

# **The Artist as Entrepreneur**

## **Good News and Bad News: Income and Taxes**

### **Lesson Description**

It is important for high school students to have an awareness of income taxes, not only to better their knowledge of the government goods and services that are funded by taxes, but also to build their knowledge of personal income tax filing and payment.

In this lesson, students will examine Internal Revenue Service (IRS) Form 1040, citing particular line items that are pertinent to an artist acting as an entrepreneur. They will also learn about various sources of income and the importance of keeping accurate income records.

### **Concepts**

Income  
Taxes  
Tax return

### **Related Subject Areas**

business  
economics

### **Objectives**

Students will:

define income and taxes  
identify sources of income  
state why it is important to maintain income records  
give examples of government goods and services provided by taxes

### **Materials**

Visual 1, *Taxman*  
Visual 2, *Who Needs to File Tax Returns?*  
Visual 3, *Sales and Cash Receipts*  
Handout 1, IRS Form 1040 (this can be obtained from [www.irs.gov](http://www.irs.gov). Type in 1040 in the search box for forms. It will download in .pdf format.)

### **Procedure**

1. Explain that income taxes are considered by many to be a necessary evil. Taxes are mandatory payments made by citizens and residents to the government that then provides goods and services that benefit all citizens. However, reporting income and expenses on tax forms to determine the amount of taxes owed is a

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cumbersome procedure. And, of course, people frequently complain about the amount of tax they must pay.

2. Explain that when George Harrison was with The Beatles, he wrote and sang a song that expressed his displeasure with the income tax structure in England. Recite the following quote from George Harrison, and ask students what percentage rate of taxation is implied. (*95 percent*)

*Let me tell you how it will be  
There's one for you, nineteen for me  
'Cause I'm the taxman  
Yeah, I'm the taxman*

3. Display Visual 1, *Taxman* by George Harrison, and check for student understanding of Harrison's complaint. (*Students should note further reference to the 95 percent rate of taxation.*)
4. Explain that although Harrison's views are shared by many, citizens receive goods and services in return for the taxes they pay. Taxes pay for national defense, roads and bridges, education, research and development of drugs and treatments, aid to disadvantaged people, and many other goods and services. This is especially true in England where the government pays significant portions of education and health care costs. At the time of this writing, British university students are protesting the government's proposal to have students pay a portion of their university costs. Up until now (December 2003), university students in England pay no portion of their higher education expenses.
5. Display Visual 2, *Who Needs to File Tax Returns?* and explain that citizens and residents of the United States who earn above a certain dollar amount in income, must pay taxes. Assist students in understanding the table. Note that people working part time, such as many students, may not make the minimum gross income required for filing. However, it is still important to file a return if taxes have been deducted from the part-time worker's paycheck. Workers who have paid taxes through payroll deductions and have not earned the minimum gross income are due a refund of all taxes collected.
6. Explain that self-employed persons, such as sole proprietors, independent contractors, and anyone receiving fees for services rendered, are required to file a return if net earnings from self-employment are \$400 or more.
7. Explain that people can have various sources of income. Income is money received. It can come in many forms, such as gifts or interest payments, but for most people, income comes from work performed. All income must be reported to the Internal Revenue Service (IRS), even prizes, awards and gambling winnings, including the lottery. Some interest income might not be taxable, but it must be reported.

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8. Explain that for most people, filing taxes is an annual event. However, for those in business, taxes are often paid quarterly. In either case, the process can involve several different reporting forms. In general, tax returns report a person's income and the deductions for which he or she is eligible. Sometimes people make mistakes when reporting their deductions. In the case of people operating a business, mistakes can be made when reporting expenses. In many cases, the IRS will audit tax returns and find these mistakes. When they do, the taxpayer must pay the taxes due, often with interest. Sometimes a penalty will apply; however, mistakes in the areas of deductions and expenses are somewhat common and easily made.
9. Point out that making a mistake when reporting income is another matter. Calculating deductions and expenses can be confusing. However, calculating income is a simple process. All money received is income. There aren't many excuses one can offer for not providing an accurate report.
10. Explain that maintaining proper records of income is important for tax preparation. The procedure does not have to be complicated. Most artists use the Cash Method of accounting. In this method, the artist includes income actually received during the year and deducts expenses paid in that year. Basically, it can be as easy as maintaining a check register.
11. Display Visual 3, *Sales and Cash Receipts*. Note that the format can be simple, but should state when the payment was made, from whom the payment was received, the amount of the payment, and the good or service provided for the payment. Invoices, contracts, copies of checks, bank deposit slips, W-2 Forms, and 1099 Forms will probably make up your income paper trail.
12. Distribute Form 1040 and explain that the typical artist files the Form 1040, known as the "long form." In addition to completing the front and back of that form, they might complete other forms for reporting income or expenses related to the business. Draw students' attention to the various components of the form as follows.
  - Form 1040 includes 73 lines including filing status, exemptions, income (including unemployment compensation), adjusted gross income, tax and credits, other taxes, such as sales tax or state income tax, and refund or payment amount due.
  - Some figures, such as wages (Line 7), only appear on Form 1040.
  - Some, such as business income (Line 12) are carried over from other forms.

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13. Point out the following tips for artists.
- Royalty income (line 17) from your copyrights in literary, musical or artistic works in money paid to you for the right to use your work during a specific time period. Notice that line 17 says this information comes from Schedule E. If you are claiming to be a business, then royalties should be reported on Schedule C, Profit or Loss from Business, rather than on Schedule E, Supplemental Income and Loss. Ask students if they understand why the artist should use Schedule C. (*Schedule C is used by people who are operating a business. Schedule E is simply for people who have a little commerce going on the side.*)
  - Interest on student loans (line 25). Art schools are expensive, so chances are that you will have a student loan to repay. Even if you take occasional classes, you may have to seek student loans. Repaying student loans might be cumbersome, but you are able to deduct student loan interest. Also, the income level at which your deduction will be reduced or eliminated will be increased, so you might qualify for this deduction even as your income increases. See Publication 970, *Tax Benefits for Higher Education*, for more information.
  - Self-employment tax deduction (line 28). You may deduct one-half of your self-employment tax from Schedule SE.
  - Self-employment health insurance deduction (line 29). Most self-employed individuals can deduct 100 percent of the premiums they pay for health insurance. See Publication 535, *Business Expenses*.
  - Earned Income Credit (line 63). This credit is available to certain people who work and have low incomes. To claim the EIC, you must meet several requirements, which are explained in Publication 596, *Earned Income Credit*. For a single person with no children, the maximum credit is \$376. The \$376 credit is granted to those single persons with an annual income between \$4,900 and \$6,150. Beyond \$6,150, the credit declines.
14. Explain that while the regulations in effect now are likely to change by the time students are filing their taxes. Although tax codes change, it seems they never become easier to understand, so many artist entrepreneurs hire someone to prepare their taxes. However, even those who have their taxes done by professionals should be aware of the various business and personal deductions and credits.

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#### **Closure**

Ask the following questions. Allow students to refer to the 1040 form to aid in their responses.

- What are taxes? (*Taxes are mandatory payments made by citizens to the government.*)
- What is the money received from taxes used for? (*Taxes pay for government provided goods and services.*)
- What government provided good or service do you consider very important? (*Answers will vary, but students should respond with goods and services such as roads, national defense, medical care for the poor, and so on.*)
- What is the number of the primary form used to file tax returns? (*1040*)
- What type of income information is required on this form? (*Answers will vary, but students should recall that income includes business income, royalties, wages, tips, interest payments, unemployment compensation, prizes and other winnings, and several other items.*)
- What types of adjustments to gross income would likely apply to the artist entrepreneur? (*student loan interest, self-employment tax, self-employment health deduction*)
- Why is it important to maintain precise income records? (*All income must be reported to the IRS.*)

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Visual 1

**Taxman**

“Should five percent appear too small  
Be thankful I don't take it all  
'Cause I'm the taxman  
Yeah, I'm the taxman”

“If you drive a car, I'll tax the street  
If you try to sit, I'll tax your seat  
If you get too cold, I'll tax the heat  
If you take a walk, I'll tax your feet”

*George Harrison*

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Visual 2

**Who Needs to File Tax Returns?**

2003 Filing Requirements for Most Taxpayers			
Marital Status	Filing Status	Age	Gross Income
Single Including divorced and legally separated)	Single	Under 65 65 or older	\$7,700 \$8,850
	Head of household	under 65 65 or older	\$9,900 \$11,050
Married, with a child, living apart from your spouse during the last 6 months of 2001	Head of household	Under 65 65 or older	\$9,900 \$11,050
Married, living with your spouse at end of 2001	Married, joint return	Both under 65	\$13,850
		One 65 or older Both 65 or older	\$14,750 \$15,650
	Married, separate return	Any age	\$3,000
Married, not living with your spouse at end of 2001	Married, joint or separate return	Any age	\$3,000

*Source: Publication 17, Your Federal Income Tax*

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Visual 3

**Sales and Cash Receipts**

Date	From	Amount Due	Amount Received	Art Sales	Portfolio Photography
1/2/04	Art STL	\$200	\$200	\$200	
1/18/04	T. Jones	\$150	\$75		\$75
1/23/04	Gallery 2010	\$420	\$420	\$420	
1/25/04	T. Jones	\$75	\$75		\$75