

Tax Calculation Flowchart

This flowchart illustrates the step-by-step process of calculating your federal income tax, highlighting where deductions and credits are applied in the calculation sequence.

1 Start with Total Income

Add up all sources of income:

- Wages and salaries
- Interest and dividends
- Business income
- Capital gains
- Retirement distributions
- Other income

Total Income = Sum of all income sources

Example: \$60,000 wages + \$1,000 interest + \$2,000 dividends = \$63,000 Total Income



2 Subtract Above-the-Line Deductions

These are also called "adjustments to income" and can be taken regardless of whether you itemize. This is the first place deductions appear in the tax calculation process.

- Student loan interest (up to \$2,500)
- Educator expenses (up to \$300)
- Health Savings Account contributions
- Self-employed health insurance
- Retirement plan contributions (Traditional IRA)
- Self-employment tax (50%)

Adjusted Gross Income (AGI) = Total Income - Above-the-Line Deductions

Example: \$63,000 Total Income - \$2,500 student loan interest - \$6,000 Traditional IRA contribution = \$54,500 AGI



3 Subtract Standard or Itemized Deductions

This is the second place deductions appear in the tax calculation process. Choose the option that gives you the larger total deduction:

Option A: Standard Deduction (2023)

- Single: \$13,850
- Married Filing Jointly: \$27,700
- Head of Household: \$20,800

Option B: Sum of Itemized Deductions

- Mortgage interest
- State and local taxes (up to \$10,000)
- Charitable contributions
- Medical expenses (exceeding 7.5% of AGI)
- Other eligible itemized deductions

$\text{Taxable Income} = \text{AGI} - (\text{Standard OR Itemized Deductions})$

Example: \$54,500 AGI - \$13,850 Standard Deduction = \$40,650 Taxable Income



4 Calculate Tax Based on Tax Brackets

Apply the progressive tax rates to your taxable income, based on your filing status.

2023 Tax Brackets (Single Filer)

- 10% on income up to \$11,000
- 12% on income from \$11,001 to \$44,725
- 22% on income from \$44,726 to \$95,375
- 24% on income from \$95,376 to \$182,100
- Higher brackets: 32%, 35%, and 37%

$\text{Initial Tax Liability} = \text{Sum of tax calculated for each bracket portion}$

Example for \$40,650 Taxable Income (Single)

10% of first \$11,000 = \$1,100

12% of next \$29,650 (\$40,650 - \$11,000) = \$3,558

Initial Tax Liability = \$1,100 + \$3,558 = \$4,658



5 Subtract Tax Credits

This is where tax credits are applied in the tax calculation process. Credits directly reduce your tax bill, dollar-for-dollar:

Nonrefundable Credits (can reduce tax to zero, but not below)

- Child and Dependent Care Credit
- Lifetime Learning Credit
- Foreign Tax Credit
- Adoption Credit
- Saver's Credit (Retirement Savings Contributions)

Refundable Credits (can reduce tax below zero, resulting in a refund)

- Earned Income Tax Credit (EITC)
- Additional Child Tax Credit
- American Opportunity Credit (partially refundable)
- Premium Tax Credit (for health insurance)

$$\text{Tax After Credits} = \text{Initial Tax Liability} - \text{Tax Credits}$$

Example:

\$4,658 Initial Tax Liability
- \$2,000 American Opportunity Credit
= \$2,658 Tax After Credits



6 Compare to Withholding and Payments

The final step is to compare your tax after credits to what you've already paid through:

- Federal income tax withholding from paychecks
- Estimated tax payments made during the year
- Other tax payments

$$\text{Tax Due or Refund} = \text{Tax After Credits} - \text{Total Payments}$$

Example:

\$2,658 Tax After Credits

- \$3,200 Federal Withholding

= -\$542 (Negative amount means you get a \$542 refund)

Key Points to Remember

- **Deductions appear in Steps 2 and 3**, reducing the income that will be taxed
- **Credits appear in Step 5**, directly reducing the tax after it's calculated
- The value of deductions depends on your tax bracket, while credits have the same value regardless of income
- Refundable credits can result in a refund even if your tax liability is zero
- Tax planning often involves optimizing both deductions and credits to minimize your overall tax liability

Note: This flowchart is for educational purposes only and does not constitute tax advice. Tax laws and amounts change regularly. For specific tax advice, consult a qualified tax professional.

PFL Academy - Chapter 2.4: Understanding Tax Deductions and Credits