

Chapter 1: Earning Income and Investing

In This Chapter

- ✓ Earning income from your job
- ✓ Getting income from a job you invented
- ✓ Collecting earnings from your savings and investments

Fanny Price, the protagonist of Jane Austen's novel *Mansfield Park*, knew a thing or two about income: She said, "A large income is the best recipe for happiness I ever heard of." The information presented in this chapter may not guarantee you happiness or a large income, but you figure out the ins and outs of where income comes from and how to keep track of it all. And that, at least, is a good first step in a recipe for managing your personal finances.

Making Money at Your Job

Work. We spend our childhood merrily going to school, playing in the yards of our youth, practicing scales and etudes, pitching balls on sandlots, making and losing friends, collecting our allowance money, getting tucked in at night, and doing it all over again, day after endless day. When we're really little, the concept of *work* is limited to something our parents do when we're not looking. Later, work gets thrown in our face as an empty threat: "Someday you'll have to work for a living, and then you'll understand . . ."

Then comes the day when the allowance ends, there are no more exams, the yards all need mowing, the piano keys are dusty, the sandlots have been turned into parking garages, and our friends have moved on. Seemingly overnight, that idyllic youth is replaced with the need to *go out and earn a living*, whatever that is. So we choose a path, master some skills, and get a job, taking our place in a society of worker-bees. We collect our paychecks, and do our jobs all over again, day after endless day, with the goal of amassing enough green stuff so we can enjoy our time off, buy things that make us happy, have a cool place to live, and with luck, have enough left over so we don't starve in our old age.

Not only do you have to fund your lifestyle with the money you get from your job(s), but you have to keep track of it all, make sure there's enough to pay the bills, and figure out how to finance the larger expenses in life. It may seem

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like a daunting task, but trust me, the task is even more daunting if you leave it to chance. Fortunately, you can follow the paper trail explained in this chapter to keep track of all the money you earn from various sources, and then use the nifty Quicken program, explained throughout the rest of this book, to keep up-to-date financial information only a few clicks away.

Filling out the W-4 form

One of the first tasks you perform whenever you start a new job is the chore of filling out the W-4 form, shown in Figure 1-1. W-4 is another name for Employee's Withholding Allowance Certificate. You use this form to advise your employer, and more particularly the person who writes the checks at your place of employment, of useful details such as

- ◆ The correct spelling of your name
- ◆ Your real address
- ◆ Your date of birth, so they can schedule the appropriate office party (just kidding)
- ◆ Your unique Social Security number, so that your paychecks made out to Dolores Schnazeldorf won't get mixed up with the checks for that other Dolores Schnazeldorf down the hall
- ◆ Your marital status, so people know whether to invite you to the singles parties
- ◆ The number of allowances you are claiming
- ◆ Any extra amount above and beyond the regular tax amount that you want your employer to send to Uncle Sam on your behalf

Back up to that one about the allowances because that's the item that usually throws people for a loop. You can use one of four methods to decide what number to put on this line:

- ◆ Pick a number that sounds reasonable.
- ◆ Calculate the number using the Personal Allowances Worksheet that comes with the W-4 form.
- ◆ If you don't like the result you get on the Personal Allowances Worksheet, you can use the Deductions and Adjustments Worksheet.
- ◆ If all else fails and you're not yet hopelessly confused, you can use the Two-Earner/Two-Job Worksheet.

All of these worksheets come with the W-4 form, so you don't have to go anywhere to find them. Here's a summary of how each of these methods works.

Figure 1-1:
A sample
W-4 form.

that apply. exceed \$35,000 (\$25,000 if married) see the Two-Earner/Two-Job Worksheet on page 2 to avoid having too little tax withheld.
 • If neither of the above situations applies, stop here and enter the number from line H on line 5 of Form W-4 below.

Cut here and give Form W-4 to your employer. Keep the top part for your records.

Form **W-4** **Employee's Withholding Allowance Certificate** OMB No. 1545-0010
 Department of the Treasury Internal Revenue Service **2005**

1 Type or print your first name and middle initial Last name 2 Your social security number

Home address (number and street or rural route) 3 Single Married Married, but withhold at higher Single rate.
Note: If married, but legally separated, or spouse is a nonresident alien, check the "Single" box.

City or town, state, and ZIP code 4 If your last name differs from that shown on your social security card, check here. You must call 1-800-772-1210 for a new card.

5 Total number of allowances you are claiming (from line H above or from the applicable worksheet on page 2) 5 6 Additional amount, if any, you want withheld from each paycheck 6 \$

7 I claim exemption from withholding for 2005, and I certify that I meet both of the following conditions for exemption.
 • Last year I had a refund of all federal income tax withheld because I had no tax liability and
 • This year I expect a refund of all federal income tax withheld because I expect to have no tax liability.
 If you meet both conditions, write "Exempt" here 7

Under penalties of perjury, I declare that I have examined this certificate and to the best of my knowledge and belief, it is true, correct, and complete.
 Employee's signature (Form is not valid unless you sign it) Date

8 Employer's name and address (Employer: Complete lines 8 and 10 only if sending to the IRS.) 9 Office code (optional) 10 Employer identification number (EIN)

For Privacy Act and Paperwork Reduction Act Notice, see page 2. Cat. No. 10220Q Form W-4 (2005)

Choosing a reasonable number of allowances

If you've "been there, done that" for a few jobs already, this W-4 form is nothing new to you, so just fill out the number of allowances you always claim, and turn in your form so you can start collecting your paychecks.

Using the Personal Allowances Worksheet

The Personal Allowances Worksheet is an easy fill-in-the-blank worksheet where you answer some simple questions about whether you have children and a spouse, and which options you plan to choose on your tax return this year. Based on your answers in this worksheet and your responses to a quick Rorschach test, you find out if you get the corner office or a damp room in the basement. All kidding aside, you add up the numbers on the right side of this worksheet, and the total is the maximum number of allowances you are supposed to claim on your W-4.



TIP

Keep in mind that this is a maximum number. You don't have to claim all those allowances. If you would rather have more tax withheld, you can go with a smaller number of allowances. Some people like to get a fat refund when they file their tax return in the spring, and, in the spirit of Fanny Price, that's not necessarily a bad thing. So if your worksheet tells you to claim six allowances and you only want to claim three, claim three. The IRS will be happy because they get more of your money to play with during the year.

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Using the Deductions and Adjustments Worksheet

The Deductions and Adjustments Worksheet gives a different approach to increasing the number of allowances you can claim on your W-4 form. This is designed for

- ◆ People who take advantage of the tax laws to itemize their deductions
- ◆ People who reduce their income on their tax return with adjustments or credits
- ◆ People who actually know what everything I just said means

Math is required for this worksheet — you have to add, subtract, and divide to figure out the form. And you're supposed to enter information from the Personal Allowances Worksheet, so go back and fill out that worksheet, and then come back here.

Follow along in the Deductions and Adjustments Worksheet, noting these key issues:

- ◆ Step 1 may be a deal-breaker: You have to estimate how much your total itemized deductions are going to be on the tax return you prepare next spring. So, if you're filling out the W-4 form in January 2006, you have to guess what your itemized deductions will be on the tax return that you're going to prepare in April 2007. Go ahead; take a stab. Use an old tax return and round the numbers up or down, depending on what seems right. You only need a ballpark figure here.
- ◆ Do some math, and then you get to step 4, where you have to estimate the adjustments that will be on that tax return you file a year from now. Adjustments include alimony you have to pay, deductible contributions you make to an Individual Retirement Account (see Book VI for more on this), deductible moving expenses (more on this in Book V), health insurance costs, and one-half of your self-employment tax if you're self-employed, interest paid on student loans, and tuition and school fees you may be deducting. The best way to estimate all of this is to repeat what you reported for adjustments on last year's tax return.
- ◆ For step 6, you need to estimate any taxable income you expect to earn this year that is not from your job. This includes the boring income like dividends and interest, as well as the edgier sorts of income such as jury duty fees, fees for sitting on some company's board of directors, income you earn (or amounts you lose) from second guessing (or not) the stock market, income from illegal activities that you plan to report on your tax return, and so on.
- ◆ The rest is math. Do the calculations, and then take the final number and use it for your W-4 allowances. Or not. If you and your spouse both have jobs, or if you have another job, or if you're just a glutton for punishment, move on to the Two-Earner/Two-Job worksheet.

Using the Two-Earner/Two-Job Worksheet

You've made it this far, and you're still trying to figure out what number of allowances to put on that pesky W-4. You're probably rethinking the whole job idea at this point, but hang on — you're nearly finished. Soon you'll start collecting paychecks and amassing great wealth.

Even greater math skills are required to fill out this worksheet because now you get to subtract, divide, *and* multiply, and you get to compare numbers and take the lowest, or the highest, depending on which way the wind is blowing, and you're no doubt thanking your parents for pushing you to take those higher math courses in high school.

If you haven't figured it out yet, the various worksheets that accompany the W-4 form are designed to

(a) confuse the living daylights out of you

(b) persuade you to go to court and change your name to something other than Dolores Schnazeldorf

and

(c) provide a rough estimate of how your tax withholding should be computed in order to come pretty close to the actual amount of tax you will owe for the year.

So do the best you can, and don't fret if your calculation isn't perfect. If you're worried about owing tax on your tax return, do the worksheets, and then subtract 1 from your final number, just to have a little extra withheld so you'll be safe.



If you start getting paychecks and your personal situation changes in such a way that your answers on those worksheets might be different, ask your employer for another W-4 form and start all over again. You can change your withholding at any time during the year.

Your paycheck

People just starting out in the workforce are always shocked when they see their first paycheck. That large amount of money they were expecting to receive from their job is depleted by income taxes, Social Security taxes, Medicare taxes, “benefits” that the employee has to pay for, and more.

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The *pay stub* that comes with your check breaks down all of the various amounts that have been taken from your earnings. The key elements to notice are as follows:

- ◆ **Gross pay** (or Total Wages, or Salary, or some similar description — usually the top line on your pay stub): This is the amount you earned from all of your hard work. It's nowhere near the amount you see on your check, but this is what you started with before your employer withheld money to pay for all the other stuff.
- ◆ **Federal income tax**: This is the amount that goes to Uncle Sam.
- ◆ **Social Security (or FICA)**: This is the other amount that goes to Uncle Sam.
- ◆ **Medicare**: This is yet another amount that goes to Uncle Sam.
- ◆ **State income tax**: This is the amount that goes to Uncle Sam's little helper.
- ◆ **Deductions**: This area can include amounts for union dues, health insurance, life insurance, contributions to a flex plan, or pretty much anything else your employer offers that you are allowed to pay for from your paycheck.

Usually your pay stub provides information about your current paycheck and also year-to-date totals, so you can see at a glance how much you've given to the government so far this year and how much you've been allowed to keep.

Benefits you get at work

A job comes with all sorts of benefits. Not only do you get paid real money (after taxes) to do what you love, but, depending on the type of job you have, you may get a fancy uniform to wear, special tools to play with, built-in friends to share coffee and gossip with every day, a free place to park, a big truck to drive, free food, a cubicle to decorate with pictures of your pets, or the occasional trip to faraway places like Des Moines or Pittsburgh to attend free training.

Some benefits are called benefits even though you pay for them. This type of benefit is often billed as a tax-free benefit, which means that you get to pay for the benefit, but the amount you pay gets deducted from your gross pay when it comes to figuring out how much income tax you owe.

Here are some important things to keep in mind regarding the tax-free benefits you get at work:

- ◆ The benefits recorded on your pay stub represent amounts paid for certain perks that are offered by your employer. Every employer offers different types of benefits (some employers don't offer anything), so this section of your pay stub varies from job to job.

- ◆ You probably can't take a deduction for the cost of the benefits on your tax return. If you have a certain amount withheld from your paycheck for health insurance, for example, chances are excellent that no tax is being withheld on this amount. When you prepare your tax return next year, you can't deduct the amount you paid for health insurance because the income you report on your tax return (see the section entitled "The W-2 form" later in this chapter) has already been reduced by the amount you paid for health insurance. In effect, you've already deducted the health insurance, and deducting it on your tax return would amount to deducting the health insurance twice.
- ◆ On the other hand, some deductions from your pay are not taken out before taxes and do indeed generate a tax deduction. Contributions to organizations such as United Way are a good example of amounts that appear on your pay stub that you can also deduct on your tax return. Union dues are another.
- ◆ The benefits you see on your pay stub may not appear on your W-2 form at the end of the year. The pay stub may be the only place where you see how much you've spent on the various goodies offered at work. So don't just toss the pay stub in the trash. Use this stub to record and keep track of how much money you have paid for the various benefits. In particular, hang on to the last stub of the year because it shows you the year-end totals of all of your payments.

Bonus time

Some businesses pay bonuses to their employees in addition to the regular pay. The IRS expects you to keep track of the bonus you receive and, of course, share a little bit of it with the federal government.

To make this whole sharing process easier, many employers simply withhold tax on the bonuses they give. It's common for employers to withhold a flat 25 percent income tax from the bonus amount. Trust me, it's kind of a let-down to have the boss tell you your hard work was worth an extra \$500 bonus but here's a check for only \$375.

Some bonuses are small enough that the IRS is actually willing to let you keep the entire bonus without sharing anything. These bonuses fall under the general heading of, "Turkeys, Hams, and Other Items that are Difficult to Tax." The IRS rules specifically state that employees whose excellent service to their employer resulted in a bonus of a turkey or ham or "other item of small or nominal value" do not have to report the value of such gifts on their tax returns, nor does the employer have to withhold a portion of the gift to send to the government.

You're relieved, I'm sure, to know that you don't have to cut off one of the turkey legs and package it up for delivery to the fine folks at the IRS. However, if instead of a turkey or ham or other item that is difficult to tax, your boss

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decides to give you cash, or worse yet, a gift certificate or some tickets to an athletic event that you might be able to easily convert to cash, it's your responsibility to report the value of such a gift on your tax return, "regardless of the amount involved."

The W-2 form

Each January, every employer you worked for in the previous year is required to send you a W-2 form. The W-2, or Wage and Tax Statement, summarizes all of the money you earned from that job in the year that just ended, along with all of the taxes you paid and sometimes other information.



Every job, no matter how minimal the pay, is a catalyst for a W-2 form at the end of the year. Even if your entire job consisted of one midnight to 6 a.m. shift as the night waitress at the Hour House Café, and your total wages for the night were only \$8.00 (not counting the \$.36 in tips you received and not taking into account the cost of the shoes you had to replace when a drunken customer threw up on your feet), you still should expect a W-2 form from the employer. If you move during the year, be sure to contact employers you worked for earlier in the year, even if you never want to speak to them again because they wouldn't pay to replace your shoes, and let them know your new address.

The W-2 form should include the same information that appeared on your last pay stub for the year, so there shouldn't be any surprises.

What to do if the dog eats your W-2 form

You can try your best to hang on to that W-2 form, but sometimes uncontrollable forces are at work, like vacuum cleaners, overzealous housekeepers, children who need to apply their artistic skills, and yes, underfed or drooling dogs.

Fortunately, you can easily circumvent many of life's little mishaps, and in the case of W-2 forms, it's a snap. First of all, if you're only missing one copy of the W-2 form, just photocopy one of the remaining pages. For example, if you lose Copy B of the W-2, the page that's supposed to go with your federal tax return, photocopy Copy C or Copy 2, and attach that to your tax return instead.

If all the copies of your W-2 form are lost or destroyed, call the payroll department at your place of employment and ask that they make you a copy of the W-2 form. There's no magnetic ink on these forms, nor does the color matter, so a photocopy is an easy solution.

If all else fails, copy the income and withholding information from your last pay stub of the year onto a piece of paper, include your name and Social Security number, and attach that to your tax return along with a statement saying the original was lost or destroyed.

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The information on your W-2 is used when you prepare your income tax return. In fact, as you probably know if you've ever filed an income tax return, the IRS asks that you attach the W-2 form to your tax return, so don't throw this form away when it comes in the mail.

You're Self-Employed: You've Created Your Own Job!

Just because you don't work as an employee for someone else, doesn't mean for a minute that you don't have to keep track of your income and the amounts you spend for your job. In fact, the record-keeping chore can be rather overwhelming if your work entails getting income from lots of places and buying lots of things for your job.

The advantages of working for yourself and basically creating your own job can sometimes be overshadowed by the paperwork, the sporadic nature of your income, and the sheer personal responsibility for making the job a success. If you've got the bug to work for yourself, here are some points to keep in mind when it comes to tracking your finances.

Getting paid

When you are self-employed, it's up to you to stay on top of how much you earn, where that money is coming from, and how quickly you receive your payments. A record-keeping system is imperative so that you don't lose track of money owed to you. If your business involves customers who don't always pay in a timely fashion, you should develop some sort of collection system so that you not only know who owes you and how late they are, but so that you can successfully recover the money that's owed to you.

You find out more about using Quicken to account for your business receivables in Book VIII. For now, here are some pointers for keeping track of and collecting the money you've earned. (If your business is a cash business where you get paid immediately, you can ignore this list.)

- ◆ **Use paper or electronic invoices** to send to your customers, and keep a copy of each invoice yourself.
- ◆ **Keep a list of your receivables**, either on your computer or even on paper. Don't rely only on your memory. Record the receivables, along with the date on which the invoices were issued, so none of them slip by unnoticed.
- ◆ **Send monthly statements** reminding your customers of unpaid amounts. If you relax the rules and don't send statements, even the best of customers is likely to relax a little too much and send payments late, or not at all.

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- ◆ **Consider assessing finance charges** for hard-to-collect amounts. If you have customers who regularly pay late, the mere threat of a finance charge may be just what it takes to get those customers on a better schedule.
- ◆ **Be aggressive.** It's your money, so don't be afraid to ask for it. *You* wouldn't expect to receive the goods or services you offer and not pay for them promptly, and you have the right to receive the same respect from your customers.
- ◆ **Have a serious collection plan in place.** For those times when conventional methods just don't work, you should have a relationship with a collection agency or an attorney to pull out the big guns and go after customers who simply won't pay.

Issuing 1099 forms

Because you are a responsible businessperson, you probably already know the rules for issuing 1099 forms. But if you're new to business, or if this is the first time you made payments that require a 1099 form, you may not be on top of the rules.

Here's the breakdown of who needs to receive a 1099 form from you. Oh, and by the way, don't send a 1099 form whenever you hit the threshold for required forms. Wait until the end of the year and send out your 1099 forms all at once. The IRS requires that the 1099 forms be mailed by January 31 of the year after the payments are made. See the "Sending 1099 forms to your workers" sidebar for the complete rules for preparing and mailing 1099 forms.

- ◆ **1099-MISC:** You are required to send a 1099-MISC to any person or partnership to whom your business paid \$600 or more for service or for rent (not for stuff you buy) during the entire year. Included in the definition of person or partnership is any attorney, even if the attorney is incorporated. If you paid \$599 or less, no form is necessary.
- ◆ **1099-INT:** Send a 1099-INT to anyone to whom your business paid \$10 or more in interest during the year.
- ◆ **1099-DIV:** If your business pays dividends, you must send a 1099-DIV to anyone to whom you paid \$10 or more in dividends during the year.
- ◆ **1096:** Form 1096 is the cover sheet that needs to accompany all of your various 1099 forms when you send them to the government.



Filing 1099 forms is serious business. You can be penalized up to \$50 per form for each form you neglect to file.

Sending 1099 forms to your workers

If you have a service take care of preparing and sending your 1099 forms, you've succeeded in avoiding a major headache each January. If you prepare and send the 1099 forms yourself, follow these steps in order to avoid raising the ire of the IRS.

1. Acquire blank 1099 forms.

If you don't have any blank forms, contact the IRS at 1-800-TAX-FORM (give them about two weeks' notice) and ask for the blanks, or visit your local IRS office and pick up the forms yourself. Be sure to get a 1096 form while you're at it.

Although most IRS forms can be downloaded from www.irs.gov, forms 1096 and 1099 are exceptions. You must submit

scannable versions of these documents, so be sure to get these forms directly from the IRS or from an office supply store; otherwise, you might be fined by the IRS.

2. Prepare the 1099 forms and the 1096 summary form.

3. Mail the recipient copies of the 1099 forms to the people whose names appear on the forms by January 31 of the year after the payments were made.

4. Send the 1096 and the government copies of the 1099 forms to the IRS by February 28th.

(This deadline is March 31st if you're filing the forms electronically.)



If your business sends out a lot of 1099 forms, you may already have a system in place for processing these forms and may be doing so electronically. If you only need to send out a few forms, poke around the Internet — you can find some great online services that take care of all of this paperwork for a really small fee.

Offsetting income with expenses

In addition to keeping track of how much money your business rakes in, you've got to keep track of how much you spend. There are several reasons why you might want to have this information.

- ◆ **Taxes:** The more you spend on your business, the more you can write off on your tax return, thus lowering the income on which your tax is calculated (and possibly encouraging a personal visit from the friendly auditors at the IRS). There's really nothing to worry about when it comes to IRS examinations as long as you can (a) justify the expenses you deduct on your tax return as legitimate business expenses, or (b) schedule a lengthy trip out of the country when it's time for your examination. When you start taking deductions for dog food, toys for the kids, and that business (wink, wink) trip to see your old high school buddies at a posh resort, the IRS inevitably starts taking a closer look at your expense deductions.

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- ◆ **Knowledge:** When you're operating a business, no matter what kind of business it is, you need to know how much money you have. Keeping track of what you earn is one part of the picture. Keeping track of what you spend is another. If you don't monitor your spending (see Book I, Chapter 3 on budgeting for more on how to monitor your spending) and just hope there's money in the bank every morning, you'll probably learn soon enough that you have a lot more to worry about than whether or not the IRS is going to disallow your dog food deductions.
- ◆ **Investors and lenders:** At some point, you may want to expand your empire and bring some outside investors into the mix. In order to encourage people to invest in or loan money to your business, you need to show them how well your business is doing, and this means you need to provide detailed and accurate reports (see Book VII for more on reports) of how much you make and how much you spend.
- ◆ **Future planning:** Crystal balls may not really exist, but you can get a pretty good prediction of how your business is going to do in the future by looking at how much you earned and how much you spent in the past.

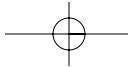
To keep track of your expenses, you should keep a paper trail of what you spent by writing checks or using a charge card instead of paying cash. You'll get bank statements and charge card statements each month itemizing all of your transactions, and then you can have the fun of reconciling those statements to make sure everything was recorded properly.

Fortunately, the days of bank statement reconciliation headaches are a thing of the past thanks to the wonders of Quicken. You'll see in Book II that reconciling bank and credit card statements can actually be fun!

Estimating taxes

Somewhere between the days when you are an employee and the days when you are so wealthy that you can hire someone else to take care of paying your taxes for you, you're going to have to pay your own taxes on your self-employment income. Employees have it easy because their bosses pay the taxes for them. When you're self-employed, you not only have the chore of making the tax payments yourself, but you also get to pay way more tax than employees do thanks to the wonders of our federal stealth tax system.

If you're an employee, you have the regular tax withholdings of federal income tax, Social Security tax, Medicare tax, state income tax, and maybe city income tax too. You may be lucky enough to live in a state or city where there is no income tax, in which case you either pay a higher sales and property tax than the rest of the country, or you have a lot of holes in your roads. The upside of being an employee, from a tax point of view, is that you get to work for an employer who matches your Social Security and Medicare tax payments with equal amounts out of his own pocket.



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Self-employed people don't have those employers hanging around to pick up the slack, so they have to pay double the Social Security and Medicare taxes themselves. These Social Security and Medicare taxes, which are called *self-employment taxes* when you're self-employed, get combined with your federal income tax and paid to the government in the form of estimated taxes.

You should pay one-fourth of your estimated tax for the year with each payment. The estimated taxes for self-employed individuals are supposed to be paid quarterly, based on following schedule:

- ◆ **First quarter payment:** Due April 15
- ◆ **Second quarter payment:** Due June 15
- ◆ **Third quarter payment:** Due September 15
- ◆ **Fourth quarter payment:** Due January 15 after the year ends

For our purposes, *due* means *postmarked by*, and if the 15th falls on a Saturday or Sunday or federal holiday, you get until the next business day to get the postmark.

Note that the rules for making estimated payments are different for corporations. The January payment is due on December 15th.

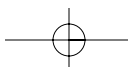


Consider making monthly payments. The IRS won't object if you want to make your payments early. Sometimes it's easier to budget tax payments if you pay $\frac{1}{12}$ th of your estimated tax each month instead of paying $\frac{1}{4}$ th of the tax four times a year.

The amount you're supposed to pay for estimated taxes is calculated with one of the following formulas:

- ◆ Your estimated payments should add up to at least 90 percent of your current year's income tax, or
- ◆ Your estimated payments should add up to at least 100 percent of your previous year's income tax, keeping in mind that,
- ◆ If your taxable income is more than \$150,000 (\$75,000 if you're single or married filing separately), your estimated payments should add up to at least 110 percent of your previous year's income tax.

It probably goes without saying that it's easier to calculate what your estimated tax should be if you keep track of your income and expenses during the year. By keeping good records, you are also prepared for any tax you owe in the spring and won't have any nasty surprises that involve having to go into hock to pay your tax bill.



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Keeping Track of Earnings from Your Investments

When you think of investments, you probably think of things like bank savings accounts, money market funds, brokerage accounts, shares of stock, savings bonds, retirement funds, Swiss bank accounts, that stash of cash hidden in your parents' freezer, and so on. These are all called *cash investments* because the only thing you can do with them is turn them into cash (or in the case of Enron stock certificates, make a nice campfire). Other types of investments include stamp and coin collections, artwork, antiques, jewelry, rare books, classic cars, vintage Mr. Potato Head kits, and just about any kind of tangible object you might own that is worth more today than what you paid for it.

It's important to know how much money you are making off of your investments, or by how much your investments are increasing in value, so you can make decisions about whether you want to keep your money tied up in those investments or change your investing strategy.



Besides knowing how much your investments earn, it's useful to know how much your investments are worth. Although the financial institution holding the money usually insures cash investments, the insurance on tangible objects is your responsibility. Make a list of all of your valuable stuff and how much it's worth, and then pay a visit to your insurance agent. Find out what is covered by your homeowner's or renter's insurance and decide what other type of insurance coverage you might need.

For cash investments, the banks, stockbrokers, and other companies that process and hold your investments send you regular statements showing how your investments are doing. Be sure to hang on to these statements — especially the one you get at the end of the year — so you'll have a record of your progress. If your cash investments aren't making particularly stellar progress, at least you can use the statements for packaging material around your precious (and much more valuable) collection of *Monkees* memorabilia.

In addition to statements, each of these organizations will send a 1099 form to you in January showing your earnings for the previous year. The information on your 1099 forms must be included on your tax return.



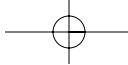
The IRS gets a copy of your 1099 forms, and they check to make sure there are like amounts on your tax return, so no cheating!



You don't have to attach the 1099 forms to your tax return — they are for your records. The exception to this rule is that if there is a record of taxes withheld on your 1099 form, you should attach the form to your tax return.

Earning interest on your savings account

Money deposited in a savings account earns interest, which increases the amount of money in the account. The bank gives the depositor interest in



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exchange for the letting the bank have the use of the money. The bank can lend out the money at a higher rate of interest, and thus make a profit on the use of your savings money. Meanwhile, you are required to pay tax on the interest that the bank gives you.

At the end of the year, your bank statement reflects the amount of interest you earned for the entire year and that amount is also reported to the IRS. (Unless of course you earned less than \$10 for the year, in which case the IRS doesn't get a statement, but you're still supposed to abide by the honor system and report the earnings on your tax return.)

If you use a paper passbook and record your interest the old-fashioned way, by writing down the amount of interest every month when your bank statement comes, or if you're more modern and use Quicken to automatically record the interest each month, you already know how much interest you earned and won't have to wait for the bank to summarize the interest for you.



If you bank online at your bank's Web site, or if you use Quicken's funds transfer features, you can move money into your savings account right from your computer. Saving money doesn't get any easier than that.

Money markets and mutual funds

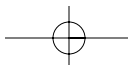
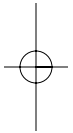
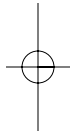
One of the best ways to get involved in investing is through money markets and mutual funds. These investment vehicles are conduits whereby a group of investors pools their available money and the fund invests all of the money together on behalf of the participants.

Savings, 1950s-style

Back in Leave It To Beaver-land where I grew up, we had a program at my school called Bank Day. On Bank Day, all of us kids would bring the spare change we had collected by mowing lawns (standard rate, 50¢) and taking pop bottles to the corner store for the deposit refund (2¢ per bottle), and we'd give the money to our teacher, who would record our deposit in our savings account passbooks. Somebody from the school would take the money from all the classes to the bank. These nickel and dime deposits would earn a little bit of interest, and in exchange, we learned a little bit about saving.

Meanwhile, our parents belonged to Christmas Clubs at their jobs where they turned in a fixed amount each week. They'd get the money back early in December, plus interest, and that was what they were supposed to spend on presents. It was an easy way of saving so that holiday spending didn't break the budget.

You don't hear much about those programs anymore, and it's kind of a shame. In the 1950s, saving money was a way of life, just another part of going to school or work.



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You don't have to know a lot about investing to choose an investment fund, and your risk is minimized because the fund can buy a wide variety of investments instead of putting all of its investment eggs in just one basket.

I've lumped money markets and mutual funds together in this section because the record-keeping for both types of investments is similar. However, there are distinct differences between money market investments and mutual funds.

Money market accounts and money market funds

A *money market account*, also known as a money market deposit account, is an interest-bearing account offered by a financial institution (otherwise known as your friendly neighborhood bank, credit union, or savings and loan). Much like a savings account but with a higher minimum balance, the money market account is insured by the FDIC. Money market accounts pay interest, typically at a rate higher than a savings account.



If you've got plenty of money to invest, you need to know this important info about the FDIC. FDIC insurance only covers the first \$100,000 in a covered account, so investments that exceed \$100,000 should be spread among multiple institutions to benefit from the FDIC protection.

The banks and other institutions that offer money market accounts limit the number of transactions you can have in the account each month, so you can't use the money market account like an interest-bearing checking account, paying all of your bills from the account while you earn the nice interest rate.

You don't own shares in a money market account — you just put in a certain amount of money and watch it grow. Typically the interest rate on a money market account is stated up front and is non-fluctuating.

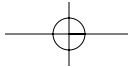
You need to keep track of the interest you receive on your money market account because the interest is taxable and must be reported on your income tax returns.

A *money market mutual fund* is sold in shares, with each share costing \$1, and usually you must buy a minimum number of shares on your initial investment. The fund purchases short-term debt instruments, such as treasury bills and other government securities, as well as corporate money market securities, and typically the money market investments mature in 13 months or less.



Money market mutual funds are not insured by the FDIC, but don't let that be a deterrent. This is one of the safest investments around.

The interest rate on a money market mutual fund changes depending on the fund's investments, so no interest rate is stated up front.



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Money market mutual funds often work like checking accounts in that you can have check-writing privileges and then you have the added joy of reconciling your account each month. But never fear. Reconciliation isn't a dirty word when you use Quicken.

Mutual funds

Mutual funds make the stock market and other types of investing accessible to nearly anyone. One mutual fund might invest in hundreds of stocks or bonds, and with your investment, you own a little piece of each of the fund's holdings. By joining a mutual fund, you don't have to have buckets of money to invest in blue chip stocks, international currency, government bonds, or whatever other type of investment interests you.

The advantage to investing in a mutual fund over investing directly in the stock market is that you get the chance to spread your money over a great variety of investments, thus presumably minimizing your risk. And for a very low fee (which is typically taken out of your earnings, so you don't actually see the cost of participation in the fund), you get to benefit from the expertise of the fund manager, who, with luck, won't take your money and run away to a private island in the Caribbean.



There is a slim chance that your mutual fund manager actually will take a hike with a bundle of cash from the fund, or, a more likely scenario is that a fund that looked good when you bought into it doesn't do too well and loses money. For these reasons, it's always prudent to spread your investible cash over a variety of investment options.

For a small initial investment, you can open a mutual fund account and continue making regular investments. Over time, if the fund is successful, your investments will continue to increase in value. Many mutual funds require an opening investment of \$500 or \$1,000 (some high roller funds require much more), but some funds let you open up an account for as little as \$50 if you agree to a monthly automatic withdrawal from your bank account for continued investment.



Rumor has it that even though some funds publicize their opening investment at \$1,000 or \$2,000, if you call them on the phone and plead your case, you can negotiate a lower initial deposit. The negotiation probably goes more smoothly if you agree to a monthly investment schedule.

Unlike with stock investments, where it's probably more common to take your dividend earnings in checks (see "Playing the stock market" below), most mutual fund participants leave their earnings in the fund to grow and to be reinvested. So instead of receiving little checks in the mail each time a dividend is declared by one of the stocks owned by the mutual fund, your share of the dividend is added to the value of the fund and the value of your investment in the fund increases.



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Usually, mutual funds send monthly statements showing how much your shares earned in the last month, how much you invested in the fund (or withdrew from the fund), and how many new shares you now own due to your investment or your reinvested earnings.



Hang on to *all* of your mutual fund statements. You may want to be able to recall all of your investment and reinvestment activity when you take money out of the fund. Taking cash out of a mutual fund has the same effect as selling individual shares of stock, only in this case, you are selling shares of your mutual fund. See Book V for more information on how to report the redemption of mutual fund shares on your tax return.

Playing the stock market

Companies sell stocks, or ownership shares, to raise money for their business. The shareholders of a company actually own the business and have an opportunity to vote on certain business decisions.

If you want to buy stock, you can't just go up and knock on the front door of General Motors and ask to purchase a share of stock. You need to use the services of a stockbroker who makes the purchase for you. You can work with a brokerage company and deal with a real person who helps you make investment decisions, or you can use the Internet to acquire the services of a stock trading service, and make your own trading decisions right at your computer.

When you buy and sell stocks, the most important thing to remember, at least from a record-keeping standpoint, is to keep track of the dates on which you make purchases and sales and the amounts you spent and collected. You are expected to be able to reproduce this information on your tax return.

The purchase information for stocks is also important if you give the stock away, either to another person or as a contribution to an organization.

So find a safe place to keep your stock purchase information because you might have to hold on to this information for many years. In the good old days, everyone had a safe deposit box at the bank, and that is where they kept the deeds to their houses, savings bonds, and stock certificates. Anymore, many people do their banking online or over the phone and purchase stocks through an Internet service such as e-Trade or Ameritrade, so the regular trip to the bank to sequester important documents in a safe deposit box seems to be less of a tradition.



For more information on investing in stocks, pick up a copy of *Stock Investing For Dummies* by Paul Mladjenovic (Wiley).

Bonds and treasury bills

A *bond* is another word for a loan — by purchasing a bond, you in effect loan money to the company or government entity from which you make the purchase. A bond has a fixed life expectancy and when you make the purchase, you expect to have your money returned to you when the term of the bond ends.

Typically, bonds pay interest over the course of the bond's term. Then, when the bond obligation is fulfilled, the bond is retired and you receive your original investment back.

Bonds are rated based on how likely it is you will actually get your money back. The higher the rating, the safer the risk. Likewise, the lower the rating, the riskier the bond. The riskier bonds are usually offered at a higher interest rate, in order to attract investors who are willing to gamble and take the higher risk.

You can purchase bonds in one of several ways:

- ◆ Buy bonds at banks. U.S. government savings bonds are available at your bank in increments as small as \$25. These bonds are sold at 50 percent of face value, so \$25 gets you a \$50 savings bond. When the bond matures, you get \$50. If you purchase series EE or series I savings bonds and redeem them to pay for higher education costs, there is no tax on the difference on the bond's interest.
- ◆ Buy U.S. Treasury bonds and savings bonds online at the Treasury Department's Web site, www.treasurydirect.gov.
- ◆ Buy bonds from a broker.
- ◆ Some employers offer a payroll withdrawal program that allows you to purchase bonds at work.
- ◆ Buy bonds by buying shares in a mutual fund that specializes in bonds.

Treasury bills, like government savings bonds, are purchased at a discount. Instead of receiving payments of interest over the course of the bill's life, the bill itself increases in value until it reaches its stated value. At that time, the bill is redeemed and you receive the full face amount of the Treasury bill.

The interest you receive on bonds and treasury bills is taxable, so it's important to keep track of your earnings throughout the year. Some bond interest is taxable on both your federal and state income tax returns, other interest is taxed only on your federal return, and still other interest is only taxable on your state return. Here are the general rules:

- ◆ Interest on U.S. savings bonds and other federal government investments is taxable on your federal income tax return but not on state and local income tax returns.

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- ◆ Interest on corporate bonds is taxable on all of your income tax returns.
- ◆ Interest on municipal bonds is tax exempt on your federal income tax return, but may be taxable on your state tax return. If the bond was issued by a municipality or tax exempt organization (such as a school) in your own state, the bond interest is probably not taxable on your state tax return. Check the instructions that accompany your state tax return for more information about municipal bond interest.

Earnings in retirement funds

You've got plenty stashed away for your nest egg, right? Individual Retirement Accounts (IRAs), 401(k)s, 403(b)s, 402(c)s, 609(y)s, whatever. And of course there's that Rumpelstiltskin pile of gold called Social Security waiting for all of us. Just knowing you have all this money waiting for you in your waning years should be security enough. But actually knowing how much you can expect to have when you're ready to retire and how much your long-term investments are earning would be pure heavenly bliss, or at least common-sense satisfaction.

Keeping track of earnings in your retirement funds can be a sticky area. Not only is it possible that you own several funds, but the possibility also exists that some of your retirement fund money is tax-free, some of it is tax-deferred, and some of it will be fully taxable. All of those tax rules affect how much money will actually be yours to keep.

It's imperative that you keep track of all of your retirement money, know where it is invested, know how it will be taxed, and maintain some control over the investments, so that you don't jeopardize your financial future. You'll find Book VI on retirement planning to be quite useful in figuring out how you can take advantage of all that Quicken has to offer for helping you stay on top of your retirement investments.

For now, here are some basic descriptions of the various types of retirement funds that may be available to you.

401(k), 403(b) tax-deferred retirement plans

Many employers offer 401(k) plans to their employees. A 401(k) is a long-term savings plan funded by automatic withholdings from your paycheck and often enhanced with matching funds provided by your employer.

If you work for a school or church or government, you may have a 403(b) instead of a 401(k), but the idea is basically the same. These plans are tax-deferred, meaning you can fund them with money on which you pay no income tax, and the earnings in the plans grow, untaxed, until you're ready to take the money out.

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When it's time to get your hands on the money in a tax-deferred retirement plan, usually when you turn age 59½ (the minimum age for penalty-free withdrawals), or a bit older if you decide to wait awhile, the amounts you take out of the plan are taxed at your current rate of income tax.

Try not to take the money out of a tax-deferred plan before the plan says you can do so without a penalty. The penalty for taking money out early is 10 percent of the amount you withdraw. This is on top of the income tax you pay.

Typically, participants in a 401(k) or similar plan have a variety of options from which to choose for investing their plan money. The options will be a choice of mutual funds, some riskier than others. You can split your investment if you like so that some of the money goes in safe funds and some in the riskier but potentially higher earning funds.

Monitor your 401(k) money closely and consider changing your mix of investments to take advantage changes in the stock market. Also, as you get closer to your own retirement, you'll want to think about moving your 401(k) money into more conservative investments that may not earn as much but are less risky.

Traditional Individual Retirement Accounts

The traditional IRA (“traditional” is used to differentiate from the IRA’s baby brother, the Roth IRA) is a tax-deferred retirement account you can open yourself. Contributions to the IRA of up to \$4,000 per year may be tax-deductible if you meet certain picky requirements (see Table 1-1).



The annual IRA contribution limit of \$4,000 is good for the years 2005-2007. In 2008 the amount is scheduled to increase to \$5,000. Starting in 2009, the amount is scheduled to increase each year based on an annual inflation adjustment. Table 1-1 applies to taxpayers who are covered by a retirement plan at their job.

Table 1-1 Who Can Deduct IRA Contributions?

<i>Filing Status</i>	<i>Single or Head of Household</i>	<i>Married Filing Jointly or Surviving Spouse</i>	<i>Married Filing Separately*</i>
Adjusted Gross Income			
\$10,000 or less	Full deduction	Full deduction	Partial deduction
\$10,000-\$45,000	Full deduction	Full deduction	No deduction
\$45,000-\$55,000	Partial deduction	Full deduction	No deduction
\$55,000-\$65,000	No deduction	Full deduction	No deduction
\$65,000-\$75,000	No deduction	Partial deduction	No deduction
Over \$75,000	No deduction	No deduction	No deduction

*If you don't live with your spouse at all during the year, you should use the guidelines for Single.

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Table 1-2 applies to taxpayers who are not covered by a retirement plan at their job.

Table 1-2 Who Can Deduct IRA Contributions?			
Filing Status	Single, Head of Household, Surviving Spouse, or Married Filing Jointly with a Spouse Also Not Covered by a Retirement Plan at Work	Married Filing Jointly, Spouse Is Covered by a Retirement Plan at Work	Married Filing Separately
Adjusted Gross Income			
\$10,000 or less	Full deduction	Full deduction	Partial deduction
\$10,000-\$150,000	Full deduction	Full deduction	No deduction
\$150,000-\$160,000	Full deduction	Partial deduction	No deduction
Over \$160,000	Full deduction	No deduction	No deduction

**If you don't live with your spouse at all during the year, you should use the guidelines for Single.*

If you're 50 years old or older, you can contribute another \$500 each year to your IRA (\$1,000 starting in 2006), also deductible if you fit the descriptions above.



No matter what your age or filing status or income level or whether you prefer Original Recipe or Extra Crispy, you can contribute the maximum amount to an IRA each year and *not* take a deduction. So don't use the restrictions from the tables above as an excuse to not sock any money away for retirement. You won't get to take a deduction for your contribution, but the earnings in the account will continue to grow, tax-deferred, until you are ready to retire.

When you retire, you can take the money out of your IRA based on convoluted schedules provided by the IRS that may make the hairs on the back of your neck stand up because they tell you when you're expected to die. Any amounts you withdraw from the IRA are taxed at the time you take the money. The exception to that rule is that if you contributed money to the account but did not take a deduction for your contribution, you've already paid the tax on that amount so you don't have to pay tax again.

Roth Individual Retirement Accounts

Former U.S. Senator William Roth invented the Roth IRA, a hybrid IRA that encourages people to contribute to savings without the benefit of a current tax deduction for their contribution. The pie in the sky with the Roth IRA is that you never pay tax on the money you take out of the account.

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So if you invest successfully and your Roth IRA contributions grow astronomically, you can take the money and spend it on yourself, guilt-free, not ever having to share a dime with the IRS.

Setting up a Roth IRA is not quite as easy as it may sound. As with anything touched by the IRS, there are restrictions and hoops to jump through. Table 1-3 shows who gets to contribute to a Roth IRA.

<i>Filing Status</i>	<i>Single, Head of Household</i>	<i>Married filing Jointly</i>	<i>Married Filing Separately</i>
Adjusted Gross Income			
\$10,000 or less	Full deduction	Full deduction	Partial deduction
\$10,000-\$95,000	Full deduction	Full deduction	No deduction
\$95,000-\$110,000	Partial deduction	Full deduction	No deduction
\$110,000-\$150,000	No deduction	Full deduction	No deduction
\$150,000-\$160,000	No deduction	Partial deduction	No deduction
Over \$160,000	No deduction	No deduction	No deduction

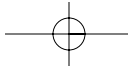
**If you don't live with your spouse at all during the year, you should use the guidelines for Single.*



You should note that with both types of IRA, the amount of your annual contribution is limited to lower of the maximum contribution amount or the amount you earn from a job. So if you only made \$1,500 at your job during the year, the most you can contribute to an IRA is \$1,500, no matter how much more the tables may suggest you can contribute.



If you don't make any money at a job but you are married to someone who does, the spousal IRA rules kick in, and you can "borrow" earned income from your spouse to qualify for your own IRA contribution.



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