

YOUR MONEY

This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers visit <https://www.djreprints.com>.

<https://www.wsj.com/articles/first-time-paying-taxes-buckle-up-11568367002>

TAX REPORT

First Time Paying Taxes? Buckle Up

The tax code is always complicated, but it helps to know the basics



By
Laura

Saunders

Sept. 13, 2019 5:30 am ET

This column is part of the Journal's "The New Rules of Money" package about the financial challenges facing young adults.

If you're getting your first paycheck this year, congratulations! You've arrived. Welcome to the strange, confusing world of U.S. income taxes.

You're joining more than 200 million Americans each year who gather forms, face complex calculations and file an income-tax return with the Internal Revenue Service by April 15.

Often the tax code seems like a crazy quilt, and not just for new filers. Some features came in when typical households had one earner and dial telephones, so they don't mesh well with the 21st century.

Always, the tax code is complicated. That is partly because of how Congress works —or doesn't work. But the code also reflects modern economic life, which is far from simple. Its provisions have profound effects on individuals' retirement savings, investments, health care, homeownership and charitable giving, among other things.

Above all, the U.S. individual income tax is a powerhouse. It raises nearly half of all federal revenue, a much higher percentage than in many developed countries.

You'll likely be filing income taxes for a long time, so here are answers to some basic questions.

How much money can I earn before I owe federal income taxes?

The short answer is \$12,200.

That is the "standard deduction" for most single people in 2019. For most married couples, it doubles to \$24,400.

With taxes, a deduction is something everyone hopes for. Deductions are amounts subtracted from income the government taxes you on, so having them lowers your tax bill.

People can either list key deductions for items like state taxes or charitable donations on a special form, or they can skip that process and choose the standard deduction. This year nearly 90% of filers will opt for the standard deduction because it will save them more.

Often the tax threshold is higher than \$12,200 or \$24,400, however. People paying student-loan interest get a special deduction of up to \$2,500 for such interest per return. So a single person taking it can earn up to \$14,700 before owing tax.

Workers who contribute to retirement accounts like a traditional IRA or a 401(k) can raise their nontaxable amount by \$6,000 or more. Less often, taxpayers qualify for credits that reduce their actual taxes rather than just their income.

What are the rates on taxable income?

They range from a low of 10% to a high of 37%, and they phase in as income rises. State or local income taxes are on top of that.

OK, so why did the company that paid me a pittance for an internship take out so much for taxes?

The answer is withholding—and it has nothing to do with emotional style.

THE NEW RULES OF MONEY

Read more of the Journal's coverage of the financial challenges facing young adults.

- • Your Parents' Financial Advice Is (Kind Of) Wrong
- • Five Cities: Living on \$50K a Year
- • When a Sublet Scam Wipes Out Your Starting-Out Cash
- • Money Advice From the Pros
- • A Financial Starter Kit

Th
e
U.S
. tax
sys
te
m
is
pa
y-

Join WSJ journalists on a member-only call about the "New Rules of Money" package. Register here, and send your money-related questions to subscribercall@wsj.com.

as-you-earn. Employers usually must send part of each worker's paychecks to the government so the workers don't have to cope with a big bill at tax time. These payments are called withholding.

To be safe, your employer may have withheld more income taxes than you'll actually owe. In that case, you get the extra back by filing a tax return and claiming a refund.

Meanwhile, you may be able to adjust your withholding and get higher take-home pay by filling out an IRS Form W-4 and giving it to the business. There is a useful IRS

calculator for this.

But beware of withholding too little. The law requires most filers to pay 90% of the income tax they owe before year-end or soon after, or face penalties.

Also check your pay stub. Maybe the withholding is mostly for Social Security and Medicare taxes, not income taxes.

Why are my Social Security and Medicare taxes so high?

Lower earners often owe more for these social-insurance taxes than for income tax, because they can kick in on the first dollar of pay.

For example, the Social Security and Medicare tax on the first \$12,200 of pay for a single employee this year comes to \$933, while the federal income tax on it can be \$0 due to the standard deduction.

The Social Security tax is a flat 6.2% per employee, plus 6.2% for the employer, on the first \$132,900 of a worker's wages this year. The Medicare tax is 1.45% each for the employee and the employer, and it applies to all pay.

People who are self-employed, like gig workers and business owners, can owe even more in these taxes. More on this below.

How are education scholarships and stipends taxed?

You practically need a Ph.D. to figure it out. Scholarships that are used to pay for tuition, fees and textbooks are usually tax-free if the student is pursuing a degree or certificate. Tuition waivers for graduate student teaching and research are often tax-free as well.

So what's taxable?

Financial aid and stipends used to pay for living expenses such as room, board and transportation, among other things, says Mark Kantrowitz, publisher of Savingforcollege.com

This is where things get difficult. A 2017 law greatly raised the tax rates on taxable aid for many students under age 24. Advocates are hoping Congress will change the provision, but it hasn't yet.

Meanwhile, many colleges don't detail what part of an aid package is taxable, and currently they don't have to report taxable aid to the IRS. Tax specialists say the IRS isn't enforcing the law in this area.

How do I file my taxes if I don't have a permanent address, or if I lived in several states in the past year?

The IRS communicates by mail, so it needs a mailing address for each filer. If you don't have someone you trust to accept mail, consider a post office box.

Note that refund checks can be deposited directly to financial accounts. They don't have to be sent to the address on the tax return.

Workers who lived in more than one state during a year should check with each one to see if they need to file multiple state returns.

I'm a gig-economy worker. Are my taxes different?

So different! This is a vast topic that we've touched on before, but here's a quick outline.

If you're paid for work, but you aren't a business's employee, then you're "self-employed." Businesses that hire you likely won't withhold taxes from your pay, even if they pay you regularly. You'll be responsible for paying estimated taxes quarterly, but you'll also likely be able to deduct business expenses that employees can't.

SHARE YOUR THOUGHTS

What confuses you most about your taxes? Join the conversation below.

And you'll likely owe higher Social Security and Medicare taxes because gig workers owe both the employee and the employer portion of these taxes, although they get a deduction for half of it.

Advice for gig workers: Take your taxes seriously now, not later. The penalties for getting them wrong can be severe, and the IRS can be relentless. Consider asking a tax professional to outline the obligations, traps and benefits you're facing, even if you wind up doing your own taxes. Always, always keep good records.

What's the cheapest way to do my taxes?

Get ready to do research.

In theory, about 100 million filers earning below about \$66,000 have access to free online tax preparation provided by a dozen commercial firms through an IRS program known as Free File.

Yet recently only about 3 million filers annually have used Free File commercial tax prep, leading to charges that some firms have made it difficult on purpose. The IRS has hired a consultant to review the program, and Congress has also shown interest in possible changes.

If you want to use Free File, be sure to go through the IRS's website, not the individual providers' sites. Many states also offer free state tax-prep online, and some are linked to IRS Free File.

Separately, the IRS also offers an option called Free File Fillable Forms that has no income limit. This IRS site doesn't give advice, but confident taxpayers can fill in forms that do simple math and then e-file them to the IRS for free. IRS Publication 17 is a basic guide.

Credit Karma Tax provides free tax preparation for members, and it hopes filers will share their tax data for other uses. Intuit, the seller of TurboTax, and H&R Block provide free tax-prep through Free File and sometimes their own sites.

For taxpayers who don't qualify for Free File, Block and TurboTax still offer desktop software that can be used to prepare up to five federal returns. Last filing season, this option started at \$14.95 for Block and \$29.99 for TurboTax. State tax returns are often extra.

Finally, there is still the option of pencil, paper and U.S. mail, especially if you have a simple return. It is free, except the postage. Forms are available from the IRS online, and 2019 returns must be postmarked by midnight on April 15, 2020.

Wondering what happens if you don't file?

That is a long story, but just know that it's not good.

Write to Laura Saunders at laura.saunders@wsj.com

Copyright © 2020 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers visit <https://www.djreprints.com>.