Section 38 of income tax act

You've probably heard the phrase "tax deductions" a hundred times. But what does it mean? And how can you be sure you're taking all the tax deductions you're entitled to?By John BarrymoreSo-called sin taxes, excise taxes on things the government deems dangerous, can discourage bad behavior, but can they be too effective?By Oisin CurranHere's to you, conscientious citizen. Not only are your energy-efficient home improvements good for the ol' bank account, they're good for the environment, too. You deserve a reward -- or two or three. How do some tax breaks sound?By Kate KershnerIf there's anything certain in this world, it's that kids ask tons of questions. Sure, you may know what to say when they ask why dogs bark or why the sky is blue, but when your kids want to know about paying taxes, what should you tell them?By Kate KershnerYou get two things when you donate to a charity: a feel-good moment and a tax deduction. And donations don't have to take the form of a cash or check. Property and goods and services count, too — sometimes.By Alison CooperIf you're not the organized type, your tax returns may be languishing in a forgotten file folder in a closet. But never fear — if you need one for a mortgage or loan application and can't find it, the IRS can help you out. Pretty easily, too.By Alison CooperNobody wants their business to operate at a loss. But come tax time, you might at least be able to get some help if your business is in the red.By Susan SherwoodApplying for a federal tax ID number couldn't be simpler. All you need is a computer, a telephone or access to a post office.By Susan SherwoodThis might be the scariest phrase in the English language: tax audit. But not every missive you receive from the IRS is going to be bad news.By Susan Sherwood Filing income taxes in April is akin to "settling up" with the IRS. In reality, you've been paying taxes all year long. In April, all you are doing is determining if you paid the right amount. If you paid too much, you get a refund; too little and you're writing another check. Income tax forms like the 1040 are notoriously confusing, but that's because they're based on a U.S. tax code that's more than 5,000 pages long [source: Shinske]. Here are the basic steps to completing a tax return:Start by adding up your gross income, which includes salary or wages from a job, investment interest income, pensions and annuities. If you have job, your employer will send you a W-2 form in the mail which shows how much you earned and how much income tax was already withheld.Subtract any adjustments (examples: alimony that you paid, deposits in retirement plans, self-employment estimated taxes paid, moving expenses, interest that you paid on a student loan, etc.). The difference is called adjusted gross income (AGI).Once you know your AGI, you have two choices: Either subtract a standard deduction, or subtract itemized deductions, whichever is greater. Itemized deductions might include medical and dental expenses, charitable contributions, interest on home mortgages, and state and local taxes from the previous year.Next, subtract personal exemptions. For 2013, the IRS allows you to subtract $3,900 each for you, your spouse and each dependent if your AGI is under a certain amount [source: IRS]. Everything left over is called your taxable income.This is where it gets a little complicated, because the United States uses a marginal or progressive tax rate system. The more you earn, the higher your tax rate. To determine exactly how much you owe, look up your taxable income on the IRS tax table. Find the number that matches your filing status: single, married filing jointly, married filing separately, head of household, or qualifying widow(er) with dependent child, which is the same as "married filing jointly." That number is your gross tax liability. Don't worry, you have one more chance to lower your tax bill.From your gross tax liability, subtract any credits. The Child Tax Credit is a big one: $1,000 for each qualifying child. Other credits include the Earned Income Tax Credit (or Earned Income Credit) for low-income working families, which can be as much as $6,000, and the Child and Dependent Care Credit for childcare expenses.The final number is your net tax. If it's a positive number, you owe money to the IRS. If it's negative, you're getting a refund.You must file your federal income tax return and pay any taxes owed by April 15. Filing or paying late results in penalties and interest that accrues over time. If you are due a refund, the IRS mails most of them out within two weeks of receiving a return. You could also have the money electronically deposited directly into a bank account.Income Tax and the Self-EmployedIf you are a freelancer, independent contractor or otherwise self-employed, no one is going to withhold income taxes each time you get paid by a client or customer. Instead, it's your responsibility to pay estimated taxes quarterly based on your taxable income the year before. Not only is it the law (you'll pay a small penalty if you don't), but it allows you to avoid a big tax bill in April.Page 2Tax mistakes can happen to anyone -- just ask President Obama. At last count, at least four nominees to Obama's administration were found to owe back taxes. Tom Daschle, nominated to head the U.S. Department of Health and Human Services, owed more than $100,000 in taxes related to unreported income and untaxed limousine service. News of the unpaid taxes led Daschle to withdraw himself from consideration for the position. Tim Geithner, Obama's secretary of the Treasury, faced fierce criticism for his failure to pay $34,000 in taxes related to his work for the International Monetary Fund, among other things. Tax issues also hindered or derailed the nominations of Obama's picks for U.S. trade representative (Ron Kirk) and chief performance officer (Nancy Killefer).You might (or might not) be inclined to cut the president's nominees some slack. After all, the official U.S. Tax Code now numbers more than 70,000 pages long and grows thicker every year. That's the equivalent of more than 33 Oxford American dictionaries [source: Reuters]. Clearly, it's difficult to keep up with all of these constantly changing rules and regulations.You don't need to be a tax accountant, however, to avoid some of the most common mistakes people make when filing their returns. While most of these mistakes won't land you in a jail cell next to Bernie Madoff, they might cause you a few headaches as you deal with delays in your refund check or pay penalties and interest. So without further ado, and in no particular order, let's get on to some tax doozies that you won't commit after reading our list.April 15. The date stirs feelings of dread and anxiety in working Americans nationwide, and with good reason. Between gathering your W-2s, finding all of your receipts and financial records, and filling out your tax forms, doing your taxes can be an ordeal. No wonder people tend to wait until the last possible moment to file their taxes. In fact, the Internal Revenue Service (IRS) reports that more than 20 percent of Americans wait until the last week to file their taxes [source: Reuters]. These people typically have more complicated returns as well, adding to their stress as the tax deadline draws near.While taxpayers might naturally be tempted to wait a few weeks after the deadline before filing, that decision could cost them. The IRS charges interest (compounded daily) at an annual rate equivalent to the federal short-term rate plus 3 percent on any unpaid taxes, starting from when payment is due until the payment is received. In addition to charging interest, the IRS also charges a penalty for filing late (5 percent of the amount owed for each month or partial month the payment is late, up to a total of 25 percent). Depending on the amount someone owes and how long he or she waits to pay, interest and penalties can mount up in a hurry.If you need any more motivation to get started on your taxes early, the IRS notes that people who wait until the last minute to file typically make more mistakes on their returns. What kinds of mistakes? Read on to find out.You've gathered all your records, filled out your paperwork and sent everything in on time. What's holding up your refund check? Chances are your return wasn't fully filled out. Maybe your Social Security number was incomplete or illegible. Perhaps you incorrectly filled out your routing information, so instead of having your refund check deposited directly into your bank account, the check was sent by mail. Although these mistakes are easily fixable, they happen a lot, and they can result in substantial delays in processing your return. And make sure to sign before you file. Mark Green, IRS spokesman for Georgia, says, "One of the main errors that we notice, and this is generally with people that wait toward the end to file, is that they forget to sign their returns."These errors can be particularly costly if you have a tax liability, since the time required to fix the mistake can effectively push the filing date past April 15 (see mistake No. 10). A little diligence can ensure these types of mistakes don't happen to you. If you're filing by mail, make sure that you've filled in correctly and legibly all required information. If you're filing jointly, both individuals must sign the return. Better yet, file electronically, or e-file. According to Green, processing e-file returns costs the IRS 35 cents, compared to $2.87 to process a paper return. You'll be helping yourself, too. E-filing can result in quicker turnaround time for refunds. In addition, your tax software can catch a number of mistakes for you, including the next type on our list.Careless mistakes. The phrase conjures up memories of algebra class and tests covered in red X's. For some of us, math class might have been the last time we dusted off the calculator and crunched some numbers. No wonder, then, that math errors are common on tax returns. Filing electronically can help, since your tax software will do most of the math for you. Of course, if you accidentally enter the wrong numbers in the first place, your tax software won't be able to help you out.The IRS does check the returns, and sometimes those math errors work out in your favor, resulting in bigger returns than you were expecting. Other times, you may end up owing the IRS money and incur interest payments as well. Even the IRS makes mistakes occasionally, so if you receive a letter from the agency regarding math errors on your return, make sure to check its work, too.Avoiding the next mistake on our list requires more effort, but that effort can be very rewarding. Read on to find out why.We've already established that keeping up with the latest changes to the tax code can be quite a challenge, but you can miss out on some major opportunities if you fall too far out of the loop. This year, for instance, first-time U.S. homeowners who purchased their homes in 2007 and 2008 are eligible for substantial tax credits. The IRS also posts the latest news for individuals affected by natural disasters, as well as information about the latest tax scams or even Super Saturday, when the agency teams up with community partners to prepare qualified individual tax returns for free.The easiest way to get this information is through the IRS Web site, irs.gov (the "Latest News" section is particularly helpful). Looking through some of the agency's resources can be time very well spent. You can also talk to tax professionals about your situation. If they're knowledgeable and current on the latest changes, and they should be if you're paying them, they can tell you of any credits or rebates that might apply to you. After you've read up on the latest changes and filed your tax returns, make sure to avoid the next mistake on our list.You probably have a file cabinet (or two or three) full of papers you never look at. When it comes time to get rid of some of them, make sure your prior tax returns don't make it into the "shred" pile. What if you made a mistake on a previous return? In that case, you can file an amended U.S. income tax return (Form 1040-X) and possibly receive a larger refund for the amended year. While you'll need to file an amendment within three years of the initial filing date, Green recommends letting your initial return process before filing an amended one, since having both returns open at the same time can cause massive headaches for both you and the IRS.The IRS has several guidelines to help you know how long to keep your returns. For instance, if you fail to report income greater than 25 percent of the income reported on your return, the agency has six years before the statute of limitations runs out, so you should hold onto the return in question for six years.Most people don't need to worry about tax fraud investigations and unreported income. Still, definitely get a copy of your return, particularly if you enlist the help of a tax professional. Your previous tax returns will help you to see trends in your income taxes and to prepare your tax returns in the future, making them well worth a little space in your filing cabinet.The next mistake goes well beyond paperwork and filing folders. Read on to see what we mean.On Jan. 11, 2009, financier Marcus Schrenker's private plane crashed in the Florida Panhandle. Schrenker, strangely enough, was nowhere to be found. After tracking down Schrenker over the next few days, investigators now believe he may have been faking his own death in an attempt to run from financial and legal problems.Granted, faking your own death may not strictly fall under a list of "common" tax mistakes, but Schrenker wouldn't be the first person to give it a try. In 2007, British nightclub bouncer Mark Vaughan was convicted of two counts of tax evasion related to faking his death. Vaughan's scheme was a bit less dramatic than Marcus Schrenker's plan. Vaughan simply called the tax office and informed them that he'd died of a stroke, and he actually managed to go two years before he was finally caught. Faking your own death is hardly the only way to commit tax fraud. Hiding money offshore and abusing charity donations also fall into the category of fraud and can land you in serious trouble.More recently, the IRS has reported an alarming increase in phishing, where scam artists send e-mails claiming to represent the IRS in an attempt to gain sensitive financial information from unwitting taxpayers. According to Green, however, the IRS never sends unsolicited e-mails or asks for detailed personal and financial information. He also encourages taxpayers to be cautious and aware, and to forward suspicious e-mails to phishing@irs.gov.Up until now, most of the mistakes on our list were the sort that result in penalties and hassles. Missing tax credits and deductions can sting in a different way, since you can end up paying way too much when you file. You wouldn't be alone. In fact, Americans overpay taxes by almost a billion dollars every year [source: Johnson].To make sure you don't contribute to that figure, pay close attention to any tax credits or deductions that apply to you. Tax credits are particularly valuable and work by directly reducing the amount of taxes you owe. For instance, people with children can often receive a $1,000 credit, assuming their income doesn't disqualify them. Deductions work by reducing the amount of taxable income the IRS considers when determining what an individual owes. Charitable donations, mortgage interest, medical expenses -- there are a number of costs that qualify as itemized deductions. If those itemized deductions add up to be greater than the standard deduction (determined by your filing status), then they can lower your taxable income. Less taxable income translates into less money going to Uncle Sam and more money in your pocket.If you're interested in itemizing your deductions, you might want to pay particular attention to avoiding the next mistake on our list.There are three different forms people can use when filing an individual tax return; 1040, 1040A and 1040EZ. Form 1040 takes the longest to fill out, but it also gives you the flexibility to do things like itemize deductions or reflect self-employment income. At the other end of the spectrum, the 1040EZ is fairly easy to complete (as you might have guessed from the name), but the form is only appropriate if you have a simple tax situation (no student loan interest or IRA contributions to write off, for instance). The IRS encourages all filers to use the simplest form that they can to speed up processing refund checks. Make sure, though, that you don't end up overpaying on your taxes for the sake of an easy filing process or so that you can get your refund check. As we learned from our discussion on tax credits and deductions, credits and deductions can result in huge savings to the taxpayer at the end of the day. At the very least, however, you'll want to maximize your standard deduction by avoiding the next mistake on our list in the process. Choosing your status has a big impact on the types of standard deductions you'll receive on your tax return. While the process is often straightforward, a couple of areas can cause some confusion. First, make sure to check only one status. If you're married, for instance, make sure to choose between filing separately and filing jointly. For many people, their status changes during the year. If you get married or divorced over the course of the year, make sure to reference your status as of Dec. 31 of that year.Checking head of household can be particularly tricky. While filing as the head will get you a larger standard deduction than filing as single, you should make certain that you qualify for that status. Again, the IRS has multiple resources available to answer any questions you might have about filing status, so take advantage of them.Although choosing the right status on your returns is important, avoiding our next mistake is even more so.Even if you don't have the funds to pay your tax liability at the moment, the IRS encourages everyone to file something.One option is to file an installment agreement request (Form 9465). This form allows you to outline a payment schedule for your taxes in the event you don't have the money to pay all at once. The IRS will accept your installment plan if you meet a certain set of requirements. For instance, you'll can't already be on an installment plan with the IRS. While you will still be charged interest and penalties once you've worked out a repayment schedule, those rates are much better than the rates for not filing at all.Another option is to file for an application for automatic extension of time to file U.S. individual income tax return (Form 4868). Granted, the form's name is a mouthful, but the six-month extension for filing your returns that you'll receive in return will help you forgive the clunky title. While a 4868 doesn't grant you an extension on payments, the penalties for late payment are much less severe.No matter what you do, don't let April 15 pass you by without filing your returns. Even if you're owed a refund, you'll cause yourself problems in the future by not filing (and you can lose your refund in the process).Keep reading for more links on the tax man.Bankrate. "Bankrate's 2009 Tax Guide." (March 27, 2009) Kay. "Which tax return form should you use?" Jan. 7, 2009. (March 27, 2009) Kay. "2008 deduction mounts." Bankrate. Jan. 5, 2009. (March 27, 2009) . "Tax issues prompt Obama nominee to withdraw." Feb. 3, 2009. (March 27, 2009) Nicola. "Tax dodger faked death." Manchester Evening News. Sept. 24, 2007. (March 27, 2009) . "Amended Returns & Form 1040X." Nov. 26, 2008. (March 27, 2009) ,id=199548,00.htmlIRS. "Checklist of Common Errors When Preparing Your Tax Return." Feb. 26, 2009. (March 27, 2009) . "Collection Procedural Questions." March 5, 2009. (March 27, 2009) ,id=199556,00.htmlIRS. "How long should I keep records?" April 8, 2008. (March 27, 2009) ,id=98513,00.htmlIRS. "IRS Urges Taxpayers to Avoid Last Minute Filing: Tips to Avoid the Rush of the April 15 Deadline." Feb. 20, 2007. (March 27, 2009) ,id=108441,00.htmlIRS. "IRS Urgest Taxpayers to Avoid Common Mistakes." April 3, 2007. (March 27, 2009) ,id=169240,00.htmlIRS. "Tax Fraud Alerts." July 17, 2008. (March 27, 2009) ,id=121259,00.htmlJohnson, Caitlin A. "Don't Give Uncle Sam Too Much At Tax Time." Feb. 28, 2007. (March 27, 2009) . "Missing pilot had ties to Delta bankruptcy case." Jan. 13, 2009. (March 27, 2009) Robert. "Daschle Pays 3 Years of Tax on Use of Car." Jan. 30, 2009. (March 27, 2009) . "CCH CompleteTax Highlights Tax Changes Affecting 2008 Individual Income Tax Returns." Jan. 30, 2009. (March 27, 2009) 30-Jan-2009+BW20090130Solomon, Deborah. "Geithner Apologizes, Calls for 'Dramatic' Action." Jan. 22, 2009. (March 27, 2009) Jonathan. "Obama Pick for Trade Job Agrees to Pay Back Taxes." The Wall Street Journal. March 2, 2009. (March 27, 2009)