

Notes –Income Tax Day 1 AGI and Taxable Income

Does the government owe you money?

What is income tax? Income tax is a tax you must pay on both earned income (wages, salaries, commission, tips) and unearned income (interest, dividends, income from rental property). The more you make, the more you pay in taxes, right? Not exactly. There are many ways to reduce your taxable income so that you pay less in income tax. The government may owe you money! The following steps (continued on day 2), will give you a general idea of how to calculate your taxable income.

Step 1: Calculate your gross income: Your gross income is the total amount of money that you make during the year. This includes wages, tips, profits from a business, interest and dividends from investments, and any other income you receive.

Step 2: Calculate your adjustments: Adjustments are certain expenses which directly reduce your gross income. Contributions made to a tax-deferred savings plan, such as an IRA or a 401(k), is an example of an adjustment. Other examples of adjustments are:

- [Classroom expenses for teachers and educators](#)
- [Qualified performing artists and other professions](#) – out of pocket job related expenses
- [Traditional IRA deduction](#)
- [Moving expenses](#)- relocation for work
- [Self-employment tax deduction](#)
- [SEP-IRA, SIMPLE IRA and 401\(k\) deductions for the self-employed](#)
- [Early withdrawal penalty](#)
- [Alimony paid](#)

Step 3: Calculate your adjusted gross income (AGI): Your adjusted gross income is found by taking your gross income minus your adjustments.

1-2 Last year, Kevin earned \$18,200 in wages and \$275 in interest. He contributed \$200 to a tax deferred retirement plan.

1) What's Kevin's gross income?

2) What's Kevin's adjusted gross income?

3-4 Last year Andrea waitressed at Valle Luna and earned \$9,250 in wages and \$6,250 in tips. She earned \$600 in interest on a savings account at Wells Fargo and contributed \$550 into an IRA.

3) What's Andrea's gross income?

4) What's Andrea's adjusted gross income?

Step 4: Calculate your personal exemptions: Individuals are entitled to claim a personal exemption for themselves and any dependents they support. The personal exemption acts just like a tax deduction: it reduces your taxable income, so you end up paying taxes on less income. **For tax year 2012, the personal exemption amount is \$3,800.**

5) Jose earned wages of \$34,200, received \$750 in interest from a saving account, and contributed \$1200 to a tax-deferred retirement plan. He was entitled to a personal exemption of \$3800. Find his gross income, adjusted gross income, and his taxable income at this point.

6) Darian earned wages of \$43,987, made \$13,000 in interest, and contributed \$10,000 to an IRA. He's entitled to a personal exemption of \$3800 plus he has 3 kids which he can claim an exemption of \$3800 for each one. Find his gross income, adjusted gross income, and his taxable income at this point.