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02 FAQs

- **What is tax law?**

Tax law involves the taxation of income and property acquired through personal and professional efforts. The area of tax law effects most areas of life. In addition to income tax, there is sales tax, gift tax, inheritance tax, capital gains tax, property tax and many other areas of tax. Tax law is divided into both federal tax and state tax. The federal government and the state governments each have a tax laws that are independent, and in some cases, different from one another. The more assets that an individual owns, the more complicated the tax law becomes.
- **What is a tax base?**

A tax base is the difference between a person`s taxable income for the year and the person`s deductions. A person may choose to itemize their deductions or take the standard deduction that is provided by the federal or state government.
- **What are tax rates?**

Tax rates are mathematical tables that determine the amount of tax that an individual owes. Tax rates are based on income. The higher an individual`s income, the higher the tax rate. Presently, the highest taxable rate for income is 39.6% of income.
- **How is income defined?**

Income is defined as the realization of gain. This sounds complicated, but it`s really not. Anytime that you receive money, be it a paycheck or the selling of your house, you have realized a gain. Realizing gain is a key requirement in the tax law.
- **Is severance pay taxable?**

Yes. Amounts you receive as severance pay are taxable. A lump-sum payment for cancellation of

your employment contract is income in the tax year you receive it and must be reported with your other salaries and wages.

- **I made some money repairing radios and television sets last year. How do I report this income?**
A sole proprietor files Schedule C, or in some cases, Schedule C-EZ, Form 1040, to figure the profit or loss from the business, and Schedule SE, Form 1040, to figure self-employment tax.
- **Are alimony payments considered taxable income?**
Alimony, separate maintenance, and similar payments from your spouse or former spouse are taxable to you in the year received.
- **This is the first year that I received retirement benefits, are any of my benefits taxable?**
If you receive retirement benefits in the form of pension or annuity payments, the amounts you receive may be fully taxable, or partly taxable.
- **Are gifts, bequests, or inheritances taxable?**
Generally, property you receive as a gift, bequest, or inheritance is not included in your income. However, if property you receive this way later produces income such as interest, dividends, or rentals, that income is taxable to you.
- **I rent my home out for two weeks each year. Do I have to show the income on my return?**
If you use a dwelling as a home and rent it for fewer than 15 days during the year, do not report any of the rental income and do not deduct any expenses as rental expenses. In this case, you may deduct some expenses on Schedule A (Form 1040), such as mortgage interest, property taxes, and any casualty losses.
- **I won \$1000 in a charity raffle. Do I need to declare this as earned income?**
Yes. Gambling winnings are fully taxable and must be reported on your tax return.
- **What is "itemizing" and is it beneficial to me?**
"Itemizing" is listing on the Schedule A of Form 1040 all amounts you paid during the year for certain items such as medical and dental care, state and local income taxes, real estate taxes, home mortgage interest, and gifts to charity.

When you complete your list, you total the amount spent and compare the total with your standard deduction. The larger of the two deductions, standard or itemized, will be the deduction to choose, since it will lower the amount of federal income tax you will owe.

- **Can I take a deduction for the interest I paid on my student loan?**
Beginning January 1, 1998, taxpayers who have taken loans to pay the cost of attending an eligible educational institution for themselves, their spouse, or their dependent generally may subtract from income the interest they pay on these student loans.
- **Our house caught fire this last July. Can we claim a loss on our income tax return?**
If you lose property through casualty or theft, you may be entitled to a tax deduction. A casualty is the damage, destruction, or loss of property resulting from an identifiable event that is sudden, unexpected, or unusual in nature. Some examples of casualties include car accidents, fires, and vandalism. If your property is covered by insurance, you cannot deduct a loss unless you file a timely insurance claim for reimbursement.
- **I went through a divorce last year and paid a lot of legal fees. Are these deductible on my tax return?**
Legal fees for the divorce itself and for property settlement are not deductible, however, legal fees

to collect taxable income, such as alimony, are deductible as miscellaneous itemized deductions on Form 1040, Schedule A. Most miscellaneous itemized deductions are subject to the 2% limit. This means you can deduct the amount left after you subtract 2% of your adjusted gross income from their total.

- **I use part of my living room as an office. Can I take a deduction for business use of my home?**

In general, if you use a part of your home for both personal and business purposes, no expenses for business use of that part are deductible. Exceptions apply for qualified day-care providers and for the storage of inventory or product samples used in the business.

- **I use my home for business. Can I deduct the expenses?**

Yes. If you use part of your home exclusively and regularly as the principal place of business or as a place where you meet or deal with customers, you may deduct expenses for use of part of your home.

- **For business travel, are there limits on the amounts deductible for meals?**

Meal expenses are deductible only if your trip is overnight or long enough that you need to stop for sleep or rest to properly perform your duties. Generally, the deduction for unreimbursed business meals is limited to 50% of the cost.

Instead of keeping records of your meal expenses and deducting the actual cost, you can generally deduct a standard meal allowance ranging from \$30 to \$42 depending on where and when you travel.

- **I just completed my return and find that I owe the IRS money. What should I do?**

You should file your return even if you can't pay the entire amount you owe. File by April 15, and pay as much as possible. By filing on time, you avoid the late filing penalty. By paying as much of the amount you owe as possible, you reduce the amount of interest and late payment penalty that you will owe.

- **Can I ask to make installment payments on the amount I owe?**

Yes. If you cannot pay the full amount due with your return, you may ask to make monthly installment payments. However, you will be charged interest and a late payment penalty on the tax not paid by April 15, even if your request to pay in installments is granted. Before requesting an installment agreement, you should consider less costly alternatives such as a bank loan.

- **What kind of penalties and interest will I be charged for paying and filing my taxes late?**

Interest, compounded daily, is charged on any unpaid tax from the due date of the return until the date of payment. The interest rate is the federal short-term rate plus 3 percent. That rate is determined every three months. In the last five years, the interest rate on underpayments has varied from 7% to 10%. The current rate of 9% has been in effect since July 1, 1996.

In addition, if you filed on time but didn't pay on time, you'll generally have to pay a late payment penalty of one-half of one percent of the tax owed for each month, or part of a month, that the tax remains unpaid after the due date, up to 25 percent. The one-half of one-percent rate increases to one percent if the tax remains unpaid after several bills have been sent to you and the IRS issues a notice of intent to levy.

If you owed tax and didn't file on time, the penalty is even higher. The combined late-filing and late-payment penalty is five percent of the tax owed for each month, or part of a month, that your return was late, up to 25 percent. And if your return was more than 60 days late, the minimum penalty is the smaller of \$100 or 100 percent of the tax owed.

- **Can my refund be used to pay other debts?**

Under the law, state and Federal agencies refer to the IRS the names of taxpayers who are behind in their support payments, taxes, and loans. Your tax refund may not be refunded to you if you are delinquent in child support payments or you have a past due Federal debt (such as a student loan). Therefore, your refund may be used to pay other debts you owe.

- **I am unable to pay my delinquent taxes. Will the IRS accept an Offer in Compromise?**

An offer-in-compromise may be an alternative for resolving your tax delinquency. The IRS accepts an offer in compromise to settle unpaid accounts for less than the amount owed when doubt exists as to whether you owe the liability or when there is doubt that the liability can be collected in full and your offer reasonably reflects collection potential.