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A Checklist For Reviewing An Individual Tax Return

Executive Summary

- While a tax return isn't quite the "window to your soul", the reality is that the depth and breadth of information that must be disclosed on a tax return provides *substantial* insight into an individual's family situation, income, net worth, and even lifestyle and spending behaviors.

- The core of the personal income tax return is Form 1040, filed by individuals and couples, which reports the household's gross income from all sources, the available deductions from income, the calculation of the tax liability itself, and the availability of any tax credits to reduce the amount owed.

- A detailed look at income sources can provide substantial insight into a household's financial situation, including even net worth. For instance, given typical interest rates of just 2% to 3%, a tax return reporting "just" $10,000 of interest actually implies fixed income investments of $300,000 to $500,000! Similarly, dividends can be used to estimate the size of a stock portfolio, at least in a taxable account.

- Capital gains, reported on Schedule D, not only provide perspective on investment assets, but can also reveal outside investment accounts, to the extent that any turnover triggers reportable gains or losses.

- Sole proprietorships provide substantial insight into actual business activities with their reporting on Schedule C of the individual tax return. And outside businesses that are pass-through entities provide at least some limited reporting on Schedule E. Both provide insight into a household's overall income and business affairs.

- Itemized deductions reported on Schedule A can be used to better understand the household's ongoing expenditures, from the likely size of the personal residence (based on the amount of mortgage interest payments and real estate taxes), to the client's charitable inclinations, and even whether there are other financial advisors involved (as their fees are claimed as miscellaneous itemized deductions).

- A review of the actual taxes owed on the tax return helps to reveal whether the client is under-withholding on taxes (or underpaying estimated tax obligations), or conversely is enjoying "too much" of a tax refund that could have been held back and invested (or at least kept liquid) instead.

- Certain household types have relatively 'common' tax return line items to review. For instance, any household with (minor) children should be reviewed for claiming the child tax credit, additional tax credits for college expenses (e.g., American Opportunity Tax Credit or Lifetime Learning Credit), and whether any Kiddie Tax was due… all of which can be determined from the household's tax return.

- For those who are still working, a review of the tax return provides perspective on whether the individual is an employee earning wages, or a self-employed business owner, whether common deductions are being missed (e.g., maximizing retirement account contributions), and whether there are AMT planning opportunities.

- In the case of a retiree, the review of a tax return can uncover numerous planning opportunities, from asset location decisions about in which account types the high-return tax-inefficient investments are being held, to the potential phase-in of Social Security taxation, and how retirement income is being generated between interest, dividends, capital gains, retirement account distributions, and more.

- Ultimately, the tax return only reports income, and not assets themselves, but the income tax return itself can nonetheless provide substantial insight into a household's likely net worth as well.

About the Author

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Introduction

An individual's tax return can speak volumes about what someone does with both their money and even their personal time. The tax return is viewed as such an important window into an individual's affairs that it is commonly released by Presidential candidates (President Trump notwithstanding), and gathering an individual's past year (or few) of tax returns is a staple of data gathering for financial advisors.

However, since most advisors are not typically CPAs or Enrolled Agents who actually prepare a tax return, not all financial advisors have even been trained in how to 'navigate' a tax return to spot the potential planning issues and opportunities. Especially since the reality is that there's a *lot* to cover in a tax return. And the ever-growing complexity of our tax system means the number of lines and forms just gets longer and longer (at least until the next round of tax reform finally occurs!).

Fortunately, though, the reality is that for the overwhelming majority of all clients that financial advisors will ever see, a relatively small number of line items on the tax return describe most of the "important" and most commonly relevant information, while the rest are there to facilitate reporting special rules for income, deductions, or credits, that are rarely used and even less likely to be relevant.

Accordingly, in this month's newsletter we explore a checklist process to highlight the most common lines items that financial advisors *should* review in a tax return, to spot potential planning issues and opportunities. As with any good checklist approach, almost by definition it will not cover *every* line item – at that point, it would simply be an instructional document for the entire tax return itself! Instead, the goal is simply to cover the most typically common and relevant issues, that advisors will likely face and should be cognizant not to miss!

Financial Planning Checklist For Reviewing An Income Tax Return

An individual (and couple's) tax return is filed on IRS Form 1040. Notably, Form 1040 does change a bit from year to year, as new tax laws are introduced that alter some of the individual line items; as a result, the particular line items listed here may shift slightly. All line items below are based on the currently available 2016 Form 1040 that will be used to report the 2016 tax season.

For best use, print the last two pages of this newsletter – an annotated version of the 2016 version of Form 1040 – to follow along with the reported line items.

Form 1040: Page 1 (Front Page) Income & Above-The-Line Deductions

The front page of Form 1040, also known as "Page 1", contains both the "background" information on the taxpayer (e.g., name, Social Security number, and filing status), but also all of the taxpayer's actual income (reported in the main "Income" section in the middle of the page).

In addition, the first page of the tax return shows an individual's so-called "above-the-line" tax deductions, which are subtracted from income to determine Adjusted Gross Income (AGI) at the bottom of the first page of Form 1040.

The sections below detail the key line items to consider on the front page of Form 1040.

Filing Status

The first thing to investigate on page 1 of the tax return, immediately below the individual(s) names, is the filing status.

Is this person a Single filer? Married filing jointly? Is it a couple that is Married filing separately (and if so, is that because they're one of those unique dual-high-income couples where it's tax-advantageous to do so, or is it because they're an estranged couple!?). Are they a head of household, or a qualifying widow(er) with a dependent child?

Important insight can be gained for many planning situations – with respect to both marital status, and family size – simply by seeing how the individual or couple claimed their filing status.

Exemptions

How many exemptions is the individual (or couple) claiming? Are there any dependent children being claimed, and if so how many? (Though remember that adult children living in the household might not be claimed on the tax return; data about children and family size should be confirmed in the client data gathering meeting.)

Are there any dependents *besides* just children? Check column (3) of the dependents section, on "dependent's relationship to you"? Are there dependent *parents* being cared for in the household? A niece/nephew who might be living there due to unfortunate family circumstances? Is some other family situation indicated that could merit a further discussion?

Above the Line Income and Deductions (For Calculating AGI)

At line 7 of Form 1040, you reach the "numbers" part of the tax return, and the remainder of page 1 (the "front" page of the 1040) is a list of all (taxable) income sources, along with a subset of so-called "above-the-line" deductions.

The subsections below explore the notable and most-likely-to-be-relevant line items of the front page of the tax return.

Line 7: Wages

On line 7 itself, wages are reported. At the most basic level, this helps to clarify if someone is actually employed (as a W-2 employee). Bear in mind that the "wages" amount reported on line 7 will be *after* any pre-tax deductions *from* wages itself, including employer retirement plan contributions, and any (pre-tax) payments for other employee benefits (e.g., a Section 125 plan, or even group disability insurance in certain cases).

If there's a dollar amount on line 7, check out the supporting Form W-2 (typically attached to tax return), which reports further details of any deductions that were made from the individual's paycheck. Look in particular at Boxes 1 (total wages), and 13 (and whether the "Retirement Plan" checkbox is marked). And verify whether or not anything is filled in on the W-2 for lines 12a through 12d, which reports a "code" for various deductions from wages on the left, and the dollar amount on the right, including common codes C for taxable group life insurance, codes D or E for elective deferrals to a 401(k) or 403(b) plan (or codes AA or BB to the Roth version), code V for exercising non-qualified incentive stock options, and code W for employer contributions to an HSA.

Notably, *self-employed* income is reported later, on line 12.

Line 8: Interest

On line 8, taxable interest is reported. This can be a good opportunity to understand the client's prospective net worth, as the reality is that in an ultra-low interest rate environment, "just" $10,000 to $20,000 of interest on line 8 can indicate a *very* large dollar amount in bonds or CDs. For instance, at a 2% interest rate, seeing $10,000 of reported interest actually means there's a $500,000 fixed income account out there!

The supporting Schedule B will show further details regarding the interest reported on line 8, and most accountants (and/or tax preparation software) will note the source account or institution. Which means you can quickly identify whether interest is being driven by holdings in bonds in a brokerage account, CDs at a bank, or elsewhere. Are there any accounts/investments referenced on Schedule B that were not previously disclosed in the data-gathering process?

Also, note whether there is any amount on line 8b, which represents *tax-exempt* interest. Is the client invested in muni bonds? With intermediate high-quality muni bonds yielding around 2.5% right now (give or take a little), multiple the interest on line 8b by 40 to get a rough estimate of the municipal bond account balance.

Notably, line 8 and line 8b are reported *separately*, so the two can be added together to get some perspective on the potential total size of the client's fixed income allocation (at least in taxable investment accounts).

Line 9: Dividends

Line 9 of Form 1040 reports the amount of dividends, both qualified dividends (line 9b) and nonqualified (line 9 itself). Notably, in the case of dividend, line 9 reports the total of *all* dividends (qualified and nonqualified), and line 9b simply states the portion of line 9 that was qualified. (This is different from interest on line 8, where taxable and tax-exempt interest are reported *separately* and must be added together to get the total amount.)

Nonetheless, as with line 8, the opportunity with line 9 is to get a glimpse of how much is invested in equities (at least, in taxable accounts), based on the amount of dividends that passed through. Assuming a roughly 2% average dividend rate, multiply by 50 to estimate the total amount of equities held in taxable accounts. Bear in mind that this estimate should only be done based on line 9 itself (not combined with 9b, as that would double-count the qualified dividends).

Regarding line 9b itself, note what portion of the total dividends were qualified dividends. A high percentage (often 100%) is typical for US-centric investment portfolios. A low percentage indicates that the portfolio's equity positions are failing to qualify, which implies either a high turnover portfolio (failing to meet the 60-day holding period requirement for qualified dividends), or a large percentage of equities held in foreign securities not eligible for qualified dividend treatment (particularly a lot of emerging markets stocks).

Line 11: Alimony

Line 11 of Form 1040 is where any *received* Alimony is reported (given that it's taxable to the recipient). Notably, any alimony *paid* (and the associated tax deduction) is reported later, on line 31a.

From the financial planning perspective, it's important to know if there's any alimony being paid or received, as it speaks to financial commitments (how long will the alimony last from here?), marital status (at least one previous divorce), and the potential that there are other related financial commitments (e.g., child support payments also being paid or received).

Line 12: Self Employment Income

Technically line 12 is labeled as "business income", but in practice this is where self-employment income as a sole proprietor is reported – the net income based on schedule C.

Any dollar amount reported on line 12 means there is at least *some* kind of self-employment activity (without a separate business entity). This could be consulting income, professional services, or even a substantial "business" itself (operated in sole proprietor format). To say the least, it invites a discussion as to what kind of business activity the client is engaged in, and income expectations.

If there *is* any income reported on line 12, be certain to look at the Schedule C itself for further detail, including the nature of the business (Line A), total revenue of the business (Part I, line 1), various expenses of the business (lines 8 thru 27 in Part II, which shows a lot about the nature of the business based on the breadth and type of deductions), whether it's a home-based business (home business deduction on line 30), and the final net income of the business. Looking at page 2 of the Schedule C, part V – which details "Other Expenses" – can also sometimes be illuminating, to see what other kinds of expense deductions are associated with the business.

Line 13: Capital Gains

The net amount of any capital gains (or losses) are reported on line 13. As a result, the first question for line 14 is simply whether there's *any* dollar amount, and if so, whether it is positive, or negative.

A negative dollar amount not only indicates losses, but given that only $3,000 of losses can be deducted against ordinary income, any time -$3,000 is actually shown on line 13, it's an indicator that there will be some carryforward losses as well (that couldn't be claimed due to the $3,000 cap on losses offsetting ordinary income). Accordingly, obtain a copy of the Schedule D, and look to line 7 in Part I for short-term capital loss carryforwards, and line 15 of Part II for long-term capital loss carryforwards.

A further look at Schedule D also indicates exactly *what* was sold to generate capital gains or losses in the current year, and again can be a helpful indicator of portfolio size and activity. Notably, over the past several years broker-dealers and custodians have been required to report gains and losses via Form 1099-B, which in turn is either copied over to (or attached to) a supporting Form 8949 with the tax return. As a result, you'll need to find the Form 8949 to see the actual capital gain/loss transactions (but again, it should be attached directly to Schedule D).

Are there any investments sold for a gain or loss that are 'surprising', either given the size of the gain/loss, or the fact that it might be an investment from an account you weren't aware of? In some cases, advisors become aware of entire accounts that may not have been previously disclosed by the client, because the gains and losses are reported in detail on Schedule D, and the positions that triggered the gain or loss weren't investments the advisor had implemented/sold in the first place.

Line 15: IRA Distributions (And Roth Conversions)

Line 15 of the tax return reports any type of IRA "distribution" event that was taxable. It could be a withdrawal, or a required minimum distribution (which is simply a "forced withdrawal" for tax purposes), *or a Roth conversion*.

Notably, not all IRA distributions are taxable, either fully or at all. As a result, line 15a reports the *total* amount of any distributions for the year, and line 15b reports how much was *taxable*. A gross amount on line 15a that leads to $0 on line 15b is typically just an IRA rollover (where the rollover was completed in a timely manner), although if the dollar amount is modest it could also be a Roth conversion that was entirely after-tax contributions (e.g., a "backdoor Roth" contribution). For those over age 70 ½, an IRA distribution where the taxable amount is $0 is often a Qualified Charitable Distribution (QCD), though a QCD is also typically noted as such (literally, written right onto the tax return on line 15 or in the margin nearby).

At the most basic level, the primary issues to note here are simply *whether* an amount is reported, and if so, whether it 'jives' with the client's stage of life. Those who are 60-something or older typically have IRA distributions. Those who are 70 or older *should* have IRA distributions (due to RMDs, unless they literally have a *zero* dollar balance in retirement accounts, or happen to meet the still-working exception for an employer retirement plan). Those under age 60 (i.e., under the age 59 ½ exception to the early withdrawal penalty) typically won't have any amounts reported here, unless it's an IRA rollover (in which case line 15b will be zero) or it's a Roth conversion (where the distribution may be partially or fully taxable).

Line 16: Annuities And Employer Retirement Plans

While line 15 reports distributions from IRAs, line 16 reports distributions from "Pensions and Annuities". Notably, a "pension" in this context really means a distribution from *any* employer retirement plan, including both a defined benefit pension plan, and also any withdrawal from a 401(k), 403(b), etc. In addition, a Roth conversion that came out of a pre-tax employer retirement plan (whether done directly to an IRA, or as part of an intra-plan Roth conversion) is reported as a distribution on Line 16.

As with line 15, on line 16 the dollar amounts are broken down into the gross amount (16a) and the taxable amount (16b). Similar to the IRA, gross distributions that are not taxable could include a Roth conversion of after-tax amounts in a 401(k), or simply a rollover *to* an IRA (where the distribution is reported on Form 1099-R, but the fact that it was rolled over with a matching Form 5498 affirms it was not taxable).

Again, note the sheer dollar amount of the distribution, and whether it jives with the client's overall situation. Be cognizant, though, that determining the exact source of the income for line 16 may require delving further, as it could be from a defined benefit plan, any number of defined contribution plans, or a non-qualified annuity. Though not required to be reported to the IRS (because it already receives a copy directly), the tax return may include one or several Form 1099-Rs attached, which will provide further detail on the source for any/all distributions reported on Line 16.

Line 17: Pass-Through Businesses And Trusts

Line 17 of the tax return is a crucial one – it's where the reported for any/all pass-through business entities will roll up, along with distributions from any trusts (at least to the extent they're non-grantor trusts that made distributions to the beneficiary). Any non-zero-dollar amount on line 17 merits further exploration.

Notably, dollar amounts on Line 17 will almost always be positive (as claiming a net operating loss is possible, but rare). However, even a dollar amount of $0 (where the line shows $0, but isn't blank) is an important indicator (as $0 typically signifies a business with material losses, that were limited to $0 due to the passive loss limitations, as opposed to a blank line that simply indicates there *are* no pass-through businesses or trusts).

Further details about the nature of the pass-through businesses (or trusts) are found on Schedule E. Part I of Schedule E reports any real estate investing activity, while Part II reports pass-through from partnerships (or LLCs) or S corporations, and Part III reports income distributed from trusts (or an estate where the individual was the beneficiary). If there are multiple real estate properties, there is often a duplicate version of Part I for each property; if there are multiple businesses, there are typically reported all together in Part II (listed at line 28).

Bear in mind that the Trusts section of Schedule E typically only reports distributions from non-grantor trusts, as a grantor trust (e.g., a revocable living trust) is the grantor's own individual income anyway, and is simply reported on the respective interest/dividend/capital gain line items directly on Form 1040.

Line 20: Social Security Benefits

On line 20 any/all Social Security benefits are reported. Given that anywhere from 0% to 85% of Social Security may be taxable, line 20 is split into the gross Social Security benefits (line 20a) and the taxable amount (line 20b). Doing the quick math to see whether line 20b is 85% of line 20a will tell you whether the client is still phasing in the taxability of Social Security (which has significant planning implications given how it impacts and can drastically increase the marginal tax rate), or whether it's already phased in to the maximum.

Identifying whether Social Security benefits are being paid in the first place is also important. If the client is between ages 62 and 70, any dollar amount on the Social Security line means that someone has started Social Security benefits; for a married couple, it often makes sense for one person to start early while the other delays, though for an individual, it's a direct indication he/she didn't delay. Notably, the maximum Social Security benefit is just under $32,000/year, which means any Social Security benefits above this amount indicates both members of a couple are claiming benefits (and/or there's some other family benefit being paid).

Give special note to any reported Social Security benefits for those under age 62, as it may indicate widow's benefits (between ages 60 and 62), or some other unusual situation involving family benefits and minor children.

Above The Line Deductions

Lines 23 through 35 report the so-called "above the line" deductions on the tax return. These are deducted directly from income in calculating the taxpayer's "Adjusted Gross Income" (AGI), which is reported at the bottom of page 1 of the tax return.

When it comes to the above-the-line deductions, the reality again is that several of the deductions are relatively rare and uncommon, while others are common and should at least be noted and reviewed in discussion with clients, and may even provide an indication of further planning opportunities or issues.

Line 25: Health Savings Account

Line 25 is where taxpayers report their own (but not their employer's) deductible contributions to a Health Savings Account (HSA). The details of HSA contributions are reported on Form 8889, including whether or how much of a contribution was permitted (and the Form 8889 is also used to calculate the tax consequences of HSA distributions). From a practical perspective, if there's an amount reported on Line 25, it means there was a (permissible and deductible) HSA contribution that occurred.

From the financial planning perspective, issues to spot when there's an amount reported on Line 25 include affirming the details (i.e., premiums and benefits) of the High-Deductible Health Plan (HDHP), whether there actually *is* enough in the HSA (or other emergency savings) to cover the high deductible, and whether the client is maxing out the permissible HSA contribution (which is $3,350 for individuals and $6,750 for married couples, plus a $1,000 catch-up contribution for those over age 55).

Bear in mind that even if the client doesn't *need* more money in the HSA to cover upcoming medical expenses and the deductible (e.g., because there were carryover amounts from prior years), maxing out the HSA (and it's related tax deduction) may still be appealing to further build up the HSA account to cover Medicare and other future health care expenses in retirement.

Line 28: Self-Employed Retirement Plans

For any self-employed individuals – including both those who are sole proprietors (with income on line 12) or more-than-2%-owners of pass-through businesses (from line 17) – it's line 28 that reports deductible contributions to an employer retirement plan, whether a SEP or SIMPLE IRA, or a 401(k) or profit-sharing plan.

To the extent that lines 12 and 17 were blank – there was no self-employment income – clearly line 28 will (or at least, should!) be blank as well.

But conversely, if there was income reported for a sole proprietorship on Schedule C, or a pass-through business (e.g., partnership, LLC, or S corporation), hopefully there will be a (deductible) retirement account contribution reported here as well. If there was business income and no retirement contribution (or a very small one relative to the income), investigate further as to whether the small business retirement plan needs to be changed in the future (or implemented if there isn't one and there's still time to put one in place for the current or even prior tax year!).

Line 29: Self-Employed Health Insurance

For those who are self-employed, a major question is where/how they're getting their health insurance. If there was any self-employment income reported on lines 12 or 17, hopefully there's a deduction reported on line 29 for self-employed health insurance (reported here for those who are more-than-2% owners in pass-through entities, and any sole proprietors).

Of course, in some situations a self-employed individual is married to someone who is a wage employee and gets health insurance through their business. But the whole point of spotting a deduction on line 29 is to clarify whether the client is getting health insurance directly from or through his/her own self-employment business (or a health insurance exchange), or if this line is blank, which implies health insurance is being obtained through an employee spouse (or that the couple is potentially uninsured!).

A glance at the health insurance premiums paid may also raise the question of whether the client is paying a reasonable amount *for* health insurance, and/or whether alternative health insurance plans should be considered to save on premiums.

Line 31: Alimony Paid

While line 11 reported any the income from alimony being received from an ex-spouse, line 31 reports any deduction for alimony being paid *to* an ex-spouse.

As with line 11, any dollar amount here is important not only for the tax deduction itself, but the related questions it raises – how long must the alimony continue (and at what levels), are there also child support payments, and is there additional relevant information about the status of and relationship to the ex-spouse (and any children from the former marriage)?

Line 32: IRA deduction

On line 32, deductible contributions to an IRA are reported. However, line 32 can be confusing, because only the *deductible* portion of an IRA contribution is reported here.

Thus, any contribution to a Roth IRA is not claimed on line 32, and anyone who makes a nondeductible contribution to a traditional IRA (e.g., because he/she is an active participant in an employer retirement plan and over the income limits) also does not report a dollar amount on line 32. Instead, nondeductible contributions and the "basis" they create in the IRA are reported on Form 8606. (Notably, Form 8606 is also used to calculate how much of a Roth IRA distribution is treated as a return on after-tax basis, although technically the taxpayer must track their own basis until a distribution is actually reported.)

The fact that so many types of IRA (and Roth IRA) contributions are *not* reported on Line 32 means that it's also important to review Form 8606 to further clarify if a non-deductible traditional IRA contribution was made. Notably, though, the Roth IRA contribution isn't actually reported at all (not on Line 32 of Form 1040, nor on Form 8606); it's simply up to the taxpayer (and often the IRA custodian) to affirm that any contribution amount was compliant with the rules in the first place.

Line 37: Adjusted Gross Income (AGI)

Line 37 at the bottom of the front page of Form 1040 defines a taxpayer's "Adjusted Gross Income" (AGI). This number represents the total of all (taxable) income from all sources, less the list of available "above the line" deductions that are subtracted directly from income to calculate AGI.

The significance of AGI is that so many *other* limitations of the tax code are determined based on AGI, as noted in Figures 1 (individuals) and 2 (couples) on the next page. Income surtaxes like the phaseout of itemized deductions (Pease limitation) and personal exemptions (PEP), and the Medicare surtax on net investment income, are triggered based on AGI. Limitations on the ability to claim a wide range of popular tax credits, including the child tax credit, education tax credits (e.g., Lifetime Learning Credit and American Opportunity Tax Credit), and the retirement savings contribution credit, are all based on AGI (or some modified version of it). The ability to deduct IRA contributions (as an active participant in an employer retirement plan), or make Roth IRA contributions, are also based on AGI. And both the medical expense itemized deduction, and miscellaneous itemized deductions, are built around percentage-of-AGI thresholds.

Given the wide-reaching impact of these dynamics, special attention should be paid to the client's AGI. Especially in light of the fact that being as little as $1 on the "wrong" side of a threshold can drop certain tax credits or benefits all the way to $0.

Form 1040: Page 2 (Back Page) Below-The-Line Deductions And Determining Tax Liability

On the back side of Form 1040 – in essence, page 2 – the taxpayer claims their so-called "below the line" deductions (named as such because they're past 'the line' of Adjusted Gross Income), along with personal exemptions.

Figure 1. AGI Limitation Or Phaseout Thresholds for Individuals

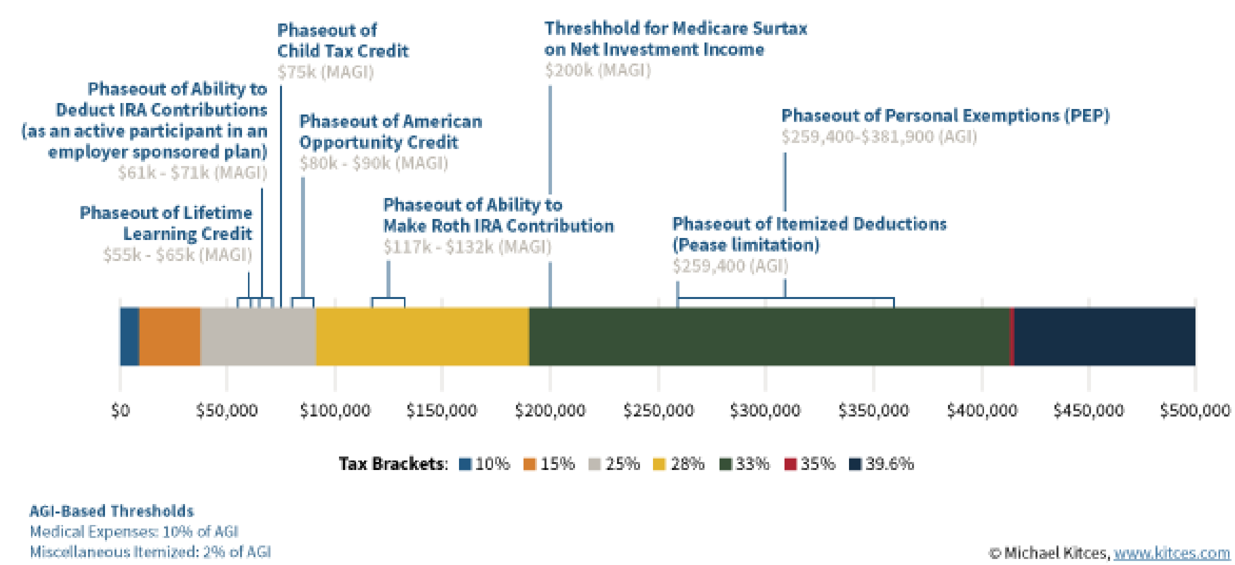
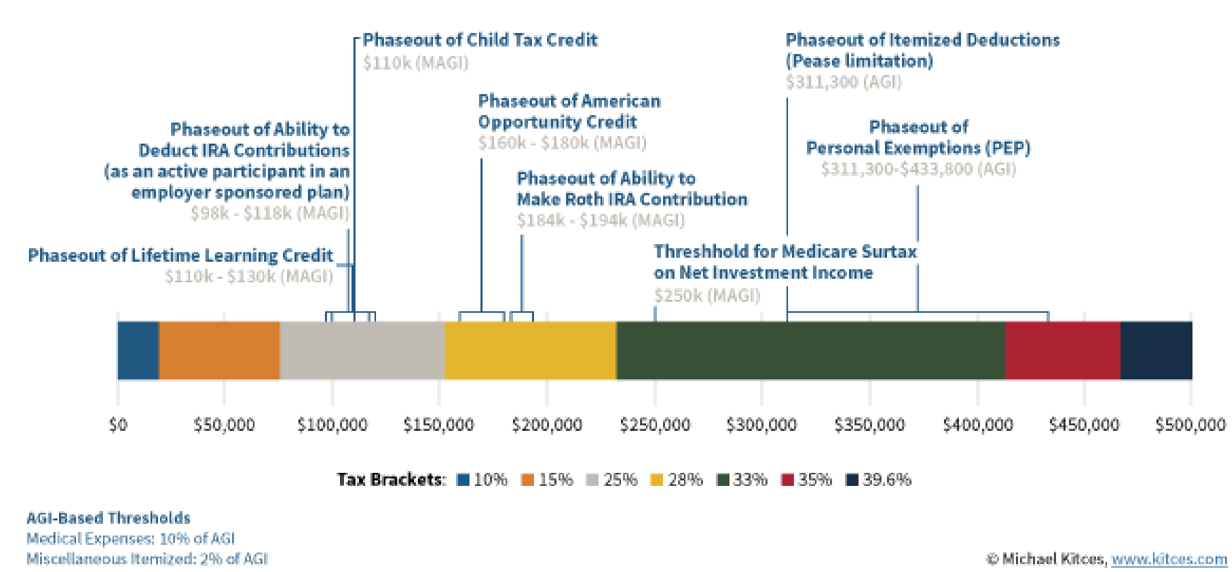


Figure 2. AGI Limitation Or Phaseout Thresholds for Couples



Once these deductions are subtracted, it's possible to calculate the taxable income base to which the income tax brackets will actually be applied. Notably, though, this is not the final determination of how much someone actually *owes* in taxes, as once the initial tax liability is determined, it is further adjusted for various tax credits that may be available.

The end of the backside of Form 1040 reveals whether the individual received a tax refund at the end, or actually owed a tax liability – along with whether any penalties may have applied (e.g., for failure to sufficiently pay estimated taxes throughout the year).

Line 40: Itemized Deductions

On line 40, taxpayers claim either the standard deduction, or itemized deductions if that amount produces a greater tax benefit. The standard deduction in 2016 is $6,300 for individuals, $12,600 for married couples (filing jointly), and $9,250 for a head of household; thus, if one of these dollar amounts is shown on line 40, it's confirmation that he/she/they claimed the standard deduction.

Clients who claim the standard deduction indicate that

Understanding Schedule A

Most deductions that individuals can claim for their various expenses are claimed as itemized deductions on Schedule A. As a result, reviewing Schedule A in detail can itself provide significant insight into where and how a household spends its money.

For instance, the details of itemized deductions can reveal whether there are any major health issues (triggering large medical expense deductions), the kind of residence the client owns (given the mortgage interest deduction and real estate property taxes claimed), and whether the client has charitable inclinations (and their style of giving, cash or in-kind).

Key line items and questions to review as a part of Schedule A include:

- Line 4: Medical Expense Deductions - Were there substantial medical expense deductions? Did they actually exceed the 10%-of-AGI threshold (or 7.5%-of-AGI for those over age 65) to claim a deduction?

- Line 5: Deduction For State/Local Taxes Paid - Did the client claim the state income tax deduction, or if in a state with little or no state income taxes, the state sales tax deduction instead?

- Line 6: Deduction For Real Estate Taxes Paid - How much was paid in real estate taxes? Given the dollar amount, what does this imply about the size/value of the personal residence? (Of course, given that the client's address is listed on the front page of Form 1040, it's also possible to simply look up the value using an online service like Zillow!)

- Line 10: Mortgage Interest Deduction - How much mortgage interest was paid/deducted, and what does this imply about the potential size of the mortgage? At a 4% assumed interest rate, multiple the amount of mortgage interest paid by 25 to roughly estimate the size of the outstanding mortgage balance.

- Line 14: Investment Interest Deduction - Was any deduction claimed for investment interest, indicating that the client has been investing with a margin account, or doing other investment-based borrowing?

- Lines 16 & 17: Charitable Deduction - Does the client do any charitable giving, and if so do they typically donate more by cash/check (line 16), or by donating property in kind (e.g., to Goodwill or similar, reported on line 17)?

- Line 18: Charitable Deduction Carryforward - Is there a charitable contribution carryforward from a substantial prior year gift? Was the client able to use all of the current and prior-year-carryforward deductions this year?

- Line 23: Miscellaneous Itemized Deductions – What other various itemized deductions are claimed in the miscellaneous section, such as investment management fees paid (to a prior or current advisor), tax preparation fees, variable annuity losses, or other notable expenditures?

- Line 29: Pease Limitation - Was the client subject to the Pease limitation that partially phases out itemized deductions? Line 29 will report the dollar amount of deductions that were lost.

they have very limited deductions at all; this typically implies either that they rent rather than own a home (and thus no mortgage or real estate taxes deductions), live in a no-tax-rate state like Florida or Texas, or are not very charitably inclined (and thus didn't have large enough charitable deductions to push them over the threshold of the standard deduction, even when combined with any other available deductions).

If there's a larger dollar amount reported, then the client itemized their deductions, and there should be a supporting Schedule A showing the details of these "below-the-line" itemized deductions (which in turn can provide additional insight into the household's cash flow expenditures). See sidebar, prior page, for further information regarding Schedule A.

Line 43: Taxable Income

Line 43 reports the client's "taxable income" – a specific term that defines the final amount of income used to calculate taxes due, after all personal exemptions and (the standard or itemized) deductions have been claimed.

Taxable income is the actual income line item used to determine which tax bracket(s) the client falls in to, as shown in the chart below. The client's tax liability itself (reported on the subsequent line 44) is calculated by using the appropriate tax tables (see Figure 3, below), given the dollar amounts that fall within each bracket.

Line 44: Tax Liability

On line 44, the client's actual tax liability is shown, determined by applying the tax bracket tables and using the taxable income from the preceding line 43. This is the actual amount of taxes the taxpayer incurred for the tax year (before the application of any tax credits, as discussed below).

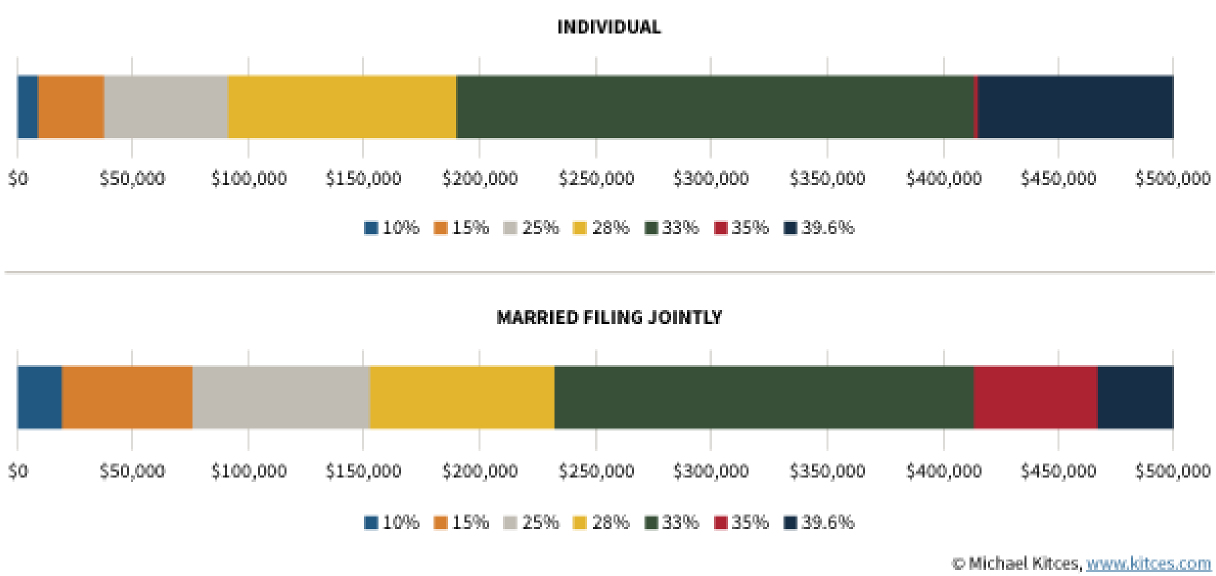
Of note on line 44 is whether box (a) is checked. If the box is checked, the client was subject to the so-called "kiddie tax" for a dependent child. Notably, though, the final dollar amount on line 44 will simply be the total of *all* taxes due, including both the client's own tax liability, and any kiddie tax that rolled up. The details of the amount of kiddie tax due are reported separately on the underlying Form 8814.

Line 45: Alternative Minimum Tax (AMT)

Line 45 is where the "dreaded" alternative minimum tax (AMT) is reported.

Technically, all taxpayers calculate their tax liabilities twice: once under the regular tax system (claiming those exemptions and deductions and using those 10% through 39.6% tax brackets) on Form 1040 (culminating in the tax liability on line 44), and again under the AMT system (with those fewer exemptions and deductions, and the AMT 26% and 28% rates) on Form 6251.

Figure 3. Tax Bracket Thresholds Based On Taxable Income For Individuals & Married Filing Jointly



If the calculation under the AMT system on Form 6251 results in a higher tax liability than what was reported on Line 44, the client must pay an additional tax to bring their regular tax liability *up* to the amount calculated for AMT purposes. That extra tax caused by the AMT, and the gross-up amount (the extra tax that must be paid to bring it up to the "minimum" required on Form 6251) is reported here on line 45.

From the perspective of reviewing a tax return, if there's any dollar amount on line 45 – which means the AMT system did cause at least some additional taxation – review the supporting Form 6251 to see the underlying details of the various AMT adjustments and preference items that caused the AMT.

Most commonly, the AMT is simply triggered by the loss of personal exemptions ($4,050 for the taxpayer, his/her spouse, and each dependent, but not available under the AMT system), and the loss of deductions for taxes paid to other entities (as state/local, real estate, and any/all other taxes deducted, are added back on line 3 of Form 6251). In some cases, adding back miscellaneous itemized deductions (line 5 of Form 6251) can be the AMT trigger (especially if the taxpayer's miscellaneous itemized deductions include a sizable investment management fee!). Any *other* large line item deduction on Form 6251 besides lines 3 and 5 is notable, and usually worth exploring further.

Line 54: AMT Minimum Tax Credit

While the Alternative Minimum Tax by definition will cause taxpayers to pay more in income taxes, any additional AMT liability that was caused by an AMT adjustment that merely changed the *timing* of income (most commonly, for recognizing the bargain element of an Incentive Stock Option) creates a Minimum Tax Credit (MTC). The MTC is a tax credit against any future *regular* income tax liability, but only to the extent that the credit doesn't reduce your tax liability so low that it *causes* AMT exposure again. Any excess that can't be used is carried forward to the next year.

The fact that the MTC is limited means that those who are already subject to the AMT may find themselves repeatedly unable to claim the MTC year after year. The good news is that the MTC does carry forward indefinitely (at least until you pass away). But it's important to know that the MTC is there.

If any of the MTC was actually *used* in the current year, it will be reported on line 54, and the box for Form 8801 will be checked. The supporting Form 8801 itself will detail the amount of the MTC, including whether/how much is still remaining and carrying forward to future years.

Notably, though, because line 54 only reports the MTC if it is used, if the client had any AMT tax paid on line 45 (which means the MTC couldn't be used, even if it was available), it's a good idea to check whether there's a Form 8801 included with the tax return, that might be reporting an ongoing MTC carryforward that wasn't claimed.

The MTC carryforward itself is reported on line 26 of Part II of Form 8801.

Line 59: IRA-Related Penalties

Most of the time, line 59 reporting penalties related to IRA accounts will be blank, but anytime it's *not* blank, it's a big deal.

The most common forms of "penalties" reported on line 59 are:

- 10% early withdrawal penalty

- 6% excess contribution penalty for contributing beyond the limits to a traditional IRA (or contributing to a Roth IRA when not otherwise eligible at all)

- 50% penalty for failure to take a Required Minimum Distribution (RMD)

Also included on line 59 are penalties for other types of tax-preferenced accounts that have an early withdrawal penalty, including nonqualified distributions from a Coverdell Education Savings Account (the so-called "Education IRA"), a 529 college savings (or prepaid tuition) plan, or a 529A ABLE account for a disabled beneficiary. Notably, the distribution itself wouldn't be reported on line 59, but any 10% early withdrawal penalty associated with a nonqualified withdrawal would be.

Ultimately, the details of exactly which penalty (or penalties) applied, and the type of underlying account on which it was based, will be reported on a supporting Form 5329.

Line 61: Health Insurance Mandate Penalty

As a part of the Affordable Care Act, many individuals who don't have health insurance must obtain coverage via a health insurance exchange, or pay a penalty.

In 2016, the penalty is the greater of either a flat dollar amount of $695 per uninsured adult and $347.50 per child, or 2.5% of "household income" (which is defined as AGI, plus tax-exempt bond interest and untaxed Social Security benefits, reduced by the tax filing threshold of $10,350 for individuals of $20,700 for married couples). The penalty for failing to purchase health insurance is capped at the cost of just buying a bronze plan on the individual insurance exchange (in the taxpayer's state of residence).

To the extent the client was subject to the health insurance mandate and didn't obtain coverage, the amount of the penalty will be reported on line 61. While ideally health insurance should be purchased in any/all situations, the larger the penalty, the more relevant it is to buy health insurance, as the cost of a basic bronze plan could actually be close to the cost of the penalty itself (especially for higher-income individuals paying the 2.5%-of-income version of the penalty).

Of course, any penalty reported on Line 61 is also an important indicator that at least one person in the household is uninsured against potential medical expenses, which itself is a serious financial planning concern (beyond just trying to minimize the penalty itself).

Line 62: Medicare Surtax

Line 62 reports either/both of the two so-called "Medicare surtaxes" that were first introduced in 2013 under provisions of the Affordable Care Act.

The first is a 0.9% surtax on any earned income (from wages or self-employment income) above $200,000 for individuals, or $250,000 for married couples. For high-income individuals, the tax is typically withheld directly from his/her paycheck (part of the "Federal income taxes withheld" line 64, and reported on Form W-2), and simply reported here to reconcile what has already been paid. However, with a dual-income couple where their combined income may put them (further) over the threshold than either individual was – such as when each person earns "just" $150,000, below the $200,000 individual threshold, but the couple together at $300,000 is over the $250,000 threshold – it's necessary to calculate the combined tax exposure. And often that surtax amount for couples will not have already been withheld (since neither individual employer knew it was necessary). If the client was subject to this tax, the box for "Form 8959" on line 62 will be checked, and Form 8959 itself will show the exact calculation of this Medicare surtax.

The second checkbox on line 62 is for Form 8960, which calculates the somewhat more complex Net Investment Income Tax (NIIT), a 3.8% surtax on "investment income" (which is broadly defined to include interest, dividends, rents, royalties, annuities, income from a passive business, and capital gains). The 3.8% NIIT only applies to investment income that falls above the AGI threshold of $200,000 for individuals and $250,000 for married couples.

Notably, because the 0.9% surtax is only calculated on earned income, while the 3.8% NIIT is calculated on investment income, it is possible that a client will be subject to one, the other, both, or neither. The checkboxes on line 62 will indicate which surtax(es) applied (with further detail on the supporting forms), and the total on line 62 will simply report the cumulative amount assessed for both taxes (though the final amount *owed* is reduced by any amounts already previously paid or withheld, as reported on the next lines of the tax return).

Lines 64 & 65: Taxes Already Paid

Employees typically have taxes withheld directly from their paycheck, while self-employed individuals, those with pass-through business entities, and those with substantial investment or other taxable income sources, are obligated to make quarterly estimated tax payments.

Lines 64 and 65 report, respectively, the amount of Federal income tax withholding (from Form W-2) and estimated taxes (along with a prior year tax refund applied towards estimated taxes) that have already been paid. Notably, any taxes withheld from an IRA or 401(k) distribution will also be included in the Federal income tax withheld on line 64 (and reported on the associated Form 1099-R from the retirement account custodian), along with any taxes withheld to cover the 0.9% Medicare surtax on earned income.

Ultimately, whether the taxpayer actually under-withheld or over-withheld on taxes is reported later, but it is at least notable here to see whether the client is paying any estimated taxes (line 65), and whether that is consistent with their current situation (as self-employed individuals and passive investors *should* typically be making estimated tax payments).

Line 69 – Premium Assistance Tax Credits

Line 69 has the rather innocuous label "Net premium tax credit", but its significance is that this is where clients would report the Premium Assistance Tax Credit (PATC) for health insurance purchased on an exchange. The calculation of the credit itself is determined on the underlying Form 8962.

From the financial planning perspective, knowing if/whether someone is obtaining health insurance from a health insurance exchange is very important, as it speaks to both the source of coverage itself, that he/she may *need* to get health insurance from the exchange (i.e., that neither Medicare, Medicaid, nor an employer health insurance plan is available), and that premiums are being managed (potentially to a material extent) by the premium assistance tax credit.

Bear in mind, though, that a $0 amount or blank on line 69 doesn't necessarily mean the taxpayer is uninsured; if that was the case, a penalty would have likely been reported on line 61. Instead, it may simply be that the individual bought health insurance on the exchange, but his/her income was above the (modified Adjusted Gross Income) threshold to be eligible for the credit. The income thresholds vary by family size, from $47,520 for individuals, to $64,080 for a married couple, and $97,200 for a family of four.

Of course, anyone who simply obtains health insurance through an employer, or is on Medicare (or Medicaid) will not be eligible for a Premium Assistance Tax Credit at all.

Line 75: Overpaid Taxes

To the extent that total taxes paid after credits (line 74) exceeds total taxes owed (line 63), the excess is "overpaid" taxes reported on line 75. In essence, this is the amount of the tax refund that the client was eligible for (which in turn is either refunded directly on line 76a, or applied to the first estimated tax payment for next year on line 77).

The primary question on line 75 is simply whether there was a Federal tax refund (i.e., whether there was a positive dollar amount reported), and if so what the magnitude was. A modest tax refund indicates the client's withholding plus estimated taxes were relatively "on target". A very large tax refund, though, implies that the client is either substantially over-withholding, or over-paying on estimated taxes – which suggests that tax withholding or estimated tax payments should be revisited for the upcoming year, given that overpaid taxes that are refunded cannot be invested and do not otherwise generate any interest/yield throughout the year.

Lines 78 and 79: Taxes Owed, And Underpayment Penalties

To the extent that taxes were overpaid and a refund is due, the amount would have been reported on line 75. Conversely, if the client *underpaid* on their tax obligation throughout the year, the remaining balance of taxes owed are reported on line 78.

A modest amount of tax owed arguably just represents good tax planning (paying enough to avoid penalties, but little enough to keep the extra cash available and even growing in the taxpayer's bank or investment accounts throughout the year). However, a large amount owed on line 78 could indicate a need to adjust tax withholding (from wages) or estimated tax payments higher.

Be certain to check whether line 79 is blank or not as well. Any non-zero dollar amount in line 79 indicates that not only were taxes due, but there was a penalty assessed for failing to pay sufficient estimated taxes (with the exact penalty calculated on Form 2210).

If a separate line-79 penalty was reported (which is included in the total on line 78), then at a minimum estimated tax payments should be updated (i.e., increased) for the upcoming year to avoid the risk of repeating another estimated tax penalty, either by paying 90% of the expected tax liability for the upcoming year, or 100% of this most recent year's tax liability reported on line 63. Notably, the estimated tax obligation for the upcoming year is 110% of line 63 if AGI on the most recent tax return was $150,000 or more (regardless of filing status).

Form 1040: Paid Preparer Identification

At the very bottom of page 2 of Form 1040 is a section labeled "Paid Preparer Use Only", where the tax preparer signs (if there was one), and includes his/her firm name, and preparer tax ID number (PTIN).

If a third-party paid tax preparer was used, look to see whether it was a CPA, or a mass-market tax preparation provider (e.g., H&R Block, Jackson Hewitt, etc.), as this can potentially be an indicator of both the quality of the tax preparation (and the risk of errors if there is a complex tax situation), and also could be a potential new professional referral relationship (in the case of an accountant).

On the other hand, a blank "Paid Preparer" section is an indicator that the client self-prepared the tax return. Which, depending on the sophistication of the client and the complexity of the situation, may either be an indication of the need for careful review to identify potential mistakes, or that the client may be receptive to more advanced tax planning strategies.

Reviewing Individual Tax Return Supporting Schedules & Forms

Beyond Form 1040 itself, and the associated Schedules A (itemized deductions), B (interest and dividends), C (sole proprietors), D (capital gains), and E (pass-through businesses and trusts), there are a number of common supporting Forms filed with the individual tax return.

Figure 4. Common Supporting Schedules/Forms With An Individual Form 1040 Tax Return

Schedules	
	Description
A	Itemized Deductions
B	Interest and Dividends
C	Sole Proprietorship Gains/Losses
D	Capital Gains
E	Pass-Thru Businesses & Trusts

Tax-Preferenced Account-Related	
Form	**Description**
1099-R	Distribution from Tax-Preferenced Accounts
5498	IRA Contributions
8889	HSA Contributions
8606	Non-Deductible IRA Contribution
5329	IRA Penalties

AMT-Related	
Form	**Description**
6251	AMT Calculation
8801	Minimum Tax Carryforward

Income-Related	
Form	**Description**
W-2	Wage and withholding information
1099-B	Broker-dealer/custodian reporting of gains/losses
8949	Reporting of actual capital gain/loss transactions

Child-Related	
Form	**Description**
8814	Kiddie Tax
8917	Above-the-Line tuition and fees deduction
8863	Lifetime Learning & American Opportunity Credits
2441	Child and Dependent Care Credit
8812	Child Tax Credit

Other Penalty, Surtax, or Credit	
Form	**Description**
8959	Medicare Surtax (earned income)
8960	3.8% Net Investment Income Tax
8962	Premium Assistance Tax Credit
2210	Penalty for insufficient estimated taxes

Fortunately, the existence and relevance of all of these forms will be indicated by their respective line items on Form 1040 itself, as discussed earlier. Nonetheless, it's important to be aware of the various Forms that exist, and the potential need to delve further into them, to better understand a particular tax credit, deduction, or other unique aspect of the tax situation.

The most common supporting Schedules and Forms typically attached to an individual tax return are indicated in Figure 4.

Special Exceptions And Common Tax Planning Scenarios

When reviewing an individual income tax return, the reality is that even amongst the most "common" line items that may be relevant, not all of them are likely relevant for every client. Instead, certain combinations of line items are more likely to be relevant for particular client situations, such as families with children, people who are still working (as a W-2 employee), those who are consultants or self-employed business owners, and retirees.

Reviewing A Family's Tax Return

The "unique" thing about reviewing the tax return for a family that has children – who are either minors, or are college-aged – is that there are several additional line items on the tax return that are specifically relevant in situations with children.

Key areas to review for families, given the various tax credits and deductions available to/for children in particular, include:

- Which/how many children are claimed as dependents in the Exemptions section (and what are their relationships in column (3), and are they minors under age 17 in column (4))?

- If there are any children in college, did the parents claim (and/or were they eligible to claim) the above-the-line tuition and fees deduction on line 34 (calculated on Form 8917), the Lifetime Learning Credit on line 50 (calculated on Form 8863), or the American Opportunity Tax Credit on line 68 (and again calculated on Form 8863). Notably, parents themselves who go back to school may be eligible to claim the Lifetime Learning Credit as well!

- If the children are under age 13, were there any child care expenses paid that could be claimed under the child and dependent care credit on line 49? (With the exact amount of the credit calculated on Form 2441.)

- Was the family eligible for the Child Tax Credit of $1,000 per child, claimed on line 52? (Calculated on Form 8812, but beginning to phase out at modified AGI levels above $75,000 for individuals or $110,000 for married couples.)

- Did the family enjoy all of its personal exemptions on line 42, or were they partially phased out due to the Personal Exemption Phaseout (PEP)?

- Was box (a) of line 44 checked, indicating a kiddie tax liability on Form 8814?

In practice, most families will not claim *all* of these various credits and deductions, and some families will only be eligible for a few, or none at all. But these line items should at least be checked and evaluated against the current family situation, to determine whether one of them might have been missed, and/or if planning strategies could be adjusted in the coming year to better maximize them.

Reviewing A (Wage) Worker's Tax Return

When it comes to the typical client who is still employed as a W-2 wage employee, the reality is that the bulk of tax benefits come directly from the available employee benefits, and the flexible tax strategies commonly used by self-employed business owners generally aren't available. Tax preparation is often little more than copying over the relevant details from the W-2 tax reporting form, along with perhaps a few Form 1099s reporting investment-related interest and dividends and some capital gains.

Notwithstanding this relative simplicity from the tax planning perspective, there are still a number of lines of the tax return that should be reviewed for the typical wage worker:

- Verify that the person you believe is a wage employee is *really* "just" a wage employee. So there *should* be an amount reported on line 7 (wages), and line 12 (sole proprietor income) should be blank. Line 17 (for pass-through businesses) should also be blank, unless the income is truly attributable to an entirely unrelated business, a passive pass-through investment (e.g., rental real estate or a passive partnership), or the individual inherited money that is being paid out to him/her from a trust (in which case you can view the associated K-1 attached to the tax return).

- Examine any relevant portfolio income, as reported on lines 8 (interest), 9 (dividends), and 13 (capital gains). What does it imply about the investment assets, the size of the portfolio, and whether there may be "other" assets not already discussed?

- Did the client claim the standard deduction, or itemized deductions on line 40? If it's the latter, what deductions are shown (or not) on Schedule A? Does the client own a home (mortgage deduction)? Have medical issues (medical expense deduction)? Appear to be charitably inclined (given cash or non-cash donations)? Have another advisor (because there's a miscellaneous itemized deduction for fees that weren't for your own services)?

- Was there any AMT due on line 45, such that the taxpayer really needs "AMT planning" instead of "regular" tax planning?

- Given what "should" normally be sufficient tax withholding from the paycheck, was there enough withheld (line 64) to cover the tax liability (line 63)? Did the client get a material tax refund (line 75) or have a significant shortfall (line 78)? Was there enough investment and other non-wage income that estimated taxes *should* be paid, and that not doing so last year resulted in a failure-to-pay-estimated penalty on line 79?

It's important to recognize that even if the typical wage employee doesn't have a lot of creative income tax planning opportunities (given the limited flexibility of being an employee), an individual tax return can still provide a lot of insight about a client's lifestyle, spending patterns, and even portfolio size (at least in terms of taxable accounts).

In addition, it's also important to review a wage employee's Form W-2 itself, to confirm total compensation, underlying any pre-tax employee benefits that may be received, and affirm participation in an employer retirement plan (if available).

Reviewing A Self-Employed Business Owner's Tax Return

Self-employed individuals – whether operating as sole proprietors, or owners of pass-through partnerships, LLCs, or S corporations (in which they're an active participant) – often have some of the most complex tax planning scenarios, and also the most opportunities.

Key line items to review for a self-employed client's tax return include:

- Line 7. The client may be "self-employed" but are there any wages reported on line 7? If so, why? Is that because the spouse is employed separately? Because the spouse is employed in the business? Because it's an S corporation and the business owner is paying themselves a "reasonable compensation" salary?

- How much "business" income is reported either as a sole proprietor on line 12, or as a pass-through business entity on line 17? Review a copy of the Schedule C, or the Schedule E, for further details on the nature of the business income. (In the case of a business reported on Schedule E, ideally get a copy of the actual business tax return as well, although an in-depth line-by-line review of a business tax return is beyond the scope of this article!)

- Which "above-the-line" tax deductions are being claimed? There should be a deduction for ½ of self-employment taxes (line 27), and usually for health insurance (line 29) as well. And if there's a health insurance deduction, is there also a deduction for a Health Savings Account (HSA) contribution on line 25?

- Is the client saving into a small business retirement plan (line 28)? If not, is there an opportunity to create one? If yes, how much was saved into it, can the client afford to save more, and if so is there an opportunity to re-design the small business retirement plan to improve the outcome (e.g., moving from a SIMPLE to a SEP, from a SEP to an individual 401(k), from a standard profit sharing plan to a cross-tested plan, or from a defined contribution plan to a defined benefit plan)?

- Is the client subject to the AMT (line 45)? If so, see whether any of the material adjustments on Form 6251 are related not to the "common" adjustments like state/local taxes paid and miscellaneous itemized deductions, but perhaps due to deductions claimed as a part of the business? And if so, is there a Minimum Tax Credit carryforward from line 54 (and/or unused but reported on the supporting Form 8801)?

- How much is being paid in estimated taxes (line 65), and is it enough to cover the full tax liability (line 63)? Was there a big tax refund at the end of last year (line 75), or a big amount owed (line 78)? Was there a penalty on line 79 for failing to withhold enough, such that estimated tax payments (and perhaps overall business cash flows) *really* need to be adjusted for next year?

Ultimately, actual "small business planning" is really a tax planning challenge unto itself, but at a minimum, it's crucial to review the personal individual tax return for a small business owner to better understand the context of the business and income situation. And because business income in particular can be especially volatile for some companies, with small business owners it is especially important to obtain 2-3 years' worth of prior year tax returns as well, to understand how the situation has changed (or not) over time.

Reviewing A Retiree's Tax Return

In the case of a retiree, much of the tax return gets "simpler" again. There are usually no longer any children in the household, so all the child/family-related tax credits and deductions are a moot point. There's typically no longer any employment income (by definition of being "retired"), so no wages or self-employment income to contend with. Even deductions often "slow down", as many retirees fully pay off their mortgage and move to a lower-tax-rate state, which can even bring them to the point of "just" claiming the standard deduction (which is increased for those over age 65).

Nonetheless, there is still value to reviewing the tax return, if only to further clarify the client's true "retired" status, and whether/where any tax planning opportunities may linger:

- Review lines 7 and 12. Is there any wage or self-employment income, suggesting that the client is actually still engaged in part-time work or perhaps part-time consulting (which in turn might open the door to a small business retirement plan?)?

- Is there any income reported on line 17? If the client really is retired, this is likely passive investment income, perhaps from rental real estate, a passive limited partnership holding, or possibly distributions from a trust, but should be explored further.

- How much investment income is being claimed between interest (line 8), dividends (line 9), and capital gains (line 13). Review Schedule B and Schedule D to understand the scope of investment assets in taxable accounts (i.e., what does the income yield imply about the value of the entire portfolio), and whether there is a capital loss carryforward. Should the client be invested in muni bonds instead (line 8b instead of 8a), or not? Does the type of taxable income being generated in taxable accounts imply that the retiree needs to shift the location of where certain assets are being held, into an IRA or Roth IRA?

- Are there any distributions occurring from IRAs or employer retirement plans, or via pensions or annuities, reported on lines 15 and 16? (And if not, how is the client generating retirement income cash flows?) If the client is at least 70 ½, is there (hopefully) a distribution on line 15 to signify that the RMD is being taken properly?

- Is the client claiming Social Security benefits already, as reported on line 20a? If so, is it nontaxable, maximally taxable (where line 20b is the full 85% of line 20a?), or in between where the taxation of Social Security is phasing in (which can cause a spike in marginal tax rates)?

- On line 40, did the client actually itemize deductions, or claim the standard deduction? For those over age 65, the standard deduction increases from $6,300 to $7,850 for individuals, and for couples it's $12,600 *plus* $1,250 for each member of the couple over age 65 (a maximum of $15,100). If the couple is claiming the (higher) standard deduction, it's important to recognize that "typical" itemized deductions may have little or no benefit. (And if the retiree does itemize, then review the details of Schedule A. Are there significant medical expenses? State tax deductions? Still a large mortgage, or any mortgage, or not? A lot of charitable giving?)

- Is the retiree subject to the AMT on line 45? And/or working off a Minimum Tax Credit on line 54?

- Verify that no penalties were paid for either early withdrawals from an IRA, or failure to take an RMD, on line 59. If *anything* is reported on line 59, delve into Form 5329 to see what the penalty was.

- Is the retiree paying estimated taxes properly on line 65? Was the estimated tax payment sufficient to cover the taxes due? Was it too much, triggering a refund on line 75? Did the retiree underpay on estimated taxes on line 78, and/or pay a penalty on line 79?

In the end, a lot of the focus on tax planning for retirees is around partial Roth conversions, timing of liquidations, and making good asset location decisions, which is a function of proactive tax strategies, not a retrospective look at the prior year's tax return(s). Nonetheless, reviewing the tax return can provide an indicator of a wide range of tax issues, along with the retiree's overall tax situation, including the current marginal tax bracket, whether Social Security taxation is being phased in, and more.

Conclusion

In the end, there are still limitations around what can be gleaned from a tax return alone.

While the amount of taxable interest and dividends can provide real insight into the likely size of at least taxable investment accounts, it says nothing about (tax-deferred) retirement accounts. Similarly, while the Schedule A deductions for mortgage interest and real estate taxes can give some context to the size/value of the client's residence, and charitable deductions give perspective on the client's charitable inclinations, there are still even more expenses that are *not* deductible – from automobiles to restaurants to clothing and furnishings and more – which means it's hard to really peg a client's overall lifestyle from their deductible, tax-return-disclosed expenses alone.

Nonetheless, the insights provided from the tax return, along with the supporting schedules and forms (as detailed earlier in Figure 4) can be highly effective to provide information up front for a prospective client before the data gathering meeting, as a means to corroborate the information gathered in the meeting, and even as a way to identify pertinent details that might *not* have been disclosed up front. Especially when multiple years' worth of tax returns are reviewed, which provides even greater insight into how a household's income (and to some extent, spending) behaviors may have changed over time.

In addition, the tax return can be used to spot prospective tax planning opportunities going forward as well, from "room" in the current tax bracket to do partial Roth conversions, missed opportunities to claim tax credits associated with children (especially to maximize the tax credits when there are kids in college), enhanced retirement account contribution strategies (especially for small business owners), and decisions to adjust where investments are held for asset location purposes.

And of course, the fact that the tax return also discloses who prepared the tax return (or if the client self-prepares), can further open doors to work productively with the accountant on additional tax planning strategies in the future!

Form 1040 — Department of the Treasury—Internal Revenue Service (99)

U.S. Individual Income Tax Return 2016

OMB No. 1545-0074 | IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2016, or other tax year beginning , 2016, ending , 20 | See separate instructions.

Your first name and initial	Last name	Your social security number
If a joint return, spouse's first name and initial	Last name	Spouse's social security number
Home address (number and street). If you have a P.O. box, see instructions.	Apt. no.	▲ Make sure the SSN(s) above and on line 6c are correct.
City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions).		**Presidential Election Campaign** Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☐ You ☐ Spouse
Foreign country name	Foreign province/state/county	Foreign postal code

Filing Status

Check only one box.

1 ☐ Single
2 ☐ Married filing jointly (even if only one had income)
3 ☐ Married filing separately. Enter spouse's SSN above and full name here. ▶
4 ☐ Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
5 ☐ Qualifying widow(er) with dependent child

Exemptions

6a ☐ **Yourself.** If someone can claim you as a dependent, **do not** check box 6a
b ☐ **Spouse**

Boxes checked on 6a and 6b

c **Dependents:**

(1) First name Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) ✓ if child under age 17 qualifying for child tax credit (see instructions)
			☐
			☐
			☐
			☐

If more than four dependents, see instructions and check here ▶ ☐

No. of children on 6c who:
- lived with you
- did not live with you due to divorce or separation (see instructions)

Dependents on 6c not entered above

d Total number of exemptions claimed

Add numbers on lines above ▶

Income

Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.

If you did not get a W-2, see instructions.

7	Wages, salaries, tips, etc. Attach Form(s) W-2		7	
8a	**Taxable** interest. Attach Schedule B if required		8a	
b	**Tax-exempt** interest. **Do not** include on line 8a	8b		
9a	Ordinary dividends. Attach Schedule B if required		9a	
b	Qualified dividends	9b		
10	Taxable refunds, credits, or offsets of state and local income taxes		10	
11	Alimony received		11	
12	Business income or (loss). Attach Schedule C or C-EZ		12	
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐		13	
14	Other gains or (losses). Attach Form 4797		14	
15a	IRA distributions 15a	b Taxable amount	15b	
16a	Pensions and annuities 16a	b Taxable amount	16b	
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E		17	
18	Farm income or (loss). Attach Schedule F		18	
19	Unemployment compensation		19	
20a	Social security benefits 20a	b Taxable amount	20b	
21	Other income. List type and amount		21	
22	Combine the amounts in the far right column for lines 7 through 21. This is your **total income** ▶		22	

Adjusted Gross Income

23	Educator expenses	23		
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24		
25	Health savings account deduction. Attach Form 8889	25		
26	Moving expenses. Attach Form 3903	26		
27	Deductible part of self-employment tax. Attach Schedule SE	27		
28	Self-employed SEP, SIMPLE, and qualified plans	28		
29	Self-employed health insurance deduction	29		
30	Penalty on early withdrawal of savings	30		
31a	Alimony paid b Recipient's SSN ▶	31a		
32	IRA deduction	32		
33	Student loan interest deduction	33		
34	Tuition and fees. Attach Form 8917	34		
35	Domestic production activities deduction. Attach Form 8903	35		
36	Add lines 23 through 35		36	
37	Subtract line 36 from line 22. This is your **adjusted gross income** ▶		37	

Tax and Credits

38 Amount from line 37 (adjusted gross income) . . . 38

39a Check if: { ☐ **You** were born before January 2, 1952, ☐ Blind. ☐ **Spouse** was born before January 2, 1952, ☐ Blind. } **Total boxes checked ▶ 39a**

b If your spouse itemizes on a separate return or you were a dual-status alien, check here ▶ **39b** ☐

Standard Deduction for—
- People who check any box on line 39a or 39b **or** who can be claimed as a dependent, see instructions.
- All others:

Single or Married filing separately, $6,300

Married filing jointly or Qualifying widow(er), $12,600

Head of household, $9,300

40 **Itemized deductions** (from Schedule A) **or** your **standard deduction** (see left margin) . . 40

41 Subtract line 40 from line 38 . . . 41

42 **Exemptions.** If line 38 is $155,650 or less, multiply $4,050 by the number on line 6d. Otherwise, see instructions 42

43 **Taxable income.** Subtract line 42 from line 41. If line 42 is more than line 41, enter -0- . . 43

44 **Tax** (see instructions). Check if any from: **a** ☐ Form(s) 8814 **b** ☐ Form 4972 **c** ☐ 44

45 **Alternative minimum tax** (see instructions). Attach Form 6251 . . . 45

46 Excess advance premium tax credit repayment. Attach Form 8962 . . . 46

47 Add lines 44, 45, and 46 . . . ▶ 47

48 Foreign tax credit. Attach Form 1116 if required . . . 48

49 Credit for child and dependent care expenses. Attach Form 2441 49

50 Education credits from Form 8863, line 19 . . . 50

51 Retirement savings contributions credit. Attach Form 8880 51

52 Child tax credit. Attach Schedule 8812, if required . . . 52

53 Residential energy credits. Attach Form 5695 . . . 53

54 Other credits from Form: **a** ☐ 3800 **b** ☐ 8801 **c** ☐ 54

55 Add lines 48 through 54. These are your **total credits** . . . 55

56 Subtract line 55 from line 47. If line 55 is more than line 47, enter -0- . . . ▶ 56

Other Taxes

57 Self-employment tax. Attach Schedule SE . . . 57

58 Unreported social security and Medicare tax from Form: **a** ☐ 4137 **b** ☐ 8919 . . 58

59 Additional tax on IRAs, other qualified retirement plans, etc. Attach Form 5329 if required . . 59

60a Household employment taxes from Schedule H . . . 60a

b First-time homebuyer credit repayment. Attach Form 5405 if required . . . 60b

61 Health care: individual responsibility (see instructions) Full-year coverage ☐ . . . 61

62 Taxes from: **a** ☐ Form 8959 **b** ☐ Form 8960 **c** ☐ Instructions; enter code(s) 62

63 Add lines 56 through 62. This is your **total tax** . . . ▶ 63

Payments

64 Federal income tax withheld from Forms W-2 and 1099 . . 64

65 2016 estimated tax payments and amount applied from 2015 return 65

If you have a qualifying child, attach Schedule EIC.

66a **Earned income credit (EIC)** . . . 66a

b Nontaxable combat pay election 66b

67 Additional child tax credit. Attach Schedule 8812 . . . 67

68 American opportunity credit from Form 8863, line 8 . . . 68

69 Net premium tax credit. Attach Form 8962 . . . 69

70 Amount paid with request for extension to file . . . 70

71 Excess social security and tier 1 RRTA tax withheld . . . 71

72 Credit for federal tax on fuels. Attach Form 4136 . . . 72

73 Credits from Form: **a** ☐ 2439 **b** ☐ Reserved **c** ☐ 8885 **d** ☐ 73

74 Add lines 64, 65, 66a, and 67 through 73. These are your **total payments** . . . ▶ 74

Refund

75 If line 74 is more than line 63, subtract line 63 from line 74. This is the amount you **overpaid** 75

76a Amount of line 75 you want **refunded to you.** If Form 8888 is attached, check here . ▶ ☐ 76a

Direct deposit? See instructions.

▶ b Routing number ▶ c Type: ☐ Checking ☐ Savings

▶ d Account number

77 Amount of line 75 you want **applied to your 2017 estimated tax** ▶ 77

Amount You Owe

78 **Amount you owe.** Subtract line 74 from line 63. For details on how to pay, see instructions ▶ 78

79 Estimated tax penalty (see instructions) . . . 79

Third Party Designee

Do you want to allow another person to discuss this return with the IRS (see instructions)? ☐ **Yes.** Complete below. ☐ **No**

Designee's name ▶ Phone no. ▶ Personal identification number (PIN) ▶

Sign Here

Joint return? See instructions. Keep a copy for your records.

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and accurately list all amounts and sources of income I received during the tax year. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Your signature	Date	Your occupation	Daytime phone number
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
Firm's name ▶			Firm's EIN ▶	
Firm's address ▶			Phone no.	