PFL Academy

Chapter 2.5: Tax Planning and Compliance

Student Activity Packet

THE CHALLENGE

Kate and Dave both earn $65,000, but their approaches to taxes couldn't be more different. Kate contributes to her Roth IRA, tracks expenses year-round, and files in February. Dave ignores taxes until April, keeps receipts in a drawer, and misses deductions due to lost documentation. Over 10 years, Kate's proactive approach saves her thousands in taxes and earns her refunds months earlier—while Dave pays unnecessary penalties and leaves money on the table.

What's the difference between legal tax planning and illegal tax evasion, and how can proactive planning improve your financial outcomes?

Learning Objectives

- Differentiate between legal tax planning and illegal tax evasion.
- Identify core tax planning strategies for different life stages.
- Recognize common tax mistakes that lead to penalties.

CORE CONCEPTS

Term	Definition
Tax Planning	Legal strategies to minimize tax liability through deductions, credits, and timing decisions.
Tax Evasion	ILLEGAL non-payment or underpayment of taxes through deception, fraud, or concealment.
Tax-Advantaged Account	Accounts with special tax benefits (401(k), IRA, HSA) that reduce current or future taxes.
Tax Deferral	Postponing tax payments to a future date, often through retirement account contributions.
Tax Compliance	Following tax laws correctly and filing accurate, timely returns.

The Key Difference: Tax planning works WITHIN the law to minimize taxes (legal and encouraged). Tax evasion BREAKS the law through hiding income or lying (criminal, with severe penalties including fines and imprisonment).

APPLY IT

PART A: PLANNING VS. EVASION CLASSIFICATION

Classify each action as TAX PLANNING (legal) or TAX EVASION (illegal).

Action 1: Contributing $6,000 to a Traditional IRA

Reduces taxable income now; pay taxes when you withdraw in retirement.

Classification: ______________________________ (Planning / Evasion)

Action 2: Accepting payment in cash to avoid reporting income

A contractor asks to be paid cash and doesn't report the income on their tax return.

Classification: ______________________________ (Planning / Evasion)

Action 3: Timing charitable donations in December

Making donations before year-end to claim deductions in the current tax year.

Classification: ______________________________ (Planning / Evasion)

Action 4: Claiming children who don't live with you as dependents

Filing for the Child Tax Credit for children you don't actually support.

Classification: ______________________________ (Planning / Evasion)

PART B: TAX-ADVANTAGED ACCOUNT COMPARISON

Complete the comparison of retirement account options.

Feature	Traditional 401(k)/IRA	Roth 401(k)/IRA
Contribution Tax Treatment	Pre-tax (reduces taxable income NOW)	After-tax (no deduction NOW)
Withdrawal Tax Treatment		
Best For (Income Level)		
2024 IRA Contribution Limit	$7,000 (or $8,000 if 50+)	

1. Why might a young person in a low tax bracket today prefer a Roth account over a Traditional account?

PART C: CREATE YOUR TAX PLANNING CHECKLIST

Check off the items relevant to YOUR current situation and identify one action you can take.

Income Tracking:

- ☐ W-2 employment income
- ☐ Self-employment/freelance income (1099)
- ☐ Investment income (interest, dividends)

Potential Deductions:

- ☐ Student loan interest
- ☐ Education expenses
- ☐ Retirement contributions (IRA/401k)
- ☐ Charitable donations

Potential Credits:

- ☐ American Opportunity Credit (college)
- ☐ Lifetime Learning Credit (education)
- ☐ Saver's Credit (retirement contributions)

2. Based on your checklist, what is ONE specific action you could take to improve your tax situation?

CHECK YOUR UNDERSTANDING

1. Which is an example of LEGAL tax planning?

- ☐ A. Not reporting cash income from a side job
- ☐ B. Contributing to a 401(k) to reduce taxable income
- ☐ C. Claiming deductions for expenses you didn't incur
- ☐ D. Hiding income in an unreported foreign account

2. What are the potential consequences of tax evasion? List at least three.

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3. Explain the "triple tax advantage" of a Health Savings Account (HSA).

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4. Compare Kate's proactive approach to Dave's reactive approach. Give two specific examples of how Kate's strategy results in better financial outcomes.

5. Reflection: Are you currently more like Kate (proactive) or Dave (reactive) when it comes to financial planning? What specific steps could you take to become more proactive about tax planning?