
INCOME GENERALLY

BY

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INCOME

EMPLOYEE COMPENSATION- (Not covered elsewhere in this course)

Wages

Back pay

Settlements including payments for damages, unpaid life insurance and unpaid health insurance premiums

Reportable on form W2

Advance Commissions and other advance pay

Repayment in same year - reduce income by repayment

Repayment in later year

Deduct as itemized on Schedule A

Or take a credit in year of repayment if income was included under a claim of right.

Vacation allowances

Severance pay

Interview expense reimbursement (excess over expenses)

Rewards/Awards/Bonuses

Includes prizes such as vacation trips for meeting sales goals

If goods or services received must include FMV in income

Special rules for employee achievement awards-see following

Cash or readily convertible to cash **GIFTS**

Employer holiday bonuses regardless of amount

(Does not include turkey, ham, or other item of nominal value)

Purchased property at reduced price from employer (difference between payment/ FMV)

Strike and lockout benefits

Property received for services

If **restricted** may not have to include until restrictions no longer exist.

Dividends received on restricted stock are extra compensation

Secured note received for services

Include FMV (usually discount value) in income when received

Later receipt - Proportionate part of each payment is recovery

of FMV previously included and not reportable when received.

Unsecured note received for services

Principal payments are compensation only when received.

INCOME

EMPLOYEE COMPENSATION (Not covered elsewhere in this course)

Social Security and Medicare taxes paid by employer without withholding from employee.

Accrued leave pay - Federal employee lump sum payments

If retire from one agency and re-employed by another agency and repayment of any part of lump sum leave payment:

Reduce gross wages and attach statement to tax return

If retire on disability, the lump sum leave payment is salary-not sick pay

Stock appreciation rights in the year you use the right

Non-statutory option to buy stock or other property as payment for services

Usually income when option received or when exercised

Statutory stock option (incentive or employee stock purchase plan)

Special rules generally delay tax until sell or exchange the shares

OTHER THAN EMPLOYEE COMPENSATION (Not covered elsewhere in this course)

Barter Income

Bad debt recoveries previously deducted

Fees for services

Alimony received (covered under separate course)

Kickbacks, side commissions, push money

Gambling winnings (**NOT netted with losses**) including raffle and lottery winnings

Losses are deductible as itemized deduction up to extent of winnings

FMV of non cash prizes

Free tour from travel agency - taxable at FMV if not in trade or business as misc.

income on form 1040. (Trade or business on Schedule C)

Solar energy grants

Personal items sold at a gain (gain is taxable)

Interns income while in training

Stock options exercise - cash payments received

Commissions received by life insurance agent on policies on self/family

Illegal income

Alaska oil royalties

Prizes and awards (non employee) - taxable at FMV (lucky number drawings,

beauty contests, quiz programs)

INCOME-GENERALLY NON TAXABLE

Nominal value gifts other than cash (turkey) and **not** convertible to cash (certificate)

Cash rebate on auto purchase (or any other item you buy)

Reduce basis, not income

Value of meals and lodging if furnished by employer and for employer convenience

Employer contributions to **qualified pension** plan at time of the contribution

Life insurance

Group life insurance premium if coverage is forfeited on termination of employment

CHILD SUPPORT

Mortgage assistance (235) payments

Medical insurance reimbursement not previously deducted

Inheritances

Welfare

Workers Compensation

Foster parent allowances

Campaign contributions (unless diverted for personal use)

Must be spent for campaign purposes or kept in fund for use in future campaigns

Interest, dividends or sale proceeds from donated property taxable

on form 1120-POL

Funds transferred to an office account must be included in officeholder's income

Living expenses paid by insurance company

Tax sheltered annuities - partial

Sale of residence (limited)

Group legal services plan paid by employer

Black lung benefits

Gifts

Fishing income for members of an Indian tribe from protected fishing activities

Energy conservation subsidies from public utilities for purchase or installation of an energy conservation measure for a dwelling unit.

Includes modifications primarily designed to reduce consumption or improve management of energy demand.

FRINGE BENEFITS

EMPLOYEE ACHIEVEMENT AWARDS

Excluded from income to extent of employer's cost for all such awards received during the tax year up to

\$1,600 for qualified plan awards

\$400 for awards that are not qualified plan awards.

Must be tangible personal property

Not cash, gift certificate or equivalent items

Must be made as part of a meaningful presentation, under conditions that do not create a significant likelihood of being disguised pay

Must be for length of service or safety achievement

Exception---- NOT applicable to:

Length of service awards if

Received for fewer than 5 years service

Or

Received another length of service award during the year or the previous 4 years

Safety achievement award if:

Manager, Administrator, Clerical employee or other professional employee

Or

If more than 10% of eligible employees previously received safety achievement awards during the year.

FRINGE BENEFITS

FULLY TAXABLE FRINGE BENEFITS

Personal use of employer's auto, aircraft, vacation trip

Discount on property or services by employer

Personal use of employer membership in country club

Tickets to entertainment received from employer

EXCLUDED FROM INCOME, IF QUALIFIED

✓ NO ADDITIONAL COST SERVICES

- ▶ offered for sale to customers and no substantial addition to the cost in providing it to employees. (i.e. stand by flights on airline; telephone service to telephone employee)
- ▶ reciprocal agreement
- ▶ includes services provided to:
 - spouse
 - dependent child
 - former employee if retired or disabled
 - surviving spouse
 - surviving child under age 25
- ▶ Must be non-discriminatory (not just to highly compensated or officers).

✓ QUALIFIED EMPLOYEE DISCOUNTS

- ▶ If discount does not exceed gross profit percentage of the price at which property is being offered for sale to customers.
- Or
- ▶ The discount does not exceed 20% of the price at which services are offered for sale to customers.

FRINGE BENEFITS

EXCLUDED FROM INCOME, IF QUALIFIED (Continued)

✓ **WORKING CONDITION FRINGE**

- ▶ Non taxable for value of property or services provided by employer if employee would be allowed to take a business deduction for them if the employee had paid for them. (**Business** use of company car or subscriptions to business periodicals provided by employer)

- ▶ Employer provided free parking

- ▶ Car salesman demonstrator auto **IF:**

Provided mainly so that employee can help employer

substantial restrictions on personal use of the car

Car is inventory of the dealership

Car is available for test drives by customers during normal business hours.

✓ **DEMINIMIS FRINGE**

- ▶ Benefits that are so normal that record keeping would be impractical. (Occasional personal use of company copy machine, holiday gifts with low fair market value.)

- ▶ **Qualified** employer provided eating facilities.

- ▶ On premises athletic facilities use if **QUALIFIED** facility.

Continued

FRINGE BENEFITS

✓ GROUP LIFE INSURANCE

- ▶ **Term** life insurance premiums paid by employer are **non** taxable **except** cost of the **premiums** related to the excess of \$50,000 coverage is taxable as wages on W2
- ▶ **Permanent** life insurance premiums paid by employer are **taxable**
- ▶ Key employees - premiums taxable if discrimination in favor of key employees - should be shown on W2
- ▶ Employee payment of part of cost reduces dollar for dollar the amount otherwise included in income
- ▶ Accidental or other death benefits (travel insurance) are **not** included as group life insurance (when certain requirements are met).
- ▶ Two or more employers - must combine total for \$50,000 limits
 Figure cost for each month of coverage by multiplying the number of thousands of dollars by coverage less \$50,000 (both figured to nearest tenth) by the cost from Table provided by Internal Revenue Service.
Prorate cost if less than full month of coverage involved.

| <u>COST PER \$1,000 OF PROTECTION FOR ONE MONTH</u> | | | |
|---|-------------|--------------|-------------|
| <u>INSURANCE PROVIDED BEFORE JULY 1999</u> | | | |
| <u>AGE</u> | <u>COST</u> | <u>AGE</u> | <u>COST</u> |
| Under 30 | 8 cents | 30-34 | 9 cents |
| 35-39 | 11 cents | 40-44 | 17 cents |
| 45-49 | 29 cents | 50-54 | 48 cents |
| 55-59 | 75 cents | 60-64 | \$1.17 |
| 65-69 | \$2.10 | 70-? | \$3.76 |
| <u>COST PER \$1,000 OF PROTECTION FOR ONE MONTH</u> | | | |
| <u>INSURANCE PROVIDED AFTER JUNE 1999</u> | | | |
| Under 25 | 5 cents | 50-54 | 23 cents |
| 25 -29 | 6 cents | 55 - 59 | 43 cents |
| 30 -34 | 8 cents | 60-64 | 66 cents |
| 35 - 39 | 9 cents | 65-69 | \$1.27 |
| 40 -44 | 10 cents | 70 and older | \$2.06 |
| 45 - 49 | 15 cents | | |

FRINGE BENEFITS

✓ MEALS AND LODGING

- ▶ NOT income if:
 - ▶ provided at employer's place of business
- AND ▶ provided for employer's convenience
- AND ▶ for lodging (not meals) provided as a condition of employment.

- ▶ Lodging: Includes heat, electricity, water, gas, sewer

- ▶ Faculty housing (educational institution)
Income to extent excess of fair rental value over amount actually paid.

- ▶ Meals: Generally excluded if provided during working hours to have employees available for emergency calls or because business restricts meal period to short period (30-45 minutes)

- ▶ *Cash allowances for meals are TAXABLE.*

✓ CAFETERIA PLANS

- ▶ Separate written plans that allow participant who must be employees to choose among two or more benefits consisting of cash and qualified benefits.

- ▶ Qualified benefits: Any benefit not currently taxable to the employee

- ▶ Must be non discriminatory.

FRINGE BENEFITS

✓ DEPENDENT CARE ASSISTANCE PLAN

- ▶ Child or disabled dependent care services to allow employee to work.
- ▶ Excluded amount **limited** to **smaller of**:
 - ▶ Earned income
- OR ▶ \$5,000 (\$2,500 married filing separate)
- ▶ For earned income limits - full time student or incapable of self care rules apply the same as for Child Care Credit.
- ▶ **Must be reported on employee's W2 form**

✓ EDUCATIONAL ASSISTANCE PLAN EXCLUSION

- ▶ **Extended to apply to courses beginning before Jan 1,2002**
- ▶ Employer may exclude first \$5,250 of qualified educational assistance paid for employee
- ▶ **Graduate courses:**
1991-1996 graduate courses included as part of the program.
1997-2001 - program does **not** include graduate courses.
Beginning in 2002 program includes graduate courses.

✓ QUALIFIED TUITION REDUCTIONS

- ▶ Non taxable
- ▶ Reduction in tuition for education below graduate level furnished by an educational institution to employee.

FRINGE BENEFITS

✓ **EMPLOYER PROVIDED TRANSPORTATION EXCLUSION**

- ▶ Qualified transportation fringe benefit (value of)
 - Commuter highway vehicle (i.e.-van) between home and work place
 - Transit pass
 - Qualified parking

- ▶ Cash reimbursement by employer for these expenses is also excludable **if** under bona fide reimbursement plan.
 - Transit pass - cash only if voucher of similar item that can be exchanged only for a transit pass is not readily available for direct distribution to employee
 - Commuter highway vehicle transportation and transit pass at maximum of \$120 per month for January and February 2009. And \$230/Mo for March through December 2009 &all of 2010.

- ▶ Qualified parking maximum of \$230 per month

- ▶ **Benefits in excess of limits must be included in employee income.**

Commuter highway vehicle

Must seat at least six adults (not including driver)
At least 80% of vehicles mileage must reasonably be expected to be for transporting employees between home and work and on trips which employees occupy at least half of the vehicle's seating capacity.

Qualified parking

At or near employer's place of business

On or near a location from which employee commutes to work from in commuter vehicle

Does not include parking at or near employee's home.

FRINGE BENEFITS

✓ **EXECUTIVE HEALTH PROGRAM**

- ▶ Value is TAXABLE

✓ **FINANCIAL COUNSELING FEES PAID BY EMPLOYER**

- ▶ Taxable to employee

✓ **MEDICAL INSURANCE PREMIUMS**

- ▶ Paid for employee, spouse, dependents by employer (former employer if retired) are **non** taxable.
- ▶ Paid by employer after employee's death for spouse/dependents **non** taxable
- ▶ Considered an employee during layoff periods for this benefit.

Exception:

If CHOICE when retire to receive medical insurance or lump sum payment - must include lump sum or premium in income when received.(Deduct as medical insurance premiums as itemized deduction)

✓ **ARCHER MEDICAL SAVINGS ACCOUNTS**

- ▶ Contribution by employer are **not** included in income but must be reported on W2 form Box 12, Code R. Must be reported on the tax return.

✓ **LONG TERM CARE COVERAGE**

- ▶ Contributions by employer generally not included in income.
- ▶ If under flexible spending or cafeteria plan **must** include in income as wages

FRINGE BENEFITS

✓ **ADOPTION ASSISTANCE**

- ▶ Amounts paid or expenses incurred by employer in connection with adoption of eligible child under 18. 2010 Amount is \$12,150.
- ▶ Amount excludable from wages is reduced if the employee's modified adjusted gross income is more than \$182,520 for 2010. Limited to \$222,520 for 2010.
- ▶ Reportable on W2 box 12, Code T and subject to SS and Medicare tax
- ▶ Must file form 8839 with tax return

✓ **RETIREMENT PLAN CONTRIBUTIONS**

- ▶ Taxable for amounts paid into plan through payroll deductions
- ▶ Employer's contributions to qualified plan are not included in income at time contributed.
- ▶ Cost of life insurance included in plan may be taxable
- ▶ **Elective deferrals (401k)**
Treated as employer contribution to qualified plan
Subject to limits
Subject to Social Security and Medicare tax
Federal employees - applies to contributions to Thrift Savings Plan
- ▶ Employer's contributions to non qualified plan generally taxable as wages unless substantial risk of forfeiture.

✓ **ELECTIVE DEFERRALS LIMITS**

For 2009 & 2010 & 2011 = \$16,500. (\$5,500. For age 50 and over)
Simple Plans - \$11,500. (Plus \$2,500 for age 50 and over)
Excess must be included in income

INCOME- MISCELLANEOUS

BABYSITTING

Babysitting for relatives or neighborhood children, whether on a regular basis or periodically - child care provider rules apply.

Income is taxable

S E tax applicable

If required to be classified as an employee - reportable on W2 as wages

SICK PAY

Amounts received from employer are part of salary. Including:

Amounts paid by employer

Paid by welfare fund

Paid by a state sickness or disability fund

Paid by association of employers or employees

Paid by insurance company *if employer paid for the plan*

If premiums paid by **taxpayer** - benefits are not taxable

If covered by insurance through cafeteria plan and premiums were not included in taxable income, **not** considered to have paid the premiums and must include benefits in income.

Railroad Sick Pay

Taxable unless for on the job injury

JURY DUTY

Taxable

If required to give jury duty payments to employer because employer continues to pay salary, can deduct amount paid to employer from **AGI** {this is **not** an itemized deduction.}

INCOME- MISCELLANEOUS

COURT AWARDS AND DAMAGES

Taxable:

- ✓ Interest on any award
- ✓ Compensation for lost wages or lost profits in most cases
- ✓ Punitive damages
Regardless of if they relate to physical injury or sickness
- ✓ Amounts received in settlement of pension rights (if taxpayer did not contribute to plan)
- ✓ Damages for:
 - ▶ Patent or copyright infringement
 - ▶ Breach of contract
 - ▶ Interference with business operations
- ✓ Back pay and damages for emotional distress received to satisfy a claim under Civil Rights Act.

Non - Taxable:

- ✓ Compensatory damages for personal physical injury or sickness
- ✓ Damages received for emotional distress due to physical injury or sickness are included in non taxable

CREDIT CARD INSURANCE

Benefits received under a credit card disability or unemployment insurance plan are generally taxable.

Benefits - Payment of minimum monthly payment on account

Taxable on page 1 of Form 1040 to extent benefits received during the year exceed premiums paid **during the year**

INCOME- MISCELLANEOUS

PULITZER, NOBEL, SIMILAR PRIZES

In recognition of past accomplishments - generally taxable

- ✓ Religious
- ✓ Charitable
- ✓ Scientific
- ✓ Artistic
- ✓ Educational
- ✓ Literary
- ✓ Civic

Not taxable if meet ALL of requirements

- ✓ Selected without any action on taxpayer's part to enter the contest
- ✓ Taxpayer not required to perform substantial future services as a condition to receiving the prize or award
- ✓ Prize or award is transferred by the **payer** direct to a governmental organization or tax exempt charitable organization as designated by recipient.

STATE TUITION PROGRAMS

Payments received taxable only to extent they exceed amount contributed to the program.

BARTERING

Exchange of property or services
Included in income at FMV when received
Barter exchange club- taxable when received regardless of when used.

INCOME- MISCELLANEOUS

CANCELLED DEBT

If not a gift or bequest, - taxable income
Non business bad debt - form 1040
Business bad debt - Schedule C

Interest included in canceled debt

If would not be deductible (personal interest) included in income.

If **would** be deductible (business loan) include **net** amount of canceled debt in income

Discounted mortgage loan

Discount offered for early payment of mortgage loan - canceled debt
Must include discount (canceled amount) in income

Stockholder debt

Canceled debt is **dividend** income

Excluded debt

Not a taxable canceled debt if:

- ✓ Canceled in bankruptcy under title 11
- ✓ Canceled while insolvent to extent of insolvency
- ✓ Debt is qualified farm debt and is canceled by qualified person
- ✓ Debt is qualified real property business debt

INCOME- MISCELLANEOUS

CANCELED DEBT

Exceptions to inclusion of canceled debt in income.

- ✓ **Nonrecourse debt** - may have gain or loss if debt is canceled or forgiven in conjunction with foreclosure or repossession of property to which the debt attaches
- ✓ **Student loans**
No canceled debt if provision that all or part of debt incurred to attend qualified educational institution is canceled if student works for a certain period of time in certain professions for any of a broad class of employers. No canceled debt if agreed to this provision and then performed the services required.
Loan must have been made by:
 - ▶ Federal, State, or local government, or an instrumentality, agency, or subdivision thereof.
 - ▶ Tax exempt public benefit corporation that has assumed control of a state, county, or municipal hospital, and whose employees are considered public employees under state law.
 - ▶ An educational institution that meets certain qualifications**Refinance student loan**
 - ▶ Will qualify as an exception to canceled debt if it was made by an educational institution or a tax exempt 501(c)3 organization under its program designed as part of a program to encourage students to serve in occupations or areas with unmet needs and under which the services provided are for or under the direction of a governmental unit or a tax exempt section 501(c)(3) organization.
- ✓ **Deductible debt**
Not income from cancellation of debt if payment of debt would be deductible. (Applicable only if cash basis taxpayer)
- ✓ **Price reduced after purchase**
Generally **not** income - reduces basis instead

RECOVERIES

TAX BENEFIT RULE

Include in income in year received
To the extent the deduction for the recovered amount reduced tax in earlier year

FEDERAL INCOME TAX

Refunds not included in income because never allowed as a deduction
(For STATE purposes, this may not be the case if federal tax deduction was allowed)

TAXABLE REFUNDS AND RECOVERIES (to extent of tax benefit)

**State income tax refunds, Property tax refunds,
Mortgage interest refunds and Medical expense reimbursement**

INTEREST ON ANY KIND OF RECOVERY IS TAXABLE

RECOVERY AND EXPENSE IN SAME YEAR

Recovery reduces expense or credit and is not included in income

RECOVERY FOR 2 OR MORE YEARS

Must allocate to determine if tax benefit

STANDARD DEDUCTION LIMIT

Only itemized deductions that are more than standard deduction are subject to recovery
(Except if required to itemize)

If total deductions on earlier year return were not more than income for that year,
include in year of refund, the **smaller of**

Recovery

Amount by which itemized deductions exceeded the standard deduction

Recovery limited to deduction - include in income **smaller of**

Amount deducted on Schedule A or

Amount recovered.

FOREIGN EMPLOYER

Foreign government

International organization

Foreign embassy

Any foreign employer)

U. S. CITIZEN

Wages are taxable

Employed in US by international organization or foreign government or qualifying wholly-owned instrumentality of a foreign government

Exempt from social security and medicare employee tax

Must pay S.E. tax on earnings performed in the U.S.

NON U.S. CITIZEN (Or U.S. Citizen **and** citizen of the Philippines)

Employer is international organization

Salary exempt from tax

Employer is foreign government and work in the United States

Salary exempt *if* work is like work done by employees of the U.S. in that foreign country and the foreign country gives an equal exemption to employees of the U.S.

DIFFERENT RULES APPLY FOR EMPLOYMENT ABROAD - SEE FOREIGN INCOME EXCLUSION

INCOME EARNED ABROAD

FOREIGN INCOME EXCLUSION

- ✓ Total exclusion can not exceed foreign earned income
- ✓ Qualified individual:
 - ▶ Tax home in foreign country
 - ▶ U. S. Citizen
 - ▶ Bonafide resident of foreign country for **entire** taxable year
 - OR**
 - ▶ Present in foreign country for 330 days in any 12 consecutive month period
- ▶ First **\$82,400** **of EARNED income attributable to presence in a foreign country excludable from taxable income (\$91,500 if **both** spouses **work** abroad and **each** meets the bona fide residence or physical presence test.
- ▶ Housing exclusion: May also deduct excess housing expenses over a base housing amount (16% of salary of GS-14 step 1 U. S. Government employee figured on a daily basis.)

Form 2555 or 2555(EZ)

TIPS

ALL TIPS ARE TAXABLE

Received direct from customers

Charge customers tips paid to employee by employer

Share of tip-splitting agreements

Value of noncash tips, such as tickets, passes, or other items

TIPS OVER \$20 PER MONTH

From any one employer

Subject to withholding **and** social security tax

Value of noncash tips are not subject to social security and medicare tax

REPORTING TIPS

Along with wages on tax return

To employer:

Not required to report to employer if less than \$20 per month

If \$20 or more - report to employer by 10th of next month

Do not report non cash tips

Failure to report without reasonable cause

Penalty 50% of social security and medicare tax owed

WHEN TAXABLE

If reported to employer, taxable **when reported**

If not reported, taxable **when received**

TIP ALLOCATION REQUIREMENTS

Large food and beverage establishments are required to allocate tips based on sales

Tip allocation may be added to gross income unless taxpayer can prove (by records) a lesser amount. IRS may determine that a larger amount was received than the tip allocation.

DISABILITY PENSIONS

Generally -taxable as compensation income (wages) until minimum retirement age is reached.

Military and Government DISABILITY Pensions

Exclusion from income -service connected disability income

From:

- Armed Forces of any country
- National Oceanic and Atmospheric Administration
- Public Health Service
- Foreign Service

If any of following conditions apply

- Entitled to receive disability payment before 9-25-75
- Were a member of a listed government service or its reserve component, or were under a binding written commitment to become a member, on 9-24-75
- Receive the disability payments for a combat-related injury.
 - results directly from armed conflict
 - takes place while engaged in extra-hazardous service
 - takes place under conditions simulating war, including training exercises such as maneuvers, or
 - caused by an instrumentality of war.
- You would be entitled to receive disability compensation from the Dept of Veterans Affairs if you filed for it. (Exclusion equal to the amount would be entitled to receive from VA)

Disability pensions based on years of service

Generally - taxable

If from active service in one of the government services and the above conditions apply, the part of the pension that would have been received if it had been based on percentage of disability is not taxable.

Retroactive VA determination

If retire based on years of service and are later given retroactive service-connected disability rating by VA, retirement pay for the retroactive period is excluded from income up to the amount of VA disability benefits you would have been entitled to receive.

Amend open years for refund.

HOBBY INCOME

DEFINITION OF HOBBY - An activity **not** engaged in for profit

HOBBY REPORTING RULES

May **not** use losses to offset income from other sources.

Income reported as misc income on form 1040

Deductions allowed only as **itemized** deductions in following order:

- Interest, taxes, and other items deductible whether or not business related
- Operating expenses to extent gross income exceeds item (a)
- Depreciation and other basis adjustments only to extent gross income exceeds (a) and (b).

PROFIT PRESUMPTION

Presumed to have been for profit (and therefore not a hobby) if profit results in 3 of 5 CONSECUTIVE years.

POSTPONING DETERMINATION OF PROFIT

In an activity that has operated less than 3 years - may postpone determination of profit presumption by filing form 5213

INCOME

UNEMPLOYMENT

ALL UNEMPLOYMENT IS TAXABLE, INCLUDING

- Amounts received under unemployment compensation law of U.S. or State
- Amounts received from state or District of Columbia from Federal Unemployment
- Railroad unemployment compensation benefits
- Disability payments under government program if because of a disability but instead of unemployment (but not Workmans Compensation benefits)
 - ▶ Trade re-adjustment allowances
 - ▶ Disaster Relief Act compensation
- Benefits paid by union out or regular union dues.

EXCLUDING: **Beginning in 2009 the taxpayer may exclude the first \$2,400.**

SUPPLEMENTAL UNEMPLOYMENT BENEFITS

From company - financed fund (employees did not contribute to the plan)

Not unemployment

Fully taxable as **wages**

PRIVATE UNEMPLOYMENT FUND

To which employee voluntarily contributes are **not** taxable until receipts exceed payments into fund.

GUARANTEED ANNUAL WAGE

During periods of unemployment are **wages**, not unemployment

INCOME

UNEMPLOYMENT

REPAYMENT OF UNEMPLOYMENT COMPENSATION BENEFITS

If received and repaid in SAME year, report net difference and enter "Repaid" on dotted line next to 19 of form 1040 or related line on 1040A

Repayments for a prior year TO QUALIFY FOR TRADE READJUSTMENT ALLOWANCES may be deducted from AGI on form 1040.

Can not use form 1040A or 1040EZ.

Include repayment on line 32 of 1040 and put "Sub-Pay TRA" and the amount on dotted line next to line 32

REPAYMENT (IF NOT QUALIFIED FOR ABOVE)

If repaid in same year - deduct repayment on 1040, 1040A or 1040EZ
Enter "Repaid" and amount on dotted line

If repaid in subsequent year - deductible only as itemized deduction on Schedule A subject to 2% limits.

REPAYMENT OF AMOUNTS OVER \$3,000 - May elect to deduct per above OR take a credit against tax.

1. Figure tax on current year claiming a deduction for the repayment
2. Figure tax on current year without deducting the repayment
3. Re-figure tax from earlier year without including in income the amount of repayment
4. Subtract tax in #3 from tax shown on return for earlier year
5. Subtract answer in #4 from tax for current year figured without the deduction for the repayment in #2

If step one is less tax, deduct the amount repaid on the same form or schedule that the income was previously reported.

If step 2-5 tax is less, claim the credit on form 1040. Write in "I.R.C.".

SOCIAL SECURITY AND RR BENEFITS
RECIPIENTS OF FULL RETIREMENT AGE

If you do not retire until you are of full retirement age as defined by the Social Security Administration, you will no longer be limited to the amount of income you earn.

Full retirement age is scheduled to be:

| Year Born | Full Benefit Age | Year Born | Full Benefit Age |
|------------------|-------------------------|------------------|-------------------------|
| 1937 & prior | 65 years | 1955 | 66 yrs & 2 mos |
| 1938 | 65 yrs, 2 mos | 1956 | 66 yrs & 4 mos |
| 1939 | 65 yrs, 4 mos | 1957 | 66 yrs & 6 mos |
| 1940 | 65 yrs, 6 mos | 1958 | 66 yrs & 8 mos |
| 1941 | 65 yrs, 8 mos | 1959 | 66 yrs & 10 mos |
| 1942 | 65 yrs, 10 mos | 1960 and beyond | 67 yrs |
| 1943 - 1954 | 66 yrs | | |

If you reach full retirement age during 2006, you can earn up to \$12,480
2007 is \$12,960 2008 is \$13,560 2009 & 2010 is \$14,160
in the months prior to reaching full retirement age.

After full retirement age there is no limit. - YEA!!!

SOCIAL SECURITY AND R R BENEFITS
RECIPIENTS NOT OF FULL RETIREMENT AGE

SOCIAL SECURITY AND TIER I EQUIVALENT MAY BE TAXABLE

Dependent upon other income and filing status

Can elect to have federal income tax withheld from benefits

DOES NOT INCLUDE SUPPLEMENTAL SOC. SEC. (SSI) BENEFITS

DOES INCLUDE MONTHLY SURVIVOR AND DISABILITY BENEFITS

TAXABLE AMOUNT:

LESSER OF:

1. One half of net benefits received
or 2. One half of the amount by which MODIFIED AGI
PLUS one half of net benefits exceeds **specified base** amounts

MODIFIED A G I

Sum of **tax exempt** interest

PLUS

Other AGI income **without** Soc. Sec. Or R. R. Tier 1 benefits

Without regard to

- Foreign earned income exclusion and housing exclusion deduction
- Exclusion of income from U. S. possessions
- Exclusion of income from American Samoa or Puerto Rico
by bona fide residents
- **Employer-provided adoption benefits**

BASE AMOUNTS

If income plus half social security benefits exceeds the following:

\$25,000 Single Filing Status

\$25,000 Married and do not file joint **AND** did **NOT** live with
Spouse at **ANY TIME** during tax year

\$32,000 Married filing Joint Filing Status

Then up to 50% of the benefits will be taxable

See next page and following page for adjusted base amounts for higher income taxpayers

- 0- Married filing separate and **DID** live with spouse at **any time** in tax year:
Lesser of 85% of Social Security or 85% of provisional income.
(See Next Page and Following Page.)

FIGURING YOUR TAXABLE BENEFITS

Before you begin: Is your Filing Status Married Filing Separately?

NO: Go to line 1 below

YES: Did you live apart from your spouse all year?

NO: Go to line 1 below

YES: Do the following if you file:

Form 1040: Enter 'D' to the right of the word 'benefits' on line 20a, & 1 below.

Form 1040A: Enter 'D' to the right of the word 'benefits' on line 14a, & 1 below.

1. Enter the total amount from box 5 of ALL your forms SSA-1099 and RRB-1099.....1. _____
 Note: If line 1 is ZERO or LESS Stop here. None of your benefits are taxable. Otherwise, go to line 2.
2. Enter one-half of line 1.....2. _____
3. Enter the total of the amounts from:
 - Form 1040: lines: 7, 8a, 9a, 10-14, 15b, 16b, 17-19 and 21
 - Form 1040A: lines: 7, 8a, 9a, 10, 11b, 12b, and 13.....3. _____
4. Enter the amount, if any, from Form 1040 or 1040A, line 8b.....4. _____
5. Form 1040 filers: Enter the total of any exclusions/adjustments for:
 - ^ Qualified U.S.Savings Bonds Interest (Form 8815, line 14)
 - ^ Adoption benefits (Form 8839, line 30)
 - ^ Foreign earned income or housing (Form 2555, lines 43 and 48, or Form 2555-EZ, line 18) and
 - ^ Certain income of bona fide residents of American Samoa (Form 4563, line 15) or Puerto Rico
 Form 1040A filers: Enter the total of any exclusions for:
 - ^ Qualified U.S. Savings bond interest (Form 8815, line 14)
 - ^ Adoption benefits (Form 8839, line 30).....5. _____
6. Add lines 2, 3, 4 and 5.....6. _____
7. Form 1040 filers: Enter amounts on Form 1040, lines 23 through 32, & any write in amounts from dotted line next to line 36
 Form 1040A filers: Enter amounts on Form 1040A, lines 16 and 17.....7. _____
8. Is the amount on line 7 less than the amount on line 6?
 NO: 'STOP', NONE of your Social Security benefits are taxable.
 YES: Subtract line 6 from line 5.....8. _____
9. If you are:
 - ^ Married filing jointly, enter \$32,000
 - ^ Single, Head of Household, Qualifying Widow/er, or Married Filing Separately and you lived apart from your Spouse for all of the year, enter \$25,000.....9. _____
 NOTE: If you are married filing separately and you lived with your spouse at any time in the year, skip lines 9 through 16
 Multiply line 8 by 85% (.85) and enter the result on line 17. Then go to line 18.
10. Is the amount on line 8 less than the amount on line 7?
 NO: 'STOP' None of your benefits are taxable. Do not enter any amounts on Form 1040, line 20b, or on Form 1040A, line 14b. But if you are Married Filing Separately and you lived apart from your spouse for all of the year, enter D to the right of the words 'Benefits' on Form 1040, line 20a, or on Form 1040A, line 14a.
 YES: Subtract line 9 from line 8.....10. _____
11. Enter \$12,000. If Married Filing Jointly, \$9,000 if Single, Head of Household, Qualifying Widow/er, or Married Filing Separately and you lived apart from your spouse for all of the year.....11. _____
12. Subtract line 11 from line 10. If zero or less, enter -0-.....12. _____
13. Enter the smaller of line 10 or line 11.....13. _____
14. Enter one-half of line 13.....14. _____
15. Enter the smaller of line 2 or line 14.....15. _____
16. Multiply line 12 by 85% (.85), if line 11 is zero, enter -0-.....16. _____
17. Add lines 15 and 16.....17. _____
18. Multiply line 1 by 85% (.85).....18. _____
19. Taxable benefits. Enter the smaller of line 17 or line 18.....19. _____
 - ^ Enter the amount from line 1 above on Form 1040, line 20a, or on Form 1040A, line 14a.
 - ^ Enter the amount from line 19 above on Form 1040, line 20b, or on Form 1040A, line 14b

NOTE: If you received a lump-sum payment in this year that was for an earlier year, it may be treated differently.

SOCIAL SECURITY AND R R BENEFITS
RECIPIENTS NOT OF FULL RETIREMENT AGE

ADJUSTED BASE AMOUNTS FOR HIGHER INCOME TAXPAYERS

If income PLUS one half of social security benefits is more than the following:

| | |
|---|----------|
| Single, Head of Household, Qualif. Widow(er) Status | \$34,000 |
| Married filing joint | \$44,000 |
| Married filing Separate AND lived apart ALL year..... | \$34,000 |
| Married filing separate and lived with spouse at ANY time | -0- |

For above threshold taxpayers, gross income includes **lesser** of:

- 1) **85%** of taxpayers Soc. Sec. Or RR tier 1
- or 2) the **sum** of
 - a) The smallest of
 - (i) amount included under present law
 - or (ii) \$4,500 single/\$6,000 joint
 - plus**
 - b) **85%** of excess of provisional income over applicable second tier threshold amounts.

Married filing separate gross income includes **lesser** of

85% of social security or RR tier 1 or 85% of taxpayers provisional income

SEE WORKSHEET ON PREVIOUS PAGE

CHILD'S SOCIAL SECURITY

If child receives soc. Sec. But check is made out to parent, the child's portion is **not** included in computing parents taxable social security. Support Test?

REPAYMENTS OF SOCIAL SECURITY

Subtract from **current** year benefits (not amended return)

If result is negative amount, possible itemized Sch. A. deduction or credit computed in same manner as unemployment repayments method previously shown.

Subject to 2% AGI limits if negative amount is less than \$3,000

If over \$3,000 deduction is **not** limited to 2% and **may** be eligible for a credit

LUMP SUM PAYMENTS RECEIVED FOR PRIOR YEARS (From SSA Form)

Generally included in income in the year received

Option - spread over prior years (See IRS Publication 915)

ARMED FORCES

| <u>FEDERAL TAXABLE</u> | <u>FEDERAL NON TAXABLE</u> |
|--|--|
| Active Duty Pay | Subsistence |
| Reserve Training | Uniforms and Housing |
| Re-enlistment bonus | Move to extent of expense |
| Naval Aviation College | Family separation allowances |
| ROTC instructor pay | Life insurance benefits |
| Separation pay (self) | Death gratuity/burial services |
| Retirement pay based on length of service / age | Dependent education |
| Academy Pay | Forfeited pay |
| Student loan repayments from General Education Loan repayment program | Disability benefits |
| Hostile Fire Pay | Defense and Family counseling |
| | Mustering out pay |
| | Dependent education and Annual round trip |
| | Medical and Dental benefits |
| | Educational assistance |
| | Emergency assistance |
| | Evacuation allowances |
| | <i>Overseas cost living allowances**</i> |
| | if stationed in Alaska, Hawaii or outside U.S. |
| | Travel (including dependents) for special tour duty |
| <p>**Allowances and differentials that increase basic pay as an incentive for taking a less desirable post of duty are taxable. (Includes Foreign Post, Foreign Service, and Overseas Tropical differentials)</p> <p><u>COMBAT PAY IS NEVER TAXABLE</u></p> | |

VETERANS PAY

| <u>TAXABLE</u> | <u>NON TAXABLE</u> |
|---|--|
| <p>Payments to hospital patients for services (Rehabilitative program payments)</p> | <p>Education</p> <p>Disability compensation</p> <p>Wheelchair allowances</p> <p>Special motor vehicle grants</p> <p>Pension to vet/family</p> <p>Insurance proceeds / dividends</p> <p>Endowment insurance paid Pre-death</p> <p>Interest on insurance dividends left on deposit with VA</p> |

ACTION VOLUNTEERS

| <u>TAXABLE</u> | <u>NON TAXABLE</u> |
|--|--|
| <p><u>PEACE CORPS</u></p> <p>Allowances to <u>spouse</u> and <u>dependents</u> while training in US</p> <p>Allowances for personal items</p> <p>Leave allowances</p> <p>Readjustment allowances (termination)</p> <p>University year for action program stipend.</p> <p><u>VISTA</u></p> <p>Meals and lodging allowances</p> | <p><u>PEACE CORPS</u></p> <p>Travel and living allowances for the <u>volunteer</u></p> <p>Allowances for <u>basic</u> necessities (Housing, Food, Clothing)</p> <p><u>VISTA</u></p> <p>All other</p> |

OTHER VOLUNTEER PROGRAMS

Amounts received from supportive services or out of pocket reimbursements for the following are **not** taxable.

- ◆ Retired Senior Volunteer Program (RSVP)
- ◆ Foster Grandparents program.
- ◆ Senior Companion Program
- ◆ Service Corps of Retired Executives (SCORE)
- ◆ Active Corps of Executives (ACE)
- ◆ Volunteer Counseling for the Elderly
- ◆ Reimbursements for transportation, meals and other expenses in training for or actually providing volunteer **federal** income tax counseling for the elderly. (TCE)

UN-reimbursed out of pocket expenses are CHARITABLE deduction.

CLERGY

TAXABLE CLERGY INCOME

Salaries - reported as wages

Honorariums - offerings, fees for marriages, funerals, etc. - Sch. C

Except: If the honorarium is paid to the religious institution, not taxable to the clergyman

Outside earnings turned over to organization - taxable to clergyman and deductible as a contribution.

NON TAXABLE CLERGY INCOME- HOUSING ALLOWANCE

Must be ordained, licensed, or commissioned (includes retired, but not spouse)

- ✓ Rental value of home that is furnished to clergy
- ✓ **Specified** rental **allowance** received (**home owned by clergy or rented**)
 - ▶ to extent **used** to provide home and utilities
 - ▶ must be **specifically designated** by organization

Used to provide home and utilities includes

- ✓ Rent
- ✓ Furniture payments
- ✓ Garage expenses
- ✓ Utilities
- ✓ House payments **including down payment**, interest, mortgage payment, taxes and repairs.

Limited to fair rental value of home, including fair rental value of furnishings, plus cost of utilities.

CAUTION

This means that the specified **allowance received** can be non taxable. It does **not** mean that expenses are deductible if no allowance is received. (Rent, furniture payments, garage expense utilities and principal portion of house payment and repairs are not otherwise deductible)

CLERGY

CLERGY -HOMEOWNERS

Can deduct interest and taxes on Schedule A **even if** use nontaxable housing allowance to pay them with.

SELF EMPLOYMENT TAX

The rental value or rental allowance **is** subject to S. E. tax and must be added to other self employment income on Schedule SE (not Schedule C)

SPECIAL RULES

Members of religious orders who take vow of poverty and turn over all funds to the order.

- ✓ Services performed for the order
Amounts turned over to the order are not included in taxpayer's income
If order directs performance of services for another agency of the supervising church or associated institution, considered to be performing the services as an agent of the order.
- ✓ Services performed outside the order
If directed to work outside the order, work does not constitute exercise of duties required by the order unless meet **both** of following tests
 - ▶ Services are the kind that are ordinarily the duties of members of the order and
 - ▶ Services are part of duties that must be exercised for, or on behalf of, the religious order as its agent.If employee of a third party, services will not be considered directed or required of you by the order. - Amounts received are taxable income, even if taxpayer has taken a vow of poverty.

TEACHERS OR ADMINISTRATORS

Employed by church school, college, or university - considered performing ministerial duties for purpose of housing exclusion.

If **non** church college or school and specific duties involve no religious functions, can **not** exclude housing allowance.

THEOLOGICAL STUDENTS

Can **not** exclude housing allowance unless ordained, commissioned, licensed minister.

TRAVELING EVANGELISTS

Can exclude amounts received from out of town churches for evangelistic services that are designated as a housing allowance and **actually used** to maintain **permanent** home **and** if ordained.

CLERGY

RETIRED MEMBERS OF CLERGY

Rental value of home provided rent free by church for past services is **not income** if retired minister. Housing allowance is **not** income **to extent used** for utilities, maintenance, repairs and similar expenses that are directly related to providing a home.
Not included in net earnings for self employment

General convention of national religious denomination can designate a housing allowance for retired ministers, if the local congregations authorize the general convention to establish and maintain a unified pension system for all retired clergy members of the denomination for their past services to local churches.

SURVIVING SPOUSE OF RETIRED MINISTER

Can **not** exclude a housing allowance from income.
Reportable as pension on form 1040.

INTEREST INCOME

TAX EXEMPT INTEREST MUST BE SHOWN ON TAX RETURN

IN GENERAL - Interest income is taxable if received or credited to account.

FEDERAL TAXABLE

Bank accounts
Loans and Notes
Bonds (Except State/Local)
Bldg and Loan Associations
Savings and Loan Associations
Credit Unions
U S Savings Bonds (see specific section)
*U.S. Treasury bonds/ Notes
*U.S. "T" Bills
FMV of gifts for opening savings accounts
Interest on condemnation award
Arbitrage bond interest
Industrial development bond
Original issue discounts
Bearer bond interest
Wrap around interest
Interest on tax refunds
Money market certificates
Deferred payment contracts
Interest received as beneficiary of estate
Interest on insurance dividends that
 can be withdrawn annually
Interest on life insurance proceeds received in
 installments
Usurious interest (interest charged at illegal rate)
 *T Bills: Interest (discount) taxable at **maturity**
 *Treasury notes and bonds taxable **when received**
Foreign Source Interest Income

FEDERAL NON TAXABLE

Interest on **state, local, political**
 subdivision obligations
Money Market Funds
Interest income on IRA until withdrawn

Interest on VA insurance dividends
 left on deposit for 1991 and after

INCOME

INTEREST

LIFE INSURANCE INTEREST FOR SURVIVING SPOUSE

Pre 86 TRA \$1,000 per year for surviving spouse on life insurance if received in installments (not affected by remarriage) was **non taxable**

86 TRA repealed this exclusion *with respect to deaths occurring after enactment date.*

Payments being received for deaths prior to 10-23-86 are **still excluded**

BACKUP WITHHOLDING REQUIREMENTS:

If no certification or social security number, payer is required to withhold 30% tax on interest income.

DIVIDENDS THAT ARE ACTUALLY INTEREST

Cooperative banks
Domestic Building and Loan Associations
Domestic Savings and Loan Associations
Federal Savings and Loan Associations
CREDIT UNIONS
Mutual savings banks

PENALTY FOR EARLY WITHDRAWAL

Total interest shown on 1099 form must be reported in **full** (not netted)
Early withdrawal penalty is deducted as an adjustment to income on form 1040.

BONDS SOLD BETWEEN INTEREST DATES

Part of the sales price is taxable as interest.

SAVINGS ACCOUNT WITH PARENT AS TRUSTEE

Taxable to **child** if:

- ✓ Legally belongs to child
- and ✓ Parents are not legally permitted to use any of the funds to support the child.

INCOME

INTEREST

NOMINEE INTEREST

If 1099 INT is received which includes interest belonging to another person

3. Show **full** amount on schedule “B”
4. Show amount separately below a subtotal of all interest income that belongs to another party and **subtract** it on Schedule B
5. Issue a 1099 INT to the other party (and to IRS along with form 1096)

INTEREST INCOME ON FROZEN DEPOSITS

Definition: Interest credited on deposits that **could not** be withdrawn by year end due to bankruptcy or insolvency of the financial institution or limited withdrawal by state.

Exclusion election:

May elect to exclude from income:

The amounts credited to the account on frozen deposits

Minus the **sum of:**

- Plus**
- a) net amount withdrawn during the year
 - b) amount available for withdrawal by year end (not reduced by early withdrawal penalties)

MONEY MARKET FUNDS (MUTUAL FUNDS)

Generally, income from money market funds are **dividends**, not interest

MONEY MARKET CERTIFICATES

If interest is paid in fixed intervals of one year or less -taxable as **interest income**.

Money borrowed to invest in money market certificates:

Interest **paid** on such loans is deductible **only as investment interest** and can not be “netted” against the interest income from certificates.

INCOME

INTEREST

SECOND TRUST NOTES - DISCOUNT INCOME

Trust notes **bought at a discount** usually consist of:

- ▶ Interest as stated in terms of note - Taxable as **interest** income
- ▶ Return of capital which is **non** taxable
- ▶ Discount income - taxable as **interest**

BOND PREMIUM

Amortizable bond premium (after 12-31-87) is treated as an **offset** to interest income rather than as an interest **deduction**. Basis reduction required.

INTEREST ON SELLER FINANCE MORTGAGE IF BUYER USES FOR PERSONAL RESIDENCE

Must show buyers **name, address, and social security number** on **Schedule B**. Buyer and seller must exchange Soc. Sec numbers.

ORIGINAL ISSUE DISCOUNT

A form of interest

Included in income as accrues over term of debt instrument whether or not receive funds

Generally OID occurs when debt instrument is issued for a price less than its stated redemption price at maturity.

Amount of OID is difference between purchase price and redemption price

All instruments that pay no interest before maturity are presumed to be issued at discount
OID rules generally do not apply to short term obligations (fixed maturity of one year or less)

Treat discount as zero if it is less than 1/4 of 1% of stated redemption price at maturity multiplied by number of full years from date of original issue to maturity.

INCOME

U S. BOND INTEREST

U S BOND INTEREST - SERIES E

May **elect** to report annually or at earliest of maturity or cash in date.

1952 AND PRIOR 'E' BONDS

Report **all** deferred interest at end of the 40th year for bonds issued before December 1965
Report **all** deferred interest at end of 30th year for bonds issued after November 1965.

U S BOND INTEREST SERIES EE

First issued in July 1980
Maturity at 30 years
Interest payable when bonds are redeemed

U S BOND INTEREST SERIES 'T'

First issued in 1998
Inflation -indexed issued at face amount
Maturity 30 years.
Interest payable at maturity

U S BOND INTEREST SERIES H OR HH

Interest is actually **paid** twice each year and is taxable when received.

TRANSFER OF OWNERSHIP E OR EE BONDS

If purchased **entirely with own funds** and re-issued in co-owner's name
or in beneficiary's name **alone** - interest is taxable to **transferee**
Bonds reissued in **own** name **alone** not taxable at time of transfer

EXCHANGE OF E OR EE BONDS FOR H OR HH BONDS

Can not exchange series I bonds for series HH bonds
Interest previously earned and deferred is taxable only to extent of cash received
at transfer.

INCOME

U S BOND INTEREST

CHANGE OF ELECTION FOR SERIES E OR EE

Does not require IRS permission

Year of change:

Report all interest accrued to date and not previously reported

Can change from deferred method to annual method but once elected to report annually can **not** change back.

Election affects any bonds owned and any future bonds purchased.

CASH IN BOND INTEREST PREVIOUSLY REPORTED

If cash in Series E and receive 1099 for **full** amount but have reported on annual basis, may adjust **income** reported and identify as U.S. Savings bond interest previously reported.

CO OWNERSHIP OF U S SAVINGS BONDS

Interest taxable to co owner who **bought** the bond (even if co-owner allowed to redeem and keep proceeds.)

If **jointly** owned bonds are **reissued** to each separately in the same proportion as original contribution to purchase price, **no** interest is taxable at time of re-issue if elected to defer previously.

TRANSFER OF U S BONDS TO TRUST (SERIES E)

If all rights of ownership given up at transfer, deferred income is taxable at transfer time.

INCOME
EDUCATIONAL SAVINGS BOND INTEREST EXCLUSION

U.S. Savings bonds used to finance **higher** education of
Taxpayer Spouse Dependent for whom you can claim an exemption
Must be issued after 12-31-89 to an individual who is age 24 or older

Modified AGI limits

Phaseout of exclusion when modified AGI exceeds phase out ranges:
(Joint & Qual Widow/er: \$98,400 - \$128,400; Single or H of H: \$65,600 - \$80,600)

Modified AGI - AGI per tax return modified by adding back:

- ▶ Foreign earned income exclusion
- ▶ Foreign housing exclusion or deduction
- ▶ Exclusion of income for bona fide residents of American Samoa
- ▶ Exclusion of income from Puerto Rico
- ▶ Exclusion for adoption assistance program
- ▶ Deductions for student loan interest.

Qualified expenses

Include contributions made to qualified state tuition program

Include contributions to and education IRA

Not for course/education involving sports, games, hobbies, other than as a part of a degree program.

Not expenses for room and board

Do not count expense used to claim Hope or Lifetime Learning Credit.

Net of scholarships etc - Reduce qualified expenses by:

- ▶ Qualified scholarships that are exempt from tax
- ▶ Any other nontaxable payments (other than gifts, bequests, or inheritances) received for educational expenses
 - ▶ Veterans educational assistance benefits
 - ▶ Benefits under a qualified state tuition program
 - ▶ Certain employer-provided educational assistance benefits

Educational institution:

Most public and non profit universities and colleges and certain vocational schools that are eligible to participate in student aid programs.

Joint return

If married, can qualify for the exclusion only if file joint return

Amount excludable

If total proceeds (interest and principal) from the bonds redeemed during the year are not more than qualified higher educational expenses for year - full amount of interest is excludable

If proceeds are more than expenses - only part of interest is excludable

Multiply total interest by fraction OF:

Qualified higher education expenses **Divided by:** Total proceeds received (interest and principal)

INCOME

U S. BOND INTEREST

SERIES E BOND INTEREST - DECEDENTS

If **decedent** elected to defer interest reporting:

Interest earned **before** death:

1. Reported in full on final return of decedent in which case heirs only report, as income, interest earned **after** death.

Or

2. May be included in estate of deceased in which case heirs report **all** of interest earned (before and after death) on the **heirs** returns.
 - a. If **heirs** have chosen to defer all Series E interest, they may do so on inherited bonds also, until cashed or maturity.
 - b. Whether **heirs** elect to defer until maturity or cash - in date, or pay tax on interest in year of death and as earned thereafter; they must report **all** of the interest and then are allowed a **Deduction** (*) for the **estate** tax (Federal), if any, On the amount that was included in the estate of the deceased.

(*) Note: Estate tax deductions are **itemized** deductions. This is **not** a reduction of the interest income amount.

If reported under #1 above, and heirs receive 1099 for the **full** amount of interest earned (before and after death) in the year the bond is cashed or matures, they may adjust the **income** that is reported on their returns by the amount previously reported on the decedents return. This amount should be identified as “US Savings bond interest previously reported”.

INCOME

Who pays Tax on U. S. Savings Bond Interest

| <u>IF</u> | <u>Then</u> tax on the bond interest must be paid by |
|---|---|
| <hr/> <p>You use your funds to buy a bond in your name and the name of another person as co-owners</p> <hr/> | <hr/> <p style="text-align: center;"><u>You</u></p> <hr/> |
| <hr/> <p>You buy a bond in the name of another person who is the sole owner of the bond.</p> <hr/> | <hr/> <p>The person for whom you bought the bond</p> <hr/> |
| <hr/> <p>You and another person buy a bond as co-owners, each contributing part of the purchase price.</p> <hr/> | <hr/> <p>Both you and the other co - owner, in proportion to the amount each paid for the bond.</p> <hr/> |
| <hr/> <p>You and your spouse, who live in a community property state, buy a bond that is community property</p> <hr/> | <hr/> <p>You and your spouse. If you file separate returns, both you and your spouse generally pay tax on one half.</p> <hr/> |

INCOME DIVIDENDS

DIVIDENDS IN GENERAL

If total is over \$1500 must itemize on Schedule B, unless qualified dividends

QUALIFIED DIVIDENDS

Paid out of earnings and profits of a domestic corporation

Ordinary income whether common or preferred, if does not meet holding period

Includes:

Money Market Funds

Dividends on capital stock of savings and loan associations

Stock in two or more names:

Each person taxable share is determined by local law.

Schedule D Income if held 60 days in the 120 day period beginning 60 days before ex-dividend date. See Pub.550 if you receive dividends not reported on Form 1099DIV.

Eligible for the lower capital gain tax rate of 5% or 15%.

INCOME
DIVIDENDS

DIVIDEND REINVESTMENT PLAN

Allows taxpayer choice to use dividends to buy more shares of stock instead of receiving cash:

If plan allows purchase at FMV of stock, cash dividends are taxable
If plan allows purchase at LESS than FMV, FMV of stock is taxable.

CAPITAL GAIN DISTRIBUTIONS

Paid by regulated investment companies, mutual funds, and real estate investments trusts.

Reported as long term capital gains REGARDLESS OF HOLDING PERIOD

Capital Gain dividends must be reported on Schedule D.

REPORTING GAIN

| | |
|---|-------|
| FMV of old stock | _____ |
| FMV of stock dividend (cash) | _____ |
| FMV of old stock and stock dividend | _____ |
| | |
| Basis (cost) of old stock after the stock dividend (\$200/\$210 x \$100) | _____ |
| Basis (cost) of stock dividend (\$10/\$210 x \$100) | _____ |
| Total Basis | _____ |
| | |
| Cash received | _____ |
| Basis (cost) of stock dividend | _____ |
| <u>GAIN</u> | _____ |

INCOME DIVIDENDS

RETURN OF CAPITAL DIVIDENDS

Return of investment in the stock
Reduces basis in investment
Non taxable until basis is recovered in full

LIQUIDATING DISTRIBUTIONS

Non taxable until basis is recovered

STOCK DIVIDENDS AND STOCK RIGHTS

Generally non taxable

Taxable if:

- a) Any shareholder has choice to receive cash instead
- b) Any cash actually given to some shareholders
- c) Distribution is in convertible preferred stock and has same effect as in (b)
- d) Distribution gives common stock to some and preferred to others
- e) Distribution is on preferred stock (generally)

FRACTIONAL SHARES

Fractional shares are NOT dividends - they are SALE of stock

DIVIDENDS ON INSURANCE POLICIES

Return of premium
Non taxable until they are more than premiums paid.

PATRONAGE DIVIDENDS

Generally taxable
Non taxable if on property bought for personal use
Non taxable if on capital assets or depreciable property bought for use in business
- but basis reduced accordingly.

SCRIP DIVIDENDS

Scrip certificate that entitles to a fractional share generally nontaxable when received
If choose to have corporation sell certificate for you and give you proceeds-taxable
Gain is difference between proceeds and portion of basis in the stock that
is allocated to the certificate.
If redeem certificate for cash instead of stock - taxable at fair market value when received

EXPENSES RELATED TO DIVIDEND INCOME

Deductible only if itemized on Schedule "A"

INCOME

ROYALTY INCOME

Royalty income is income from:

- Copyrights
- Patents
- Oil
- Gas
- Other mineral property

Royalty income is reported as ordinary income on Schedule E

Copyrights and patents

Basis is recovered through depreciation over life of the copyright/patent

Worthless before expiration - deduct unrecovered cost/basis in year worthless

BASIS - includes stationery, supplies, travel, modes, legal

Oil, Gas, Minerals

Royalties based on number of units extracted of natural resources from property over a period of lease.

Depletion allowance method used for recovery of cost.

Coal and iron ore - Under certain circumstances treat amounts received from sale as from sale of capital asset instead of royalty income.

Considered a SALE, not a royalty, if give up rights to the property.

INCOME

FOSTER CARE PROVIDERS

EXEMPT INCOME

Payments received from **state, political subdivision or tax exempt child-placement agency** for providing care to qualified foster individuals in your home

Taxable if for care of more than 5 individuals

Taxable if difficulty of care payments

Qualified foster individual

Living in a foster family home

and Placed there by:

Agency of the state or one of its political subdivisions

or a tax exempt child placement agency

licensed by state or one of its political subdivisions

Difficulty of care payments

Additional payments designated as compensation for care for physically, mentally, or emotionally handicapped qualified individuals.

State must determine additional amount needed

Care must be provided in taxpayer's home

Must include in income such payments received for more than

10 qualified individuals

or 5 qualified individuals.

Payments to maintain space in home for emergency foster care - taxable

Taxable payments are subject to SE tax

INCOME

RENTAL INCOME

DEPRECIATION OF APPLIANCES ETC USED IN RENTAL ACTIVITY

Appliances, carpets, furniture, etc. used in rental real estate activity are classified as 5 year property.

Prior classified as 7 year property

Can choose to continue as 7 year property or change to base it on the property's classification as 5 year property.

ADVANCE RENT

Include in rental income in year received regardless of period covered or method of accounting

SECURITY DEPOSITS

Do not include in income when received if plan to return at end of lease.
If part of deposit is kept, include amount you keep in income for that year
If the amount is to be used as final payment of rent, it is advance rent, and must be included in income when received.

CANCELED LEASE PAYMENTS RECEIVED

Amount received is rent and taxable in year received.

EXPENSES PAID BY TENANT

Payments are rental income
May deduct as rental expenses if they are deductible.

PROPERTY OR SERVICES RECEIVED INSTEAD OF MONEY AS RENT

Include FMV of the property or services in rental income

INCOME

RENTAL INCOME

RENTAL OF PROPERTY ALSO USED AS A HOME

If rented for fewer than 15 days during the tax year, do not include rent in gross income.

Do not deduct rental expenses.

Include interest, taxes, and casualty and theft losses that are allowed on Sch. A