

Income Tax Deductions

LESSON DESCRIPTION (Background for the Instructor)

In this lesson, students will learn about the process of how income taxes are calculated starting with a taxpayer's gross income and ending up with an amount that is owed to, or refunded by, the IRS. Specifically, students will learn about how income taxes can be legally reduced by tax deductions and the math calculations behind the amount of money saved by itemized tax deductions.

The lesson includes five activities that instructors can select from. In these activities, students will:

- ◆ View the video *Personal Income Taxes-A Visual Explanation* and answer debriefing questions
- ◆ Conduct a *Web Quest* to learn about tax law changes made by the Tax Cuts and Jobs Act of 2017
- ◆ Complete math problems to calculate the value of itemized deductions at various income tax brackets
- ◆ Search class notes or go online to answer the 12-question *Is It Tax Deductible?* activity handout quiz
- ◆ Use a hypothetical scenario to test the *Should I Itemize or Take the Standard Deduction?* calculator

The lesson also contains 10 assessment questions (5 multiple choice and 5 True-False), learning extensions (i.e., suggested learning activities beyond the scope of the lesson plan), and references and resources.

INTRODUCTION (Background for the Instructor)

Tax deductions reduce taxable income, resulting in less income tax paid to the Internal Revenue Service (IRS). They are a tool tools for practicing *tax avoidance* (minimization), which is the use of legally available tax reduction strategies to decrease the amount of income tax owed. *Tax evasion*, on the other hand, is the use of illegal tax reduction methods and is punishable by criminal charges and penalties.

Another tax-reduction method is a *personal* exemption (a tax exemption taken for yourself) and a *dependent* exemption (a tax exemption taken for people who qualify as a dependent according to IRS rules). **Tax exemptions were eliminated from 2018-2025 by the 2017 Tax Cuts and Jobs Act (TCJA). They are still described below because they were taken previously and could return in the future.**

A personal exemption is a flat dollar amount that is subtracted from a taxpayer's adjusted gross income (AGI) before a deduction (standard or itemized) is subtracted and taxable income is calculated. AGI is calculated as gross income (i.e., all income that is subject to income tax, including salaries, business profits, and pensions, minus certain allowable adjustments (e.g., contributions to Traditional IRA accounts).

Taxpayers can take one personal exemption on their tax return for themselves if they are not claimed as a dependent on another person's tax return (e.g., a child being claimed by a parent). In other words, members of a family cannot "double dip" on tax exemptions. If parents are eligible to claim a child as a dependent and take a dependent exemption, the child cannot also claim a personal exemption.

Parents are allowed to take exemptions for children who live with them for more than half a year and who don't provide more than half of their own financial support. The age limit for dependent personal exemptions for a child is under age 19 or under age 24 if the child is a full time student. The IRS has a series of [requirements](#) for claiming a qualifying child and these should be reviewed before filing taxes.

Personal exemptions do not require any special record-keeping or documentation (e.g., receipts for expenses) like itemized deductions do. In other words, there are no restrictions except the rule that an individual cannot be an exemption on more than one tax return. However, tax exemptions do phase out at higher income levels. Previous to their elimination from 2018-2025, personal exemption amounts were indexed annually. **Again, exemptions on federal income tax returns were eliminated from 2018-2025.**

The amount of taxes owed also depends on the amount of deductions that a taxpayer claims. Tax deductions shave additional money off taxable income. The IRS allows two types of deductions: standard and itemized. The *standard deduction* is a specific amount of money established each year in the tax code. Taxpayers do not need to keep receipts but, rather, may claim the amount of standard deduction permitted for their tax filing status (e.g., single or married filing jointly). **Standard deduction amounts were raised significantly (\$12,000 for singles and \$24,000 for couples filing jointly) under the TCJA.**

Itemized deductions are amounts spent on certain approved expenses throughout each tax year. Itemized deductions can be taken if they exceed the standard deduction. Deductible items include mortgage interest, state income taxes, charitable gifts, and property taxes. Receipts should be kept for itemized deductions. **Under the TCJA, there is a \$10,000 annual cap on deductible state and local taxes (2018-2025).**

The impact of a tax deduction depends upon a taxpayer's marginal [tax bracket](#) (i.e., an income range associated with tax rates). For example, if a taxpayer is in the 24% tax bracket and is considering possible deductions, a \$1,000 tax deduction will lower this person's tax liability by \$240 (24% of \$1,000). The other \$760 spent on a tax-deductible item (e.g., a donation to a charity) would be paid out-of-pocket.

Only about 10% of taxpayers are expected to be able to itemize under the TCJA. All others will have a standard deduction that is greater than the amount that they are able to itemize. Thus, they will not receive any special tax write-off for deductible expenses. To claim itemized deductions, taxpayers must keep good records and save receipts in case they have to prove their expenses to the IRS in the event of a tax audit.

Again, taxpayers will benefit from itemized deductions only if they total more than the standard deduction. Contributions made to charitable organizations, state income taxes and property taxes up to the \$10,000 cap, and the interest paid on home mortgages are examples of allowable tax deductions. Schedules are forms that are attached to tax forms to show specific expenses, deductions, or income. Schedule A is used to report itemized deductions. Specific details about tax schedules can be obtained from the IRS [website](#).

For most people, their first tax experience begins when they get a job. One of the first things given to new employees is a W-4 form which determines the amount of money withheld from their paycheck. The amount of withholding is based upon the number of withholding allowances listed on a worker's W-4 form.

The *larger* the number of allowances, the less tax withheld and the smaller a person's tax refund. Conversely, if more tax is withheld (*fewer* allowances), a worker's paycheck (net pay) is smaller and tax refund will be larger. When a person gets a tax refund, they are simply getting their own money back.

Tax refunds come without any interest, however. Therefore, the government has had taxpayers' money, when they could have saved it and earned interest. Refunds are also subject to delay in identity theft cases. Some people have difficulty saving, however, and see a tax refund as a viable strategy for forced savings.

Tax deductions need to be considered when completing a W-4 form because they both reduce a worker's taxable income. The W-4 form includes a worksheet to help workers do an accurate calculation of their anticipated tax liability and determine the number of withholding allowances that they should claim. There are spaces on the W-4 form worksheet to include the number of dependents and an anticipated amount for adjustments to income (to determine AGI) and itemized deductions. The more carefully the W-4 worksheet is completed, the more accurate tax withholding is likely to be.

OBJECTIVES

Students will be able to:

- ◆ Define the terms tax exemption and tax deduction and describe how they lower income taxes.
- ◆ Distinguish between the standard deduction and itemized deductions.
- ◆ Provide examples of expenses that qualify as itemized deductions on a federal income tax return.
- ◆ Describe what a marginal tax bracket is and how it is related to tax savings from itemized deductions.
- ◆ Appreciate how tax deductions affect financial planning behavior (e.g., buying a home and gifting).
- ◆ Calculate the income tax savings from itemized deductions by completing a series of math problems.

NEW JERSEY PERSONAL FINANCIAL LITERACY STANDARD

- ◆ Standard 9.1.12.A.10: Demonstrate how exemptions and deductions can reduce taxable income. See <http://www.state.nj.us/education/aps/cccs/career/FLFAQ.htm#gradcredit> and <http://www.state.nj.us/education/cccs/2014/career/91.pdf> for information about Standard 9.1

TIME REQUIRED

45 to 180 minutes (depending upon student progress and content depth and number of activities used)

MATERIALS

- ◆ YouTube Video (4:04): *Personal Income Taxes-A Visual Explanation* <https://www.youtube.com/watch?v=auUcnb7vIAs> and debriefing questions
- ◆ *Web Quest: Tax Cuts and Jobs Acts* activity handout
- ◆ *Tax Deduction Math* activity handout and *Is it Tax Deductible?* activity handout
- ◆ *Should I Itemize or Take the Standard Deduction?* calculator <https://www.calcxml.com/calculators/inc10> and activity handout
- ◆ *Income Tax Exemptions and Deductions Quiz* (ASSESSMENT)

Teachers are encouraged to use as many of the student learning activities as time permits to provide a fuller understanding of income tax exemptions and deductions. The activities can also be used for extra credit assignments, homework, or after-school activities.

PROCEDURE

1. Ask students if they know if and how they personally affect their parent's income tax return. In other words, do their parents get any type of income tax benefit for having children?

Answers will likely vary. Students may or may not mention tax credits such as the Child Tax Credit, Child and Dependent Care Credit, and Adoption Credit. Another tax break for parents is the dependent exemption, which shelters a specific dollar amount from taxes regardless of when a child is born.

2. **Activity 1:** Show the video *Personal Income Taxes-A Visual Explanation* (Seeing Finance) and debrief the following questions (based on video content) with students:

Name three types of taxes that are deducted from workers' paychecks.

Three common payroll taxes are Social Security and Medicare tax (often collectively shown as FICA tax on workers' paychecks) and federal, state, and/or city income tax.

What is take-home pay? How does it differ from a worker's salary?

Take-home pay (a.k.a., net pay) is workers' actual earnings after deductions are taken from their salary (gross income) for taxes and other items (e.g., insurance premiums, retirement savings plan deposits, charitable contributions, and union dues). Take-home pay will always be a smaller number than gross pay to reflect the payroll deductions that are taken.

What is a W-2 Form?

A W-2 Form is a document sent by employers to their workers to report earnings for the previous calendar year and the amount that was deducted for federal and state income taxes (withholding).

What is income tax withholding?

Income tax withholding is the process of deducting federal and state income tax payments from workers' paychecks as required by law. To be accurate, the amount of withholding should be based on marital status and the number of exemptions and amount of deductions that a taxpayer expects to claim.

When do taxpayers have to send an income tax payment to the IRS?

When the amount that was withheld by their employer [or that they sent to the IRS as quarterly estimated tax payments, if workers are self-employed] is less than the amount that is owed.

When do taxpayers receive an income tax refund?

When the amount that was withheld by their employer [or that they sent to the IRS as quarterly estimated tax payments, if workers are self-employed] is more than the amount that is owed.

What is the sequence of steps in determining the amount of income tax due?

Start with Gross Income and SUBTRACT adjustments to arrive at Adjusted Gross Income (AGI)
SUBTRACT a deduction (Standard or Itemized) and exemptions (**if they exist**) to get Taxable Income
CALCULATE tax (from tax tables or tax schedules based on marginal tax rates, depending on income)
SUBTRACT tax credits, if any, and ADD other taxes (e.g., Self-Employment Tax), if any
The RESULT is the Total Tax Due (a.k.a., "the bottom line")
COMPARE Total Tax Due to tax withholding to determine amount of income tax payment or refund

What are two common types of adjustments on a federal income tax return to determine AGI?

Answers may include student loan interest, IRA retirement savings plan contributions, educator expenses, and half of self-employment tax (Social Security and Medicare), if self-employed.

What are two common types of itemized tax deductions on a federal income tax?

Answers may include property taxes, state and local income taxes, home mortgage interest, charitable contributions, and unreimbursed medical expenses that exceed 7.5% of AGI in 2018 and 10% of AGI thereafter (2019 and beyond).

What are exemptions?

Exemptions are a flat dollar amount (adjusted annually for inflation) subtracted from adjusted gross income (AGI) to reduce the amount of income that people pay taxes on. Exemptions are available personally for individual taxpayers and for eligible dependents. **Tax exemptions were eliminated from 2018-2025 by the 2017 Tax Cuts and Jobs Act (TCJA). They are still included in this lesson because they were taken previously and could return in the future.**

What is taxable income?

Taxable income is the amount used to determine a taxpayer's income tax liability. It is determined by subtracting a deduction (Standard or Itemized) and exemptions from adjusted gross income (AGI).

What are marginal tax rates?

The tax rate (i.e., percentage of income) paid on the last (highest) dollar of personal or (if married) household earnings. To calculate the tax on a certain amount of income, tax rates for each underlying tax bracket must be added together as shown below [**Note: The figure shows pre-TCJA tax rates**].

10% Bracket	<ul style="list-style-type: none">• Range of income (\$0–\$18,150)• $\\$18,150 \times 10\% = \\$1,815$
15% Bracket	<ul style="list-style-type: none">• Range of income (\$18,150–\$73,800)• $\\$55,650 \times 15\% = \\$8,348$
25% Bracket	<ul style="list-style-type: none">• Range of income (\$73,800–\$95,000)• $\\$21,200 \times 25\% = \\$5,300$
Total Tax Due	<ul style="list-style-type: none">• Total tax due (all brackets)• $\\$1,815 + \\$8,348 + \\$5,300 = \\$15,463$

Source: *Focus on Personal Finance* (2016), p. 83.

3. **Activity 2:** Distribute the *Web Quest: Tax Cuts and Jobs Act* activity handout. Ask students to conduct an online search to find information from reputable sources (e.g., the IRS and tax preparation companies) to learn more about the Tax Cuts and Jobs Act (TCJA). Search for words such as “2017 income tax law,” “Tax Cuts and Jobs Act,” and “2018 Income Tax Rules.” Debrief the activity by having students discuss what they found out about tax rules concerning income tax deductions, exemptions, and other features of the TCJA.

Among the key TCJA features that are likely to be mentioned by students are:

- ◆ *Eight-year period of lower individual tax rates from 2018 through 2025 ranging from 10% to 37%*
- ◆ *Chained CPI (consumer price index) will be used for future indexing, resulting in lower inflation adjustments than the previous CPI*
- ◆ *Elimination of personal exemptions (from 2018-2025)*
- ◆ *Larger standard deduction (\$12,000 for singles; \$24,000 for married couples filing jointly in 2018)*
- ◆ *Enhanced child tax credit of \$2,000 per qualifying child; \$1,400 of the credit is refundable*
- ◆ *Alimony is no longer deductible by spouses who pay or taxable to recipient spouses for divorce decrees signed after December 31, 2018*
- ◆ *The moving expense deduction is suspended from 2018 through 2025 except for service members*
- ◆ *Interest on home equity loans will no longer be deductible from 2018-2025 with no grandfathering for existing home equity loans*

4. **Activity 3:** Distribute the *Tax Deduction Math* activity handout and ask students to go online to search for information (e.g., to determine a person’s marginal tax bracket) and complete the math questions shown below to calculate the value of itemized deductions at various income tax brackets.

Joe Rota, a single college graduate, is 28 years old and has a \$36,000 taxable income after subtracting the standard deduction from his annual gross income. What federal marginal tax bracket is he in (i.e., the income range that determines the tax rate paid on his last dollar of income)?

According to the IRS [tax tables](#), Joe is in the 12% marginal tax bracket (a range of \$9,526 to \$38,700 of taxable income for single taxpayers in 2018, adjusted annually for inflation). His last dollar of income is taxed at 12%. However, not all of his income is taxed at a 12% rate. Marginal tax brackets are progressive and the rate of tax paid increases when people reach the “break point” for a higher income tax bracket. A portion of Joe’s income will be taxed at the lower 10% rate.

Joe is considering making a \$100 donation to the American Cancer Society to honor his uncle who recently passed away. How much will this save him on income taxes?

Nothing. Charitable contributions provide no income tax benefit (i.e., tax savings) to people who claim the standard deduction. Only people who itemize deductions on Schedule A can deduct charitable contributions. To itemize deductions, taxpayers must have deductible expenses that, combined, exceed the amount of the standard deduction. Only about 10% of taxpayers are expected to be able to itemize deductions as a result of the Tax Cuts and Jobs Act vs. about 30% before the TCJA passed.

Joe is considering the purchase of a condo in New Jersey. The mortgage interest and property taxes, combined, will be \$1,200 less than the amount of the standard deduction allowed for single taxpayers. How much would his housing expenses save him on his income taxes?

Nothing. Joe will not benefit from itemized deductions because they total less than the standard deduction. However, he will still build equity over time as mortgage payments are made.

Joe buys the condo and takes the standard deduction on his income taxes. How much will a \$100 donation to the American Cancer Society save him on taxes?

Nothing. Donors who take the standard deduction are not able to write off charitable donations on their federal income tax returns.

Joe completes additional job training and earns a promotion and a raise. He is now in a higher marginal tax bracket and his last dollar of income is taxed at a 24% rate. All of his tax-deductible expenses, combined, exceed the standard deduction by \$5,000. How much would itemizing deductions save him on his income taxes?

The answer is \$1,250. This is the amount that the total of itemized deductions exceeds the standard deduction (\$5,000) multiplied by Joe’s new (higher) 24% marginal tax rate ($\$5,000 \times .24 = \$1,200$).

What is the take-away message about itemized tax deductions from these math calculations?

Taxpayers can claim *either* the standard deduction or itemized deductions and should choose whatever method lowers their tax liability the most. The higher a taxpayer’s marginal tax rate, the more money itemized deductions will save on taxes. For example, \$1,000 in itemized deductions reduces taxes by \$120 for someone in the 12% tax bracket and by \$240 for someone in the 25% tax bracket.

5. **Activity 4:** Distribute the *Is it Tax Deductible?* activity handout and ask students to work together in small groups to search their class notes or online to determine if the 12 items shown below are tax deductible. Debrief the activity with the entire class.

Charitable Contributions- Deductible, if total of itemized deductions exceeds the standard deduction.

Excise Tax on Gas or Cigarettes- Not deductible. Excise taxes are built into the price of these items.

State Income Tax- Deductible. The amount paid is on a worker's final annual pay stub and W-2 form.

Mortgage Payment (Principal and Interest)- Not deductible. Only mortgage *interest* is deductible.

Local Property Taxes- Deductible. Homeowners will receive an annual summary of total taxes paid.

Volunteer Time- Not Deductible. However, costs of mileage and supplies to do work can be deducted.

Medical/Dental Expenses- Deductible, if unreimbursed bills exceed 7.5% of AGI in 2018; 10% after

Commuting Costs- Not deductible. Only travel between multiple worksites in a day can be deducted.

Political Candidate Contributions- Not deductible, whether to candidates or groups supporting them.

Tax Preparation Fees- Not Deductible: miscellaneous expenses were **eliminated (2018-2025)**

Gym Membership- Not Deductible. This is simply a personal expense that people pay for themselves.

Insurance Premiums- Not Deductible. This, too, is a personal expense that people pay for themselves.

6. **Activity 5:** Distribute the *Should I Itemize or Take the Standard Deduction?* activity handout and ask students to use the calculator at <https://www.calcxml.com/calculators/inc10> to answer the question using the following case study example. Then debrief the results of the activity (shown below).

Samantha Riggins is 31 years old and single and has a \$52,000 adjusted gross income (AGI). She had \$450 and \$380 of unreimbursed medical and dental expenses, respectively, and her state and local income taxes total \$4,000. She rents an apartment so, therefore, she pays no real estate (property) taxes, nor does she pay any personal property taxes. She pays \$150 in other taxes as payroll deductions for state unemployment insurance (SUI) and temporary disability (TDI) insurance. Samantha has no home mortgage or investment interest payments and received \$300 in investment interest and dividends. She also made \$500 in cash donations to charity.

Students' answers should be the same because they are inputting the same data. Note that many renters are unable to itemize tax deductions until they buy a home and their property taxes and mortgage interest put them over the standard deduction threshold amount. About 70% of American taxpayers do not itemize.

Results

Based on the input you provided, your Standard Deduction of \$12,000 is greater than your Itemized Deductions of \$4,500.



■ Total Itemized deduction ■ Standard deduction

CLOSURE

Asks students if they have any remaining questions about income tax deductions. Remind them that paying income taxes is the responsibility of every U.S. citizen and that the amount that they will pay will vary according to their income and expenses. Tax exemptions and deductions are both tax avoidance (minimization) strategies; i.e., available legal strategies that can be used to reduce a person's tax liability.

GLOSSARY

Adjusted Gross Income (AGI)- Gross income minus certain reductions (adjustments) including moving expenses, alimony paid to an ex-spouse, and retirement savings plan contributions.

Dependent- A person who is eligible to be claimed on another person's income tax return to lower their tax liability. A common example is minor children who are claimed as dependents by their parents.

Dependent Exemption- A tax exemption for people who qualify as a dependent according to IRS rules.

Itemized Deductions- Expenses taxpayers are allowed to deduct from their adjusted gross income (AGI) to lower their tax liability, if their combined total exceeds the standard deduction amount. Examples include charitable contributions, state income taxes, property taxes, and mortgage interest.

Marginal Tax Bracket- The ranges in income for taxpayers that are associated with marginal tax rates.

Marginal Tax Rate- The tax rate paid on the last (highest) dollar of personal or (if married) household income. Current (2018) federal marginal tax rates range from 10% to 37%.

Personal Exemption- A flat dollar amount that is subtracted from a taxpayer's AGI before a deduction is subtracted and taxable income is calculated. **Exemptions were eliminated by the Tax Cuts and Jobs Act.**

Progressive Tax- A type of tax where the tax rate increases as taxable income increases (e.g., income tax).

Schedule A- The IRS tax form used to report and calculate itemized tax deductions.

Standard Deduction- A specific amount of money, adjusted for inflation annually, that is subtracted from adjusted gross income (AGI), minus exemptions, to arrive at taxable income. No receipts or any other documentation are needed to claim the standard deduction.

Taxable Income- The amount of income that is used to calculate the amount of tax owed by an individual or household. It is calculated by subtracting adjustments, exemptions, and deductions from gross income.

Tax Avoidance- The use of legally available tax reduction strategies to decrease the amount of tax owed.

Tax Deduction- Amount of an expense (e.g., charitable donation) subtracted from gross income that lowers income tax owed by the amount multiplied by a taxpayer's marginal tax rate (e.g., \$500 x .15).

W-2 Form- Tax form sent to workers by their employer to report earnings and income tax withholding.

W-4 Form- Form used by employers to determine payroll taxes withheld from their employees' paychecks.

Withholding- The process of deducting money from a worker's paycheck to cover their future tax liability.

LEARNING EXTENSIONS

If time permits, the following activities can be used to extend the depth of this lesson:

- ◆ Ask students to check with their parents to see if their parents claim the standard deduction or itemized deductions. If it's the latter, have students ask about the types of expenses that are claimed as a deduction (e.g., property tax and mortgage interest).
- ◆ Invite a local tax preparer as a guest speaker to talk about exemptions, deductions, and other legal ways that taxpayers can lower their tax bill.
- ◆ Have students view and debrief additional YouTube videos about income taxes:

Taxes 101(Tax Basics 1/3 MoneyCoach): https://www.youtube.com/watch?v=Z2r_apNMTeM
Do I Need to Pay Taxes? (Tax Basics 2/3 MoneyCoach): <https://www.youtube.com/watch?v=N6mdqgW6Cog>
How to Do Your Taxes (Tax Basics 3/3 MoneyCoach): <https://www.youtube.com/watch?v=pPAODTySduw>
Income Taxes Explained (thebasicgist): <https://www.youtube.com/watch?v=fijwSMIn-yY&t=33s>
Tax Avoidance/Evasion (Investopedia): <https://www.youtube.com/watch?v=CIOenRSdPOA>
Tax Deductions vs. Tax Credits (Investopedia): <https://www.youtube.com/watch?v=3xgA4TSYQm4>
Calculating How Much Tax You Owe (Investopedia): <https://www.youtube.com/watch?v=E3D2kPB95o8>
The Progressive Income Tax: A Tale of 3 Brothers (Prager U):
https://www.youtube.com/watch?v=S6HEH23W_bM

- ◆ Have students try out one or more of the following income tax calculators listed below. Teachers may want to create simple case studies with personal finance data that can be entered into the calculator.

Federal Income Tax Calculator (CalcXML): <http://www.calcxml.com/calculators/federal-income-tax-calculator>
Income Tax Calculator: 1040 Tax Estimator Calculator (Bankrate): <http://www.bankrate.com/calculators/tax-planning/1040-form-tax-calculator.aspx>
W-4 Withholding Calculator (TurboTax): <https://turbotax.intuit.com/tax-tools/calculators/w4/>
Withholding Calculator (Internal Revenue Service): <https://apps.irs.gov/app/withholdingcalculator/>
Earned Income Tax Credit (EIC) Calculator (Bankrate): <http://www.bankrate.com/calculators/tax-planning/earned-income-tax-credit-calculator.aspx>
Marriage Bonus and Penalty Tax Calculator (Tax Policy Center): <http://www.taxpolicycenter.org/interactive-tools/marriage-bonus-and-penalty-tax-calculator>
Mortgage Tax Deduction Calculator (Bankrate): <http://www.bankrate.com/calculators/mortgages/loan-tax-deduction-calculator.aspx>
Student Loan Interest Deduction Calculator (Student Loan Hero):
<https://studentloanhero.com/calculators/student-loan-interest-deduction-calculator/>
What We Pay For Calculator (WhatWePayFor.com):
<http://whatwepayfor.com/default.aspx?y=2010&c=0&sort=TotalDESC>

- ◆ Have students write a summary of what they learned about tax deductions for the school newspaper.
- ◆ Have students analyze and discuss information contained within the following infographic:

A Brief History of Income Taxes Infographic (Intuit TurboTax): <https://turbotax.intuit.com/tax-tools/tax-tips/General-Tax-Tips/A-Brief-History-of-Income-Taxes/INF18754.html>

ASSESSMENT: *Income Tax Exemptions and Deductions Quiz*

Instructors are encouraged to use the questions below for content review or as a pre-and/or post-test to determine gains in student knowledge about tax exemptions and deductions after teaching this lesson.

Correct answers to the multiple choice and True-False questions are shown in boldface type.

Multiple Choice Questions

1. Which of the following *cannot* be claimed as an itemized deduction on a federal income tax return?
 - a. Medical expenses
 - b. Home mortgage interest
 - c. Child care expenses**
 - d. Charitable donations

2. Compared to a person with two withholding allowances on a W-4 form, a person with six allowances
 - a. Will have a smaller take-home pay
 - b. Will have a larger tax refund
 - c. Will have no difference in take-home pay
 - d. Will have a smaller tax refund**

3. What step comes first when calculating federal income taxes?
 - a. Adjustments to income**
 - b. Standard deduction
 - c. Personal exemption(s)
 - d. Tax credit(s)

4. The term “marginal tax rate” refers to the rate of income tax on what dollar amount?
 - a. The weighted average of taxes owed at different levels of income
 - b. The first dollar of earnings
 - c. The last dollar of earnings**
 - d. The average amount of taxes owed during the past five years

5. If a person in the 24% marginal tax bracket who can itemize deductions makes a \$1,000 contribution to a qualified charity, what is the net out-of-pocket cost after tax benefits are subtracted?
 - a. \$240
 - b. \$500
 - c. \$760**
 - d. \$1,000

True-False Questions

1. Adjusted gross income is increased by tax deductions (standard or itemized) (**FALSE: Tax deductions and exemptions are subtracted from adjusted gross income (AGI) to arrive at taxable income, which is the amount of income used to calculate the amount of tax owed by an individual or household. AGI is calculated by subtracting certain specific expenses from gross income**)

2. Taxpayers who are renters and do not have a mortgage can deduct a portion of their rent as an itemized tax deduction (**FALSE: Rent is a personal living expense that taxpayers simply pay out-of-pocket. Any tax benefits received from a rental property go to the landlord who owns the property**)
3. Children who are claimed as a dependent on their parent's income tax return cannot claim a personal exemption for themselves (**TRUE: Children who are claimed as a dependent on their parent's tax return cannot claim a personal exemption on their own tax return. Since Social Security numbers are needed to claim a dependent, the IRS can easily find out if the same person is claimed twice**)
4. Everyone gets the same tax benefit by taking a tax deduction for charitable donations (**FALSE: The amount of tax benefit that taxpayers receive for making a charitable donation depends on their marginal tax bracket. Higher earners will get a higher benefit than people with lower incomes. To determine the tax savings, multiply the amount of a deductible expense by a taxpayer's marginal tax rate. For example, \$1,000 in itemized deductions reduces taxes by \$120 for someone in the 12% marginal tax bracket and by \$240 for someone in the 24% marginal tax bracket**)
5. Tax preparation fees are tax deductible (**FALSE: Prior to the Tax Cuts and Jobs Act, tax preparation fees were considered a miscellaneous itemized deduction on federal income tax returns. They were only deductible if the total of all of a taxpayer's miscellaneous itemized expenses, combined, exceeded 2% of adjusted gross income (AGI). The TCJA eliminated this tax deduction**)

REFERENCES AND RESOURCES

Itemizing vs. Standard Deduction: Six Tips to Help You Choose (IRS):

<https://www.irs.gov/uac/newsroom/itemizing-vs-standard-deduction-six-tips-to-help-you-choose>

Kapoor, J.R., Dlabay, L.R., Hughes, R.J., & Hart, M.M. (2016). *Focus on Personal Finance*. New York, NY: McGraw Hill Education.

Personal and Dependent Exemptions (U.S. Tax Center): <https://www.irs.com/articles/personal-and-dependent-exemptions>

Personal Exemptions and Dependents (Internal Revenue Service):

<https://www.irs.gov/publications/p17/ch03.html>

Standard Deduction vs. Itemized Deductions (H & R Block): <https://www.hrblock.com/get-answers/taxes/adjustments-and-deductions/standard-vs-itemized-deductions-10729>

Tax Breaks Every Parent Should Know About (Nolo Press): <http://www.nolo.com/legal-encyclopedia/tax-breaks-for-parents-30180.html>

Tax Deduction Wisdom-Should You Itemize? (TurboTax): <https://turbotax.intuit.com/tax-tools/tax-tips/Tax-Deductions-and-Credits/Tax-Deduction-Wisdom---Should-You-Itemize-/INF12061.html>

Tax Exemptions and Deductions for Families (TurboTax): <https://turbotax.intuit.com/tax-tools/tax-tips/Family/Tax-Exemptions-and-Deductions-for-Families/INF12053.html>

What is a Personal Exemption? (TurboTax): <https://ttlc.intuit.com/questions/1899192-what-is-a-personal-exemption>

Personal Income Taxes- A Visual Explanation

Debriefing Questions

After watching the video *Personal Income Taxes-A Visual Explanation*, answer the following questions:

Name three types of taxes that are deducted from workers' paychecks.

What is take-home pay? How does it differ from a worker's salary?

What is a W-2 Form?

What is income tax withholding?

When do taxpayers have to send an income tax payment to the IRS?

When do taxpayers receive an income tax refund?

What is the sequence of steps in determining the amount of income tax due?

What are two common types of adjustments on a federal income tax return to determine AGI?

What are two common types of itemized tax deductions on a federal income tax?

What are exemptions?

What is taxable income?

What are marginal tax rates?

Web Quest: Tax Cuts and Jobs Act

Instructions:

1. Go to an online search engine (e.g., Google, Bing) and search for terms such as “2017 income tax law,” “Tax Cuts and Jobs Act,” and “2018 Income Tax Rules.”
2. Read three articles (not paid advertisements) that describe features of the Tax Cuts and Jobs Act.
3. When you are done reading, complete the table below by listing the source of the three articles that you read and a summary of what you learned.
4. Be prepared to discuss the information that you found with the entire class.

Information Source	Information About the Tax Cuts and Jobs Act

Tax Deduction Math

Instructions:

Review your class notes or go online to search for information to use to answer the following questions.

Joe Rota, a single college graduate, is 28 years old and has a \$36,000 taxable income after subtracting the standard deduction from his annual gross income. What federal marginal tax bracket is he in (i.e., the income range that determines the tax rate paid on his last dollar of income)?

Joe is considering making a \$100 donation to the American Cancer Society to honor his uncle who recently passed away. How much will this save him on income taxes?

Joe is considering the purchase of a condo in New Jersey. The mortgage interest and property taxes, combined, will be \$1,200 less than the amount of the standard deduction allowed for single taxpayers. How much would his housing expenses save him on his income taxes?

Joe buys the condo and takes the standard deduction on his income taxes. How much will a \$100 donation to the American Cancer Society save him on taxes?

Joes completes additional job training and earns a promotion and a raise. He is now in a higher marginal tax bracket and his last dollar of income is taxed at a 24% rate. All of his tax-deductible expenses, combined, exceed the standard deduction by \$5,000. How much would itemizing deductions save him on his income taxes?

What is the take-away message about itemized tax deductions from these math calculations?

Is It Tax Deductible?

Instructions: Read the list below and search your class notes or go online to find out whether these items are eligible to be taken as itemized deductions on a federal income tax return or not. Check one of the boxes next to each item to indicate yes or no.

Description of Expense	Deductible	Not Deductible
Charitable Contributions		
Excise Tax on Gas or Cigarettes		
State Income Tax		
Mortgage Payment (Principal and Interest)		
Local Property Taxes		
Volunteer Time		
Medical and Dental Expenses		
Commuting Costs		
Political Candidate Contributions		
Tax Preparation Fees		
Gym Membership		
Insurance Premiums		

Should I Itemize or Take the Standard Deduction?

Instructions: Use the calculator at <https://www.calcxml.com/calculators/inc10> to answer the question, *Should I Itemize or Take the Standard Deduction*, using the information found in the following case study example. Be prepared to share your answer with the entire class.

Samantha Riggins is 31 years old and single and has a \$52,000 adjusted gross income (AGI). She had \$450 and \$380 of unreimbursed medical and dental expenses, respectively, and her state and local income taxes total \$4,000. She rents an apartment so, therefore, she pays no real estate (property) taxes, nor does she pay any personal property taxes. She pays \$150 in other taxes as payroll deductions for state unemployment insurance (SUI) and temporary disability (TDI) insurance. Samantha has no home mortgage or investment interest payments and received \$300 in investment interest and dividends. She also made \$500 in cash donations to charity.

Should I itemize or take the standard deduction?

If you have numerous itemized deductions such as mortgage interest, charitable contributions, etc., it may make sense for you to itemize your deductions instead of using the standard deduction for your tax filing status. Use this calculator to help you make that decision.

Input and Assumptions	Dental and Medical Expenses	Taxes You Paid	Interest (Paid/Received)	Charitable Contributions
Estimated AGI (adjusted gross income) (\$)				
<input type="text" value="52,000"/>				
Number of blind filers (0 to 10)				
<input type="text" value="0"/>				
Tax filing status				
<input type="text" value="Single"/>				
Number of filers over age 65 (0 to 10)				
<input type="text" value="0"/>				

Describe your conclusion here:

Income Tax Exemptions and Deductions Quiz

Multiple Choice Questions:

Circle the correct answer from among the four answers provided.

1. Which of the following cannot be claimed as an itemized deduction on a federal income tax return?
 - a. Medical expenses
 - b. Home mortgage interest
 - c. Child care expenses
 - d. Charitable donations
2. Compared to a person with two withholding allowances on a W-4 form, a person with six allowances
 - a. Will have a smaller take-home pay
 - b. Will have a larger tax refund
 - c. Will have no difference in take-home pay
 - d. Will have a smaller tax refund
3. What step comes first when calculating federal income taxes?
 - a. Adjustments to income
 - b. Standard deduction
 - c. Personal exemption(s)
 - d. Tax credit(s)
4. The term “marginal tax rate” refers to the rate of income tax on what dollar amount?
 - a. The weighted average of taxes owed at different levels of income
 - b. The first dollar of earnings
 - c. The last dollar of earnings
 - d. The average amount of taxes owed during the past five years
5. If a person in the 24% marginal tax bracket who can itemize deductions makes a \$1,000 contribution to a qualified charity, what is the net out-of-pocket cost after tax benefits are subtracted?
 - a. \$240
 - b. \$500
 - c. \$760
 - d. \$1,000

True-False Questions:

Mark “T” for True or “F” for False in the space before each question.

- ___ 1. Adjusted gross income is increased by tax deductions.
- ___ 2. Taxpayers who are renters and do not have a mortgage can deduct a portion of their rent as an itemized tax deduction.
- ___ 3. Children who are claimed as a dependent on their parent’s income tax return cannot claim a personal exemption for themselves.
- ___ 4. Everyone gets the same tax benefit by taking a tax deduction for charitable donations.
- ___ 5. Tax preparation fees are tax deductible.

The *Income Tax Exemptions and Deductions* lesson plan was written by Dr. Barbara O’Neill, CFP®, Extension Specialist in Financial Resource Management for Rutgers Cooperative Extension (boneill@njaes.rutgers.edu).

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