



Introduction to Income Tax

In the United States, a percentage of all the money that individuals and businesses earn and spend is collected by federal, state and local governments for use in public spending. Individuals and businesses are required to pay various kinds of taxes, such as sales tax, property tax, payroll tax, and income tax.

Income taxes are the primary source of revenue for the federal government. Many states, and even some towns and cities, also impose income taxes. For many individuals, federal income tax is the largest category of tax they pay. So to be a good money manager, it's important to understand some basic concepts about federal income tax:

- A **tax return** is a pre-printed or electronic form you fill out to report information that the federal Internal Revenue Service (IRS) uses to calculate your taxes. One example of a federal tax return is an IRS Form 1040.
- Filling out a tax return form and submitting it to the IRS is called **filing** your taxes. Some people hire a professional to fill out their tax forms while others do the work themselves.
- The possible advantages to hiring a professional tax preparer include:
 1. Expert review and advice.
 2. They may give you tax-saving suggestions.
 3. Professional support in case of an audit. (This is when the taxing agency decides to carefully review your return to determine whether the information is true, the tax amount has been calculated correctly, and the positions taken on the return are permitted by law.)
- Possible disadvantages include:
 1. You have to pay for this service.
 2. During the busy tax season, you may have to wait your turn while your preparer takes care of other customers.
 3. Even professionals can make mistakes, and in some states, there are no licensing laws for tax preparers. Determine whether the preparer you're considering has knowledge, experience, and a good track record in business.
- Possible advantages to preparing your own tax returns include:
 1. Free; you don't pay someone else.
 2. You gain valuable financial experience.
 3. You have total control over your tax information and paperwork. If you use tax software, it may help you reduce errors or even identify deductions, and filing electronically is instant. Check to see if you're eligible for free software through the [irs.gov](https://www.irs.gov) website.
- Possible disadvantages include:
 1. You could make potentially costly mistakes.
 2. You may not be aware of all the deductions (reductions in taxable income) to which you're entitled.
 3. Some tax software can be confusing and may cost as much as hiring a professional tax preparer.

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- Consider preparing your taxes yourself and then taking them to a professional to look over, fix any errors, and finalize the forms. This approach could give you both good experience and peace of mind.
- If you are a U.S. citizen or resident alien, whether you must file a federal income tax return depends upon your gross income, your filing status (see below), your age, and whether you are a dependent (i.e., you depend on someone else for financial support).
- The amount of income tax you pay is based on your gross **earned income** (salaries, wages, tips, and dividends if you own stock) plus **unearned income** (for example interest income, dividend income, or capital gains), less deductions, exemptions or credits. The resulting amount—the amount that is subject to federal income taxes—is called your **taxable income**.
- A **deduction** is an amount that reduces your taxable income and therefore reduces the tax to be paid. The federal government offers a number of different kinds of deductions.
- The **standard deduction** is a dollar amount set by the federal government that reduces the amount of income on which you are taxed. Most taxpayers have a choice of taking a standard deduction or **itemizing** (separately listing) their deductions. If you have a choice, you can use the method that gives you the lower tax.
- Taking the standard deduction can make it quicker and easier to file your taxes; however, many taxpayers choose to itemize their actual deductions, such as medical expenses, charitable contributions, and taxes.
- You may benefit from itemizing your deductions if you:
 1. do not qualify for the standard deduction, or the amount you can claim is limited,
 2. had large uninsured medical or dental expenses during the year,
 3. paid interest and taxes on your home,
 4. had large unreimbursed employee business expenses or other miscellaneous deductions,
 5. had large uninsured casualty or theft losses,
 6. made large contributions to qualified charities, or
 7. have total itemized deductions that are more than the standard deduction to which you are otherwise entitled.
- Before you can determine which IRS form to use when you file, the amount of your standard deduction, and your correct tax, you must determine your **filing status**.

There are five filing statuses:

1. Single;
2. Married, Filing Jointly,
3. Married, Filing Separately,
4. Head of Household, and
5. Qualifying Widow(er) with Dependent Child.

You also use your filing status in determining whether you are eligible to claim certain other deductions and credits. If more than one filing status applies to you, choose the one that will give you the lowest tax.

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- The term **withholding** refers to “pay-as-you-earn” taxation. It’s when your employer takes out a certain amount from your check to pay taxes to the government. If you are an employee, at the end of the year, your employer will issue you an IRS **form W-2** that summarizes your taxable wages and the taxes that the employer has deducted or “withheld,” from your pay. Independent contractors receive a **form 1099** listing the amount they were paid.
- A **tax refund** is an amount that the government gives back to you if you have paid more taxes than were due.

How to learn more and get tax help

You can order free publications and forms, ask tax questions, and get help with unresolved tax issues by contacting the Internal Revenue Service (IRS). You can contact the IRS in a variety of ways, including:

Online at www.irs.gov

- E-file your return
- Check the status of your refund
- Download forms, instructions, and publications
- Order IRS products

Telephone

- To order forms, instructions, and publications, call 1-800-829-3676. You should receive your order within 10 days.
- Call the IRS with your tax questions at 1-800-829-1040.
- Call 1-800-829-44477 for *Teletax*, pre-recorded messages covering various tax topics.

Walk-in

- In addition to IRS offices, many post offices and libraries offer certain IRS forms, instructions, and publications.
- Some IRS offices, libraries, grocery stores, copy centers, city and county government offices, credit unions, and office supply stores have a collection of products available to print from a CD or photocopy from reproducible proofs.
- You can walk in to your local Taxpayer Assistance Center for personal, face-to-face tax help. To find out the location of your local office, go to www.irs.gov/localcontacts, or look in the phone book under United States Government, Internal Revenue Service.

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