How Much Tax Do I Have to Pay?

Calculating What You Owe

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When people talk about taxes, they usually are just thinking about the regular old income tax rates, but those rates can no longer stand on their own. Yes, you (or your CPA) can determine your general tax bracket, but other factors go into an income tax return and impact the rate of tax you pay – factors that can increase and/or lower the tax bracket that you have fallen (or climbed!) into. That's why when people ask questions such as *if I sell this, how much tax will I pay* – we can't just answer that question. What else *may be* factored in? Here's a breakdown of some of the different types of taxes.

Long term capital gains and qualified dividends

First, there's the regular income tax bracket, but if you have long term capital gains or qualified dividends, you can pay lower taxes on those items. The tax on these items can vary between 0% and 28%. The computation is done as part of the Schedule D form. The tax is computed here and then is transferred to the Form 1040, on page 2. The lower rates are calculated on your long term (held for more than one year) capital gains and qualified dividends. So, how do I get myself into the 0% bracket – (I call it the magical tax bracket)? The answer with all things tax is … it depends. You can work your way into any of these lower tax brackets with tax planning in advance, so make sure to seek assistance.

Alternative Minimum Tax

If you have certain itemized deductions, such as tax payments and miscellaneous itemized deductions, on your regular taxes, those cannot be deducted for another kind of tax – the Alternative Minimum Tax (AMT). AMT is a separate – alternative, if you will – computation that is prepared. And here is the true joy of this tax – you prepare both the "regular" tax calculation and AMT, and then you get to pay the highest one! Besides the add back for certain itemized deductions, there are other fairly common preferences for AMT. Certain municipal bonds have a preference component, as well as depreciation differences between regular and AMT depreciation, to list just a couple. In the past, we could look at a specific tax situation and guess whether people were going to be affected by AMT or not, based upon certain items in their tax return. The main reason was that when the tax first came into play, it was more a factor on wealthy people. And it wasn't indexed for inflation (This is no longer the case – it is now indexed for inflation). But as wages (and inflation) went up, it started affecting more people. It is now virtually impossible to determine without a projection when a taxpayer will be subject to AMT.

That's not all. There's more …

Net Investment Income Tax

If your income is over a certain level, you are probably affected by the Net Investment Income Tax (NIIT), which came about to pay for health care subsidies as part of the Affordable Care ACT (ACA). The tax applies at a rate of 3.8% on certain net investment income. The threshold is a modified adjusted gross income (AGI) of $250,000 or higher for married filing joint. The NIIT is not a substitute for your regular tax bracket, AMT or the capital gains tax. It's an additional tax.

So after looking at all these taxes, you think *well, I have a solution to all of that. I might be in a higher tax bracket but my kids are in a much lower tax bracket so I will give my income producing property to my kids and they'll pay tax at their rate.* Oh, no. There is not a loophole for that…

Kiddie Tax

Enter the Kiddie Tax. When this tax first came about it applied to children 14 years of age and younger and they paid tax on their investment income at their parent's marginal rate. Ten years ago, that age increased to 18 for the Kiddie Tax – 23 if your child was in college. So, you don't get to pay tax on your child's investment income at a lesser rate. It's paid at your marginal rate.

Self-employment Tax

If you work for yourself – which sounds like a really cool thing to do because you don't have a boss or anyone telling you what to do – what you may not realize is how you're impacted by employment taxes. When you're an employee, your employer is paying half of your employment taxes – Social Security and Medicare. But, when you're self-employed, you get to pay the entire 15.3%. So, if you're not prepared for that tax in the first year that can be somewhat of a shock!

These are the most common types of taxes that are found on page two of a Form 1040. You should strongly consider seeking the advice of your Henry & Horne CPA to navigate these various tax situations. While taxes do deal with history, there are opportunities for planning that mitigate some of the tax bite – and that is where the true value to using a CPA can be most beneficial.

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