**UC SANTA BARBARA**
**PUBLIC FINANCE LAB**

Introduction to Tax Filing
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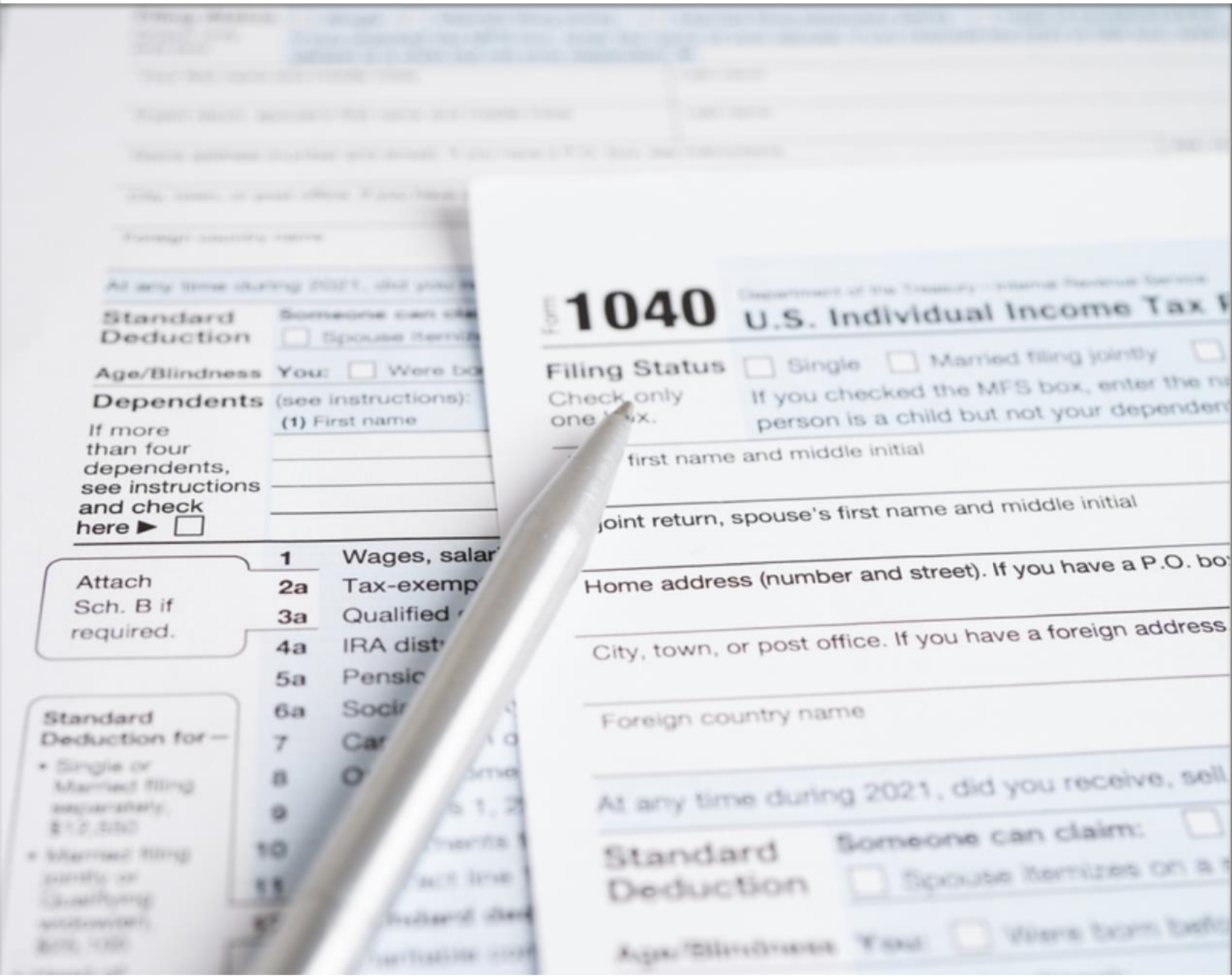


# INTRODUCTION TO TAX FILING

## For Tax Residents

A guide for students on whether to file taxes, how to file taxes, and what all those tax terms mean

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DISCLAIMER: This guide is for information purposes only. Please consult a licensed tax preparer for personalized advice.

For questions or comments, please email Prof. Alisa Tazhitdinova: tazhitda@ucsb.edu. Check out our website for other tax literacy resources: pfl.ucsb.edu.

# DO I HAVE TO FILE A TAX RETURN?

The chart on the next page walks you through the tax filing decision. **Please keep the following notes in mind:**

## Even if you are not required to file a tax return, doing so may benefit you:

You may get your money back when you file a tax return! In particular:

❖ If you had a job and had some income taxes withheld

❖ Or, if you are eligible to claim tax credits

## If you must file but you do not file

You will receive a "Failure to File" penalty that is 5% of the unpaid taxes for **each month or part of a month that a tax return is late!** The IRS will then charge you interest on this penalty. Make sure to file!

## How to file taxes (for free)

IRS Free File guides qualified taxpayers on preparing and filing federal income tax returns.

https://www.irs.gov/filing/irs-free-file-do-your-taxes-for-free

⚠ Do not Google "free tax filing," as many predatory websites appear "free" until the moment of filing. Read about it here and here.

## Deadlines

You should file your tax return **by or on April 15**. You can request an extension, but it is a complicated process, and you must prepay your taxes anyway.

You can start preparing your tax return as soon as you receive all your forms (W-2, 1098-**, 1099-***, etc.). You should receive all your forms by mid-February.

If you must file a federal return, you must file a California return. California's deadline is also April 15.

## I am scared of making a mistake!

You are much better off filing and making a small mistake than not filing when you are required to. The software will guide you through the filing process, and if you answer ⚠ truthfully, dramatic mistakes are highly unlikely. If you realize you made a mistake, you have 3 years to amend your return. Furthermore, IRS audit rates are pretty low.

## Additional Resources

**Volunteer Income Tax Assistance Program (VITA)**

Provides free basic tax return preparation for low- and moderate-income taxpayers.

## IRS Taxpayer Advocate Service (TAS)

The Taxpayer Advocate Service is an organization within the IRS that helps taxpayers and protects taxpayer rights to ensure everyone is treated fairly.

## International and Undocumented students

**Undocumented**: if you wish to file a tax return but do not have a legal SSN, you can obtain an Individual Taxpayer Identification Number to file your return, then follow the guide.

**International**: see page 5 for instructions.

(Other filing status click here) **Single** (International students click here)

Can you be claimed as a dependent on another taxpayer's return (typically your parent(s)' return)? (Note: you can be claimed as a dependent if you provide less than half of your own support.)

- **YES**
  - Was your earned income over $14,600? Or was your unearned income over $1,300? Or did you have net self-employment income over $400?
    - **YES**
      - Must file or your parents must report your income on Form 8814 if eligible.
      - Parents should claim AOC/LLC and interest deduction if eligible.
    - **NO**
      - Not required (see here for exceptions). But may be useful if earned some income. Check W-2 for fed/state taxes withheld.
      - Parents should claim AOC/LLC and interest deduction if eligible.
- **NO**
  - Was your gross income over $14,600? Or did you have net self-employment income over $400?
    - **YES**
      - Must File
      - If eligible, claim AOC/LLC, interest deduction, and EITC if age>25.
    - **NO**
      - Not required (see here for exceptions), but maybe useful if you earned some income. Check W-2 for fed/state taxes withheld.
      - If eligible, claim AOC/LLC, interest deduction, and EITC if age>25.

## Definitions:

Earned income: salaries, wages, tips, taxable scholarships, and fellowship grants.

Unearned income: interest, dividends, capital gains, unemployment compensation, Social Security benefits, pensions, annuities, and income distributions from a trust.

Gross income: earned plus unearned income.

## How does being claimed as a dependent affect my tax return?

When somebody claims you as a dependent, they become eligible for (i) tax credits that help alleviate the burden of supporting you and (ii) tax credits on your behalf. Because (i), as a dependent, you qualify for a smaller deduction: your standard deduction is limited to the greater of $1,300 or your earned income plus $450 (max $14,600 total). Because (ii), you are no longer eligible to claim certain credits and deductions, but your parents are.

# INTERNATIONAL STUDENTS

For international students, the filing requirements vary dramatically depending on whether they are considered a tax resident or tax nonresident.

**If you are an international student on an F, J, M, or Q visa and you have been in the U.S. for 5 calendar years or fewer, then you are a nonresident alien for tax purposes. Do not use this guide. Instead, download the guide for tax nonresidents here.**

Once you remain in the U.S. for more than 5 calendar years, you generally start being treated as a tax resident. Whether or not this is the case will be determined by the "Substantial Presence Test": you are considered a resident for tax purposes (for the tax year 2025) if you are physically present in the U.S. on at least:

1. 31 days during 2025; AND

2. 183 days during the 3-year period of 2025, 2024, and 2023.

This calculation includes:

i. All the days you were present in 2025

ii. 1/3 of the days you were present in 2024

iii. 1/6 of the days you were present in 2023

but does not include days for which you were an exempt individual.

If you satisfy the above two requirements, then you are considered a tax resident for the 2025 tax year.

**If you are a resident alien for tax purposes, then this guide is for you! Please follow the filing requirements listed on page 3 and the other suggestions in this document.**

**Example**: A student has been in the U.S. as a non-exempt individual for: 50 days in 2025, 90 days in 2024; and 60 days in 2023.

Then, they would calculate their days physically present as:

2025 (100% of the days) = 50 days

2024 (1/3 of the days) = 90 x (1/3) = 30 days

2023 (1/6 of the days) = 60 x (1/6) = 10 days

50 + 30 + 10 = 90 days total during the 3-year period of 2025, 2024, and 2023.

Consequently, this student would not meet the requirements of the substantial presence test (fails condition 2) and would be considered a nonresident for tax purposes.

**IRS provides many more examples here.**

If you have been in the U.S. for more than 5 years and you passed the substantial presence test, you may qualify for a closer connection exception if you were physically present in the U.S. for less than 182 days during the tax year. Make sure to review the requirements carefully.

# THE ABCs OF TAX FILING:

# (A) INCOME AND DEDUCTIONS

Your tax liability is based on your "taxable income". Roughly speaking, taxable income is the difference between the income you earn and the various adjustments that are called "deductions":

**Taxable Income = Total Income – Above-the-Line Deductions – Deductions**

## Calculating Your Total Income

Total income includes the various types of income you earned. The table on the next page summarizes the most common types of income and the tax form you will receive.

⚠️ **If you received any of the listed tax forms, the IRS also received them! Make sure to accurately report income information on Form 1040, or your return will be flagged!**

The tax forms summarize your earnings, taxes already paid (if any), and (if any) contributions to pension funds, health insurance, etc. The tax software you use to file will ask you for these details.

**Quick Side Note:** Throughout this guide, we mention the various Forms and Schedules that report different types of income or deductions. We provide these details for you to reference in case you want more detailed instructions or better clarity about the tax return structure and tax filing process. However, the tax filing software will correctly fill out the tax return on your behalf by asking you questions about the various sources of income and expenditures you have had.

## What about Scholarships, Pell grants, and other education grants?

Generally speaking, as long as the money you receive from the scholarship is (a) used to obtain a degree at an eligible educational institution (e.g. UCSB), (b) only used for qualified education expenses (tuition, etc.), and (c) not used, not clearly designated, and not earmarked for other purposes (e.g. room and board, or as payment for teaching or research), the scholarship or grant is not taxable. Consequently, Pell Grants and Other Title IV Need-Based Education Grants are tax-free if used for qualified education expenses during the period in which the grant is awarded. In contrast, work-study grants are considered taxable income.

If your only income is a completely tax-free scholarship or fellowship grant, you don't have to file a tax return, and no reporting is necessary. If all or part of your scholarship or fellowship grant is taxable and/or you are required to file a tax return, then you must report the taxable amount on your tax return.

https://www.irs.gov/help/ita/do-i-include-my-scholarship-fellowship-or-education-grant-as-income-on-my-tax-return

| Form | Income type | Details |
|---|---|---|
| W-2 | wages: included in “earned” income | Any formal employment will result in W-2. Employers typically withhold more income taxes than you owe, so it is a good idea to file a tax return to get your money back! Reported on line 1a on Form 1040. |
| W-2 | work-study wages: included in “earned” income | Work-study programs are considered “taxable scholarships”, so you will receive a W-2 and you must report this income as “wages” (line 1a of Form 1040). Work-study income is subject to federal and state income taxes but is exempt from FICA and Medicare if you’re enrolled in 6 or more credit hours or you’re working on campus. Again, a good idea to file a tax return as a tax refund is likely. |
| 1098-T | scholarships/ grants: included in “earned” income | You will receive this form if you received scholarship income or if you made qualified education expenses. If the difference between box 5 and box 1 is positive and this excess has been distributed to you, you must include it in your taxable income on line 8r of Schedule 1. (The software will do so by asking you questions.) If box 1 exceeds box 5 and scholarship income is your only income, filing is not required. |
| 1099-K | gig work: included in “earned” income | You will receive this form if you earned more than $5,000 from Uber/Lyft/Instacart/Snag/etc. or if you earned over $5,000 in gross payments from an online selling platform like eBay/Depop/etc. Venmo will issue 1099-K for payments received for “goods and services” only. The platforms typically do not withhold taxes, so you might owe income taxes as well as FICA and Medicare taxes on these earnings. Reported on Schedule C and then on Schedule 1 line 3.<br>**Remember: you must file a tax return if you received more than $400 in net self-employment income. Must pay 15.3% self-employment tax if net income above $400.** |
| 1099-NEC | gig work/ contract work: included in “earned” income | You will receive this form if you made $600 or more from incentive schemes, referral, etc. when working for Uber/Lyft/etc. or if some employer treated you as an independent contractor. Report on Schedule 1, line 8j or on Schedule 1, line 3 after filling out Schedule C.<br>**Remember: you must file a tax return if you received more than $400 in net self-employment income, however, not all 1099-NEC income is treated as “self-employment” income. Must pay 15.3% self-employment tax if net income above $400.** |
| 1099-MISC | gig work/ contract work: included in “earned” income | You should receive this form if somebody paid you more than $600 to you, e.g. for rent, as prize money, contract work, etc. Report on Schedule 1 line 8 (pick appropriate category). This is usually not included in “self-employment” income, consequently the “$14,600 gross income rule” determines filing requirements. |
| 1099-B | capital gains: included in “unearned income” | You will receive this form if you sold stocks, mutual funds, foreign currency contracts, forwards, futures, options, etc. This form provides investors with summary information about their capital gains/losses. Report this income on line 7 of Form 1040. Typically, Schedule D is also required. |
| 1099-INT | interest income: included in “unearned” income | This form is received by people that made at least $10 in interest throughout the year, however, most banks will send you the form for even smaller amounts. Legally, you are required to report income no matter the amount. The amount reported on the form is considered taxable income. Report on lines 2a-2b of Form 1040. |
| 1099-DIV | dividend income: included in “unearned” income | You will receive this form if you have received at least $10 in dividends from a company who is not your employer. Dividends are considered as taxable income. Report on lines 3a-3b of Form 1040. |

## Adjustments and Deductions

There are many ways a taxpayer can reduce his/her tax liability. Each approach has a different name and works slightly differently: **"adjustments" or "above-the-line deductions"** directly reduce your total income (these are reported on Schedule 1), **business "expenses"** reduce self-employment or gig income (these are reported on Schedule C), **"deductions"** reduce taxable income (these are reported on Form 1040 or Schedule A), while **"tax credits"** reduce tax owed. Ultimately, they all reduce the tax you must pay or increase the refund you will receive. This section will discuss above-the-line deductions, expenses, and deductions. Credits will be discussed in the following section.

## Above-the-Line Deductions (Schedule 1)

These are certain expenses that are directly subtracted from your income. The most common are various medical plan deductions, contributions to retirement funds (**IRA**, SEP, SIMPLE, etc.), alimonies, **student loan interest deductions**, and rarer adjustments. **It is in your own best interest to report above-the-line deductions you qualify for; however, it is not required.**

## "Student loan interest deduction" (Sch. 1)

Students can report the interest paid on student loans <u>in their name</u> as an above-the-line deduction. This deduction is limited to $2,500. You qualify for this deduction if: (i) your filing status is not married filing separately; (ii) <u>you are not being claimed as a dependent</u> on a tax return; (iii) you are <u>legally obligated to pay interest</u> and paid that interest on a qualified student loan; (iv) your modified gross adjusted income is less than $90,000. Use info from Form 1098-E to figure out your student loan interest deduction.

⚠️ You cannot claim this deduction if the loan is in your parents' name or if your parents claim you as a dependent. If your parents claim you as a dependent, <u>they</u> can claim this deduction, but only if <u>they</u> are co-signers on your loan. For multiple co-signers, only one person can claim the deduction at a time. Importantly, this deduction cannot be carried to future or past tax years: use it or lose it.

## Expenses for self-employed and gig workers (Schedule C).

If you have gig income or other income from self-employment, you can reduce your taxable income (and, therefore your tax liability) by deducting expenses that were incurred while you were performing the job. For example, DoorDash drivers can deduct maintenance and repairs for vehicle upkeep and driving-related expenses (gas, oil change, insurance, repairs, cleaning, registration, etc.), and any fees charged by the platforms themselves. Claim these expenses on Schedule C, and make sure to keep your receipts and/or records (approximate mileage, vehicle details, etc.). **It is in your own best interest to report expenses you incurred; however, it is not required.**

⚠️ If you have self-employment income greater than $400, you are required to pay <u>self-employment tax (15.3%)</u> on your net earnings up to $168,600. There are additional rules for high-income earners.

## Standard and Itemized Deductions

In addition to above-the-line deductions, the IRS allows individuals to **either** claim a **"Standard Deduction"** or **"Itemized Deductions".** For most students, the standard deduction (a fixed amount set by the IRS each year) is the better option. However, itemizing deductions may be optimal if you had very large medical expenses, own a house with a mortgage, have gambling losses, or losses from disasters throughout the year.

**Standard Deductions (elect on Form 1040)** are deducted from a taxpayer's adjusted gross income based on filing status. This deduction is available to all taxpayers every tax year. If you are single, you can deduct $14,600 in 2024, and if you are married, you can deduct $29,200 from your joint income. Additional deductions are available for dependents (e.g., your children). If you are claimed as a dependent, your standard deduction is limited to the greater of $1,300 or your earned income plus $450 (max $14,600 total). Claiming standard deduction is super simple, and you do not need to collect/keep receipts or do any math.

**Itemized deductions (Schedule A)** are an alternative approach if you have a lot of unusual expenses. In this case, you will make a list of the various allowed expenses using Schedule A and then subtract them from your adjusted gross income (similar to the standard deduction). You **cannot** deduct both the standard deduction and itemized deductions in the same tax year. Hence, you should choose the deduction that results in the lowest taxable income (i.e., whichever deduction is bigger).

To claim itemized deductions, you need to be able to provide proof of the incurred expenses. Thus, it is important to be organized and keep records (i.e., receipts or notes) of the expenses you would like to deduct. IRS allows numerous types of itemized deductions; however, for most students, these are not sufficiently large and typically add up to a smaller total than the standard deduction. Below are just some examples of allowable deductions:

State and Local Taxes (up to $10,000 per year)

Interest You Paid (only home mortgage interest and points are deductible)

Medical Expenses (large unreimbursed medical and dental expenses that exceed 7.5% of your adjusted gross income are deductible. These can include prescription drugs, payments to doctors, hospital bills, etc.)

Donations to charity (charitable cash and noncash contributions are deductible up to 60% of your adjusted gross income (AGI). Individuals who have made qualified contributions can deduct up to 100% of their AGI, with carryover to the next tax year for any amounts that exceed this.)

Gambling losses (this link has an interactive survey that will help you determine how to claim your gambling winnings and/or losses)

Losses from disasters and theft (involves losses from casualties, thefts, and losses on deposits)

# THE ABCs OF TAX FILING:

# (B) HOW MUCH TAX DO I OWE?

**Most likely, you will not owe any taxes and will instead receive a refund!** Why? Because more likely than not, your employer had over-withheld taxes on your behalf! Unless you were self-employed…

The "tax owed" in the formula below is a linear function of your taxable income, and it is the amount of tax you owe <u>before</u> any tax credits are deducted. (We will discuss tax credits in the next section. Tax credits are very useful for students, so keep reading!)

**Tax Liability = Tax Owed - Tax Credits**

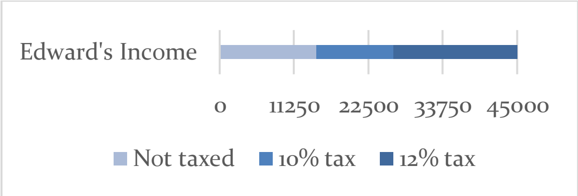
### How do you calculate tax owed?

You pay taxes as a percentage of your taxable income in layers called "tax brackets". As your income increases into a higher bracket, you pay the higher tax rate, but <u>only</u> on the part of income that is in the new bracket. The tax brackets apply to your "taxable income", i.e., total income minus deductions (recall formula from the previous section).

| Tax Rate | Tax Bracket for Single Filers |
|---|---|
| 10% | $0 to $11,600 |
| 12% | $11,601 to $47,150 |
| 22% | $47,151 to $100,525 |
| 24% | $100,526 to $191,950 |
| 32% | $191,951 to $243,725 |
| 35% | $243,726 to $609,350 |
| 37% | $609,351 or more |

The tax filing software will do this math for you; all you must do is provide information on (a) all the incomes you earned and (b) any deductions you want to claim. In the end, if you already paid more taxes than you owe, the IRS will send you a check. Otherwise, you will have to pay some taxes.

**Example:** Edward is a single taxpayer who earned $45,000 in 2024. He can claim $5,850 in itemized deductions. How much tax will he owe?




Since the standard deduction of $14,600 exceeds his $5,850 itemized deductions, Edward should claim the standard deduction! Edward's taxable income is $30,400 (=$45,000-$14,600). Using the table, we see that $11,600 of the $30,400 will be taxed at 10%, while the remaining $18,800 ($30,400-$11,600) will be taxed at 12%. **His total tax liability is $3,416** (= $11,600 x 10% + $18,800 x 12%).

# THE ABCs OF TAX FILING:

# (C) WHAT ARE TAX CREDITS?

**A tax credit is a dollar-for-dollar amount that a taxpayer can deduct from their "tax owed"** (recall formula on previous page)! Credits are thus used to offset tax liability. (In contrast, the deductions studied in the previous sections reduce tax liability. In the end, both tax deductions and tax credits are tax breaks – they reduce the amount of money you must pay to the IRS.) **It is in your own best interest to claim tax credits you qualify for; however, it is not required.**

There are many types of credits available to taxpayers: **https://www.irs.gov/credits-and-deductions-for-individuals**

Some credits are refundable, meaning you get a check even if you don't owe any taxes, but most are not.

The most common credits that students can claim are the **American Opportunity Credit** and the **Lifetime Learning Credit**. Students with children or those older than 25 are likely to qualify for the **Earned Income Tax Credit (EITC).** Part-time students may qualify for the **Saver's Credit**.

Most credits cannot be carried to future or past tax years: use it or lose it.

If you forgot to claim a tax credit on a past return or wish to make other changes, you can do so by filing an amended return. You have 3 years to do so.

## American Opportunity Credit and Lifetime Learning Credit

These credits give tax breaks for "qualified education expenses" you pay for either yourself, your spouse, or a dependent you claim on your tax return. You can claim these credits if the following key requirements are met: (i) you pay qualified education expenses for higher education; (ii) you pay the education expenses for an eligible student; (iii) the eligible student is either yourself, your spouse, or a dependent you claim on your tax return.

The amount of tax credit you qualify for depends on the amount of **"qualified education expenses"** paid throughout the year. This includes tuition, required enrollment fees, and course materials that the student needs for a course of study, whether or not the materials are bought at the educational institution as a condition of enrollment or attendance. Student activity fees are included in qualified education expenses, but only if the fees must be paid to the institution as a condition of enrollment or attendance. The following school-related expenses cannot be included: insurance, medical expenses (including student health fees), room and board, transportation, or similar personal, living, or family expenses. This is true even if the amounts must be paid to the institution as a condition of enrollment or attendance. Use Form 1098-T to figure out your qualified education expenses.

The expenses you use for one credit (e.g. American Opportunity Credit) cannot be used to claim the other credit (e.g. Lifetime Learning Credit), nor can they be used to deduct higher education expenses on your income tax return (as, for example, a business expense) or to calculate a tax-free portion of a distribution from a Coverdell education savings account or qualified tuition program.

**American Opportunity Credit (AOTC)**

The **tax credit amount** (per eligible student) is the sum of:

100% of the first $2,000 of qualified education expenses plus 25% of the next $2,000 of qualified education expenses

up to a maximum of $2,500.

The American Opportunity credit is only available to students who have not yet completed the first 4 years of postsecondary education and is only available for 4 tax years per eligible student. This credit is more generous than the Lifetime Learning Credit and should be claimed by undergraduate students. Once you graduate, you can claim the Lifetime Learning Credit for all your future education expenses.

**Lifetime Learning (LLC)**

The **tax credit amount** (per eligible student) is:

20% of the first $10,000 of qualified education expenses.

Thus, the maximum is $2,000.

Either credit amount is gradually reduced when your income exceeds $80,000, and you stop qualifying when your income exceeds $90,000 (higher income cutoffs if married).

If your parents claim you as a dependent, then they must claim the relevant credit. If your parents do not claim you as a dependent, then you should claim the credit. Note that while the LLC is always nonrefundable, 40% of AOTC could be refundable. Unfortunately, for full-time students under the age of 24, AOTC is refundable only if your earned income (wages, work study wages, gig work) exceeds one-half of your support (expenses for food, shelter, education, etc.). Practically, this means that the tax credit is only useful when you face a tax liability, but not otherwise.

What if you have scholarship income? The short answer is you cannot claim AOTC on the portion of education expenses that were covered with nontaxable scholarship income. However, usually, you can allocate your scholarship income towards whichever expenses you like. Thus, **if your scholarship income exceeds your education expenses, it is best to cover all but $4000** of your education expenses with scholarship money. For example, if your education expenses are $10,000 and your scholarship income is $40,600, then you should "assume" that $6,000 of education expenses were covered by the scholarship and the rest by personal funds. Then $34,600 of your scholarship will be taxable, but you will qualify for a $2500 AOTC. Your taxable income is $20,000 (after subtracting the standard deduction) and your tax liability is $2168-$2500<0. In contrast, if instead you covered all your education expenses with scholarship income, then only $30,600 would be taxable but you would not qualify for the AOTC. In this case, you would owe $1688 in taxes! This strategy works because a $4000 increase in income increases your tax owed by $480 (12% tax bracket) but forces you to miss out on a $2500 credit! This strategy works best if your scholarship income is high or if your parents claim you as a dependent. (If your income is low and you under age 24, you will not face tax liability either way.) Finally, check the fine print of your scholarship. If the fine print requires you to use the scholarship income to pay for tuition (or other qualified expenses) then the above approach will not be allowed.

### Earned Income Tax Credit (EITC)

Students over the age of 25 who are not claimed as a dependent can claim this credit if their income is less than $18,591. The maximum credit amount is $632.

### Saver's Credit

This credit is available to part-time students only who made eligible contributions to an IRA, Roth IRA, or an employer-sponsored retirement plan. The maximum credit amount is $1,000. This credit is nonrefundable.

### The bottom line:

Most tax credits are nonrefundable. Since they operate by offsetting your tax liability, they are only useful if you owe taxes. Nonrefundable credits allow you to get money back if your tax liability is zero. EITC is a refundable credit, AOTC is refundable for students who support their education by working.

## EXAMPLES

**Example 1.** You earned $20,600 as a work-study. Your W2 shows that your employer withheld $2000 of federal and $500 of state taxes on your behalf. You paid $8,000 for tuition, books, etc, and $500 in student loan interest. You must file because your earned income exceeds the filing threshold. What deductions and credits should you claim?

**Case 1:** you are less than 25 years old and your parents claim you as a dependent. Then you should claim the standard deduction ($14,600) to receive a (partial) refund of your federal and state taxes paid. Your parents should claim the American Opportunity Credit ($2500). Your parents can claim the student loan deduction ($500) but only if they co-signed your student loan. Your taxable income is $6000 and you will owe $600. Since you already paid $2000 of federal taxes, you will receive a refund of $1400. The math for CA taxes will follow a similar logic.

**Case 2:** you are less than 25 years old and your parents do not claim you as a dependent. Then you should claim the standard deduction ($14,600), the student loan deduction ($500), and the American Opportunity Credit ($2500).

Your taxable income is $5500 and your tax owed is $550. However, you can claim the AOTC of $2500. If you are under age 24 and your income is less than ½ of your expenses (for food, shelter, education, etc) then AOTC is nonrefundable. Therefore, your tax liability is zero, and you will receive the $2000 withheld by your employer back. If your income exceeds ½ of your expenses, then AOTC is partially refundable (up to $1000), which means your tax liability is -$1000. In this case, your refund will be $3000 ($2000 overwithheld + $1000 refundable AOTC). If you are over age 24, your refund will be $3000.

**Case 3:** same as above but you are over 25 years old. In addition to the above, you should claim EITC. Since EITC is refundable, your refund will be >$3000.

**Case 4**: you are a newly arrived international student. You must file a non-resident return. You could claim the $500 student loan deduction if the loan was issued by a U.S. institution. You cannot claim the standard deduction or the American Opportunity credit. Your taxable income will be $20,600 or $20,100 depending on the student loan origin. Your tax owed will be $2,240 or $2,180.

**Example 2.** You earned $3,000 working for a local café but quit after a month because it was distracting you from your studies. You are not required to file but you should file if your W2 shows federal or state taxes withheld. Claim the (appropriately calculated standard deduction depending on your dependent status). Expect a full refund of federal and state taxes withheld.

**Example 3.** You earned $1,000 driving for Uber. You must file because your earned income exceeds the self-employment income threshold, and the IRS knows about it. Make sure to claim relevant expenses (Uber fees, gas, oil changes, etc) and pay self-employment tax if <u>net income</u> exceeds $400. No income tax will be due.

**Example 4.** You received Form 1098-T which shows $15,000 (qualified education expenses) in box 1 and $35,000 (scholarships/grants) in box 5, earlier in the year you received a check/transfer from UCSB. You must file a tax return because the difference ($20,000) is taxable income. Claim the standard deduction and AOTC. The optimal strategy is to assume that your scholarship paid for $11,000 of your education expenses. Then your taxable income is $9,400 and your tax owed is $940. However, you can claim an AOTC of $2500. If you are less than 24, your tax liability is $0 (scholarships do not count as earned income and therefore AOTC is not refundable for you). If you are over 24, then AOTC is refundable, and your tax liability is -$1000.

**Example 5.** You received Form 1098-T which shows $10,000 (qualified education expenses) in box 1 and $10,000 (scholarships/grants) in box 5. This is your only income. You are not required and you should not file.

**Example 6.** You received Form 1098-T which shows $10,000 (qualified education expenses) in box 1 and $1,000 (scholarships/grants) in box 5. You also earned $43,600 in wages. You must file. Claim the standard deduction and AOTC. Your taxable income is $29,000 (your scholarship is not taxable because you use it to cover qualified education expenses) and your tax owed is $3,248. But your tax liability is only $748 because you qualify for a $2500 AOTC because you can use the remaining $9,000 of education expenses (after subtracting scholarship income) to claim AOTC.

# CALIFORNIA TAX RETURNS

If you must, or if it is beneficial for you to file a federal tax return, then you should also file a California tax return. The return structure and principles are the same, except that if you earn income from multiple states, things get a little bit complicated.

If you live in California for most of the year, you are treated as a California resident. California taxes the worldwide income of its residents but you get credit for taxes paid to other states if any such tax is due. If you lived inside and outside of California during the tax year then you may be considered a part-year resident. In that case, the above rule applies to the income earned while you were a California resident. But you only pay California taxes on California income for income earned while you were not a California resident. (But again, you can claim these taxes as a credit on your *other* state's tax return.)

Unfortunately, California does not offer special deductions or credits for students. If you are over age 25, then you may be eligible for California Earned Income Tax Credit. The credit operates similarly to the federal EITC credit.

The table shows taxable brackets, which operate in the same way as the federal tax brackets: as your income increases you pay the higher tax rate, but only on the part of income that is in the new bracket.

| Tax Rate | Tax Bracket for Single Filers |
|---|---|
| 1% | $0 to $10,756 |
| 2% | $10,757 to $25,499 |
| 4% | $25,500 to $40,245 |
| 6% | $40,246 to $55,866 |
| 8% | $55,867 to $70,606 |
| 9.3% | $70,607 to $360,659 |
| 10.3% | $360,660 to $432,787 |
| 11.3% | $432,788 to $721,314 |
| 12.3% | Over $721,315 |

The state provides its own free filing software, or you can use the resources listed here: https://www.irs.gov/filing/irs-free-file-do-your-taxes-for-free.

# OTHER SITUATIONS:

# STUDENTS WITH CHILDREN

If you have children, you should try to claim the following 3 credits: EITC, CTC, and CDCC.

## The Earned Income Tax Credit (EITC)

EITC is designed to help low- to moderate-income workers reduce the amount of taxes they owe. It can even possibly increase their refund. (Note: The IRS is required by law to wait until mid-February to issue refunds to taxpayers that claim the EITC.)

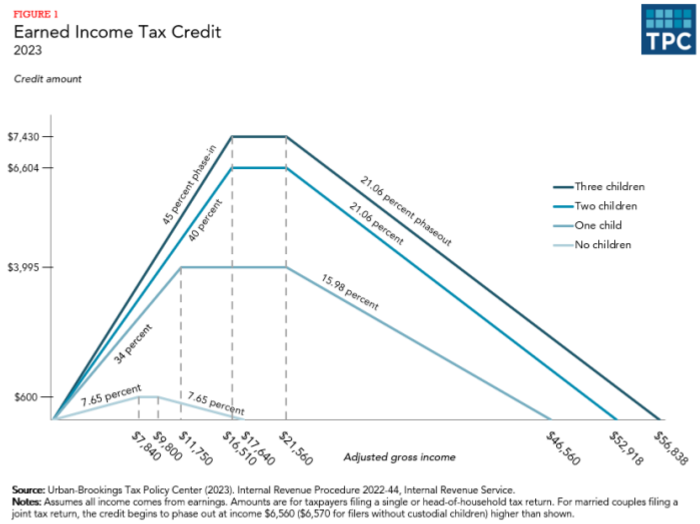
The figure shows how the amount of EITC credit one may qualify for varied with their income and number of children in 2023. The rules for tax year 2024 are similar but with slightly higher income cutoffs and credit amounts.

California offers additional state EITC credit, the rules are similar, so make sure to claim it as well.

## Child tax credit (CTC)

CTC helps give families with children a tax break. The eligibility rules are simple, and for every child under age 17, you qualify for a $2,000 credit if your income does not exceed $200,000 (single) or $400,000 (married). Children age 17 and older qualify for a reduced credit of $500 per child. To claim this credit, your child needs to have a social security number.

California also offers a credit for families with children, called California Young Child Tax Credit, so make sure to claim it as well.




## The Child and Dependent Care Credit

CDCC is used to help offset the cost of care incurred for eligible children (or other dependents). You may qualify to claim this credit if you have paid expenses for the care of a qualifying individual that allows you to work or actively look for work. A qualifying individual is generally described as a dependent under the age of 13, a spouse, or a dependent of any age who is incapable of self-care and lives with you for more than half of the year. The total expenses used to calculate this credit cannot exceed $3,000 for one qualifying individual or $6,000 for two or more qualifying individuals.

California also offers the Child and Dependent Care Credit, so make sure to claim it as well.

# OTHER SITUATIONS:

# TAX-ADVANTAGED SAVINGS STRATEGIES

The tax code allows numerous opportunities for tax-advantaged savings. The most common three approaches include one of the following three accounts:

## Traditional IRA

Contributions to these accounts are tax-deductible. The maximum contribution amount is min(your earnings, $7,000). Withdrawals from this account must be included in taxable income and, hence, are taxed at regular income tax rates. Importantly, if you make a withdrawal before turning 59.5, you will be subject to an additional 10% penalty.

## Roth IRA

Contributions to these accounts are not tax-deductible. However, withdrawals are tax-free! The maximum contribution amount is min(your earnings, $7,000) as long as your income does not exceed $150,000 (single) or $236,000 (joint). You can always withdraw your principal tax-free; however, if you withdraw any earnings on principal before turning 59.5, you will be subject to a 10% penalty.

## 401(k) and 403(b) Plans

These accounts are offered by employers. You cannot make contributions to these accounts unless you work for an employer that offers such a plan and you qualify to contribute. For some companies, contributions may be mandatory. Otherwise, these accounts operate similarly to traditional IRAs. The contributions are tax-deductible, and withdrawals are taxed at regular income tax rate. Plus, a 10% penalty for early withdrawals. The maximum contribution amount is min(your arnings,$23,000) per year.

Some employers match employees' contributions up to some maximum amount. If your employer matches – make sure to contribute the maximum amount. Why? Suppose your employer matches up to $5,000 per year. If you contribute $5,000, your 401(k) account will have $10,000 (because of the match). You can withdraw $5,000, pay the 10% penalty, and you will have $4,500 in cash and $5,000 in your 401(k) – a clear free lunch! Make sure to read the fine print as to when employer matches can be withdrawn (become "vested")!

## What should you do?

**If you are not earning much (relative to the foreseeable future), open a Roth IRA (use your bank or a financial services company), then deposit and invest all your spare savings there.**

**Reason 1:** If you save in a regular savings/brokerage account, any earnings are taxed at either income tax rate (interest income), dividend tax rate (dividends), or capital gains tax rate (capital gains). Say, you invest $1,000 in the stock market. It grows to $1,200. If this money is in your brokerage account, you will (most likely) have to pay taxes on the $200. However, if your money is in a Roth account, and you withdraw the $200 once you turn 59.5 or to buy your first house, then $200 will never be taxed. A free lunch! Because of compounding interest, tax-advantaged accounts provide fantastic tax savings in the long run.

**Reason 2:** IRAs and 401(k)/403(b) are tax-efficient for people who currently have a high tax liability and expect a lower tax liability in the future. You should use these accounts when you are at your "employment peak". In contrast, Roth IRAs are tax-efficient for people with low tax liability now and higher expected tax liability in the future. Most students fall into the latter category.

**Reason 3:** Early withdrawals from IRAs/401k/403b plans are subject to a 10% penalty, which means your savings will be "locked in". **However, you can always withdraw your principal (i.e., your contributions) from the Roth account if you need to.** Consequently, your money is not locked in. **Earnings on your principal will then remain in your Roth account and continue to grow tax-free.** You are also allowed to withdraw up to $10,000 of earnings tax- and penalty-free to purchase your first home. In other words, if you contribute $1,000 to your Roth account and the money grows to $1,200, you can withdraw the $1,000 tax- and penalty-free any time.

# GLOSSARY

**ABOVE-THE-LINE DEDUCTIONS:** These deductions reduce your TOTAL INCOME and are reported on SCHEDULE 1.

**AGI**: "Adjusted gross income" is calculated as the difference between your TOTAL INCOME and ABOVE-THE-LINE DEDUCTIONS. Reported on line 11 of FORM 1040.

**AMERICAN OPPORTUNITY CREDIT:** Tax credit of up to $2,500 for education-related expenses.

**EARNED INCOME TAX CREDIT:** Tax credit for low- to moderate-income individuals. Amounts vary depending on income and number of children. For childfree adults, the credit is limited to individuals over the age of 25.

**EXPENSES:** Business or gig work-related expenses can be subtracted from business or gig income to reduce tax liability. Reported on SCHEDULE C.

**TRADITIONAL IRA:** An "Individual retirement arrangement" is a tax-advantaged savings account for retirement. Up to $7,000 can be transferred to an IRA account each year. Any amount deposited into an IRA can then be subtracted from TOTAL INCOME as an ABOVE-THE-LINE DEDUCTION on SCHEDULE 1. Funds withdrawn from the account are subject to the usual income taxes (i.e., count as income and must be reported on FORM 1040). Funds withdrawn from the account before you turn 59.5 are charged an additional 10% penalty.

**ITEMIZED DEDUCTIONS:** Can be claimed in lieu of the STANDARD DEDUCTION. Itemized deductions reduce TAXABLE INCOME similar to the standard deduction and should only be claimed if the sum of all itemized deductions exceeds the standard deduction. Use SCHEDULE A to claim.

**FICA TAXES:** Federal Insurance Contributions tax. These taxes pay for Federal Old Age, Survivor, and Disability Insurance (OASDI) benefits. If you are a wage earner, the tax is levied on both employee and employer. The current rate is 6.2% on gross wages up to $160,200 for the employee and 6.2% on wages (also up to $160,200) for the employer. No tax is due on earnings above $160,200. If you are self-employed or get paid for gig work, then the equivalent tax is 12.4%. of the SELF-EMPLOYMENT TAX.

**FORM 1040:** Main tax return form. You can either fill it yourself or use a free filing software (best way).

**FORM W-2:** Will be sent to you (and the IRS) by your employer. Reports wages earned, tax withheld, and other information related to health insurance and pension contributions. Must be included in TOTAL INCOME. Reported on line 1a of FORM 1040.

**FORM 1099-B:** Will be sent to you (and the IRS) by your bank/broker. Reports capital gains income earned. Must be included in TOTAL INCOME. Reported on line 7 of FORM 1040. Typically, SCHEDULE D is also required.

**FORM 1099-DIV:** Will be sent to you (and the IRS) by your bank/broker. Reports dividend income earned. Must be included in TOTAL INCOME. Reported on lines 3a-3b of FORM 1040.

**FORM 1099-INT:** Will be sent to you (and the IRS) by your bank/broker. Reports interest income earned in checking/savings/money market accounts. Must be included in TOTAL INCOME. Reported on lines 2a-2b of FORM 1040.

**FORM 1099-K, 1099-MISC, 1099-NEC:** Will be sent to you (and the IRS) by your gig platform. Reports income earned. Must be included in TOTAL INCOME. Reported on line 3 of SCHEDULE 1, or line 8 of Schedule 1. Typically, SCHEDULE C is also required.

**LIFETIME LEARNING CREDIT:** Tax credit of up to $2,000 for education-related expenses.

**MEDICARE TAXES:** These taxes pay for the federal health insurance program for the aged that helps alleviate the high cost of medical care for those over age 65. Similar to the FICA taxes, for wage earners, the tax is paid by both employee and employer at the rate of 1.45% each (or 2.9% total). Self-employed individuals pay a Medicare tax of 2.9%.

**STUDENT LOAN INTEREST DEDUCTION:** An ABOVE-THE-LINE DEDUCTION for interest payments related to qualified student loans. Can be claimed on SCHEDULE 1.

**ROTH IRA:** "Roth Individual retirement arrangement" is a tax-advantaged savings account for retirement. Up to $7,000 can be transferred to a Roth IRA account each year. In contrast to regular IRAs, the amount deposited into a Roth IRA cannot be subtracted from TOTAL INCOME as an ABOVE-THE-LINE DEDUCTION on SCHEDULE 1. However, the principal can be withdrawn at any time without penalty. Withdrawals are not subject to income taxes.

**SELF-EMPLOYMENT TAX:** Refers to the sum of FICA taxes (12.4%) and MEDICARE tax (2.9%).

**STANDARD DEDUCTION:** Can be claimed on Form 1040 to reduce TAXABLE INCOME. Typically, is more advantageous for students than ITEMIZED DEDUCTIONS.

**TAXABLE INCOME:** Determines one's tax liability. Taxable income is calculated as individuals' total income minus ABOVE-THE-LINE DEDUCTIONS minus STANDARD DEDUCTION or ITEMIZED DEDUCTIONS. Reported on line 15 of FORM 1040.

**TAX CREDITS:** Offset one's tax liability. May be refundable or non-refundable. Most commonly claimed tax credits for students are AMERICAN OPPORTUNITY CREDIT, LIFETIME LEARNING CREDIT, and EARNED INCOME TAX CREDIT.

**TOTAL INCOME:** Calculated as the sum of all incomes you earn, including wages, work-study income, taxable portions of scholarships/grants, gig-work income (minus relevant EXPENSES), business or self-employment income (minus relevant EXPENSES), unemployment benefits received, etc. Reported on line 9 of FORM 1040.

**SCHEDULE 1:** Used to report less-common sources of income (e.g. gig work, self-employment income) and ABOVE-THE-LINE DEDUCTIONS.

**SCHEDULE A:** Used to report ITEMIZED DEDUCTIONS. Rarely used by students.

**SCHEDULE C:** Used to report self-employment, business or gig income and associated EXPENSES.

**SCHEDULE D:** Used to report capital gains income.