jobs. If you have a working spouse or more than one job, figure the total number of allowances you are entitled to claim on all jobs using worksheets from only one Form W-4. Your withholding usually will be most accurate when all allowances are claimed on the Form W-4 for the highest paying job and zero allowances are claimed on the others. See Pub. 919 for details.

Nonresident alien. If you are a nonresident alien, see Notice 1392, Supplemental Form W-4 Instructions for Nonresident Aliens, before completing this form.

Check your withholding. After your Form W-4 takes effect, use Pub. 919 to see how the amount you are having withheld compares to your projected total tax for 2011. See Pub. 919, especially if your earnings exceed \$130,000 (Single) or \$180,000 (Married).

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Personal Allowances Worksheet (Keep for your records.)

- | | | | | | |
|----------|--|----------------|--|---|----------------|
| A | Enter "1" for yourself if no one else can claim you as a dependent | A _____ | | | |
| B | Enter "1" if: <table border="0" style="display: inline-table; vertical-align: middle;"> <tr> <td style="font-size: 4em; vertical-align: middle;">{</td> <td style="padding: 0 10px;"> <ul style="list-style-type: none"> • You are single and have only one job; or • You are married, have only one job, and your spouse does not work; or • Your wages from a second job or your spouse's wages (or the total of both) are \$1,500 or less. </td> <td style="font-size: 4em; vertical-align: middle;">}</td> </tr> </table> | { | <ul style="list-style-type: none"> • You are single and have only one job; or • You are married, have only one job, and your spouse does not work; or • Your wages from a second job or your spouse's wages (or the total of both) are \$1,500 or less. | } | B _____ |
| { | <ul style="list-style-type: none"> • You are single and have only one job; or • You are married, have only one job, and your spouse does not work; or • Your wages from a second job or your spouse's wages (or the total of both) are \$1,500 or less. | } | | | |
| C | Enter "1" for your spouse . But, you may choose to enter "-0-" if you are married and have either a working spouse or more than one job. (Entering "-0-" may help you avoid having too little tax withheld.) | C _____ | | | |
| D | Enter number of dependents (other than your spouse or yourself) you will claim on your tax return | D _____ | | | |
| E | Enter "1" if you will file as head of household on your tax return (see conditions under Head of household above) | E _____ | | | |
| F | Enter "1" if you have at least \$1,900 of child or dependent care expenses for which you plan to claim a credit | F _____ | | | |

(Note. Do **not** include child support payments. See Pub. 503, Child and Dependent Care Expenses, for details.)

- G Child Tax Credit** (including additional child tax credit). See Pub. 972, Child Tax Credit, for more information.
- If your total income will be less than \$61,000 (\$90,000 if married), enter "2" for each eligible child; then **less** "1" if you have three or more eligible children.
 - If your total income will be between \$61,000 and \$84,000 (\$90,000 and \$119,000 if married), enter "1" for each eligible child plus "1" **additional** if you have six or more eligible children. **G** _____

H Add lines A through G and enter total here. (**Note.** This may be different from the number of exemptions you claim on your tax return.) **H** _____

For accuracy, **complete all worksheets that apply.**

- If you plan to **itemize** or **claim adjustments to income** and want to reduce your withholding, see the **Deductions and Adjustments Worksheet** on page 2.
- If you have **more than one job** or are **married and you and your spouse both work** and the combined earnings from all jobs exceed \$40,000 (\$10,000 if married), see the **Two-Earners/ Multiple Jobs Worksheet** on page 2 to avoid having too little tax withheld.
- If **neither** of the above situations applies, **stop here** and enter the number from line H on line 5 of Form W-4 below.

Cut here and give Form W-4 to your employer. Keep the top part for your records.

Form
W-4
Department of the
Treasury Internal
Revenue Service

Employee's Withholding Allowance Certificate

OMB No.
1545-0074
2011

▶ **Whether you are entitled to claim a certain number of allowances or exemption from withholding is subject to review by the IRS. Your employer may be required to send a copy of this form to the IRS.**

1 Type or print your first name and middle initial.	Last name	2 Your social security number
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Home address (number and street or rural route)	3 <input type="checkbox"/> Single <input type="checkbox"/> Married <input type="checkbox"/> Married, but withhold at higher Single rate. Note. If married, but legally separated, or spouse is a nonresident alien, check the "Single" box.
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City or town, state, and ZIP code	4 If your last name differs from that shown on your social security card, check here. You must call 1-800-772-1213 for a replacement card. ▶ <input type="checkbox"/>
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5 Total number of allowances you are claiming (from line H above or from the applicable worksheet on page 2)	5
6 Additional amount, if any, you want withheld from each paycheck	6 \$
7 I claim exemption from withholding for 2011, and I certify that I meet both of the following conditions for exemption. <ul style="list-style-type: none"> Last year I had a right to a refund of all federal income tax withheld because I had no tax liability and This year I expect a refund of all federal income tax withheld because I expect to have no tax liability. If you meet both conditions, write "Exempt" here ▶ 7	

Under penalties of perjury, I declare that I have examined this certificate and to the best of my knowledge and belief, it is true, correct, and complete.

Employee's signature

(This form is not valid unless you sign it.) ▶

Date ▶

8 Employer's name and address (Employer: Complete lines 8 and 10 only if sending to the IRS.)	9 Office code (optional)	10 Employer identification number (EIN)
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For Privacy Act and Paperwork Reduction Act Notice, see page 2.

Cat. No. 10220Q

Form **W-4** (2011)

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Deductions and Adjustments Worksheet		
Note. Use this worksheet <i>only</i> if you plan to itemize deductions or claim certain credits or adjustments to income.		
1	Enter an estimate of your 2011 itemized deductions. These include qualifying home mortgage interest, charitable contributions, state and local taxes, medical expenses in excess of 7.5% of your income, and miscellaneous deductions	1 \$ _____
2	Enter: $\left\{ \begin{array}{l} \$11,600 \text{ if married filing jointly or qualifying widow(er)} \\ \$8,500 \text{ if head of household} \\ \$5,800 \text{ if single or married filing separately} \end{array} \right\}$	2 \$ _____
3	Subtract line 2 from line 1. If zero or less, enter “-0-”	3 \$ _____
4	Enter an estimate of your 2011 adjustments to income and any additional standard deduction (see Pub. 919)	4 \$ _____
5	Add lines 3 and 4 and enter the total. (Include any amount for credits from the <i>Converting Credits to Withholding Allowances for 2011 Form W-4 Worksheet</i> in Pub. 919.)	5 \$ _____
6	Enter an estimate of your 2011 nonwage income (such as dividends or interest)	6 \$ _____
7	Subtract line 6 from line 5. If zero or less, enter “-0-”	7 \$ _____
8	Divide the amount on line 7 by \$3,700 and enter the result here. Drop any fraction	8 _____
9	Enter the number from the Personal Allowances Worksheet , line H, page 1	9 _____
10	Add lines 8 and 9 and enter the total here. If you plan to use the Two-Earners/Multiple Jobs Worksheet , also enter this total on line 1 below. Otherwise, stop here and enter this total on Form W-4, line 5, page 1	10 _____

Two-Earners/Multiple Jobs Worksheet (See <i>Two earners or multiple jobs</i> on page 1.)		
Note. Use this worksheet <i>only</i> if the instructions under line H on page 1 direct you here.		
1	Enter the number from line H, page 1 (or from line 10 above if you used the Deductions and Adjustments Worksheet)	1 _____
2	Find the number in Table 1 below that applies to the LOWEST paying job and enter it here. However , if you are married filing jointly and wages from the highest paying job are \$65,000 or less, do not enter more than “3”	2 _____
3	If line 1 is more than or equal to line 2, subtract line 2 from line 1. Enter the result here (if zero, enter “-0-”) and on Form W-4, line 5, page 1. Do not use the rest of this worksheet	3 _____
Note. If line 1 is less than line 2, enter “-0-” on Form W-4, line 5, page 1. Complete lines 4 through 9 below to figure the additional withholding amount necessary to avoid a year-end tax bill.		
4	Enter the number from line 2 of this worksheet	4 _____
5	Enter the number from line 1 of this worksheet	5 _____
6	Subtract line 5 from line 4	6 _____
7	Find the amount in Table 2 below that applies to the HIGHEST paying job and enter it here	7 \$ _____
8	Multiply line 7 by line 6 and enter the result here. This is the additional annual withholding needed	8 \$ _____
9	Divide line 8 by the number of pay periods remaining in 2011. For example, divide by 26 if you are paid every two weeks and you complete this form in December 2010. Enter the result here and on Form W-4, line 6, page 1. This is the additional amount to be withheld from each paycheck	9 \$ _____

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Table 1				Table 2			
Married Filing Jointly		All Others		Married Filing Jointly		All Others	
If wages from LOWEST paying job are—	Enter on line 2 above	If wages from LOWEST paying job are—	Enter on line 2 above	If wages from HIGHEST paying job are—	Enter on line 7 above	If wages from HIGHEST paying job are—	Enter on line 7 above
\$0 – \$5,000 -	0	\$0 – \$8,000 -	0	\$0 – \$65,000	\$560	\$0 – \$35,000	\$560
5,001 – 12,000 -	1	8,001 – 15,000 -	1	65,001 – 125,000	930	35,001 – 90,000	930
12,001 – 22,000 -	2	15,001 – 25,000 -	2	125,001 – 185,000	1,040	90,001 – 165,000	1,040
22,001 – 25,000 -	3	25,001 – 30,000 -	3	185,001 – 335,000	1,220	165,001 – 370,000	1,220
25,001 – 30,000 -	4	30,001 – 40,000 -	4	335,001 and over	1,300	370,001 and over	1,300
30,001 – 40,000 -	5	40,001 – 50,000 -	5				
40,001 – 48,000 -	6	50,001 – 65,000 -	6				
48,001 – 55,000 -	7	65,001 – 80,000 -	7				
55,001 – 65,000 -	8	80,001 – 95,000 -	8				
65,001 – 72,000 -	9	95,001 – 120,000 -	9				
72,001 – 85,000 -	10	120,001 and over	10				
85,001 – 97,000 -	11						
97,001 – 110,000 -	12						
110,001 – 120,000 -	13						
120,001 – 135,000 -	14						
135,001 and over	15						

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Privacy Act and Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. Internal Revenue Code sections 3402(f)(2) and 6109 and their regulations require you to provide this information; your employer uses it to determine your federal income tax withholding. Failure to provide a properly completed form will result in your being treated as a single person who claims no withholding allowances; providing fraudulent information may subject you to penalties. Routine uses of this information include giving it to the Department of Justice for civil and criminal litigation, to cities, states, the District of Columbia, and U.S. commonwealths and possessions for use in administering their tax laws; and to the Department of Health and Human Services for use in the National Directory of New Hires. We may also disclose this information to other countries under a tax treaty, to federal and state agencies to enforce federal nontax criminal laws, or to federal law enforcement and intelligence agencies to combat terrorism.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Code section 6103.

The average time and expenses required to complete and file this form will vary depending on individual circumstances. For estimated averages, see the instructions for your income tax return.

If you have suggestions for making this form simpler, we would be happy to hear from you. See the instructions for your income tax return.

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Review and complete the sample form I-9, which all United States employers must complete and retain for each citizen and noncitizen they hire for employment.

OMB No. 1615-0047; Expires 08/31/12

Department of Homeland Security
U.S. Citizenship and Immigration Services

Form I-9, Employment Eligibility Verification

Read instructions carefully before completing this form. The instructions must be available during completion of this form.

ANTI-DISCRIMINATION NOTICE: It is illegal to discriminate against work-authorized individuals. Employers CANNOT specify which document(s) they will accept from an employee. The refusal to hire an individual because the documents have a future expiration date may also constitute illegal discrimination.

Section 1. Employee Information and Verification *(To be completed and signed by employee at the time employment begins.)*

Print Name: Last	First	Middle Initial	Maiden Name
Address (Street Name and Number)		Apt.#	Date of Birth (month/day/year)
City	State	ZipCode	SocialSecurity #

I am aware that federal law provides for imprisonment and/or fines for false statements or use of false documents in connection with the completion of this form.

I attest, under penalty of perjury, that I am (check one of the following):

- A citizen of the United States
- A noncitizen national of the United States (see instructions)
- A lawful permanent resident (Alien #) _____
- An alien authorized to work (Alien # or Admission #) _____ until (expiration date, if applicable - month/day/year) _____

Employee's Signature _____ Date (month/day/year) _____

Preparer and/or Translator Certification *(To be completed and signed if Section I is prepared by a person other than the employee.) I attest, under penalty of perjury, that I have assisted in the completion of this form and that to the best of my knowledge the information is true and correct.*

Preparer's/Translator's Signature	Print Name
Address (Street Name and Number, City, State, ZipCode)	
Date (month/day/year)	

Section 2. Employer Review and Verification *(To be completed and signed by employer. Examine one document from List A OR examine one document from List B and one from List C, as listed on the reverse of this form, and record the title, number, and expiration date, if any, of the document(s).)*

List A	OR	List B	AND	List C
Document title: _____		_____		_____
Issuing authority: _____		_____		_____
Document #: _____		_____		_____
Expiration Date (if any): _____		_____		_____
Document #: _____		_____		_____
Expiration Date (if any): _____		_____		_____

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CERTIFICATION: I attest, under penalty of perjury, that I have examined the document(s) presented by the above-named employee, that the above-listed document(s) appear to be genuine and to relate to the employee named, that the employee began employment on (month/day/year) _____ and that to the best of my knowledge the employee is authorized to work in the United States. (State employment agencies may omit the date the employee began employment.)

Signature of Employer or Authorized Representative	Print Name	Title
Business or organization Name and Address (Street Name and Number, City, State, ZipCode)		Date (month/day/year)

Section 3. Updating and Reverification (To be completed and signed by employer.)

A. New Name (if applicable)	B. Date of Rehire (month/day/year) (if applicable)
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C. If employee's previous grant of work authorization has expired, provide the information below for the document that establishes current employment authorization.

Document Title: _____ Document #: _____ Expiration Date (if any): _____

I attest, under penalty of perjury, that to the best of my knowledge, this employee is authorized to work in the United States, and if the employee presented document(s), the document(s) I have examined appear to be genuine and to relate to the individual.

Signature of Employer or Authorized Representative	Date (month/day/year)
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FormI-9 (Rev. 08/07/09) Y Page 4

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What is Taxable?

Learning Objective: sort out taxable/nontaxable income streams and calculate taxable income

Emerson and Nevada, are both between career jobs. They are now married, and in order to make ends meet they are both working a number of part-time jobs and have some additional income streams. They sat down and made a list of everything they anticipate needing for tax season.

Emerson is still working part-time as a manager and makes around \$3,105 per month before taxes are withheld. Emerson has invested \$600 in an online business and earned of \$1,200 in sales. He also bought around \$500 in lottery tickets and won \$100 early in the year. His student loans amount to \$35,000, with a monthly payment of \$277. Emerson received an email that he paid \$2,170 in interest on his student loans in the past year.

Nevada is still working at her part-time job as an antique appraiser (10 hours per week at about \$30 per hour; working roughly 42 weeks last year). The business-related mileage on her truck totals 6,800 miles. Many of Nevada's customers tipped her, so she earned an additional \$5,780 in tips. She also profited \$1,600 by selling a portion of her coin collection. Her savings account has earned \$1.50 in interest, and her investments have paid her \$576 in dividends. Last year Nevada graduated from her undergraduate program, and she paid \$7,900 in tuition (she also qualified for the American Opportunity Credit). She is considering at going to graduate school to earn a master's degree soon.

For this example, we will ignore the possible presence of capital gains so you can group all the above forms of taxable income together along with any appropriate deductions to find this couple's taxable income. Ultimately, tax laws change every year so the key here is to get a general idea on how to treat these items. When it comes time to do their taxes, Nevada and Emerson should consult a tax professional.

3. Is there anything that Emerson and Nevada could do to shield more of their income from taxes? Explain.

4. Nevada is thinking about taking four years part-time to finish her master's degree instead of two years full-time. Would this option have any influence on their taxes?

5. Raising children can be very expensive (\$17,000 per year on average). Should tax breaks be given for children or other dependents? Explain the type and amount of tax credits or tax deductions that you feel is most appropriate for dependent care expenses.

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Name _____ Date _____ Period _____

Federal Income Tax Estimate



Purpose: To estimate your current federal income tax liability.

Financial Planning Activities: Based on last year's return, estimates for the current year, and current tax regulations and rates, estimate your current tax liability.

Gross income (wages, salary, investment income, and other ordinary income)	\$
Less Adjustments to income (see current tax regulations)	-\$
Equals Adjusted gross income	=\$
Less Standard deduction or itemized deduction	
Medical Expenses (exceeding 10% of AGI)	\$
State/local income, property taxes	\$
Mortgage, home equity loan, interest	\$
Charitable contributions	\$
Casualty and theft losses (federally declared disaster areas only)	\$
Amount -\$ Total	-\$
Equals Taxable income	=\$
Estimated tax (based on current tax tables or tax schedules)	\$
Less Tax credits	-\$
Plus Other taxes (AMT/Self-Employment Tax)	+\$
Equals Total tax liability	-\$
Less Estimated withholding and payments	-\$
Equals Tax due (or refund)	=\$

What's Next for Your Personal Financial Plan?

- Develop a system for filing and storing various tax records related to income, deductible expenses, and current tax forms.
- Using the IRS and other websites, identify recent changes in tax laws that may affect your financial planning decisions.

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Tax Planning Activities

Purpose: To consider actions that can prevent tax penalties and may result in tax savings.



Financial Planning Activities: Consider which of the following actions are appropriate to your tax situation.

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	Action to be taken (if applicable)	Completed
Filing status/withholding <ul style="list-style-type: none"> - Change filing status due to changes in life situation. 		
<ul style="list-style-type: none"> - Change amount of withholding due to changes in tax situation. 		
<ul style="list-style-type: none"> - Plan to make estimated tax payments (due the 15th of April, June, September, and January). 		
Tax records/documents <ul style="list-style-type: none"> - Organize home files for ease of maintaining and retrieving data. 		
<ul style="list-style-type: none"> - Send current mailing address and correct Social Security number to IRS, place of employment, and other income sources. 		
Annual tax activities <ul style="list-style-type: none"> - Be certain all needed data and current tax forms are available well before deadline. 		
<ul style="list-style-type: none"> - Research tax code changes and uncertain tax areas. 		
Tax-savings actions <ul style="list-style-type: none"> - Consider tax-exempt and tax-deferred investments. 		
<ul style="list-style-type: none"> - If you expect to have the same or a lower tax rate next year, accelerate deductions into the current year. 		

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- If you expect to have the same or a lower tax rate next year, delay the receipt of income until next year.		
- If you expect to have a higher tax rate next year, delay deductions since they will have a greater benefit.		
- If you expect to have a higher tax rate next year, accelerate the receipt of income to have it taxed at the current lower rate.		
- State or increase use of tax-deferred retirement plans.		
- Other		

What's Next for Your Personal Financial Plan?

- Identify saving and investing decisions that could minimize future income taxes.
- Develop a plan for actions to take related to your current and future tax situation.

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