

## A taxing adventure for Susan.

Let's consider some tax questions for Susan who graduated from UNC Charlotte with a MACC in 2015. She earns a salary of \$50,000.

**What is a tax?** Susan will generally pay TAXES to our government which provides services for our citizens (streets, fire department, police protection, etc.).

**What are FEES?** Susan may pay an annual fee for a driver's license, or a monthly fee for garbage collection. Such FEES are not considered to be taxes because a direct service or benefit is received by Susan who pays for the service or benefit.

### Property Tax

If Susan owns a home, she will likely pay a PROPERTY TAX (based on the value of the home) - to the city and county.

Susan may have a child who attends a local school. The school may be partly funded by local property taxes.

Here, she may receive an "indirect" benefit, but her payment is considered a tax – not a fee. Susan may pay the property tax even if she has no children.

**A TAX PENALTY** is intended to punish a taxpayer for bad or illegal behavior.

### Tax Base for Sales Tax.

We determine the amount of the "tax base" and then we multiply that base by the **tax rate or rates**, to compute total tax owed.

(See text page 1–5.)

### Sales Tax for Purchase of a Coat

Susan purchased a coat with a price of \$100, and the government imposes a sales tax of 8%. She will pay sales tax of \$8 on the \$100 purchase. The amount of the purchase (\$100) is the **base** for computing your sales tax.

### A flat tax

If Susan buys two \$100 coats, she will pay sales tax of \$16 on the \$200 purchase. This sales tax is a flat tax or proportional tax -- because the amount of tax she pays will increase proportionately as the amount of her purchases increase. The **tax rate** remains the same no matter how much she purchases.

### Sales tax is regressive in relation to a person's total income

A sales tax is generally called "regressive" because lower income individuals spend more of their income on purchases subject to a sales tax. Higher income individuals may spend a smaller portion of their income on clothing and other items that are subject to sales tax, and save more of their income. Thus, higher income individuals spend a lower "percentage of their income" on sales tax.

### What is a progressive tax?

We would have a progressive tax rate system if the tax rate were

- 8% on the first \$100 of purchases,
- 10% on the next \$100 of purchases and
- 15% on purchases above \$200.

(A progressive **tax rate increases** as the **tax base increases**.)

Our federal income tax is a progressive tax

### Gasoline Tax

When Susan buys gasoline for her automobile, she may pay state and federal taxes of about 40 cents to 50 cents per gallon of gasoline. Much of this tax goes to build and maintain the roads.

### Social Security Tax

Susan's employer will withhold 7.65% (6.2% plus 1.45%) of her \$50,000 salary for Social Security Tax (\$3,825). The government will allocate the 6.2% part mainly for social security benefits (pensions) paid to retired persons, and the 1.45% part for payment for Medicare benefits (medical care) for retired persons.

The employer will match the amount withheld (send 15.3% to the IRS.)

## Let's get on with the Tax Adventure

Let's analyze the income tax situation for Susan who graduated with a MACC in December 2015. Susan is single and does not have a dependent. She will earn a salary of \$50,000 in 2016. Her employer will withhold federal income tax of \$5,000.

Ignore state income tax.

Susan has gross income of \$50,000.

### Tax base for computing income tax.

The tax law allows certain deductions, which will **reduce her tax base**.

Therefore, Susan's base for computing her federal individual income tax is not \$50,000.

### Deductions.

The income tax law allows Susan to deduct \$4,050 as a personal exemption. (see textbook page 4–9).

(On a joint return, a \$4,050 exemption is allowed for each spouse.

An exemption is also allowed for each dependent, such a dependent child.)

Susan will also be allowed a \$6,300 standard deduction. (see textbook page 4–9).

### Compute Susan's Individual Income tax

With these facts, Susan will compute her **individual income tax**. She will

1. start with her salary of \$50,000,
2. deduct her exemption and standard deduction to get taxable income, and
3. compute the tax on her taxable income.

Please compute Susan's individual income tax. Compare your answer with part 1 on next page.

Now, assume Susan was married on 12-31-2016.

She files a joint return with her new husband, Sam, who had no income in 2016.

Compare your answer with part 2 on next page.

[If her total expenses for certain itemized deductions (property tax, contributions, etc.) exceed the standard deduction, she can claim a deduction for her total itemized expenses instead of the standard deduction.]

## Move to corporate tax Issues.

### Assume Susan owns a regular corporation (a C corporation).

Susan works for the corporation. She receives a \$50,000 salary. Assume her corporation earns revenue of \$500,000 and has expenses of \$400,000 in 2016. Susan's \$50,000 salary is included in these expenses. The corporation will have Revenue of \$500,000, Expenses of \$400,000,

**Taxable income of \$100,000.**

**See computations on last page of this file.**

### Corporate Income Tax

The corporation will owe federal income tax on its **taxable income of \$100,000**.

The corporation may also owe state income tax, and social security tax and unemployment tax on the \$50,000 salary to its employee (Susan). Ignore those taxes for now.

### Taxation of Dividend Income

As a general rule, Susan's individual income tax would not be different just because her \$50,000 salary is received from a corporation that she owns. However, if she also receives a dividend from the corporation (of say \$10,000), she will report gross income of \$60,000 (\$50,000 salary and dividend income of \$10,000). Her individual income tax will be higher if she receives a dividend from her profitable corporation. She will pay tax on dividend income that has been taxed to the corporation – double taxation.

### What is the total federal income tax burden

(corporate income tax and individual income tax) if Susan receives a salary of \$50,000 and a dividend of \$10,000? Would your answer be different if Susan receives a salary of \$50,000 and a year-end bonus of \$10,000 (No dividend)?

### Flow-through (S corporation or partnership)

If Susan elects to have the corporation taxed as an **"S corporation,"** the corporation will not pay income tax. Assuming Susan only receives a salary of \$50,000, her gross income will be \$150,000 (her salary income and the flow-through of the corporate taxable income to her personal income tax return.)

**See computations on last page of this file.**

## First Tax Computation Problem

**Part 1.** Susan, who is single with no dependent, graduated with a MACC in 2015. She will earn a salary of \$50,000 in 2016. Her employer will withhold federal income tax of \$5,000. Ignore state income tax. Compute the amount of her 2016 income tax.

### Susan, Single, 2016

	Part 1- Single		Part 2 - Joint Return	
Salary		\$50,000		\$50,000
Exemption(s)	4,050		8,100	
Standard Deduction	6,300		12,600	
Total Deductions		(10,350)		(20,700)
Taxable Income		\$39,650		\$29,300

### Susan, Single, 2016

	Base	Rate	Tax
Lower layer(s)	37,650		5,183.75
Top layer	2,000	25%	500.00
Total	39,650		5,683.75
Income tax withheld by employer			(5,000.00)
Income tax to be paid to IRS with return			683.75
Average tax rate			

**Part 2.** Susan dated Sam, a MACC student who graduated in December, 2016. Sam had no income in 2016. They were married on December 31, 2016. She earned a salary of \$50,000 in 2016. Her employer withheld federal income tax of \$5,000. They will file a joint return for 2016. Please compute their income tax for 2016.

### Susan, Joint Return

	Base	Rate	Tax
Lower layer(s)	18,550		1,855.00
Top layer	10,750	15%	1,612.50
Total	29,300		3,467.50
Income tax withheld			(5,000.00)
Income tax to be paid or (refunded)			(1,532.50)

Please download a form 1040 for 2015 from IRS.Gov and prepare the joint tax return. Forms for 2016 have not been printed. Use 2016 amounts on the 2015 returns.

Exemption amount for 2016: \$4,050 for each spouse and \$4,050 for each dependent.

Standard Deduction amount for 2016: \$6,300 on single return and \$12,600 on joint return.

Single Rates, 2016		Amount of Income Tax-Single				
Layers of income at various rates		Taxable income is:		Tax on all	of Taxable	
Amount of Layer	Tax Rate on Layer	Over	But not over	Previous Layers	Plus	Income over:
9,275	10%	\$0	\$9,275		10%	\$0
28,375	15%	9,275	37,650	927.50	15%	\$9,275
53,500	25%	37,650	91,150	5,183.75	25%	\$37,650
99,000	28%	91,150	190,150	18,558.75	28%	\$91,150
223,200	33%	190,150	413,350	46,278.75	33%	\$190,150
1,700	35%	413,350	415,050	119,934.75	35%	\$413,350
	39.6%	\$415,050		120,529.75	39.6%	\$415,050

Example: Taxable income of \$37,650 has 2 layers: (1) \$9,275 at 10% and (2) \$28,375 at 15%.

Single taxpayer has taxable income of \$37,700, (income of \$50 of income will be taxed at 25%).

Joint Return Rates, 2016		Amount of Income Tax-Joint Return				
Layers of income at various rates		Taxable income is:		Tax on all	of Taxable	
Amount of Layer	Tax Rate on Layer	Over	But not over	Previous Layers	Plus	Income over:
18,550	10%	\$0	\$18,550		10%	\$0
56,750	15%	18,550	75,300	1,855.00	15%	\$18,550
76,600	25%	75,300	151,900	10,367.50	25%	\$75,300
79,550	28%	151,900	231,450	29,517.50	28%	\$151,900
181,900	33%	231,450	413,350	51,791.50	33%	\$231,450
53,600	35%	413,350	466,950	111,818.50	35%	\$413,350
	39.6%	\$466,950		130,578.50	39.6%	\$466,950

Case may require a thorough explanation by the instructor. See what you can do with it.

### Choose the tax paying entity - C Corporation or S Corporation?

Susan will receive a salary of \$50,000 from Susan Corporation. She owns Susan corporation. Corporation has revenue of \$500,000 and expenses of \$400,000, including Susan's salary.

There is no state individual or corporate income tax. Ignore social security tax.

Susan is single and has no dependent. Ignore any special taxes in the new health care law.

Susan Corporation (C corporation)				Susan (personal tax return)			
Revenue		\$500,000		Salary		\$50,000	
Salary Expense - Susan		(\$50,000)		Deduction for Exemption		(\$4,050)	
Other corporate expenses		(\$350,000)		Standard Deduction		(\$6,300)	
Corporate Taxable Income		<b>\$100,000</b>		Susan's Taxable Income		<b>\$39,650</b>	
Corporate Income Tax (Below)		<b>\$22,250</b>		Income tax (below)		<b>\$5,684</b>	
Income Layers	Amount	Rate	Tax	Income Layers	Income	Rate	Tax
First layer	\$50,000	15%	<b>\$7,500</b>	Base layers	\$37,650		<b>\$5,184</b>
Second layer	\$25,000	25%	<b>\$6,250</b>	Top layer	\$2,000	25%	<b>\$500</b>
Third layer	\$25,000	34%	<b>\$8,500</b>	Taxable income	<b>\$39,650</b>		
Taxable Income	\$100,000			Total Individual Income Tax			<b>\$5,684</b>
Total Corporate Income Tax		<b>\$22,250</b>		Total Corporate Income Tax			<b>\$22,250</b>
				Total Indiv. & Corp. Income Tax			<b>\$27,934</b>

Subchapter S status IS elected Susan Corporation (S Corporation)		Subchapter S status IS elected Susan (personal tax return)	
Revenue		\$500,000	
Expenses		(\$400,000)	
Corporate net income (loss)		<b>\$100,000</b>	
Corp. Income Tax (Note Below)		<b>\$0</b>	
		Add: S Corporation Income	
		<b>\$100,000</b>	
		Susan's Taxable Income	
		<b>\$139,650</b>	
		Individual Income tax (below)	
		<b>\$32,139</b>	
An S Corporation does not pay income tax, generally.		Income Layers	
S Corporation net income or (loss) is reported on the tax return of the owner(s) of the S corporation.		Base layers	
		\$91,150	
		Top layer	
		\$48,500	
		28%	
		<b>\$13,580</b>	
		Total income	
		<b>\$139,650</b>	
		Total Individual income tax	
		<b>\$32,139</b>	
		Total Individual & corporate tax	
		<b>\$32,139</b>	

#### Federal Income Tax Rates-Single. 2016

Taxable income:		Total Federal Income Tax			
Over	But not over	Tax on all Previous Layers.	Plus	Tax Rate	on Taxable Income over:
\$0	\$9,275	0.00	+	10%	\$0
9,275	37,650	927.50	+	15%	\$9,275
37,650	91,150	5,183.75	+	25%	\$37,650
91,150	190,150	18,558.75	+	28%	\$91,150
190,150	413,350	46,278.75	+	33%	\$190,150
413,350	415,050	119,934.75	+	35%	\$413,350
\$415,050		120,529.75	+	39.6%	\$415,050

Example: with taxable income of \$9,375, rate is 10% on \$9,275 and 15% on \$100.

## Federal Income Tax Rates-Single. 2016

Taxable income:		Total Federal Income Tax			
Over	But not over	Tax on all Previous Layers	PLUS	of Taxable Income over:	
\$0	\$9,275	0.00	+	10%	\$0
9,275	37,650	927.50	+	15%	9,275
37,650	91,150	5,183.75	+	25%	37,650
91,150	190,150	18,558.75	+	28%	91,150
190,150	413,350	46,278.75	+	33%	190,150
413,350	415,050	119,934.75	+	35%	413,350
\$415,050		120,529.75	+	39.6%	415,050

Example: with taxable income of \$9,375, rate is 10% on \$9,275 and 15% on \$100.

## Federal Income Tax Rates:Joint - 2016.

Taxable income:		Total Federal Income Tax			
Over	But not over	Tax on all Previous Layers	PLUS	of Taxable Income over:	
\$0	\$18,550	0.00	+	10%	\$0
18,550	75,300	1,855.00	+	15%	18,550
75,300	151,900	10,367.50	+	25%	75,300
151,900	231,450	29,517.50	+	28%	151,900
231,450	413,350	51,791.50	+	33%	231,450
413,350	466,950	111,818.50	+	35%	413,350
\$466,950		130,578.50	+	39.6%	466,950

## Income Tax Rates - Separate - 2016.

Taxable income:		Total Federal Income Tax			
Over	But not over	Tax on all Previous Layers	PLUS	of Taxable Income over:	
\$0	\$9,275	0.00	+	10%	\$0
9,275	37,650	927.50	+	15%	\$9,275
37,650	75,950	5,183.75	+	25%	\$37,650
75,950	115,725	14,758.75	+	28%	\$75,950
115,725	206,675	25,895.75	+	33%	\$115,725
206,675	233,475	55,909.25	+	35%	\$206,675
\$233,475		65,289.25	+	39.6%	\$233,475

### AGI Phase-out Thresholds

Filing Status	Exemptions	Itemized Deduct.
Married, Joint	311,300	311,300
Head-of-Household	285,350	285,350
Single	259,400	259,400
Married, Separate	155,650	155,650

#### Exemptions reduced by:

2% for each \$2,500 layer above AGI Threshold above (for married filing separately, layer is \$1,250)

#### Itemized Deductions reduced by:

3% of excess of AGI over AGI Threshold above

## Income Tax Rates - Head of Household - 2016.

Individual taxable income		Total Federal Income Tax			
Over	But not over	Tax on all Previous Layers	PLUS	of Taxable Income over:	
\$0	\$13,250	0.00	+	10%	\$0
13,250	50,400	1,325.00	+	15%	13,250
50,400	130,150	6,897.50	+	25%	50,400
130,150	210,800	26,835.00	+	28%	130,150
210,800	413,350	49,417.00	+	33%	210,800
413,350	441,000	116,258.50	+	35%	413,350
\$441,000		125,936.00	+	39.6%	441,000

Standard Deduction	Basic	Age/ Blindness
Single	\$6,300	\$1,550
Married-Joint	\$12,600	\$1,250
Married - File Separately	\$6,300	\$1,250
Head of Household	\$9,300	\$1,550
Standard deduction for child who is a dependent of another	\$1,050	
Or: Earned income +	\$350	
Personal Exemption Amount	\$4,050	

AMT Exemption	Amount	Phase-out	
Joint Return	\$83,800	\$159,700	\$494,900
Separate Return	\$41,900	\$79,850	\$247,450
H-of-H and Single	\$53,900	\$119,700	\$335,300
AMT Rates (Joint, HoFH, Single)	Amount	Rate	
Rate on AMT base up to	\$186,300	26%	
Rate on AMT base above	\$186,300	28%	

FICA rate on salary up to	\$118,500	7.65%
FICA rate on excess	Excess	1.45%
Extra FICA rate - .9%. (Single & HH) Wages above		\$200,000
Extra FICA rate - .9%. (Joint) Wages above		\$250,000
NII tax (3.8%) on lesser of NII or AGI (Single & HH) above		\$200,000
NII tax (3.8%) on lesser of NII or AGI (Joint) above		\$250,000

## Federal Corporate Income Tax Rates

Taxable Income		Of the			
over	but not over	The tax is:			amount over:
\$0	\$50,000	\$0	+	15%	\$0
50,000	75,000	7,500	+	25%	50,000
75,000	100,000	13,750	+	34%	75,000
100,000	335,000	22,250	+	39%	100,000
335,000	10,000,000	113,900	+	34%	335,000
10,000,000	15,000,000	3,400,000	+	35%	10,000,000
15,000,000	18,333,333	5,150,000	+	38%	15,000,000
18,333,333				35%	