A Simple Guide to Common Tax Terms

Taxes can feel complicated, especially when you hear unfamiliar terms. While you don't need to know every detail, understanding a few key concepts can help you feel more confident when discussing your financial plan.

Taxable Income: This is the portion of your income that may be subject to taxes after certain adjustments. It can include wages, retirement income, and investment earnings, depending on your situation.

Deductions: Deductions reduce the amount of income that is subject to tax. They can come from a variety of sources, such as certain expenses or contributions. Lower taxable income may result in a lower overall tax obligation.

Tax Credits: Tax credits directly reduce the amount of tax owed. Unlike deductions, which lower income, credits reduce your tax bill itself.

Tax Brackets: Tax brackets refer to the ranges of income that are taxed at different rates. Not all income is taxed at the same rate, which is why understanding this concept can help avoid common misconceptions.

Capital Gains: Capital gains occur when an investment or asset is sold for more than its original purchase price. The length of time the asset is held may affect how it is treated from a tax perspective.

Tax-Deferred Accounts: These are accounts where taxes are typically delayed until funds are withdrawn. Retirement accounts are a common example.

Tax-Free Accounts: Some accounts allow qualified withdrawals without additional taxes. These can play a role in long-term financial planning.

Withholding: Withholding refers to the portion of income that is set aside throughout the year to cover potential taxes owed.

Estimated Taxes: Some individuals may need to make payments throughout the year rather than relying solely on withholding. This often applies to self-employed individuals or those with additional income sources.

Final Thought - You don't need to become a tax expert to make informed financial decisions. Having a basic understanding of these terms can make conversations with your financial advisor and tax professional more productive and help you feel more confident about your financial plan.