

Common Tax Terms^{122 123}

The Internal Revenue Service (IRS): the American federal government revenue service that is responsible for collecting taxes and administering the Internal Revenue Code.

Tax liability: The payment owed by an individual or business to a federal, state, or local tax authority. Income taxes, sales tax, and capital gains tax are all forms of tax liabilities. For our purposes, we will focus on income taxes. When a person earns a high-enough income, they are subject to income taxes, which most Americans pay to the IRS every April in the form of a tax liability. An individual can lower their tax liability by claiming deductions and credits.¹²⁴

Filing Status: There are 5 different filing statuses for the federal tax return: 1) single, 2) married filing jointly, 3) head of household, 4) married filing separately, and 5) qualified widow/widower with a dependent child. Your filing status depends on a number of criteria and determines the forms you need to fill out and the filing requirements, credits, deductions, exemptions, and tax rates you are subject to.

Deductions: Deductions reduce your tax obligation by lowering your **gross income** (the sum of all wages, tips, and other earnings before taxes).

When filling out their federal tax return, taxpayers can choose to take the standard deduction or itemize their deductions. **A standard deduction** depends on a person's filing status, age, and income. **Itemized deductions** are a variety of expenses the taxpayer has incurred over the year, such as charitable contributions, daycare costs, medical bills, tuition, local taxes, real estate taxes, and more. Both types of deductions reduce the amount of your income subject to taxes.

Taxable Income: Your gross income (total income) minus deductions.

Earned Income: Taxable income you make from the employer that you work for, or from a business you run. Sometimes disability benefits count as earned.

Credits: A reduction in the amount of taxes you pay. For example, if you owe \$5,000 in taxes but qualify for a \$1,000 tax credit, then your tax liability (the total amount of tax you owe the

¹²² "Tax Terms Glossary." *Intuit TurboTax*, Sept. 27, 2021. <https://turbotax.intuit.com/tax-tips/general/tax-terms-glossary/L2M1PfoYy>

¹²³ Laura Zulliger, "40 common tax terms to know when filing your own taxes." *Credit Karma*, Feb. 8, 2018. <https://www.creditkarma.com/tax/i/common-tax-terms-know-filing-taxes>

¹²⁴ "Tax Liability." *Investopedia*, Sep. 13, 2021. <https://www.investopedia.com/terms/t/taxliability.asp>