

## Tax Guide: Calculating Your Federal Income Taxes

The information that follows is intended for general informational purposes. It should not be construed as specific tax advice. Please contact a qualified tax advisor for advice on your situation.

### Step 1 – Determine Gross Taxable Income

First, determine your total taxable income for the year.

Taxable Income	Nontaxable Income
Wages Tips Bonuses Commission Alimony Business/hobby income Dividends Interest (from most sources) Capital gains (e.g., from sale of stock) Refund of state and local taxes (if deducted taxes paid previous year) Distributions from most retirement funds Unemployment compensation Social Security benefits*	Child support Refund of federal taxes Life insurance proceeds (in most cases) Gifts/inheritances Interest (from tax-exempt bonds) Welfare payments Workers compensation Social Security benefits*

\*Whether or not your Social Security benefits are taxable is dependent on your income. See [irs.gov](http://irs.gov) for more information.

### Step 2 – Calculate Adjusted Gross Income

Next, calculate your adjusted gross income. Your adjusted gross income is your gross income minus “adjustments” (also called above-the-line deductions). Typical adjustments include:

- Contributions to an IRA.
- Student loan interest.
- Alimony payments.
- Moving expenses (if you relocate to a job at least 50 miles farther from your home than your previous job).
- Medical insurance premiums and ½ of your FICA taxes, if you are self-employed.
- Tuition and fees (but cannot use same expenses to claim education credits).

Many adjustments have restrictions as to how much you can deduct as well as phase-out limits, meaning you may not be able to claim them if your income is above a certain amount. Visit [irs.gov](http://irs.gov) for more information.

### **Step 3 – Subtract Deductions**

Next, subtract your deductions from your adjusted gross income. You can either take the standard deduction (a preset amount that the IRS allows you to claim) or itemized deductions (what your deductions actually are). In general, it makes sense to take whichever is higher.

Typical deductions include:

- Medical and dental expenses, to the extent that they exceed 7.5% of your adjusted gross income.
- State and local income taxes or general sales taxes. (You can only claim one.)
- Personal property taxes.
- Home mortgage interest and points.
- Gifts to qualified charities.

Like with adjustments, many deductions have phase-out limits.

### **Step 4 – Subtract Exemptions**

Once you have subtracted your deductions from your adjusted gross income, you should calculate and subtract your exemptions. You can claim one exemption for yourself and one for your spouse (if applicable) as long as no one can claim you as a dependent. You can also claim an exemption for each dependent that you have. (The IRS sets very specific rules on who qualifies as a dependent. See [irs.gov](https://www.irs.gov) for more information.)

### **Step 5 – Calculate Tax Liability and Subtract Credits**

After subtracting your adjustments, deductions, and exemptions from your gross income, you have your taxable income. Now you can use the IRS's tax table (available on their website) to calculate your preliminary tax liability for the year. You should subtract any credits you qualify for from this amount. This is your final tax liability.

Common credits include the:

- Child Credit – for those that have qualifying children under the age of 17.
- Child and Dependent Care Credit – for working individuals with child/dependent care expenses. (The dependent must be under the age of 13 or disabled.)
- Hope Scholarship Tax Credit and Lifetime Learning Credit – for those with qualifying higher education expenses.
- Earned Income Credit – for low-income taxpayers. (Income must be "earned", such as from a job, not from a passive source, like interest income.)

There is a limit to how much you can claim for each credit, and taxpayers with higher incomes may not be able to claim them at all. Visit the IRS's website for more information.

### **Step 6 – Determine Taxes Owed or Refund Due**

Calculate the taxes that you have already paid for the year. (This includes taxes withheld from your paychecks – Form W-2 shows this amount – and quarterly estimated tax payments.) Subtract this amount from your final tax liability. If the number is positive, this is the amount you owe. If the number is negative, this is the amount of the refund you are entitled to.