DOCUMENT RESUME

ED 269 691 CG 019 077

TITLE	1986 Federal Income Tax Guide for Older Americans. Information for Filing 1985 Returns. Prepared by the Select Committee on Aging. House of Representatives, Ninety-Ninth Congress, First Session (December, 1985). Revised Edition.
INSTITUTION	Congress of the U.S., Washington, D.C. House Select Committee on Aging.
REPORT NO	House-Comm-Pub. No. 99-530
PUB DATE	86
NOTE	23p.
PUB TYPE	Legal/Legislative/Regulatory Materials (090)
EDRS PRICE	MF01/PC01 Plus Postage.
DESCRIPTORS	*Economic Status; *Income; *Older Adults; *Reference Materials; Taxes
IDENTIFIERS	Congress 99th; *Income Taxes

ABSTRACT

This document contains the Congressional 1986 Federal Income Tax Guide for Older Americans designed to help older Americans with moderate incomes file their 1985 federal income tax returns. It emphasizes issues which affect senior citizens directly and discusses each section of the tax forms. Information is provided on Internal Revenue Service publications and prerecorded telephone messages which give more detailed information on the subjects discussed. Eight sections are included: (1) who must file; (2) filing deadline; (3) which form to use; (4) assistance in preparing forms; (5) Social Security and Railroad taxability; (6) tax form preparation; (7) preparing for next year; and (8) gift and estate taxes. (NB)

[COMMITTEE PRINT]

1986 FEDERAL INCOME TAX GUIDE FOR OLDER AMERICANS

INFORMATION FOR FILING 1985 RETURNS

PREPARED BY THE

SELECT COMMITTEE ON AGING

HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

FIRST SESSION

REVISED EDITION

DECEMBER 1985

Comm. Pub. No. 99-530

Printed for the use of the Select Committee on Aging

This document has been printed for informational purposes only It does not represent either findings or recommendations adopted by this Committee

U S GOVERNMENT PRINTING OFFICE

55-992 O WASHINGTON 1986

SELECT COMMITTEE ON AGING

EDWARD R ROYBAL, California, *Chairman*

CLAUDE PEPPER, Florida
MARIO BIAGGI, New York
DON BONKER, Washington
THOMAS J DOWNEY, New York
JAMES J FLORIO, New Jersey
HAROLD E FORD, Tennessee
WILLIAM J HUGHES, New Jersey
MARILYN LLOYD, Tennessee
STAN LUNDINE, New York
MARY ROSE OAKAR, Ohio
THOMAS A LUKEN, Ohio
BEVERLY B BYRON, Maryland
DAN MICA, Florida
HENRY A WAXMAN, California
MIKE SYNAR, Oklahoma
BUTLER DERRICK, South Carolina
BRUCE F. VENTO, Minnesota
BARNEY FRANK, Massachusetts
TOM LANTOS, California
RON WYDEN, Oregon
GEO W. CROCKETT, Jr., Michigan
WILLIAM HILL BONER, Tennessee
IKE SKELTON, Missouri
DENNIS M. HERTEL, Michigan
ROBERT A BORSKI, Pennsylvania
FREDERICK C BOUCHER, Virginia
BEN ERDREICH, Alabama
BUDDY MacKAY, Florida
HARRY M REID, Nevada
NORMAN SISISKY, Virginia
ROBERT E. WISE, Jr., West Virginia
BILL RICHARDSON, New Mexico
HAROLD L. VOLKMER, Missouri
BART GORDON, Tennessee
THOMAS J MANTON, New York
TOMMY F ROBINSON, Arkansas
RICHARD H STALLINGS, Idaho

MATTHEW J RINALDO, New Jersey,
Ranking Minority Member
JOHN PAUL HAMMERSCHMIDT, Arkansas
RALPH REGULA, Ohio
NORMAN D SHUMWAY, California
OLYMPIA J SNOWE, Maine
JAMES M JEFFORDS, Vermont
THOMAS J TAUKE, Iowa
GEORGE C WORTLEY, New York
JIM COURTER, New Jersey
CLAUDINE SCHNEIDER, Rhode Island
THOMAS J RIDGE, Pennsylvania
JOHN McCAIN, Arizona
GEORGE W. GEKAS, Pennsylvania
MARK D SILJANDER, Michigan
CHRISTOPHER H. SMITH, New Jersey
SHERWOOD L BOEHLERT, New York
JIM SAXTON, New Jersey
HELEN DELICH BENTLEY, Maryland
JIM LIGHTFOOT, Iowa
HARRIS W FAWELL, Illinois
JAN MEYERS, Kansas
BEN BLAZ, Guam
PATRICK L SWINDALL, Georgia
PAUL B HENRY, Michigan
JIM KOLBE, Arizona
BILL SCHUETTE, Michigan

FERNANDO TORRES-GIL, *Staff Director*
PAUL SCHLEGEL, *Minority Staff Director*

FORWARD

This year's House Select Committee on Aging 1986 Federal Income Tax Guide for Older Americans is patterned after the well received guide published by the Committee last year.

The guide is again targeted to older Americans with moderate incomes. It not only emphasizes issues directly affecting senior citizens but also discusses each section of this year's tax forms to better help taxpayers fully understand the entire process. In addition, we have identified IRS publications and/or prerecorded telephone messages which give much more detailed information on the subjects discussed.

At the time this tax guide was being prepared, the House of Representatives had just passed a comprehensive tax reform bill (H.R. 3838). Should this or similar legislation be enacted during 1986, it is anticipated that its changes would not become effective until 1987.

We thank the Congressional Research Service, the Social Security Administration and the Railroad Retirement Board, and the Internal Revenue Service for having reviewed and commented on drafts of the guide. Finally, we thank Allen Johnston, primary author of the report, who is the Staff Director of the Subcommittee on Retirement Income and Employment which I also chair.

EDWARD R. ROYBAL, Chairman

TABLE OF CONTENTS

I. WHO MUST FILE

Generally, every person under age 65 who has wages, taxable pensions, interest and other taxable income of \$3,430 or more in 1985 (\$5,620 for a couple) must file an income tax return regardless of whether any taxes are due. These figures increased to \$4,470 for persons age 65 or over (\$6,660 for a married couple if one is age 65 or over, \$7,700 if both are age 65 or over) or to \$4,580 for persons widowed within the last two years who live with a dependent child (\$5,620 if age 65 or over).

There are some situations where persons with incomes of less than \$3,430 are also required to file tax returns. Three of the most common are:

1. If you are married but live apart from your spouse, or you live together but choose to file separate returns, you must file if you have income of \$1,040 or more.
2. If you were self-employed and had a net profit of at least \$400 in 1985, you must file in order to pay and be credited for your Social Security taxes.
3. If your employer paid you in advance for any Earned Income Credit you may be entitled to because you lived with a minor child and expected to have income less than \$11,000, you must file a return regardless of your total income.

Even if you are not required to file a tax return, you should do so if you want to claim a refund for any taxes withheld during 1985. If you do not file, you will not get a refund.

II. FILING DEADLINE

The filing deadline for 1986 is midnight, Tuesday, April 15. Any return postmarked after April 15 may be subject to tax penalties unless an individual request for an extension of the deadline is filed by that date. All taxes, however, must be paid by April 15 even if you request an extension of time to file your return.

III. WHICH FORM TO USE

There are three forms for filing federal tax returns -- Form 1040EZ, Form 1040A, and Form 1040. If you have filed taxes in the past, a tax return package, including instructions, should be mailed to you in early January. If you did not receive the proper tax package, you can probably find the forms you need at your local public library, post office, or bank. You can also call the local Internal Revenue Service (IRS) office or the toll free number listed in the telephone book to request forms or publications.

Form 1040EZ

Form 1040EZ is for single taxpayers under age 65 who have no dependents and taxable incomes from salaries, tips and interest of less than $50,000. However, if you receive more than $400 in interest income, you cannot use the 1040EZ. No tax credits or income deductions other than a partial deduction for charitable contributions may be taken on the 1040EZ.

Form 1040A

Form 1040A is primarily for individuals or couples with taxable incomes of less than $50,000 from salaries, tips, interest, dividends, and unemployment compensation. There are three tax credits and three income adjustments which can now be claimed on the 1040A. The three tax credits are for: a portion of child or dependent care expenses; an "earned income credit" for some lower income workers; and a partial credit for contributions to a political party, newsletter, or campaign. The three income adjustments are: a charitable contributions deduction for nonitemizers; the deduction for certain contributions to an Individual Retirement Arrangement; and the deduction for a married couple when both work.

Form 1040

Form 1040 is primarily for people who either have more complex tax situations or who can claim large income tax deductions for such items as mortgage interest, medical expenses and/or state and local taxes.

IV. ASSISTANCE IN PREPARING FORMS

IRS Publications

The following list of free Internal Revenue Service (IRS) publications may be particularly helpful to older

Americans. They may often be found at public libraries, post offices, and banks. You may also order these and other publications by using the form on the inside back cover of your tax package or by calling the IRS. A more complete list appears with the order form.

Pub. 017 .... Your Federal Income Tax
Pub. 524 .... Credit for the Elderly and the Permanently and Totally Disabled
Pub. 530 .... Tax Information for Owners of Homes, Condominiums & Cooperative Apartments
Pub. 553 .... Highlights for 1985 Tax Changes
Pub. 554 .... Tax Information for Older Americans
Pub. 575 .... Pension and Annuity Income
Pub. 907 .... Tax Information for Handicapped and Disabled Individuals
Pub. 910 .... Taxpayer Guide to IRS Information Assistance
Pub. 915 .... Tax Information on Social Security Benefits

IRS Tax Counseling

The Tax Counseling for the Elderly (TCE) program provides free tax assistance and return preparation to individuals age 60 and over. In addition, Volunteer Income Tax Assistance (VITA) preparers are trained to assist elderly, low-income, handicapped and non-English-speaking taxpayers. To find the nearest location, call the toll free IRS number for your area listed in your tax form instruction package or the general IRS number listed in the telephone book.

IRS Tele-Tax Recordings

The IRS has approximately 150 pre-recorded tapes that answer most common Federal tax questions. If you have a push-button phone, service is available 24 hours a day, 7 days a week. New rotary (dial) service is available Monday through Friday during business hours. Long distance charges may apply if you call from outside the local dialing area. You should have pencil and paper ready to take notes. The following is a partial list of Tele-Tax tapes which are of particular interest to older Americans.

Tape Number

100	IRS help available
101	Tax assistance for handicapped individuals and the deaf
110	Who must file ?
112	When, where, and how to file
119	Exemption for age and blindness
139	Pensions and annuities
209	Social Security and tier I railroad retirement taxability
210	Social Security Benefit Statement -- Form SSA-1009
218	Individual Retirement Accounts (IRAs)
227	Should I itemize ?
306	Child care credit
308	Residential energy credit
309	Credit for the elderly and disabled
315	Highlights of 1985 tax changes
328	Tax benefits for low income Americans
337	Checklist/Common errors when preparing your return
338	Withholding on pensions and annuities
400	Sale of personal residence -- Exclusion of gain, if age 55 and over

You can find the Tele-Tax telephone number for your area and a more complete listing of tapes toward the back of your tax instruction booklet.

Private Tax Return Preparers

You are responsible for the accuracy of every item entered on your return. If you pay someone to prepare the return for you and there is a mistake, the IRS will ask you, and not the preparer, to pay any back taxes or penalties. Therefore, you should be careful to choose someone who understands tax matters and who will prepare a complete and accurate return.

The law requires a paid preparer to sign the return and to complete the Paid Preparers Information section at the bottom of the form, just below your signature. You should also know how to locate this person in the future if the IRS has a question about your return.

V. SOCIAL SECURITY AND RAILROAD TAXABILITY

Approximately ten percent of the 36 million people who receive social security benefits will owe income taxes on a portion of the benefits they received in 1985. Also, many of the more than one million persons receiving railroad retirement benefits will be required to include a greater portion of their benefits in taxable income this year.

Since income taxes are not withheld from monthly social security checks and underwithholding may subject you to a penalty, you may want to have tax withholding increased from your other income if you expect to owe taxes on the benefits you received in 1985. Railroad retirees may elect to have income taxes withheld from their benefits. Alternatively, you may prefer to make quarterly estimated tax payments directly to IRS. See "Estimated Tax and Withholding" on page 18.

Taxation of Social Security Benefits

Generally, you will owe taxes on some of your social security benefits if your total income minus half of your social security benefits exceeds a threshold of $25,000 for singles and married persons who lived apart all year and do not file jointly, and $32,000 for married couples filing jointly. Married couples who lived together but file separate returns must include part of their benefits in taxable income regardless of the amount of other income. Since the $25,000/$32,000 threshold will not increase in future years, a greater portion of beneficiaries will have their benefits taxed each year.

The Social Security Administration (SSA) is required to send every beneficiary a statement (Form SSA-1099) showing the total amount of benefits received in 1985. Benefits for previous years which were paid to you in 1985 and any benefits you repaid in 1985 should not be included in the total "net benefits" used to determine if any of your benefits are taxable. If you do not receive an SSA-1099 by early February or you believe the statement to be incorrect, you can call your local SSA office, or for pre-recorded information on your Form SSA-1099 call either the toll free "900" number printed on your SSA-1099 or IRS Tele-Tax tape number 210.

To determine quickly whether you may owe taxes on a portion of your benefits, add up all of your income from all sources, including any tax-exempt interest you may have receive. If the total of all your income is less than $25,000 ($32,000 for couples) then you can be sure that none of your social security benefits are taxable unless you are married but live separately. For example, a single retiree with $4,800 from a private pension, $6,000 in part-time wages, $2,400 in interest on savings, $1,000 in interest on municipal bonds and $7,200 from Social Security has a total income of $21,400. Since this person's total income from all sources is less than $25,000, she can be sure that none of her social security benefits are taxable.

If the total of all your income from all sources exceeds $25,000 ($32,000 for couples), you need to check further to determine how much, if any, of your benefits will be subject to tax. One group particularly likely to owe additional taxes on their benefits is couples with one retired spouse and one spouse working. Married couples who live together but file separate returns will usually pay more taxes than if they filed jointly.

Generally, the actual amount of benefits subject to tax is the lesser of one-half of your benefits or one-half of the amount by which all of your non-social security income plus one-half of your social security benefits exceeds $25,000 ($32,000 for couples).

IRS has a worksheet for calculating the amount of benefits subject to tax on page 11 of the Form 1040 instruction booklet. For more complete information, see IRS Publication 915, "Tax Information on Social Security Benefits (and Tier I Railroad Retirement Benefits)" or call Tele-Tax tape 209, "Social security and railroad retirement taxability."

Taxation of Railroad Retirement Benefits

A railroad retirement benefit is comprised of up to four different parts. Prior to 1984, only the supplemental annuity was taxable. Beginning in 1984, the other three parts became taxable but each in a different way. Only tier I benefits are taxed in the same manner as social security benefits. Tier II benefits are fully taxable after they exceed the retirement contributions which were deducted from earning during the worker's career. Vested dual benefits, like the supplemental annuity, are fully taxable.

By January 31 the Railroad Retirement Board will send each beneficiary a Form RRB-1099 documenting the amount of tier I benefits, a Form RRB-W-2P covering the other parts, and a worksheet to help determine whether benefits are taxable. If you receive both railroad retirement and social security benefits, you should use the railroad retirement worksheet. More complete information can be found in IRS Publication 575, "Pension and Annuity Income."

VI. TAX FORM PREPARATION

This section describes the major sections of the 1040A and 1040 tax forms. Each item is discussed in the order that it appears on the forms. The tax form, line numbers, and relevant IRS pamphlets and Tele-Tax recordings are shown for each item.

Presidential Campaign Fund

You may voluntarily choose to have $1 of your taxes ($2 on a joint return) directed to this fund to help pay for Presidential election campaigns. This will not change the amount you pay or refund you receive.

Filing Status

Form 1040A, Lines 1-4; Form 1040, Lines 1-5
IRS Publication 017, "Your Federal Income Tax", Chapter 2
Tele-Tax Tapes 114 to 118

There are five different filing statuses: single, married filing jointly, qualifying widow(er); married filing singly; and head of household.

Generally, you are single if you were never married or were divorced or legally separated as of December 31. If you were married as of December 31, or if your spouse died in 1985 and you did not remarry before December 31, the IRS considers you to be married. Most married persons pay less by filing joint returns. However, you may elect to file separately.

Special provisions for qualifying widow(er)s and heads of households allow some single persons to pay taxes at rates lower than those used by other unmarried taxpayers. For instance, the tax on taxable income of $20,000 is $3,131 for a single person, but $2,898 ($233 less) for someone who is a head of household and $2,419 ($712 less) for someone who is a qualifying widow(er).

Qualifying Widow(er). If your spouse died in 1983 or 1984 and you remained unmarried in 1985, you may be able to continue to pay taxes at the lesser married filing jointly tax rates if (1) your dependent child, grandchild, etc. lived with you and (2) you paid more than one-half of the costs of maintaining your home during all of 1985.

If you meet all the requirements to file as a qualifying widow(er) you must use Form 1040. If you do not qualify because your spouse died prior to 1983, you may still be able to file as a head of household.

Head of Household. If you were unmarried as of December 31, 1985, or lived apart from your spouse for the last six months of 1985, and you provided over half cost of maintaining a home for yourself and your unmarried child or grandchild -- regardless of their age or whether they were financially dependent on you -- you may be eligible to pay taxes at the lesser head of household rates. You may also be able to file as head of household for other relatives such as your mother or father, married child, brother or aunt if you are entitled to claim them as dependents.

Exemptions

Form 1040A, lines 5a-5f & 18; Form 1040, lines 6a-6f & 36
IRS Publication 501, "Exemptions"
Tele-Tax Tapes 119-122

You can reduce your taxable income by $1,040 for each exemption you you are entitled to claim. Generally you can claim exemptions for yourself, your spouse, your minor children and any other dependent relative or member of your household who has less than $1,040 in non-Social Security income subject to federal income taxes. If you are age 65 or older on January 1, 1986, you can take an extra $1,040 exemption for 1985. An additional exemption is allowed if you are blind.

Letting Someone Else Claim Your Exemption. If you had under $1,040 in wages, dividends, interest or other non-Social Security income subject to federal income taxes, it may be possible for a relative or an unrelated person living with you to claim your $1,040 exemption on his/her return. However, this taxpayer cannot claim any extra exemption if you are age 65 or blind. Since you would not owe any taxes and your exemption could reduce the taxpayer's tax bill by hundreds of dollars, this is one financial benefit you can give this relative or other taxpayer.

In order to claim you as an exemption, your child or other individual must have provided you, either in cash or in food, shelter, or other non-cash items, with more than one-half of your support for the year. As an example, assume your total income was $200 or $300 a month from a nontaxable pension plus $20 or $30 a month from interest on savings. If you lived rent-free in a home owned by your oldest child who also purchased most of your groceries, and the contributions to your support by your older child are more than half your total support, then he/she can claim an exemption for you on his/her own tax return.

If more than one-half of your support is not provided by any one person but by two or more relatives or people living with you, then one of them -- but only one -- may be able to claim your exemption as long as he/she contributed more than ten percent of your support. The taxpayer who claims your exemption must include statements (Form 2120) from all the other contributors who provided more than ten percent of your support saying they will not claim you as an exemption this year. These people can, if they wish, then agree among themselves to let a different contributor claim you as an exemption in future years.

Total Income

Form 1040A, Lines 6-10; Form 1040, Lines 7-23
IRS Publication 525, "Taxable and Nontaxable Income"
Tele-Tax Tapes 130-207 & 209

Almost every employer or institution which pays you income is required, by January 31, to send you a Form W2 or a Form 1099 telling you how much they paid you in 1985. However, even if you were not notified, it is still your responsibility to list all taxable income.

Forms 1040A and 1040 have specific entry lines for wages, salaries, tips, interest income, dividends and unemployment compensation. The 1040 also includes space for other types of taxable income such as pensions and annuities, rent, royalties and profits from self-employment and taxable social security benefits.

Some of the important non-salary income sources for Older Americans and their tax status are listed below.

Tax-Free Income. (Tele-Tax Tape 208) Gifts and Inheritances you receive are not taxable to you. The person making the gift or bequest already paid taxes, if any, on the income used to purchase the gifts or build the estate. However, if you later receive income such as interest, dividends, or rents from such property, that income is taxable to you.

Veterans Administration payments and/or insurance proceeds are not normally taxable. Life Insurance proceeds paid at the death of the insured are usually tax free.

Generally Taxable Income. Dividend and interest income is generally taxable. However, interest earned on notes or bonds issued by a state or local government is not taxable and there is a $100 ($200 for married couples) exclusion for dividends. In addition, dividends from public utility companies which are reinvested in those companies are not taxable. (Call Tele-Tax Tapes 132 and 133.) If you fail to provide the payer of interest and dividends with your correct Social Security number or you do not include all of this income on your tax return, the IRS can require the payer to withhold twenty percent of future interest and dividend income as payment for taxes due. (Call Tele-Tax Tape 335.)

Social security benefits are tax free for most beneficiaries. However, about ten percent of beneficiaries will be required to pay income taxes on part of the benefits they received in 1985. For a more detailed discussion of the taxation of social security benefits, see "Social Security and Railroad Taxation" on page 4.

Profits from the sale of a home may be taxed at lower capital gain tax rates unless you purchase another home home of equal or greater value within two years. It is not necessary, however, to use the profit from the sale of the first home as a down payment on the second home in order to defer the taxes on the gain.

Special rules apply to the sale of a home by persons age 55 or over. If either you or your spouse were age 55 or over, and you lived in the house for three years of the five-year period ending on the date of the sale, you may elect to completely exclude up to $125,000 of the profit from taxable income regardless of whether you buy another home. You can only use the age 55 exclusion one time regardless of how much profit you realize. If your spouse has already taken the exclusion, even if it was prior to your marriage, neither of you can claim another exclusion unless the original exclusion was revoked within three years.

If you sell a large home and then purchase a smaller home, you should carefully consider whether it will be more advantageous to use the exclusion now or when you sell the second home. Since the profits on the first home are partially tax deferred due to the purchase of the second home, it might be better to wait. However, if the purchase price of the second home is much smaller than the sale price of the first, you may not be able to defer much of your gain. Therefore, you might be better off to take the exclusion on the first home. (See IRS Publication 523 "Tax Information on Selling Your Home" and/or call Tele-Tax Tapes 343, 344 and 400.)

Employer pensions or annuities are taxable except for the amount, if any, which the employee had deducted from his pay during his/her working years. If he/she receives a large lump sum payment, part of it may be subject to lower capital gain tax rates and the remainder treated as if it had been paid over a 10 year period. (See IRS Publication 575 "Pension and Annuity Income" and/or call Tele-Tax Tapes 139 through 141.)

Distributions from an IRA, whether from principal or interest, are fully taxable when received. A 10 percent tax surcharge applies to any distribution prior to age 59 1/2 except in cases of disability or death. Minimum distributions must begin by April 1 of the calendar year following the year in which you reach age 70 1/2 to avoid substantial tax penalties.

Unemployment insurance benefits may be taxable if your adjusted gross income plus your benefits exceed $12,000 ($18,000 for a married couple). (See IRS Publication 905, "Tax Information on Unemployment Compensation" and/or call Tele-Tax Tape 204.)

Adjusted Gross Income

Form 1040A, lines 11-14; Form 1040, lines 24-32
Tele-Tax Tapes 211-219

Once you have determined the total amount of income subject to taxation, you may "adjust" that income downward with any of seven major adjustments.

Contributions to an IRA and (on a joint return) up to ten percent of the earned income of the lower earning spouse (but not more than $3,000) can be deducted on either Form 1040A or Form 1040. All other adjustments must be claimed on the Form 1040. These other adjustments include: unreimbursed moving and work-related expenses by employees; contributions to a Keogh Retirement Plan by self-employed persons; penalties paid due to premature withdrawal of funds from your time savings deposits; and alimony payments.

Individual Retirement Arrangements (IRAs). Every working individual under age 70 1/2, whether or not covered by any other pension, may contribute the lesser of 100 percent of compensation or $2,000 to an IRA. You can deduct the amount contributed from your 1985 income as long as you make the contributions on or before April 15, even if you file your return earlier. You pay no taxes on either principal contributed or interest earned until you withdraw the funds.

Where only one member of a married couple works for income, up to $2,250 may be contributed to two IRAs. You can divide the contribution between the two accounts in any way except that neither can be credited with more than $2000. (See IRS publication 590, "Individual Retirement Arrangements (IRAs)" and/or call Tele-Tax Tape 218.)

Charitable Deduction

Form 1040A, line 16; Form 1040, line 34e
IRS Publication 526 "Charitable Contributions"
Tele-Tax Tape 211

Generally, every taxpayer who contributes cash or property to charity or who incurs out-of-pocket expenses when doing volunteer work for a charitable or religious organization, may deduct 50 percent of their contributions However, you can not claim this partial deduction if you claim your contributions as an itemized deduction.

Itemized Deductions

Form 1040 only, Line 34a and Schedule A
Tele-Tax Tape 227, "Should I Itemize My Deductions?"

A standard income tax deduction, now called a "zero bracket amount", is already figured into the tax tables from which you will determine your tax bill. The zero bracket amount is $2,390 for single persons and those filing as head of household, $3,540 for joint returns and for qualifying widow(er)s, and $1,770 for married persons filing separately. You can further reduce your taxes if you can itemize, or list, deductible expenses which exceed your zero bracket amount. If you itemize deductions, you must use Form 1040.

To determine whether itemizing deductions is worthwhile for you, add togethe any 1985 expenses you had in the following major areas of deductibility:

1. medical and dental expenses;
2. income, sales and property taxes paid to state and local governments;
3. interest paid on home mortgages, automobile loans, and other credit accounts; and
4. contributions to religious and charitable organizations

If your total exceeds, or even approximates, $2,390 ($3,540 for couples), you should fully review the Form 1040 instruction package to investigate how much, if any, your itemized deductions exceed your zero bracket amount.

You will find there are several deductible items in addition to the major categories listed above. They range from union and professional dues, to casualty and theft losses, to tax return preparation fees. However, you will also find that you can only deduct medical expenses, including insurance premiums, to the extent they exceed five percent of your adjusted gross income.

The Tele-Tax tape list toward the back of your instruction booklet includes eleven pre-recorded tapes (numbers 227 through 238) on itemized deductions. In addition, the free publication list and order form on the back cover of your tax package contains numerous pamphlets on specific deductible expenses.

Itemizing deductions can be time consuming. However, if you are a couple with $20,000 in taxable income who can legitimately claim an additional $2,000 in deductible expenses over and above their standard $3,540 deduction, they can reduce their taxes by $360 (from $2,419 to $2,059).

Tax Computation

Form 1040A, lines 19-20; Form 1040, line 37-40
Tele-Tax Tapes 240, and 243

Once you have claimed all your adjustments, exemptions and deductions, you are left with a figure called "taxable income" from which you determine how much you owe. To find your tax, locate your taxable income in the tax tables in the back of your tax instruction booklet and match it with the column showing your filing status. For instance, if you have $20,000 in taxable income and your filing status is head of household, you find the line for taxable incomes of at least $20,000 but less than $20,050 and look under the column labeled "head of household" to find that your tax is $2,898.

If your income in 1985 was more than forty percent greater than it averaged over the previous three years, you may be able to reduce your taxes by "income averaging". This may be helpful for recent retirees who receive large lump sum payments upon retirement. (See IRS Publication 506 "Income Averaging" and/or call Tele-Tax Tape 244.)

Tax Credits

Form 1040A, Lines 21-25; Form 1040, Lines 41-45, 59, 62-64

Tax credits directly reduce the amount of tax you owe. Partial credit for political contributions, the Earned Income Credit, and the Credit for Child and Dependent Care Expenses may be claimed on either Form 1040A or Form 1040. The Credit for the Elderly and the Permanently and Totally Disabled, the Residential Energy Credit, and all other credits must be taken on Form 1040.

Credit for the Elderly and the Permanently and Totally Disabled. This credit may reduce your taxes by as much as $750 ($1,125 if married) if you are at least age 65 or if you are under 65 but retired due to permanent and total disability and you receive a taxable disability pension. These maximum credits are reduced if you receive social security or tier I railroad retirement benefits that are not taxed, veterans benefits and/or your adjusted gross income exceeds $7,500 ($10,000 for a married couple). Generally, you are not eligible for any credit if your monthly benefits exceed $417 a month ($625 for a couple) or your adjusted gross income exceeds $17,500 ($25,000 if married).

For more information see the instructions for Schedule R of Form 1040. (See also IRS Publication 524, "Credit for the Elderly and the Disabled" and/or call Tele-Tax Tape 309.)

Credit for Political Contributions. You may take a partial credit for contributions to political parties, candidates for public office, and/or political committees established to help elect candidates. The amount of this credit is the lesser of one-half of your contributions or $50 ($100 for a joint return). (Call Tele-Tax Tape 310.)

Credit for Dependent Care Expenses. If you paid someone to take care of a disabled spouse, child under age 15, or other disabled dependent who lives with you so you could work or look for a job, you may be able to claim a credit of up to $720 ($1,440 for two or more dependents). The amount of the credit ranges from a maximum of 30 percent of expenses for taxpayers with adjusted gross incomes of up to $10,000 to a minimum of 20 percent for taxpayers with adjusted gross incomes above $28,000. The maximum amount of expenses used to compute the credit is $2,400 ($4,800 for two or more dependents). (See IRS Publication 503 "Child and Dependent Care Credit and Employment Tax for Household Employers" and/or call Tele-Tax Tape 306.)

Earned Income Credit. If you worked and had earnings less than $11,000, you may be able to claim an earned income credit if you have a dependent child or grandchild who lived with you. The credit is ten percent of the first $5000 in wage or self-employment income for a maximum credit of $550. Income over $6,000 reduces the amount of the credit. The earned income credit, unlike other credits, can be paid to you as a "refund" even if you do not owe any taxes. Your employer can even pay you in advance for this credit. (See IRS Publication 596, "Earned Income Credit" and/or call Tele-Tax tape 307.)

Residential Energy Credits. There are two types of credits which offset some of the costs of installing (1) home energy conservation devices, and (2) renewable energy source property. The credit is available only for items installed before 1986. The Energy Conservation Credit amounts to 15 percent of the first $2,000 in expenditures for items for your home such as insulation, weatherstripping, and storm windows. You must be living in a home built before April 20, 1977 to claim this credit. The Credit for Renewable Energy Source Costs equals 40 percent of the first $10,000 spent on installing equipment to produce or distribute heat or electricity from solar, geothermal, or wind energy sources. This credit can be taken in one year or over a number of years up to a maximum credit of $4,000 on any one home. (See IRS Publication 903, "Energy Credits for Individuals" and/or call Tele-Tax Tape 308.)

Other Taxes

Form 1040 only, lines 51-56

In addition to your regular income taxes, you could owe additional taxes in any of six other tax categories listed on the Form 1040. The two categories of most importance to older Americans are: (1) Social Security taxes due on the profits from self-employment; and (2) surcharge taxes on IRA funds withdrawn before age 59-1/2 or the failure to begin withdrawals by April 1 of the calendar year following the year in which you reach age 70-1/2. The other taxes are on tip income, the alternative minimum tax applicable to high income persons with large deductions and a recapture of previous investment credits by businesses.

Refund/Amount Due

Form 1040A, lines 23-27; Form 1040, lines 57-68

Once you have determined your final tax liability by subtracting out all your credits and adding in any other taxes, you have only one more step -- to determine whether you owe the government or the government owes you. If the amount of your withholding and estimated tax payments plus any other payments exceed your tax liability, you are due a refund. If not, you should attach a check or money order for the total amount of the taxes you owe.

VII. PREPARING FOR NEXT YEAR

Estimated Tax and Withholding

IRS Publication 505, "Tax Withholding and Estimated Tax"
Tele-Tax Tapes 126 and 408

The federal income tax system operates on a pay-as-you-go basis. Typically taxes are withheld from wages, salaries and other forms of compensation including some retirement payments. If taxes are not withheld you are probably required to make quarterly payments to meet your estimated tax liability. Some examples of income from which income tax is not withheld are: interest and dividends; self-employment; alimony; rental income; capital gains; and the taxable portion of social security benefits.

Estimated Tax Requirements. If you expect to have over $500 in income from which taxes are not withheld and you expect to owe taxes of $500 or more in 1986, you should make estimated tax payments on or before April 15, June 15, September 15, and January 15.

To calculate your estimated tax, add together your expected income tax, alternative minimum tax, and any Social Security self-employment tax. Next subtract anticipated income tax withholdings and tax credits. If you have income from which taxes are withheld and other income from which no taxes are withheld, you may be able to increase the withholdings on the first income and eliminate the need to make quarterly payments. If your estimated payments and withholdings total less than 80 percent of your tax liability you may incur a penalty for underpayment of taxes. No penalty is assessed, however, if the taxes you pay during 1985 equal or exceed your total tax liability for 1984.

Withholding On Pensions And Annuities. Income taxes will generally be to be withheld from the taxable part of most pension and annuity payments you receive. If you receive such payments and failed to give the payer your current marital status and the number of exemptions you can claim, taxes will be withheld as if you were married with three exemptions. Therefore, if you are single, too little tax will be withheld and you could owe additional and possibly be subject to penalties. On the other hand, if you have several dependents and/or itemize deductions, you may be paying more tax than necessary. Although you can get a refund for all your excess withholdings, the government does not pay you any interest on the money it holds.

Use Form W-4P to inform your pension or annuity payer of the proper number of exemptions you can claim. You can even tell the payer not to deduct any taxes at all. However, it is then up to you to make estimated tax payments or to increase the amount of withholdings on other income to meet your tax obligations, if any.

Highlights for 1986

Tax Indexing. The 1986 tax table and the tax rate schedules have been adjusted so that inflation will not increase your taxes. The following have also been adjusted:

1. the exemption amount will increase from $1,040 to $1,080.
2. the zero bracket amounts will be $3,670 for married individuals filing a joint return and for a widow(er) with dependent child; $2,480 for a single individual or a head of household; and $1,835 for a married individual filing a separate return.
3. the amount of gross income you may receive before you are required to file a return will increase.

You will have to file a return if your gross income is at least: $3,560, you are single and under age 65; $4,640, you are single and age 65 or over; $5,830, you are married, filing jointly and are both under age 65 ($6,910 if one is age 65 or over, $7,990 if both are age 65 or over); $1080, you are married and filing a separate return; or $4,750, you are a qualifying widow(er) and under age 65 ($5,830 if age 65 or over).

Charitable Contributions. For 1986, nonitemizers may deduct 100 percent of their charitable contributions after applying the adjusted gross income limits to the amount they contributed.

VIII. GIFT AND ESTATE TAXES

Any cash or property you receive as a gift or inheritance is generally free. Likewise, any gift or inheritance you pass on is tax-free to the recipient. Generally, if you make a gift of more than $10,000 to any one individual in the same year, you -- but not the recipient -- may be required to pay a gift tax.

For deaths occurring during 1985, no federal estate tax, nor any estate tax return, is due if the value of the deceased's estate is $400,000 or less. This amount increases to $500,000 in 1986 and $600,000 in 1987.

O