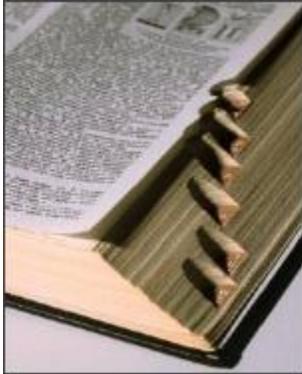


Tax Glossary A through E

NOTE: The Tax Glossary, which debuted in this form on [Dictionary Day 2015](#), has five sections. If a term you think should be here isn't, or you can add to or clarify a definition that is here, let me know via [Twitter](#) or [Facebook](#).

One of the hardest things about filing your taxes is trying to decipher the forms. You practically have to learn a new, tax-specific language.



Unfortunately, IRS-speak is a native tongue for very few folks.

And it's not easy to decipher. In fact, reading tax documents makes that dang VCR manual (yes, a few of us still use those antiquated devices!) seem almost coherent!

To help out, [Don't Mess With Taxes](#) has gathered some common tax terms and phrases and their plain English meanings in this Tax Glossary (and the Tax Glossary's precursor, a [mini tax dictionary](#), if you will, that was a blog post back in 2007). Yes, I've been working on this for a while!

As you can imagine, the IRS dictionary gives Merriam-Webster a run for its money, so I've broken the Don't Mess With Taxes glossary into several sections for ease of page loading. The first group, tax words starting with **A through E**, is below.

You can check out the other sections by clicking the links below:

- [F through J](#)
- [K through O](#)
- [P through T](#)
- [U through Z](#)

And since tax laws are continually changing (thank you, Congress ... Not!), this is an ongoing list. I'll do my best to keep it updated, but if you find a tax word that's got you stumped, [e-mail](#) it to me and I'll make sure it and its definition is added. The same goes for any tax term I've overlooked.



AARRGGHH!!! -- This is the most common nonprofane exclamation used by taxpayers, tax preparers and sometimes even the Internal Revenue Service (and [tax pirates](#)) during every tax filing season.

Ability to pay -- A concept of tax fairness that states that people with different amounts of wealth or different amounts of income should pay tax at different rates. Wealth includes assets such as houses, cars, stocks, bonds, and savings accounts. Income includes wages, interest and dividends, and other payments.

Above-the-line deduction -- These deductions are not itemized on Schedule A. Instead, they are adjustments that are subtracted from your total income on Form 1040 or Form 1040A to arrive at your adjusted gross income (see below). Since the adjusted gross income amount is entered on the last line of page 1 of the 1040 or 1040A, any tax breaks used in arriving at this amount -- such as allowable IRA contributions, student loan interest and moving expenses -- also are known as above-the-line deductions. To claim above-the-line deductions, you must file the long Form 1040 or Form 1040A. There are around a dozen or so of these deductions, depending upon what action Congress takes, on the long form 1040; only four are found on the 1040A.

Adjusted gross income (AGI) -- This amount is your total income reduced by certain deductions, more appropriately known as adjustments, that you claim at the bottom of Form 1040 or 1040A. You tabulate your AGI before you take your itemized deduction or standard deduction or claim your personal exemption amount. Your AGI appears on Form 1040 or Form 1040A at the bottom of page 1 of both those forms (and is re-entered as the first number at the top of page 2). On the 1040EZ, your AGI is on line 4.

Adjustments to income -- Certain expenses that are subtracted from gross income to reach your adjusted gross income. Often referred to as above-the-line deductions. They can be claimed regardless of whether you take the standard deduction or itemize deductions on Schedule A.

Allowance -- A specific amount that a taxpayer is allowed to subtract from his/her income to reduce the amount of money that is taxable.

Alternative Minimum Tax (AMT) -- This parallel tax primarily affects high-income taxpayers who shelter some of their income from tax through certain tax preference items or deductions. It is often referred to in tax publications as AMT and, if your income meets the limit, you have to recalculate your tax due based on the separate alternative minimum tax rates and tables.

Amended return -- A tax return filed to correct a prior year's tax return. You must correct your original filing if, for example, your bank is late in sending you an earnings statement and you filed your return without reporting the added income. You also can file an amended return if you discover you made a mistake or circumstances change that would allow you to get a refund for a previously filed return. An amended return is filed on Form 1040X.

Amount due -- Money that taxpayers must pay to the government when the total tax is greater than their total tax payments.

Appeal -- An individual or business taxpayer's call for a review of an IRS decision or proposed adjustment.

Audit -- Process by which the tax collecting agency questions and reviews items on your tax return. The Internal Revenue Service calls this an examination.

Authorized e-file provider -- A business authorized by the IRS to participate in the IRS e-file program. The business may be a sole proprietorship, a partnership, a corporation, or an organization. Authorized IRS e-file providers include Electronic Return Originators (EROs), transmitters, intermediate service providers, and software developers. These categories are not mutually exclusive. For example, an ERO can at the same time, be a transmitter, a software developer or an intermediate service provider, depending on the function being performed.



Backup withholding -- Deduction of tax that applies to payments to employees or non-employees when the recipient does not provide a Taxpayer Identification Number (TIN). Backup withholding also occurs when the recipient of a reportable prize awarded in a gaming activity does not provide a TIN. The regular withholding rate for gaming prizes is 25 percent. The backup withholding rate is 28 percent.

Basis -- Sometimes is referred to as "cost basis," is a consideration when you sell an asset and must determine if you owe any taxes on any profit. Basis can be adjusted, taking into account, for example, improvements and depreciation when the asset is real estate or transaction fees and previously paid taxes in the case of stocks or mutual funds. Correct basis will enable you to accurately compute how much profit you make, which could determine how much, if any, taxes you might owe.

Bonus -- Compensation received by an employee for services performed. A bonus is given in addition to an employee's usual compensation. Bonus money generally is taxable income.

Brackets -- The ranges of income to which specific tax rates apply.

Burden of proof -- The legal requirement to provide enough evidence to win a lawsuit. In civil cases, such as tax court, the burden is decided by the preponderance -- the most -- evidence. Except in cases of tax fraud, the burden of proof in a tax case generally is on the taxpayer.

Business -- A continuous and regular activity that has income or profit as its primary purpose. If you fail to show a profit for three out of five years, the IRS may presume your business is a hobby and disallow losses from it unless you show evidence to the contrary.



Capital asset -- An item you own for investment or personal purposes, such as stocks, bonds or real estate. When you sell a capital asset, depending on the price you get you could have a capital gain or a capital loss (definitions below).

Capital gain -- If you make a profit on the sale of a capital asset, that is, you sell it for a price that is higher than your purchase price (and some other factors that affect basis), you have a capital gain. Capital gains are usually taxable, but in some cases receive more favorable tax treatment than regular income. Capital gains can be long-term when the asset is held for more than a year before selling; selling sooner is a short-term capital gain. Long-term capital gains are taxed at a lower rate -- 15% or 20% depending on your income -- than the ordinary income tax rates, which apply to short-term capital gains. And some lower-income taxpayers will owe no tax on their capital gains.

Capital gain distribution -- This payout occurs when a mutual fund sells some of its assets and then passes along a portion to you. This distribution that you and other fund owners get is regarded by the IRS as a capital gain. That means you get the more favorable capital gains tax rate when calculating what you owe the IRS.

Capital loss -- If you sell a capital asset at a loss, it could be valuable at tax-filing time. You can use the loss amount to offset corresponding capital gains. If you have no gains, or you have more losses than gains, you can use up to \$3,000 in losses each year to reduce your ordinary income. If your loss is more than three grand, first get a new investment adviser; then carry forward the excess loss amount into future tax years. You can carry over the capital loss amount indefinitely until the total loss is used.

Citizen or Resident Test -- Assuming all other dependency tests are met, the citizen or resident test allows taxpayers to claim a dependency exemption for persons who are U.S. citizens for some part of the year or who live in the United States, Canada, or Mexico for some part of the year.

Compensation -- All forms of income from working including salary or wages; deferred compensation; retirement benefits, whether from a qualified or non-qualified employee plan (e.g., pensions or annuities); fringe benefits (e.g., personal vehicle, meals, lodging, personal and family educational benefits, low-interest loans, payment of personal travel, entertainment or other expenses, athletic or country club membership, and personal use of one's property); and bonuses.

Constructively received income -- Income that is available to you even though you don't actually have it in your possession. A check, for example, was mailed to you and arrived in your mailbox before the end of the tax year. Even though you didn't check your mailbox until the next year, the money was constructively received by you in the previous tax year and therefore reportable as income for that tax year. Similarly, directly deposited funds are constructively received by you even if you don't check your account to see that the money is there.

Credit -- A tax credit reduces the amount of the tax you owe, unlike deductions which reduce your amount of income upon which your tax liability is figured. Because credits are taken after you figure your tax amount, they make a direct dollar-for-dollar difference in your tax bill. There are two types of credits, refundable and nonrefundable, which are discussed elsewhere in this Glossary.

D

Deduction -- While a tax credit reduces the amount of the tax you owe, deductions reduce the amount of income upon which your tax liability is figured. Deductions are expenses the IRS allows you to subtract from your taxable income. If you have taxable income of \$30,000 and deductions of \$3,000, then you would figure how much tax you owe on the difference -- \$27,000. Most deductions are claimed as itemized expenses on Schedule A as medical costs, mortgage interest, state and local taxes, employee business expenses and charitable contributions. Some, however, are above-the-line deductions, discussed earlier in this Glossary section. you must itemize them to use the deductions.

Dependency exemption -- Amount that taxpayers can claim for a "qualifying child" or "qualifying relative". Each exemption reduces the income subject to tax. The exemption amount is a set amount that changes from year to year. One exemption is allowed for each qualifying child or qualifying relative claimed as a dependent.

Dependent -- a person who relies on someone else for financial support. If you have dependents, you can claim them as exemptions, which will reduce the amount of your income that is taxed. To qualify as a dependent, the person must meet certain tests established by the tax code.

Depreciation -- This is a deduction for the wearing away and expensing over time of such items as office equipment, vehicles, buildings and furniture. For tax purposes, the IRS determines the amount of time such material is expected to last, and then you depreciate, or spread the cost of, the asset over its estimated useful life rather than deducting the entire cost in the year you acquired it.

Direct Deposit -- This options allows the IRS to send taxpayers' tax refunds directly to their bank or other financial accounts. Direct Deposit generally means that refunds are received more quickly. The taxpayer must have an established checking or savings account to qualify for Direct Deposit. A bank or financial institution will supply the required account and routing transit numbers to the taxpayer for Direct Deposit.

Dividend -- A payment from a company's earnings and profits to its shareholders. Dividends are an incentive to own stock, but they are taxable to the recipients. The type of tax that must be paid is based on the type of dividend. Ordinary dividends are taxed at the same rates as ordinary income. Qualified dividends are taxed at the lower capital gains rates. Companies or brokerage firms report dividend income to you on Form 1099-DIV, which will detail which type of dividend you received.

Discharge of indebtedness (DoI) -- All or part of debt might be forgiven or discharged by the debt holder because of such things as a real estate foreclosure, a repossession, a voluntary return of the property to the lender or a loan modification. This amount of forgiven debt is known as discharge of indebtedness income. It is reported on is reported on Form 1099-C and generally must be reported as taxable gross income. There are some [exceptions and exclusions](#), however, particularly in connection with certain real property DoI situations.

E

Earned income -- Essentially, it's just like it sounds. It's compensation you receive from work, including wages, salaries, tips, commissions, and net earnings from self-employment endeavors. This money is what is taxed at the ordinary income rates that range from 10 percent to 35 percent. See income tax rates/brackets for details.

Earned Income Tax Credit (EITC) -- This is a credit that low-income workers can receive, either when they file their annual tax return or throughout the year as an advance EITC payment in their paychecks. While larger credits are available to eligible taxpayers who have dependent children, a smaller credit is also available to individuals who have no kids. Also referred to as Earned Income Credit, or EIC.

Effective tax rate -- This is the actual percentage of your income that went toward taxes. Calculate it by dividing your total taxes paid by your total, or gross,

income. The effective tax rate is generally much lower than the taxpayer's marginal tax rate. See also Marginal Tax Rate.

Electronic filing (e-file) -- The transmission of tax information directly to the IRS using telephones or computers. Electronic filing options include (1) Online self-prepared using a personal computer and tax preparation software, or (2) using a tax professional. Electronic filing may take place at the taxpayer's home, a volunteer site, the library, a financial institution, the workplace, malls and stores, or a tax professional's place of business.

Electronic preparation -- Use of tax preparation software and computers, by the taxpayer or a paid preparer, to complete tax returns

Electronic Return Originator (ERO) -- The Authorized IRS e-file Provider that originates the electronic submission of an income tax return to the IRS. EROs may originate the electronic submission of income tax returns they either prepared or collected from taxpayers. Some EROs charge a fee for submitting returns electronically.

Employer Identification Number (EIN) -- This is the business equivalent of the Social Security Number. It is a nine-digit number assigned by the IRS (in the 00-0000000 format) to employers, sole proprietors, corporations, partnerships, nonprofit associations, trusts, estates of decedents, government agencies, certain individuals, and other business entities.

Estate tax -- A tax based on the fair market value of property, less any liabilities, at the time of the owner's death. Often referred to, especially by opponents, as the death tax. Tax returns do not have to be filed for estates under a certain value, which is more than \$5 million and adjusted annually for inflation.

Estimated tax -- The method used to pay tax on income that is not subject to withholding. This includes income from self-employment, interest, dividends, alimony, rent, gains from the sale of assets, prizes and awards.

Excise tax -- A tax on the sale or use of specific products or transactions.

Exempt (from withholding) -- Income or other earnings that are free from withholding of federal income tax. A person must meet certain income, tax liability, and dependency criteria. This does not exempt a person from other kinds of tax withholding, such as the Social Security tax.

Exemptions -- Amount that taxpayers can claim for themselves, their spouses, and eligible dependents. There are two types of exemptions-personal and dependency. Each exemption reduces the income subject to tax. While each is worth the same amount, different rules apply to each.

Expensing -- Deducting business expenditures, up to a certain amount, instead of depreciating the costs over a number of years. Also known as the Section 179 deduction.