2024 Annual Federal Tax Refresher

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Contents

Introduction to the Course

Each year, various limits impacting income tax return preparation and tax planning are affected by inflation-related changes. In addition, various new tax laws may be passed. This course will examine many of those changes.

The *Annual Federal Tax Refresher* course is designed to meet the requirements of the IRS voluntary Annual Filing Season program. It discusses new tax law and recent updates for the upcoming filing season, provides a general tax review, and examines important rules governing tax return preparer ethics, practices and procedures.

In organizing this course, the term "domain" is used in place of the more common "chapter" to more closely follow the language of the IRS Annual Federal Tax Refresher course outline.

Course Learning Objectives

Upon completion of this course, you should be able to:

- Identify the principal individual income tax changes brought about by recent legislation;
- Apply the inflation-adjusted and other limits to the proper preparation of taxpayers' income tax returns;
- Recognize the federal income tax filing statuses and the criteria for their use;
- Identify the types of income that must be recognized;
- Apply the tax rules to the various credits and adjustments to income that are available to taxpayers;
- Recognize the penalties that may be imposed on a preparer for failing to meet ethical and practice standards in preparing tax returns; and
- Identify the duties and restrictions imposed on tax preparers under Circular 230.

Domain 1 – New Tax Law/Recent Updates

Introduction

Federal tax law requires that various limits be adhered to in the preparation of tax returns, and such limits may change from year to year based on an inflation adjustment or on other factors. Included in those changes for 2024 are standard mileage rates, standard deductions and various other limits. These and additional changes brought about by recent legislation affect taxpayers' income tax liability. Domain 1 will examine these changes for 2024 and will offer some context within which they apply.

Domain 1 Learning Objectives

When you have completed the domain 1 text, you should be able to:

- Identify the inflation adjustments to various federal limits;
- Recognize the optional standard mileage rates;
- Describe the reporting requirements of Third Party Network Transactions;
- Identify the resumption of automated reminders for taxable years 2021 and prior;
- Describe features of the Direct File Pilot Program;
- Recognize SECURE 2.0 Act, including:
    - Updated Roth Plan distribution rules effective for 2024
    - Catch-up contributions effective for 2024.

1.1 Annual Inflation Adjustments

Inflation adjustments are made annually to various limits that affect tax preparation, including adjustments to:

- The education savings bond program;
- Qualified long term care premiums and benefits;
- Adoption Credit;
-
- Various Affordable Care Act provisions including the –
    - refundable tax credits to assist taxpayers in purchasing qualified health plans,
    - small business health insurance premium tax credit,

- Standard mileage rates.

We will examine those adjustments in the following material.

1.1.1 Education Savings Bond Program

Although the interest on U.S. savings bonds is normally taxable as ordinary income, a taxpayer may exclude some or all of the interest on certain cashed in savings bonds if he or she pays qualified education expenses and meets federal income tax filing status and income requirements. Under the federal education savings bond program, a taxpayer may exclude some or all interest income received on qualified U.S. savings bonds if the taxpayer:

- Paid qualified education expenses for the taxpayer, a spouse or a dependent;
- Has a modified adjusted gross income (MAGI) not exceeding specified maximum amounts that are adjusted for inflation each year; and
- Has a federal income tax filing status other than married filing separately.

The U.S. savings bonds that qualify for the education savings program are series EE bonds issued after 1989 and series I bonds. The bonds must be issued either in the taxpayer's name as sole owner or in the name of the taxpayer and spouse as co-owners. Furthermore, in order for the bond to qualify, the owning taxpayer must have been at least age 24 before the bond's date of issue.

1.1.1.1 Qualified Education Expenses

Education expenses considered qualified education expenses under the education savings bond program are education expenses incurred at an eligible educational institution by the taxpayer for the taxpayer, the taxpayer's spouse or a dependent claimed by the taxpayer. Such expenses include:

- Tuition and fees;
- Contributions to a qualified tuition program; and
- Contributions to a Coverdell education savings account (ESA)

Room and board expenses **are not** qualified education expenses for purposes of the education savings bond program.

1.1.1.2 Eligible Educational Institutions

An eligible educational institution for purposes of the education savings bond program is broadly defined as one eligible to participate in a student aid program administered by the U.S. Department of Education and includes:

- College;
- University;
- Vocational school; and
- Other post-secondary educational institution.

Thus, the definition of an eligible educational institution includes virtually all accredited U.S. public, nonprofit, and proprietary post-secondary institutions.

1.1.1.3 Qualified Education Expenses Reduced by Certain Tax-free Benefits Received

To determine the amount of tax-free interest, the qualified education expenses incurred must be reduced, for purposes of the education savings bond program, by certain tax-free education benefits received. The resulting education expenses, reduced as required, are referred to as "adjusted qualified education expenses."

Thus, *adjusted* qualified education expenses are equal to the qualified education expenses reduced by all of the following tax-free benefits:

- The tax-free part of scholarships and fellowships;
- Expenses used to figure the tax-free portion of Coverdell ESA distributions;
- Expenses used to figure the tax-free portion of qualified tuition program distributions;
- Any tax-free payments received as education assistance, including –
    - Veterans' educational assistance benefits,
    - Qualified tuition reductions, and
    - Employer-provided educational assistance; and
- Any expenses used in figuring the American Opportunity and Lifetime Learning Credits.

Neither gifts nor inheritances received, however, reduce qualified education expenses for purposes of the education savings bond program.

1.1.1.4 Figuring the Tax-Free Amount

If the total amount received by the taxpayer when eligible bonds are redeemed, including both the bond investment and accrued interest, does not exceed the adjusted qualified education expenses, all interest received may be tax free. (Note, the taxpayer must still be eligible based on income.) If the total amount received on liquidation of the bonds is greater than the adjusted qualified education expenses, only a portion of the interest may be tax free.

Determining the tax-free amount of the interest distributed when the bonds are redeemed **and the adjusted qualified education expenses are less than the distribution** requires that the interest received be multiplied by a fraction. The numerator of the fraction is the adjusted qualified education expenses, and the denominator of the fraction is the total proceeds received on liquidation of the bonds during the year the bonds were redeemed.

We can illustrate the part of the interest that may be tax free in this case by considering an example. Suppose a taxpayer received a $9,000 distribution of bond proceeds during the year, and the proceeds consisted of $6,000 of invested principal and $3,000 of interest. Further suppose that the adjusted

qualified education expenses were $7,650—less than the bond proceeds, in other words. To determine the part of the $3,000 of interest that may be tax free, we need to use the following equation:

$$\text{Interest} \times \frac{\text{Adjusted qualified education expenses}}{\text{Total proceeds received}} = \text{Maximum tax-free interest}$$

By substituting the appropriate numbers into the equation, we can see that the amount of the tax-free interest in this example is $2,550, as shown below:

$$\$3{,}000 \times \frac{\$7{,}650}{\$9{,}000} = \$2{,}550$$

Since the taxpayer received $9,000 when cashing in the bonds, the $6,000 invested (or any portion of it) is tax free as a recovery of cost basis, but the portion of the interest other than the $2,550 tax-free amount—$450 in this case—is taxable interest. As noted earlier, however, a taxpayer's eligibility for the education savings bond program is determined by the taxpayer's income and filing status, discussed immediately below. Depending on the taxpayer's MAGI/filing status, some or all of the maximum tax-free interest may also be includible in income.

Let's continue with the earlier example but modify the facts slightly so that the taxpayer's MAGI exceeds the applicable dollar amount. In the earlier example we saw that $2,550 of the $3,000 interest is tax free, provided the taxpayer is eligible to take the full interest exemption. However, the excludible interest would be less than $2,550 if the taxpayer's MAGI exceeds the applicable dollar amount, i.e., it is in the phase-out range —between $145,200 and $175,200 for married filing jointly taxpayers and between $96,800 and $111,800 for other eligible taxpayers in 2024. The equation used to determine the excludible income for MFJ taxpayers is as follows:

$$\frac{\text{(MAGI – Applicable dollar amount)}}{\$30{,}000} \times \text{Maximum tax-free interest} = \text{Includible interest}$$

$$\text{Maximum tax-free interest} - \text{Includible interest} = \text{Excludible interest}$$

Suppose that the taxpayer has a $155,200 MAGI and is married filing a joint return in 2024. By substituting the actual values into the equation, we can see that the amount of the interest that must be included in gross income by the taxpayer because of his or her MAGI is $850, as shown below:

$$\frac{(\$155{,}200 - \$145{,}200)}{\$30{,}000} \times \$2{,}550 = \$850$$

Thus, the amount of interest excludible under the program is equal to the maximum tax-free interest *minus* the portion of it that must be included in income because of the taxpayer's MAGI. In this case, the taxpayer's excludible interest is $1,700. ($2,550 - $850 = $1,700)

If a taxpayer's filing status is single or head of household, the equation used to determine the taxpayer's exclusion is as follows:

$$\frac{\text{(MAGI – Applicable dollar amount)}}{\$15{,}000} \times \text{Maximum tax-free interest} = \text{Includible interest}$$

$$\text{Maximum tax-free interest} - \text{Includible interest} = \text{Excludible interest}$$

When figuring the excludible interest amount, use IRS Form 8815.

1.1.1.5 Education Savings Bond Program Eligibility Subject to Income Limits/Filing Status

The exclusion of interest under the education savings bond program reduces as the taxpayer's income increases and is eliminated at higher income levels. Under the bond program rules, the amount of a taxpayer's interest exclusion is gradually reduced if the taxpayer's modified adjusted gross income (MAGI) exceeds the applicable dollar amount for the taxpayer's filing status.

When the part of the bond interest that normally would be tax free under the education savings bond program is determined, the taxpayer's MAGI is then compared to the applicable dollar amount for the tax year to calculate the amount of the potentially tax-free interest that is excludible by the taxpayer. If a taxpayer whose filing status is married filing jointly has a MAGI that exceeds the applicable dollar amount by $30,000 or more, no interest may be excluded under the program. Similarly, if a taxpayer

whose filing status is single, qualifying surviving spouse or head of household has a MAGI that exceeds the applicable dollar amount by $15,000 or more, no interest is excludible under the program.

The applicable dollar amounts with which taxpayers' MAGI are compared are as follows:

Taxpayer's Filing Status	2024 Applicable Dollar Amount	Phase-Out Income Range	Completely Phased-Out
Single, qualifying surviving spouse or Head of Household (HH)	$96,800	$96,800 - $111,800	$111,800
Married filing jointly	$145,200	$145,200 - $175,200	$175,200

The amount of excludible savings bond interest to which a taxpayer whose MAGI is in the phase-out income range is entitled, if any, can be determined using the following equation that calculates the part of the interest that is includible:

$$\frac{\text{(MAGI – Applicable dollar amount)}}{\text{\$30,000 (\$15,000 single or HH)}} \times \text{Maximum tax-free interest} = \text{Includible interest}$$

The amount determined under the equation is then subtracted from the maximum tax-free interest amount to figure the amount of excludible savings bond interest.

1.1.2 Qualified Long-Term Care Insurance Premiums and Benefits

In 1996, Congress passed the Health Insurance Portability and Accountability Act (HIPAA). The law clarified the tax treatment of long-term care insurance policies by defining "qualified long-term care insurance." In addition, it provided for the tax-deductibility of qualified long-term care insurance premiums and, for individuals deemed to be chronically-ill, the tax-exemption of long-term care insurance benefits within certain limits.

Those limits generally change yearly.

1.1.2.1 Favorable Benefits Tax Treatment Reserved for Chronically-Ill

In order for long term care benefits to receive favorable tax treatment, the individual on whose behalf they are paid must meet the "chronically-ill" definition included in HIPAA. A *chronically-ill individual* is defined as an insured individual who has been certified by a licensed health care practitioner within the previous 12 months as an individual who:

- Is unable, for at least 90 days, to perform at least two activities of daily living (ADLs) without substantial assistance from another individual, due to loss of functional capacity; or
- Requires substantial supervision to be protected from threats to health and safety due to severe cognitive impairment.

1.1.2.2 Tax-Qualified Long Term Care Premiums Deductible within Limits

Premiums paid for tax-qualified long term care insurance may be deductible. Tax-qualified long term care insurance policy premiums are included in the definition of "medical care" and are, therefore, eligible for income tax deduction within certain limits.

For *individuals* who itemize deductions, the amounts paid for medical care—a category of expenses that includes tax-qualified long term care insurance premiums not exceeding the dollar limitations discussed below—are deductible. Medical expenses are normally tax-deductible only to the extent the taxpayer's medical expenses for the year exceed 7.5% of the taxpayer's adjusted gross income. The 7.5% floor for unreimbursed medical expenses has been permanently set at 7.5%.

Self-employed persons[1] may also deduct such premiums not in excess of the dollar limitations (noted in the chart below) ***without*** the need for medical care expenses to exceed the applicable AGI threshold. In short, tax-qualified long term care insurance policy premiums are 100% tax-deductible for self-employed taxpayers to the extent they don't exceed the dollar limits or the self-employed individual's net earnings.

The amount of any long term care insurance premium that may be included in medical care expenses is limited by certain dollar maximums that are indexed for inflation and which change as the insured's attained age changes. The dollar limitations applicable to tax-qualified long term care premiums in 2023 and 2024 are as follows:

Attained Age Before Close of Tax Year	2023 Limitation on Premium*	2024 Limitation on Premium*
40 or younger	$480	$470
41 to 50	$890	$880
51 to 60	$1,790	$1,760
61 to 70	$4,770	$4,710
Older than 70	$5,960	$5,880
** Indexed for inflation*		

1.1.2.3 Tax-Qualified Long Term Care Insurance Benefits Tax-Free within Limits

Just as the treatment of a tax-qualified long term care insurance policy as an accident & health insurance contract results in the tax-deductibility of premiums within certain limits, having such status also affects the tax treatment of benefits paid under it. Benefits, other than dividends or premium refunds, received under a tax-qualified long term care insurance policy are treated as reimbursements for expenses incurred for medical care and are generally not included in the recipient's income. Also similar to the tax treatment of premiums, the benefits from a tax-qualified long term care insurance policy that may avoid inclusion in the recipient's income are limited by certain maximums.

Benefits received under tax-qualified long term care insurance policies that may be excluded from income are those benefits not exceeding the greater of:

- The applicable *per diem* limitation for the year; or
- The costs incurred for qualified long term care services provided for the insured.

So, if the benefit does not exceed the per diem limitation, all benefits are tax-free even though the benefits exceed the actual costs incurred. Similarly, if the benefit does not exceed the actual costs incurred all benefits are tax free even though the benefits exceed the per diem limit.

The applicable *per diem* limitation for 2024 is $410. The *per diem* limitation amount is adjusted each year, as needed, to reflect inflation. (Note: Periodic payments under a life insurance contract received on behalf of a chronically-ill insured are likewise tax-exempt, subject to the limits applicable to qualified long-term care insurance benefits.)

1.1.3 Adoption Credit

Federal tax laws encourage the adoption of children by granting an adoption credit and excluding amounts received from an employer to pay adoption expenses. The adoption credit is a nonrefundable tax credit designed to offset qualified adoption expenses for eligible taxpayers adopting an eligible child or children. The adoption assistance program enables a taxpayer to exclude from income amounts a) paid by the taxpayer to adopt an eligible child or b) paid for the taxpayer by an employer to offset qualified adoption expenses under a qualified adoption assistance program.

The American Taxpayer Relief Act, legislation enacted on January 2, 2014, permanently extended the adoption credit and adoption assistance programs for tax years beginning after December 31, 2012.

[1] A self-employed individual, for purposes of long term care insurance premium tax-deductibility, includes sole proprietors, partners, and owners of S corporations, limited liability partnerships and limited liability companies.

Both the adoption credit and exclusion from income are subject to phase out and elimination at higher incomes.

Let's briefly consider the rules associated with the adoption credit and income exclusion for employer-provided adoption benefits.

1.1.3.1 Eligible Child

An eligible adopted child, for whose adoption expenses an adoption credit or exclusion could apply, may be a) a U.S. citizen or resident, or b) a foreign child. However, the rules concerning the benefit vary somewhat depending upon the citizenship status of the adopted child and whether the child has special needs.

A child whose qualified adoption expenses may give rise to the adoption credit or exclusion is a child who is:

- Under age 18 (if the child turned age 18 during the year, the child is an eligible child for the part of the year he or she was under age 18); or
- A disabled individual physically or mentally unable to care for himself or herself, regardless of age; such a child is generally referred to in connection with the adoption credit and exclusion as a "special needs" child.

1.1.3.2 Qualified Adoption Expenses

Qualified adoption expenses are those expenses that are reasonable and necessary and which are related to, and for the principal purpose of, a legal adoption of an eligible child. Such expenses include:

- Adoption fees;
- Attorney fees;
- Court costs;
- Travel expenses, including meals and lodging, while away from home; and
- Re-adoption expenses relating to the adoption of a foreign child.

Although the qualified expenses incurred in connection with a legal adoption of an eligible child include many expenses, not all expenses are deemed qualified adoption expenses. Expenses that are not considered qualified adoption expenses for purposes of the adoption credit or exclusion include expenses:

- For which the taxpayer received funds under a state, local, or federal program;
- That violate state or federal law;
- For carrying out a surrogate parenting arrangement;
- Paid or reimbursed by the taxpayer's employer or any other person or organization; or
- Allowed as a credit or deduction under any other provision of federal income tax law.

1.1.3.3 The Benefit

A taxpayer may be able to take the adoption credit or exclusion if the following criteria are met:

1. The taxpayer's filing status is single, head of household, qualifying widow(er), or married filing jointly. In most cases, a married taxpayer must file a joint return in order to take the credit or exclusion;
2. The taxpayer's modified adjusted gross income (MAGI) is less than the applicable limit for the year; and
3. The taxpayer reports the required information concerning the eligible child in part I of IRS Form 8839.

1.1.3.4 Timing of the Credit/Exclusion

The year in which the taxpayer can take the adoption credit or exclusion depends upon whether the eligible child is a citizen or resident of the United States at the time the adoption effort began. If the eligible child is a U.S. citizen or resident—an adoption referred to as a "domestic adoption"—the taxpayer can take the adoption credit or exclusion even if the adoption never became final.

The year in which a taxpayer may take the credit or exclusion in connection with a domestic adoption is as shown in the following table:

Domestic Adoptions

Qualifying Expenses Paid by Taxpayer in…	**Credit Taken in…**
Any year before the year the adoption becomes final	The year after the year of the payment
The year the adoption becomes final	The year the adoption becomes final
Any year after the year the adoption becomes final	The year of the payment
Qualifying expenses paid by an employer under an adoption assistance program in…	**Exclusion Taken in…**
Any year	The year of the payment

A taxpayer who adopts a U.S. child with special needs may be able to exclude up to the maximum amount **and** take a credit for additional expenses up to the maximum amount. The exclusion may be available even if neither the taxpayer nor the taxpayer's employer paid any qualified adoption expenses.

The year in which a taxpayer may take the credit or exclusion in connection with a foreign adoption is similarly shown in the chart below (foreign adoption rules that vary from domestic adoption rules are highlighted):

Foreign Adoptions

Qualifying Expenses Paid by Taxpayer in…	**Credit Taken in…**
Any year before the year the adoption becomes final	The year the adoption becomes final
The year the adoption becomes final	The year the adoption becomes final
Any year after the year the adoption becomes final	The year of the payment
Qualifying expenses paid by an employer under an adoption assistance program in…	**Exclusion Taken in…**
Any year before the year the adoption becomes final	The year the adoption becomes final
The year the adoption becomes final	The year the adoption becomes final
Any year after the year the adoption becomes final	The year of the payment

Unlike the rules applicable to domestic adoptions that permit a taxpayer to take the adoption credit or exclusion even if the adoption never became final, an adoption credit or exclusion for a foreign adoption is available to a taxpayer only if the adoption becomes final.

1.1.3.5 Benefit Phased-Out at Higher Taxpayer MAGI

In 2024, the maximum adoption credit is $16,810 per child. Similarly, the maximum amount of employer-provided adoption assistance that a taxpayer may exclude from gross income in 2024 is $16,810 per child. The amount of the adoption credit or excludable assistance, however, is phased out for taxpayers whose 2024 modified adjusted gross income (MAGI) exceeds $252,150 (the "applicable amount") and is eliminated for taxpayers whose MAGI is $292,150 or more.

The reduction in the maximum adoption credit or exclusion for taxpayers whose MAGI exceeds the applicable amount may be determined by using the following equation:

$$\text{Maximum adoption credit/excludable amount} \times \frac{\text{MAGI} - \text{Applicable amount}}{\$40{,}000} = \text{Reduction in maximum adoption credit/excludable amount}$$

For example, suppose a taxpayer who has a MAGI of $262,150—a MAGI in excess of the $252,150 applicable amount—adopts a child and has qualifying adoption expenses. The reduction in the maximum adoption credit or excludable amount is $4,212.50 as shown below:

$$\$16{,}810 \times \frac{\$262{,}150 - \$252{,}150}{\$40{,}000} = \$4{,}202.50$$

Thus, the taxpayer would have a maximum adoption credit per child of $12,607.50. ($16,810 - $4,202.50 = $12,607.50)

1.1.4 AMT Exemption for Child Subject to Kiddie Tax

The exemption amount applicable to a child for whom the "kiddie tax" applies, for the purposes of the alternative minimum tax, may not exceed the sum of the child's earned income for the taxable year plus $9,250.

1.1.5 Expenses of Elementary and Secondary School Teachers

A tax deduction is available for elementary and secondary school teachers who purchase certain items for use in the classroom. The amount of the deduction is for 2024 is $300 and may be used by an eligible educator in connection with:

- Books;
- Supplies (other than nonathletic supplies for courses in instruction for health and physical education);
- Computer equipment (including related software and services); and
- Other equipment and supplementary materials used by the eligible educator in the classroom.

1.1.6 Capital Gains and Losses – Changes for 2024

High-income taxpayers are subject to higher capital gain and qualified dividend tax rates, and these rates generally are adjusted annually. For tax years beginning in 2024, the long-term capital gain and qualified dividend tax rate is as follows:

- The 0% rate applies to –
    - Single filers and married filers filing separately with income up to $47,025,
    - Head of household filers with income up to $63,000,
    - Joint filers with income up to $94,050,
    - Trusts and estates with income up to $3,150;
- The 15% rate applies to –
    - Single filers with income between $47,025 and $518,900,
    - Married filers filing separately with income between $47,025 and $291,850,
    - Head of household filers with income between $63,000 and $551,350,
    - Joint filers with income between $94,050 and $583,750,
    - Trusts and estates with income between $3,150 and $15,450; and
- The 20% rate applies to –
    - Single filers with income exceeding $518,900,
    - Married filers filing separately with income exceeding $291,850,
    - Head of household filers with income exceeding $551,350,
    - Joint filers with income exceeding $583,750,
    - Trusts and estates with income exceeding $15,450.

1.1.7 Small Business Premium Tax Credit

Small employers may be eligible to receive a nonrefundable tax credit for premiums paid for employee health insurance coverage. The credit may be carried back one year and forward 20 years.

The credit is available to eligible employers for two consecutive taxable years and is subject to limitations based on:

- The number of employees; and
- The average annual wages paid to employees.

The maximum small employer health insurance premium credit available to eligible small employers is 50% of workers' healthcare premiums paid by small employers and 35% of such premiums paid by small tax-exempt employers, such as charities. If an employer receives a tax credit for premiums paid, its tax deduction for the cost of providing health insurance coverage is reduced by the amount of the credit.

1.1.7.1 Eligibility Requirements

Not all small employers are likely to be eligible to receive the small employer health insurance premium credit. The credit is available only if the employer meets the following three requirements:

1. The employer paid premiums for employee health insurance coverage under a qualifying arrangement—one under which the employer is required to pay at least 50% of the premium for the employee—obtained through a Small Business Health Options Program (SHOP);
2. The employer had fewer than 25 full-time equivalent employees (FTEs), not counting employees with ownership interest, for the tax year; and
3. The employer paid average annual wages for 2024 of less than $64,800 (indexed for inflation) per full-time equivalent employee.

Small employer health insurance premium tax credits are available for no more than two consecutive years.

1.1.7.2 Average Annual Wage Limitation

A small employer's health insurance premium credit is also reduced if the employer paid average annual wages in 2024 of more than $32,400 and is eliminated if the employer paid average annual wages of $64,800. For purposes of the health insurance premium credit, the term "wages" means wages subject to Social Security and Medicare tax withholding determined without considering any wage base limit. For purposes of this limitation, wages paid to a seasonal employee who worked 120 or fewer days during the tax year should not be included.

In order to figure the average annual wages an employer paid for the tax year, follow the steps below:

1. Figure the total wages paid for the tax year to all individuals considered employees; and
2. Divide the total wages paid by the employer by the number of FTEs the employer had for the tax year.

If the result of the following the steps above is not a multiple of $1,000—$1,000, $10,000 or $20,000, for example—the result should be rounded down to the next lowest multiple of $1,000. Thus, if the result is $25,750, it should be rounded down to $25,000.

1.1.8 Adoption Assistance Programs

The amount that can be excluded from an employee's gross income for the adoption of a child with special needs is $16,810 in 2024. For taxable years beginning in 2024, the amount that may be excluded from an employee's income for the amounts paid or expenses incurred by an employer for qualified adoption expenses provided under an adoption assistance program for the employee is $16,810.

1.1.8.1 Phase- out for Higher Incomes

The amount excludible from an employee's gross income begins to phase out for taxpayers with modified adjusted gross incomes (MAGI) of $252,150 and is completely phased out for taxpayers with MAGIs of $292,150 or more.

1.1.9 Gross Income Limitation for a Qualifying Relative

Certain tax credits, including the Earned Income Credit, Child Care Credit, and Child Tax Credit (and Head of Household tax-filing status) permit taxpayers to base the amount of credit on qualifying relatives. In 2024 the limit on a qualifying relative is an earned income of $5,050.

1.1.10 Interest on Education Loans

For taxable years beginning in 2024, the maximum $2,500 deduction for interest paid on qualified education loans begins to phase out for taxpayers with MAGIs in excess of $80,000 ($165,000 for joint returns), and is completely phased out for taxpayers with MAGIs of $95,000 or more ($195,000 or more for joint returns).

1.1.11 Threshold for Excessive Business Loss

Businesses other than corporations may deduct business losses not exceeding $305,000 ($610,000 for joint returns) in 2024.

1.1.12 Annual Exclusion for Gifts

Each year the amount that may be gifted to any person gift-tax free generally increases. For 2024, the excludible amount is $18,000 to any person ($36,000 in the case of a joint gift in which the spouse participates). In addition, the first $185,000 of gifts to a spouse who is not a citizen are not included in the total amount of taxable gifts made during that year.

1.1.13 Social Security Limits

Social Security taxes are comprised of two components: OASDI (old age, survivors and disability income) and HI (health insurance) taxes. OASDI is a tax imposed on a worker's wages up to the applicable Social Security taxable earnings limit. That limit is $168,600 in 2024 and generally increases annually. The employee tax rate for the OASDI part of Social Security is 6.2%.

HI, the second component of Social Security taxes, is a tax of 1.45% imposed on all taxpayer wages—no earnings limit applies, in other words—to fund Medicare Part A.

1.2 Standard Mileage Rates

The standard mileage rates enable a taxpayer using a vehicle for specified purposes to deduct vehicle expenses on a per-mile basis rather than deducting actual car expenses that are incurred during the year. The rates vary, depending on the purpose of the transportation.

Accordingly, the standard mileage rates differ from one another depending on whether the vehicle is used for:

- Business purposes;
- Charitable purposes; or
- Obtaining medical care or moving.

Rather than using the optional standard mileage rates, however, a taxpayer may choose to take a deduction based on the actual costs of using the vehicle.

1.2.1 Business Use of a Taxpayer's Personal Vehicle

The 2024 standard mileage rate applicable to ***eligible*** business use of a vehicle is 67¢ per mile, up from 65.5¢ in 2023. In order for such expenses to be deductible, they must have been:

- Paid or incurred during the tax year;
- For the purpose of carrying on the taxpayer's trade or business; and
- Ordinary and necessary.

Provided the vehicle expenses meeting these three criteria are not reimbursed, the deductible personal vehicle expenses include those incurred while traveling:

- Between workplaces;

- To meet with a business customer;
- To attend a business meeting located away from the taxpayer's regular workplace; or
- From the taxpayer's home to a *temporary* place of work.

In addition to using the standard mileage rate, a taxpayer may also deduct any business-related parking fees and tolls paid while engaging in deductible business travel. However, parking fees paid by a taxpayer to park his or her vehicle at the usual place of business are considered commuting expenses and are not deductible.

The Tax Cuts and Jobs Act (TCJA) suspends all miscellaneous itemized deductions that are subject to the two-percent of adjusted gross income floor under § 67, including unreimbursed employee travel expenses, for taxable years beginning after December 31, 2017, and before January 1, 2026. Thus, the business standard mileage rate provided in this notice cannot be used to claim an itemized deduction for unreimbursed employee travel expenses during the suspension. Notwithstanding the foregoing suspension of miscellaneous itemized deductions, deductions for expenses that are deductible in determining adjusted gross income are not suspended.

For example, members of a reserve component of the Armed Forces of the United States (Armed Forces), state or local government officials paid on a fee basis, and certain performing artists are entitled to deduct unreimbursed employee travel expenses as an adjustment to total income on line 12 of Schedule 1 of Form 1040 (2023), U.S. Individual Income Tax Return, not as an itemized deduction on Schedule A of Form 1040 (2023), and therefore may continue to use the business standard mileage rate.

1.2.2 Personal Vehicle Use for Charitable Purposes

A taxpayer may deduct as a charitable contribution any unreimbursed out-of-pocket expenses, such as the cost of gas and oil, directly related to the use of a personal vehicle in providing services to a charitable organization. Alternatively, a taxpayer may use the standard mileage rate applicable to the use of a personal vehicle for charitable purposes. The standard mileage rate applicable to a taxpayer's use of a personal vehicle for charitable purposes is based on statute and remains unchanged at 14¢ per mile. The taxpayer may also deduct parking fees and tolls regardless of whether the actual expenses or standard mileage rate is used.

1.2.3 Use of a Taxpayer's Personal Vehicle to Obtain Medical Care

A taxpayer may also deduct medical and dental expenses to the extent they exceed the applicable percentage of his or her adjusted gross income (AGI). The vehicle expenses a taxpayer may include as medical and dental expenses are the amounts paid for transportation to obtain medical care for the taxpayer, a spouse or a dependent. A taxpayer may also include as medical and dental expenses those transportation costs incurred:

- By a parent who must accompany a child needing medical care;
- By a nurse or other person who can administer injections, medications or other treatment required by a patient traveling to obtain medical care and unable to travel alone; or
- For regular visits to see a mentally-ill dependent, if such visits are recommended as a part of the mentally-ill dependent's treatment.

A taxpayer who uses a personal vehicle for such medical reasons is permitted to include the out-of-pocket vehicle expenses incurred—the expenses for gas and oil, for example—or deduct medical travel expenses at the standard medical mileage rate. For 2024, the standard medical mileage rate is 21¢ per mile, down 1¢ from 2023. The taxpayer may also deduct any parking fees or tolls, regardless of whether actual expense or the standard mileage rate is used.

1.2.4 Basis Reduction Amount

A taxpayer must reduce the basis of an automobile used in business by the greater of a) the amount of depreciation claimed by the taxpayer, or b) the amount of the depreciation allowable. However, if the business standard mileage rate is used, then a per-mile amount (published annually by the IRS) is used to reduce the automobile's basis. That per-mile amount is:

- 26¢ for 2022

- 28¢ for 2023
- 30¢ for 2024

1.3 Payment Card and Third-Party Transactions Reporting Requirements

Generally, if a Form 1099 is received for amounts belonging to another person, the individual receiving such a form is considered a nominee recipient. The nominee recipient, who may be a merchant acquiring entity or a third-party settlement organization (TPSO), must file a Form 1099 with the IRS for each of the participating payees showing the amounts allocable to each and must also furnish a Form 1099 to each of the participating payees.

Prior to passage of the American Rescue Plan Act of 2021 (ARPA), a payment settlement entity (PSE) that was a third-party settlement organization was required to furnish Form 1099-K, *Payment Card and Third Party Network Transactions* to participating payees when amounts exceeded a *de minimis* exemption, i.e., to participating payees who had:

- Sales totaling more than $20,000 in aggregate payments, and
- More than 200 sale transactions.

ARPA changed those requirements for years after December 31, 2021, to require reporting and furnishing of Form 1099-K by TPSOs to participating payees when amounts exceeded $600. However, as discussed in IRS Notice 2023-10[2], the IRS has regarded calendar years 2022 as a transition period for enforcement and administration of the new limits. IRS Notice 2023-74 further expanded the transition period to include 2023. Therefore, the requirement to furnish Form 1099-K ***does not apply*** to participating payees in 2022 and 2023 unless they had sales totaling more than $20,000 and more than 200 sale transactions.

Beginning January 1, 2024, Third Party Settlement Organizations would normally be required to report and furnish Form 1099-K by TPSOs to participating payees when sales total more than $600. However, the IRS plans for a $5,000 (rather than $600) threshold in 2024 to phase in implementation. The minimum number of sales transactions criterion has been eliminated. The *de minimis* exemption applicable to TPSOs does not apply to PSEs that are merchant acquiring entities.

1.3.1 Transactions that Require Reporting

The transactions that require reporting are transactions for "Goods and Services" only.

Such reportable transactions do not include:

- Personal gifts,
- Charitable contributions, or
- Reimbursements.

1.4 Tax Relief Response to the Coronavirus Disease 2019 Pandemic

A taxpayer's failure to timely pay income tax due will result in interest being added to the amount of tax due and, if the taxpayer files a return but doesn't pay all tax owed on time, a late payment penalty will generally be applied. However, in response to the Coronavirus Disease 2019 (Covid-19) pandemic, the President of the United States declared a national emergency on March 13, 2020, and further issued an emergency declaration under the Robert T. Stafford Disaster Relief and Emergency Assistance Act, providing relief from tax deadlines to eligible taxpayers who had been adversely affected by the Covid-19 emergency.

Although these additions to tax for failure to make timely payment were waived, eligible taxpayers will remain liable for interest that accrues during the relief period because of any underpayment of tax for taxable years 2020 or 2021 and will remain liable for any failure to pay tax that accrued before or after the relief period. The relief period is the timeframe that begins on the date the IRS issued an initial balance due notice to the eligible taxpayer, or February 5, 2022, whichever is later, and ends on March 31, 2024.

[2] Notice 2023-10 (irs.gov)

Those eligible taxpayers who already paid their balance in full also will benefit from the relief, i.e. the IRS will issue a refund or credit the payment toward another outstanding tax liability if an eligible taxpayer already paid failure-to-pay penalties related to their 2020 or 2021 taxes. This tax penalty relief helped nearly 5 million taxpayers for 2020 and 2021 tax returns.

1.4.1 Suspension of Automated Reminders

Additionally, as a result of the Covid-19 pandemic, the IRS suspended mailing of automated reminders to pay overdue tax bills starting in February 2022. The automated reminders would have been issued as a follow-up after an initial notice.

1.4.2 Taxpayers Eligible for Tax Relief

The waiver of late payment penalties for 2020 and 2021 applies only to eligible taxpayers for accruals of additions to tax for the failure to pay during the relief period. An "eligible taxpayer" is any taxpayer:

- Whose assessed income tax for taxable year 2020 or 2021, as of December 7, 2023, is less than $100,000, excluding any applicable additions to tax, penalties, or interest;
- Who was issued an initial balance due notice on or before December 7, 2023, for taxable year 2020 or 2021; and
- Who is otherwise liable during the relief period for accruals of additions to tax for the failure to pay with respect to an eligible return for taxable year 2020 or 2021.

The relief is available only to eligible taxpayers who have filed an eligible return. An "eligible return" is one of the following income tax returns:

- *Income Tax Returns of Individuals*:
    - Form 1040, *U.S. Individual Income Tax Return*
    - Form 1040-C, *U.S. Departing Alien Income Tax Return*
    - Form 1040-NR, *U.S. Nonresident Alien Income Tax Return*
    - Form 1040-PR, *Declaración de la Contribución Federal sobre el Trabajo por Cuenta Propia*
    - Form 1040-SR, *U.S. Tax Return for Seniors*
    - Form 1040-SS, *U.S. Self-Employment Tax Return*
- *Income Tax Returns of Trusts, Estates, Certain Taxable Corporations, and Certain Tax-Exempt Organizations*:
    - Form 1120, *U.S. Corporation Income Tax Return*
    - Form 1120-C, *U.S. Income Tax Return for Cooperative Associations*
    - Form 1120-F, *U.S. Income Tax Return of a Foreign Corporation*
    - Form 1120-FSC, *U.S. Income Tax Return of Foreign Sales Corporation*
    - Form 1120-H, *U.S. Income Tax Return for Homeowners Associations*
    - Form 1120-L, *U.S. Life Insurance Company Income Tax Return*
    - Form 1120-ND, *Return for Nuclear Decommissioning Funds and Certain Related Persons*
    - Form 1120-PC, *U.S. Property and Casualty Insurance Company Income Tax Return*
    - Form 1120-POL, *U.S. Income Tax Return for Certain Political Organizations*
    - Form 1120-REIT, *U.S. Income Tax Return for Real Estate Investment Trusts*
    - Form 1120-RIC, *U.S. Income Tax Return for Regulated Investment Companies*
    - Form 1120-S, *U.S. Income Tax Return for an S Corporation*
    - Form 1120-SF, *U.S. Income Tax Return for Settlement Funds (Under Section 468B)*
    - Form 1041, *U.S. Income Tax Return for Estates and Trusts*
    - Form 1041-N, *U.S. Income Tax Return for Electing Alaska Native Settlement Trusts*
    - Form 1041-QFT, *U.S. Income Tax Return for Qualified Funeral Trusts*
    - Form 990-T, *Exempt Organization Business Income Tax Return*

NOTE: Nearly 70 percent of the individual taxpayers receiving penalty relief have income under $100,000 per year.

1.4.3 2024 End of Pandemic-Related Relief

As the unpaid tax bill collection processes resume to pre-pandemic level, the IRS began issuing Notice LT38 - Reminder, Notice Resumption to tax professionals and taxpayers in January 2024. In January 2024, the IRS began sending out automated collection notices and letters to:

- Individuals with tax debts prior to tax year 2022, and
- Businesses, tax exempt organizations, trusts, and estates with tax debts prior to 2023

This letter will remind taxpayers about their tax liability, giving them an opportunity to address the tax issue and effectively restart the collection process once again. If the tax issue remains unresolved, the taxpayer will receive further follow-up notices in the collection progression, informing him or her of more serious steps to come for failure to pay taxes due.

1.4.4 Taxpayer Penalties and Interest

The IRS is required by law to charge interest when a tax balance is not paid on time. Interest is based on the amount of tax owed for each day it's not paid in full, compounded daily. Interest rates are determined every three months and can vary based on the type of tax; individual vs business tax liabilities. The failure-to-pay penalties resumed on April 1, 2024, for taxpayers who had been eligible for relief.

1.5 IRS Direct File Pilot Program

The U.S. Department of the Treasury and Internal Revenue Service (IRS) launched the new Direct File Pilot Program that provides a free, secure option for taxpayers with simple tax situations in 12 states to file their taxes directly with the IRS. Direct File is designed to be easy to use, with no hidden fees, and work well on a smartphone, laptop, tablet, or desktop computer. Direct File shows taxpayers the math so they can be sure that their return is accurate, and they are getting the refund they are entitled to. Live customer service support is also available for Direct File users. Initial users have saved hundreds of dollars and reported that the tool is simple and straightforward to use.

Direct File was made possible by the Inflation Reduction Act, which invested new resources in the IRS to allow the agency to provide world class service to taxpayers, including the development of new tools like Direct File that make it easier for Americans to file their taxes. Let’s take a look and eligibility requirements to use Direct File.

1.5.1 Participating States

Taxpayers in 12 pilot states who meet certain requirements can use Direct File through the April tax deadline. Pilot states include:

Arizona	California
Florida	Massachusetts
Nevada	New Hampshire
New York	South Dakota
Tennessee	Texas
Washington State	Wyoming

After completing their federal returns, taxpayers in the states with a state-income tax – Arizona, California, Massachusetts, and New York -- will be guided to a state-sponsored tool to complete their state tax return.

The IRS designed the pilot to follow the best practices for launching a new technology platform by starting small, making sure it works and then building from there. The pilot is purposefully limited to cover relatively straightforward tax situations.

The Direct File pilot is an option for taxpayers who:

1) Report income earned from jobs that generate a Form W-2; including taxpayers with more than one job providing W-2 wages;
2) Claim Earned Income Tax Credit, Child Tax Credit and the Credit for Other Dependents;
3) Claim the standard deduction, deductions for educator expenses, and student loan interest; and
4) Lived in the same state for the entire calendar year.

Note: Direct File does not support requesting an extension. If the taxpayer needs to file state taxes for AZ, CA, MA, NY, or WA, they will have to file those separately with their state.

1.5.2 Eligible Identification

Eligible identification required to use the Direct File Program includes:

- A Social Security number (SSN) or Individual Taxpayer Identification Number (ITIN) for the taxpayer, spouse or claimed dependents
- If applicable, an Adoption Taxpayer Identification Number (ATIN) for claimed dependents
- A current driver's license, state identification, passport, or passport card

1.5.3 Eligible Income

Direct File only works if the taxpayer has certain types of income. Taxpayers may use Direct File only if they have one or more of these types of income for the tax year:

- Income from an employer (Form W-2);
- Unemployment compensation (Form 1099-G);
- Social Security benefits (Form SSA-1099); or
- $1,500 or less in interest income or US savings bonds or Treasury obligations (Form 1099-INT, boxes 1 and 3).

Thus, taxpayers may not use Direct File if they have other types of income for the tax year that are not listed above such as:

- Income received from payment apps, online marketplaces, or payment cards (Form 1099-K);
- Income from independent contractor and gig work (Form 1099-NEC);
- Income from rent, prizes and awards (Form 1099-MISC);
- Income from pension and retirement account distributions (Form 1099-R);
- Allocated tips, unreported tips; and
- Alimony that is required to be included in your income.

Direct File eligibility may also depend on the taxpayer’s income and filing status. Thus, additional limitations apply to taxpayers with household incomes exceeding $125,000 and include:

- Taxpayers using the filing status Married Filing Separately with wages exceeding $125,000 are ineligible for Direct File;
- Taxpayers are ineligible for Direct File if wages exceed $200,000 ($160,200 if the taxpayer has more than one employer); and
- Taxpayers using the filing status Married Filing Jointly with total wages exceeding $250,000 are ineligible for Direct File.

1.5.4 Direct File and the Standard Deduction

Taxpayers not claiming any credits or deductions may use Direct File if they are eligible for and take the standard deduction. If the taxpayer is eligible for and takes the standard deduction, he or she may claim a limited number of credits and deductions when using Direct File, including:

- Credits:
  - Earned Income Tax Credit,
  - Child Tax Credit, and
  - Credit for Other Dependents; and
- Deductions:
  - Student loan interest, and
  - Educator expenses.

Note: Only taxpayers taking the standard deduction may use Direct File; taxpayers who itemize deductions are not eligible to use Direct File. According to the IRS, about 9 out of 10 taxpayers filing federal taxes take the standard deduction.

1.5.5 Direct File Eligibility based on Health Insurance Coverage Status

Eligible taxpayers must have certain types of health insurance or no health insurance to use the IRS Direct File program including:

- Health insurance from their employer,
- Medicare,
- Veterans Affairs health care,
- Private health insurance the taxpayer paid for out of pocket, or
- State Medicaid or Children's Health Insurance Program (CHIP).

However, Direct File is not available to taxpayers who:

- Contributed money to or withdrew money from a Health Savings Account (HSA), or
- Purchased health insurance through the Health Insurance Marketplace with HealthCare.gov or a state program for the taxpayer, taxpayers' spouse, or dependents.

1.5.6 Direct File and ID.me

In order to prevent tax fraud and keep taxpayer information secure, the IRS Direct File program requires eligible taxpayers, wanting to use Direct File, to create an IRS account with ID.me. A taxpayer can register for an IRS account with ID.me in approximately 5 -10 minutes by going to ID.me.

ID.me requires the taxpayer to have:

- A U.S. phone number that accepts texts or phone calls;
- Internet access that can support a video call; and
- A working camera on his or her phone, tablet, or desktop computer.

ID.me further requires the taxpayer to:

- Be 18 years or older;
- Prove his or her identity using a -
  - Current state issued driver's license;
  - State identification;
  - Passport; or
  - Passport card.
- Take a video selfie to match their face to the picture on their identification (ID.me not video selfie), or

- Have a video call with an ID.me agent who will confirm that the taxpayer's face matches the identification submitted if the taxpayer is unable or does not want to take a video selfie.

Learn more about ID.me by clicking here.

1.6. Roth Distributions

Although Roth contributions are not excludable from employees' income, earnings on those contributions are tax-deferred and may be tax-free when distributed. Unlike distributions from non-Roth SEP and SIMPLE accounts, which are taxable as ordinary income to the employee when distributed, distributions meeting certain requirements—referred to as *qualified distributions*—are entirely tax-free. A qualified distribution is one that is made after the five-taxable year period beginning with the first taxable year for which a contribution is made to the Roth account provided one of the following applies:

- The individual is age 59 1/2 or older;
- The distribution is a qualified first-time homebuyer distribution;
- The individual is disabled; or
- The distribution is made to a beneficiary on or after the individual's death.

As long as a Roth account has been in force for the required period, a distribution from it—both contributions and earnings—that meets one of the four tests will be entirely income tax free.

1.6.1 Lifetime Distribution Requirements for Designated Roth Accounts

The required minimum distribution (RMD) rules apply to all employer sponsored retirement plans, including profit-sharing plans, 401(k) plans, 403(b) plans, and 457(b) plans. The RMD rules also apply to traditional individual retirement accounts (IRAs) and IRA-based plans such as simplified employee pensions (SEPs), salary reduction simplified employee pension plans (SARSEPs), and savings incentive match plans for employees (SIMPLE) IRAs.

The tax law concerning RMDs appeared to contain an anomaly. Specifically, although the RMD rules do not apply to Roth IRAs while the owner is alive, they did currently apply to designated Roth accounts during the account owner's lifetime. Section 325 of the Act eliminates that anomaly effective for distributions after December 31, 2023, and RMDs will no longer apply to designated Roth accounts.

Note that the amendment made by this section does not apply to distributions required with respect to years beginning before January 1, 2024, but which are permitted to be paid on or after such date. (Clarification: Initial RMDs from designated Roth accounts required in 2023 but which may be taken by April 1, 2024 are not affected by the change in the law brought about by §325.)

1.7 Roth Contributions

As authorized under the SECURE Act 2.0, an employee participating in a SEP or SIMPLE IRA may elect to have employer contributions allocated to a Roth IRA. Such contributions are deductible by the employer making them, but they are not excludable from the employees' income.

1.7.1 Roth Catch-up Contributions

Catch-up contributions for age 50 and older defined contribution qualified plan participants were first authorized by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). Since that time, the maximum catch-up amount for a Roth IRA has grown considerably and, for 2024 is $7,000 for those under age 50 and an additional $1,000 catch up contribution for those 50 and older. Not surprisingly, however, Vanguard's report[3] shows that the percentage of age 50+ plan participants making catch-up contributions in 2022 varied substantially by income, as shown in the chart below:

[3] https://institutional.vanguard.com/content/dam/inst/iig-transformation/has/2023/pdf/has-insights/how-america-saves-report-2023.pdf.

Income	Catch-up Contribution Participation Rate
<$15,000	1%
$15,000 - $29,999	<.5%
$30,000 - $49,999	<.5%
$50,000 - $74,999	2%
$75,000 - $99,999	5%
$100,000 - $149,999	20%
$150,000+	56%

Although offering plan participants the ability to allocate elective deferrals to a designated Roth account is currently optional, plans making that option available also allow age 50+ participants to allocate some or all of their catch-up contribution to a Roth account. However, for certain plan participants, the allocation of all catch-up contributions to a Roth account will be required.

Section 603 of the SECURE Act 2.0, initially scheduled to become effective for taxable years beginning after December 31, 2023, requires that all catch-up contributions to employer-sponsored retirement plans other than SEPs or SIMPLEs made by participants whose wages for the preceding calendar year exceed $145,000 be allocated to a Roth account.

In late August 2023 the IRS announced in Notice 2023-62 that the first two taxable years beginning after December 31, 2023, will be regarded as an administrative transition period with respect to the requirement that catch-up contributions made on behalf of certain eligible participants be designated as Roth contributions. Specifically, until taxable years beginning after December 31, 2025:

- Those catch-up contributions will be treated as satisfying the requirements of section 603 of the SECURE Act 2.0, even if the contributions are not designated as Roth contributions; and
- A plan that does not provide for designated Roth contributions will be treated as satisfying the requirements of section 603.

1.7.2 Employer Matching or Nonelective Roth Contributions

Although not mandatory, employers may offer plan participants in 401(k), 403(b) and 457(b) plans the ability to allocate some or all of their elective deferrals to a designated Roth account. However, prior to the passage of the SECURE Act 2.0, the ability to allocate plan contributions to a Roth account was restricted solely to plan participants. Even if the plan offered participants the ability to make such an allocation, no employer matching or nonelective contributions could be made to a Roth account.

Section 604 of the Act, effective upon enactment, changes that and authorizes defined contribution plans to:

- Make employer matching and nonelective contributions to a plan participant's designated Roth account; and
- Provide employees making qualified student loan payments[4] with the option of receiving matching contributions on a Roth basis.

Employer matching and nonelective contributions are normally subject to the plan's vesting schedule, however, matching and nonelective contributions made by a plan sponsor to a plan participant's Roth account are nonforfeitable at the time received and are includible in the participant's gross income.

[4] Section 110 of the SECURE Act treats repayments of student loans by employees as elective deferrals to the employer's qualified retirement plan for purposes of employer matching contributions.

Domain 2 – General Income Tax Review

Introduction

Although the tax laws change and applicable limits may be subject to cost of living adjustments and other changes, much of the tax code and the principles underlying federal income tax return preparation don't vary substantially from year to year. In the domain 2 text that follows, a general review of tax law related to preparation of 2024 individual 1040 tax returns will be provided.

Domain 2 Learning Objectives

When you have completed the domain 2 text, you should be able to:

- Describe the filing status name change of qualifying widow(er) to qualifying surviving spouse;
- Identify those items included in a taxpayer's taxable earnings;
- Determine the tax treatment of foreign accounts and trusts;
- Apply the rules governing contributions to and distributions from IRAs;
- Describe the reporting and taxability of unemployment compensation;
- Determine the itemized deductions available to a taxpayer;
- Recognize the items included in self-employment income and expenses;
- Distinguish between a hobby and a business for tax purposes;
- Calculate the tax deduction for business use of a home;
- Identify the recordkeeping requirements to substantiate Schedule C entries;
- Understand the tax treatment of retirement income;
- List the factors considered in determining the tax treatment of capital gains and losses;
- Recognize the eligibility requirements for various tax credits;
- Describe the rules governing a taxpayer's tax withholding and estimated tax payments;
- Recognize the options available to a taxpayer for paying any tax due or receiving a tax refund; and
- Identify the due dates of income tax returns.

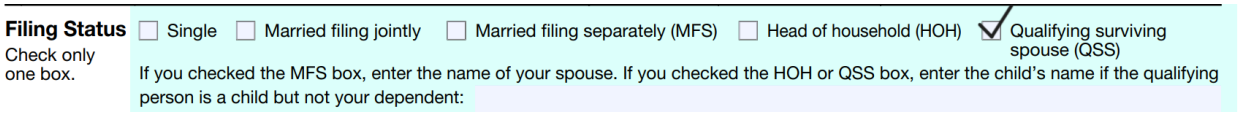
2.1 Filing Status Name Review

The IRS identifies five filing statuses. Filing status is generally determinant on whether the taxpayer is considered married or not. Those filing statuses include:

- Single(S), If on the last day of the year, the taxpayer is unmarried or legally separated from the taxpayer's spouse under a divorce or separate maintenance decree and the taxpayer does not qualify for another filing status.
- Married filing jointly(MFJ), The taxpayer is married and both the taxpayer and spouse agree to file a joint return. (On a joint return, the taxpayer reports combined income and deducts their combined allowable expenses.)
- Married filing separately(MFS), The taxpayer must be married. This method may benefit the taxpayer if they want to be responsible only for their own tax or if this method results in less tax than a joint return. If the taxpayer and spouse do not agree to file a joint return, they may have to use this filing status.
- Head of household(HOH), The taxpayer must meet the following requirements:
    1. The taxpayer is unmarried or considered unmarried on the last day of the year.
    2. The taxpayer paid more than half the cost of keeping up a home for the year.
    3. A qualifying person lived with the taxpayer in the home for more than half the year (except temporary absences, such as school). However, the taxpayer's dependent parent does not have to live with the taxpayer.
- Qualifying surviving spouse(QSS) For tax years 2022 and later, the IRS has changed the filing status name of Qualifying Widow(er)" to "Qualifying Surviving Spouse (QSS)." The specified qualifying rules and benefits have not changed with the name change, and continue to be as follows- A taxpayer, for the two years after the year of their spouse's death, may use the Qualifying Surviving Spouse filing status provided all five of the following criteria are met:

1. The taxpayer filed, or was eligible to file, as Married Filing Jointly the year in which their spouse died;
2. The taxpayer did not remarry during the year of their spouse's death nor in the two years immediately following it;
3. The taxpayer has a qualifying child or stepchild they may claim as a dependent; Note: A foster child does not qualify. However, a child that was lawfully placed with the taxpayer for legal adoption by the taxpayer does qualify.
4. The qualifying child resided with the taxpayer for the entire year, except for temporary absences (see below: 2.1.3); and
5. The taxpayer paid more than half the total cost of keeping up the home wherein both the taxpayer and the qualifying child resided for the year. Costs of keeping up a home include any of the following:
    a) food expenses,
    b) rent,
    c) mortgage interest (but **not** principal),
    d) home insurance,
    e) real estate taxes,
    f) utilities,
    g) repairs,
    h) maintenance, and
    i) other household expenses.

Note the filing status portion of the Form 1040, Form 1040-SR, and Form 1040-NR reflecting the Qualifying Surviving Spouse (QSS) status name change in the checked box below:



2.1.1 Benefits of Filing as Qualified Surviving Spouse

The tax benefits of filing as a Qualified Surviving Spouse are twofold:

1. The surviving spouse may take advantage of the Married Filing Jointly tax rate along with the common credits and deductions of that filing status; and
2. The surviving spouse may benefit from the Married Filing Jointly standard deduction, which is the highest standard deduction available.

During the year in which the taxpayer's spouse died, the taxpayer may use the filing status as Married Filing Jointly. The Qualifying Surviving Spouse filing status may only be applicable to the taxpayer for a maximum of 2 years immediately following the year in which their spouse died so long as the surviving spouse does not:

a) Remarry during the year their spouse died, or
b) Remarry during either of the 2 years following the year their spouse died.

If the taxpayer did not remarry during the year in which their spouse died, that taxpayer may file as Married Filing Jointly. If that same taxpayer did not remarry anytime during the two tax years after their spouse died, that taxpayer may file as Qualified Surviving Spouse. Once those two tax years have expired and the taxpayer has not remarried, that taxpayer is now considered to be single for tax filing purposes.

2.1.2 Criteria for Filing as Qualifying Surviving Spouse

A taxpayer, for the two years after the year of their spouse's death, may use the Qualifying Surviving Spouse filing status provided all five of the following criteria are met:

1. The taxpayer filed, or was eligible to file, as Married Filing Jointly the year in which their spouse died;

2. The taxpayer did not remarry during the year of their spouse's death nor in the two years immediately following it;
3. The taxpayer has a qualifying child or stepchild they may claim as a dependent; Note: A foster child does not qualify. However, a child that was lawfully placed with the taxpayer for legal adoption by the taxpayer does qualify.
4. The qualifying child resided with the taxpayer for the entire year, except for temporary absences (see below: 2.1.3); and
5. The taxpayer paid more than half the total cost of keeping up the home wherein both the taxpayer and the qualifying child resided for the year. Costs of keeping up a home include any of the following:
    a) food expenses,
    b) rent,
    c) mortgage interest (but **not** principal),
    d) home insurance,
    e) real estate taxes,
    f) utilities,
    g) repairs,
    h) maintenance, and
    i) other household expenses.

2.1.3 Exceptions and Special Circumstances

Situations may arise in which the taxpayer or the qualifying child may not meet the specified criteria, yet still meet the criteria for the filing status of Qualifying Surviving Spouse. Those exceptions to the criteria are temporary absences, birth or death of a child, and a kidnapped child.

1. Temporary Absences: The taxpayer is considered to have lived together with the qualifying child all year even if either the taxpayer or qualifying child is away for a temporary absence. A temporary absence includes temporarily living away from home for:

    a) School,
    b) Business,
    c) Military service,
    d) Detention in a juvenile facility,
    e) Medical treatment, or
    f) Vacation.

    With a temporary absence, the critical element is that there is an expectation the taxpayer or qualifying child will return home after the absence. Additionally, the taxpayer must keep up the home during the temporary absence.

2. Birth or Death of a Child: The taxpayer can still file as Qualifying Surviving Spouse if the qualifying child was born or died during the year, providing the taxpayer paid more than half of the cost of keeping up the home the child lived in for the entire part of the year the qualifying child was alive.
3. Kidnapped Child: If the taxpayer's qualifying child was kidnapped during the year, the taxpayer may file as Qualifying Surviving Spouse providing each of the following three statements is true:
    a) Law enforcement deemed the qualifying child to have been kidnapped by someone other than the taxpayer's family member or the qualifying child's family member,
    b) In the year in which the qualifying child was kidnapped, the child resided with the taxpayer for more than half of the portion of the year before being kidnapped, and
    c) The taxpayer would have been able to file as Qualifying Surviving Spouse if the qualifying child had not been kidnapped.

2.2 Taxability of Earnings

Taxpayers who are employees should receive an IRS Form W–2 from their employers. The amount shown in box 1 of the form is the total of wages and/or salary received from the employer during the year. That amount, along with any other compensation received for services as other than an independent contractor, must be included on the taxpayer's income tax return.

Among the other types of compensation received by a taxpayer that may or may not be taxable are the following:

- Advance commissions and other earnings;
- Allowances and reimbursements;
- Back pay awards;
- Bonuses and awards;
- Differential wage payments;
- Government cost-of-living allowances;
- Nonqualified deferred compensation plans;
- Notes received for services;
- Severance pay;
- Sick pay;
- Social Security and Medicare taxes paid by the taxpayer's employer; and
- Stock appreciation rights.

Let's briefly consider each of these compensation types.

2.2.1 Advance Commissions and Other Earnings

If a cash method taxpayer receives advance commissions or other amounts for services to be performed in the future, the taxpayer must include those amounts in income in the year in which they are received. However, if the taxpayer repays any unearned commissions or other similar amounts in the same year in which they are received, the amount included in the taxpayer's income should be reduced by the amount of such repayment. In contrast, if the taxpayer repays advance commissions or other earnings in a later tax year, the taxpayer can deduct the repayment as an itemized deduction on his or her Schedule A or may be able to take a credit for that year.

2.2.2 Allowances and Reimbursements

An employer may provide a reimbursement or allowance for business expenses that a taxpayer incurs while performing his or her job functions for the employer. Such reimbursements or allowances may be provided under an accountable or nonaccountable plan. Depending upon which approach is taken by the employer—whether it is under an accountable or nonaccountable plan, in other words—the expense allowance or reimbursement may or may not be included in the taxpayer's IRS Form W-2.

Allowances and reimbursements provided by an employer under an accountable plan are not normally included in the taxpayer's IRS Form W-2. In contrast, amounts provided to a taxpayer as an allowance or reimbursement made under a nonaccountable plan are included and are taxable.

An accountable plan under which an employer provides a reimbursement or allowance for business expenses is characterized by the following:

1. The taxpayer employee's expenses for which an allowance or reimbursement is provided must be connected to the employer's business;
2. The employee must account for expenses incurred on the employer's behalf within a reasonable time period; and
3. The employee is required to return any reimbursement or allowance in excess of the actual business expenses incurred within a reasonable period.

A nonaccountable plan is simply a reimbursement or allowance plan provided by an employer for the taxpayer under which any of the characteristic requirements of an accountable plan are **not** required.

The exception to the non-taxable nature of allowances and reimbursements provided to a taxpayer under an accountable plan are employer payments under such a plan that either a) reimburse nondeductible expenses or b) are in excess of actual expenses incurred and which the taxpayer fails to return to the employer.

2.2.3 Back Pay Awards

Back pay awards are those awards granted in a settlement or judgment for back pay. These awards include payments made to the taxpayer for:

- Damages;
- Unpaid life insurance premiums; and
- Unpaid health insurance premiums.

Such back pay awards should be included in the IRS Form W-2 provided by the employer and must be included in the taxpayer's income.

2.2.4 Bonuses and Awards

Bonuses or awards the taxpayer receives from an employer for outstanding work—awards such as vacation trips for meeting sales goals, etc.—must be included in the taxpayer's income and should be shown on the IRS Form W-2. An exception to the requirement that awards be included in income for tax purposes applies to certain employee achievement awards.

If a taxpayer receives tangible personal property, other than cash or its equivalent, as an award from an employer for the taxpayer's length of service or safety achievement, the value of such an award can be excluded from the taxpayer's income within prescribed limits. Thus, the amount the taxpayer may exclude from income for a qualified plan award is limited to the taxpayer's employer's cost and cannot be more than $1,600 for all such awards the taxpayer receives during the year. A qualified plan award is an achievement award given as part of an established written plan or program that does not favor highly compensated employees as to eligibility or benefits. If the award is other than a qualified plan award, the excluded amount is limited to no more than $400.

The ability to exclude the value of certain awards from a recipient's income does not apply to the following awards:

- A length of service award if the taxpayer received it for less than five years of service or if the taxpayer received another length of service award during the year or in the previous four years; or
- A safety achievement award if the taxpayer is a manager, administrator, clerical employee, or other professional employee or if more than 10% of eligible employees previously received safety achievement awards during the year.

2.2.5 Differential Wage Payments

A differential wage payment is defined as a payment made to the taxpayer by an employer for any period of more than 30 days during which the taxpayer was an active duty member of the uniformed services and represents all or a portion of the wages the taxpayer would have received from the employer during that period. Although differential wage payments are treated as wages subject to income tax withholding, they are not subject to FICA or FUTA taxes. The payments are reported as wages on IRS Form W-2 and must be included in income.

2.2.6 Government Cost of Living Allowances

If the taxpayer is stationed outside the continental United States or in Alaska, his or her gross income does not generally include cost-of-living allowances granted by regulations approved by the president of the United States, except as to amounts received under Title II of the Overseas Differentials and Allowances Act. The cost-of-living portion of any other allowance—a living and quarters allowance, for example—is not included in the taxpayer's income even if the underlying allowance is included in gross income. Cost-of-living allowances are not included on the taxpayer's IRS Form W-2.

2.2.7 Nonqualified Deferred Compensation Plans

A taxpayer who is a participant in an employer's nonqualified deferred compensation plan will receive an IRS Form W-2 showing the amount of deferrals for the year under the plan in box 12, using code Y. Although the amount of deferrals is shown on IRS Form W-2, the amount shown is not included in the taxpayer's income for tax purposes until distributions from the plan are received or the plan fails to meet certain requirements.

If at any time during the tax year the plan fails to meet those requirements or is not operated pursuant to them, all amounts deferred under the plan for the tax year and all preceding tax years are

included in the taxpayer's income for the current year. In such a case the amount thus shown would be included in the taxpayer's wages included in IRS Form W-2, box 1 and in box 12, using code Z.

2.2.8 Notes Received for Services

If a taxpayer receives a ***secured note*** as payment for his or her services, the taxpayer is required to include the fair market value—usually the discount value—in income in the year in which the note is received. When the taxpayer later receives payments on the note, a proportionate part of each payment is considered a tax-free recovery of the fair market value previously included in the taxpayer's income. The balance of the payment in excess of that tax-free amount must be included in income when received.

If a taxpayer receives a ***nonnegotiable unsecured note*** in payment for services, payments on the note that are credited towards the principal amount of the note are compensation income when received by the taxpayer. However, no income needs to be recognized in the year in which the nonnegotiable unsecured note is received by the taxpayer.

2.2.9 Severance Pay

The taxpayer must include in income any amount received from an employer as severance pay as well as any payment for the cancellation of the taxpayer's employment contract.

2.2.10 Sick Pay

Payments received from an employer while the taxpayer is sick or injured are considered part of the taxpayer's salary or wages and generally must be included in the taxpayer's income. Thus, the following sick pay benefits must be included:

- Payments from a welfare fund;
- Payments from a state sickness or disability fund;
- Payments from an association of employers or employees; and
- Payments from an insurance company if the employer paid for the plan.

However, if the taxpayer received benefits under an accident or health insurance policy for which he or she paid the premiums—a disability income policy, for example—such benefits would not be taxable.

2.2.11 Social Security and Medicare Taxes Paid by an Employer

Basic Social Security and Medicare taxes are normally paid by both the employer and employee. In some cases, however, an employer may agree to pay an employee's share of Social Security and Medicare taxes without deducting them from the taxpayer's gross wages. In such a case, the employee's share of Social Security and Medicare taxes paid by the employer are treated as taxable income. In addition, such payments are also treated as wages for figuring Social Security and Medicare taxes. The exception to this general rule applies in the case of a farm worker or household worker. In the case of such taxpayers, the Social Security and Medicare taxes paid by the employer are not treated as Social Security and Medicare wages.

2.2.12 Stock Appreciation Rights

A taxpayer who receives a stock appreciation right granted by his or her employer is not required to include the right in income until the taxpayer exercises it. When the taxpayer exercises the right, the taxpayer is entitled to a cash payment equal to the fair market value of the corporation stock on the date of exercise minus the fair market value on the date the right was granted. The taxpayer must include the cash payment in income in the year in which he or she exercises the right.

2.2.13 Tip Income

All tips the taxpayer receives are included in income and subject to federal income tax. Thus, the taxpayer is required to include in gross income any and all tips received directly, charged tips paid to the taxpayer by the employer and any tips received by the taxpayer under a tip splitting or tip pooling

arrangement. Additionally, the value of non-cash tips—tickets to sporting events and other items of value, for example—are considered income and also subject to income taxes.

Taxpayers who receive tips must:

- Keep a daily tip record;
- Report tips to his or her employer; and
- Report all tips on the taxpayer's income tax return.

2.3 Schedule B, Interest, Dividends, Foreign Accounts and Trusts

Form 1040 Schedule B, interest and ordinary dividends, is filed if the taxpayer:

- Had more than $1,500 of taxable interest or ordinary dividends;
- Received interest from a seller-financed mortgage and the buyer used the property as a personal residence;
- Has accrued interest from a bond;
- Is reporting original issue discount (OID) in an amount less than the amount shown on Form 1099–OID;
- Is reducing his or her interest income on a bond by the amount of amortizable bond premium;
- Is claiming the exclusion of interest from series EE or I U.S. savings bonds issued after 1989;
- Received interest or ordinary dividends as a nominee; or
- Had a financial interest in, or signature authority over, a financial account in a foreign country or received a distribution from, or was a grantor of, or transferor to, a foreign trust.

Thus, Schedule B must be filed if ***any*** of the above-mentioned situations apply. However, even if Parts I and II of Schedule B must be completed, Part III of the Schedule needs to be completed only if certain specified conditions apply. Part III of Form 1040 Schedule B must be completed only if the taxpayer:

- Had more than $1,500 of taxable interest or ordinary dividends;
- Had a foreign account; or
- Received a distribution from, was a grantor of, or transferor to, a foreign trust.

The tax preparer must check the "yes" box on line 7a of Part III of the Schedule if the taxpayer had a financial interest in or signature authority over a financial account located in a foreign country.

For purposes of completing Schedule B, a **financial account** is broadly defined to include (but isn't limited to):

- A securities account, brokerage account, savings, demand, checking, deposit, time deposit or other account maintained with a financial institution;
- A commodity futures or options account;
- An insurance policy with a cash value;
- An annuity policy with a cash value; and
- Shares in a mutual fund or similar pooled fund.

A financial account is located in a foreign country if the account is physically located outside of the United States.

2.4 Retirement Income Reporting and Taxability

Retirement income includes income derived from a range of sources, both private and public. Although some retirement income is excludable, in whole or part, from income, most retirement income is taxable as ordinary income in the year received. This section will consider the taxability and reporting requirements of distributions received from:

- Social Security;
- Pensions;
- Annuities; and
- 401(k) plans.

2.4.1 Social Security Benefits

Social Security benefits include monthly retirement, survivor and disability benefits paid under the Social Security system. The benefits may be entirely tax-free or partially taxable.

2.4.1.1 Taxability of Benefits

The taxability of Social Security benefits received by a taxpayer depends on the recipient's total income. Social Security benefits may be entirely tax-free or partially taxable depending upon whether the total of:

- Half the net Social Security benefits received during the year by the taxpayer (total benefits received during the year less any Social Security benefits repaid during the year); plus
- All other income received by the taxpayer (including tax-exempt interest)

…exceeds the base amount for the taxpayer's filing status. In general, the higher the total of the taxpayer's Social Security benefits and other income, the greater will be the taxable part of the taxpayer's Social Security benefits.

To determine how much of the taxpayer's net Social Security benefits are taxable, if any, complete Worksheet 1 contained in IRS Publication 915. Tax preparation software also will normally figure the taxable portion of any Social Security benefits.

When calculating the total of ½ the net Social Security benefits plus the taxpayer's other income with which to compare to the base amount for the taxpayer's filing status, the total of certain adjustments is determined. The adjustments are:

- Educator expenses;
- Certain business expenses of reservists, performing artists and fee-basis government officials;
- Health savings account deductions;
- Moving expenses;
- The deductible part of self-employment tax;
- Contributions to various tax favored retirement plans;
- Self-employed health insurance premiums;
- The penalty paid on any early withdrawal of savings;
- Alimony paid under pre-2019 agreements; and
- Deductible contributions to an IRA.

If the sum of the adjustments equals or exceeds the total of ½ the net Social Security benefits plus the taxpayer's other income, none of the taxpayer's Social Security benefits are taxable. However, if the sum of the adjustments is less than the total of ½ the net Social Security benefits plus the taxpayer's other income, the sum of the adjustments must be deducted from the total of ½ the net Social Security benefits plus the taxpayer's other income. The resulting amount is then compared with the applicable base amount. If the resulting amount is less than or equal to the applicable base amount, the taxpayer's Social Security benefits are tax-free.

However, if the resulting amount is greater than the applicable base amount, a portion of the taxpayer's net Social Security benefits—up to 85%—must be included in income and is subject to income tax.

The base amount with which ½ the taxpayer's net Social Security benefits plus other income must be compared varies, depending upon the taxpayer's filing status and is:

- $25,000 if the taxpayer files as single, head of household, or a qualifying surviving spouse;
- $25,000 if the taxpayer files as married filing separately and lived apart from his or her spouse for all of the tax year;
- $32,000 if the taxpayer files as married filing jointly; or
- $0 if the taxpayer files as married filing separately and lived with his or her spouse at any time during the tax year.

2.4.1.2 Reporting

If any part of the taxpayer's Social Security benefit is taxable, the taxpayer must file a federal tax return.

The taxpayer's net Social Security benefits—the amount shown in IRS Form SSA–1099, box 5—must be entered on the line for Social Security benefits, and the taxable portion of the benefit must be entered on the adjacent line "Taxable amount." If the taxpayer is married filing separately and has lived apart from his or her spouse for all the tax year, also enter "D" to the right of the word "benefits."

If the Social Security benefits are not taxable, the net benefits should be entered on the appropriate lines, and 0 should be entered on the line for "Taxable amount." If the taxpayer is married filing separately and lived apart from his or her spouse for all the tax year, also enter "D" to the right of the word "benefits" on IRS Form 1040.

2.4.2 Qualified Retirement Plans

The term "qualified retirement plan" refers to plans maintained by an employer that provide retirement income to employees or result in a deferral of income by employees for periods extending generally to the end of employment. Such plans include traditional pension plans, profit sharing plans, 401(k) plans, stock bonus plans and several other types of plans.

2.4.2.1 Contributions to Qualified Employee Plans

Funding plan participants' income in retirement requires that *someone* must make contributions. Depending on the qualified employee plan, those contributions may be made by employers and/or plan participants.

2.4.2.2 Employee Plan Contributions

Employee contributions to employer retirement plans are generally known as "elective deferrals" and are characteristic of 401(k) plans and 403(b) tax sheltered annuity plans. Unless elective deferrals are directed to a designated Roth account in the plan, the funds deferred are allocated to the plan before income taxes are paid. Funds allocated to a designated Roth account, in contrast, are made on an after-tax basis.

Plan participants are limited in the amounts they may defer under a 401(k) or 403(b) plan in any year to the lesser of:

- 100% of the plan participant's compensation; or
- A specified dollar amount that generally increases annually based on a cost of living adjustment.

The specified dollar amount in 2024 is $23,000.[5] The applicable limit on elective deferrals generally applies to the total of all elective deferral contributions (in the aggregate) made to such plans. Participants in 401(k) plans and 403(b) tax sheltered annuity plans that are age 50 or older by the end of the year may make catch-up contributions. The catch-up provision in the law permitting increased contributions by age 50 and older participants increases the otherwise applicable dollar limit on elective deferrals.

Accordingly, the additional elective deferral that age 50 and older participants in a 401(k) or 403(b) tax sheltered annuity plan are permitted is equal to the lesser of:

- The applicable catch-up dollar amount; or
- The amount of the participant's compensation (reduced by any other elective deferrals for the year).

The applicable dollar amount for 2024 catch-up contributions is $7,500 and is indexed for inflation in subsequent years.

2.4.2.3 Qualified Retirement Plan Distributions

The tax treatment of distributions from a qualified retirement plan—other than qualified distributions from a designated Roth 401(k) or Roth 403(b) account—are generally taxable as ordinary income to the plan participant or beneficiary who receives them. Any distribution made to a participant from a qualified plan—even if the distribution will be rolled over to another plan—requires that the trustee of

[5] IRC §402(g)(1).

the distributing plan withhold 20% of the distribution for taxes. Qualified distributions from a designated Roth 401(k) or Roth 403(b) account are tax free.

2.4.2.3.1 Early Distributions

A participant who takes a distribution from a qualified retirement plan before age 59 ½ is subject to a premature distribution tax penalty equal to 10% of the amount of the distribution the participant must include in income unless an exception applies. An exception applies if the participant is disabled or deceased or the distribution is:

- Part of a series of substantially-equal lifetime payments;
- Pursuant to a qualified domestic relations order;
- For medical care to the extent tax deductible;
- Made to correct excess contributions;
- Made to a terminally ill individual, i.e., diagnosed with a disease expected to result in death within 84 months;
- Made on account of separation of service after attainment of age 55; or
- A qualified birth or adoption distribution not exceeding $5,000.

2.4.2.4 Required Qualified Plan Minimum Distributions

The SECURE Act 2.0 has increased the age at which RMDs must begin for individuals who attain age 72 after 2022 to age 73. Accordingly, traditional IRA holders may defer receipt of their first RMD until April 1st of the year following their 73rd birthday. Qualified plan participants continuing to be employed by the employer sponsoring the plan in which they participate may delay their RMDs until the later of age 73 or retirement. They, too, may defer receipt of the payment until April 1st of the year following age 73 or retirement.

The SECURE Act 2.0 effectively reduces the excise tax from 50% to 25% for a taxpayer failing to take an RMD by the required date from an IRA or other retirement account. The 25% excise tax is further reduced to 10% in the case of an RMD insufficiency of IRA proceeds if the failure is corrected by the end of the second taxable year that begins after the end of the taxable year in which the distribution was required to be made.

2.4.2.5 Qualified Plan Rollovers

When a participant in a qualified plan leaves the employ of the plan sponsor, the participant may roll over the assets to his or her credit in the plan—an amount equal to the participant's vested account balance, in other words—and avoid current taxation of the funds. To avoid the plan trustee's required 20% withholding, the rollover must be made by the plan trustee to the trustee of the new plan or IRA.

2.4.2.6 Plan Death Benefits

The net amount at risk under a policy contained in a qualified plan—the difference between the policy's death benefit and its cash value—is generally received entirely free of income taxation. The policy cash value, less the amount of any imputed income recognized by the participant during lifetime due to the inclusion of life insurance in the plan, is subject to taxation at ordinary income rates.

2.4.2.7 Designated Roth Account Distributions

Elective deferrals designated to a 401(k) or 403(b) plan's Roth account do not enjoy the favorable before-tax treatment given contributions to non-Roth accounts. Instead, such Roth account elective deferrals are made with after-tax funds. The income tax benefits to which a participant in a Roth account may be entitled, in addition to tax-deferral of earnings, arise at the time of distribution.

2.4.2.7.1 Qualified Roth Account Distributions Tax-Free

Qualified distributions from a Roth account are received entirely tax-free. A qualified distribution from a Roth account is a distribution that is made no earlier than after a five taxable-year period beginning with the first year for which a contribution is made to the Roth account and which is:

- Made on or after the participant's age 59½;
- Attributable to the participant's disability;
- Made following the participant's death; or
- A qualified reservist distribution.

2.4.2.7.2 Nonqualified Roth Account Distributions

A nonqualified distribution from a designated Roth account on which earnings have been credited—a distribution that fails to meet the requirements of a ***qualified*** Roth distribution—is partially taxable. The portion of the nonqualified distribution that constitutes the employee's contribution is received tax-free. The balance of the distribution—the portion that is comprised of the earnings, in other words—is taxable.

2.4.3 Annuities

Annuities may be classified according to a range of characteristics; however, the important classifications with respect to an annuity's tax treatment relate to whether the annuity is a deferred annuity or an immediate annuity and whether it is a qualified annuity or a nonqualified annuity. A deferred annuity is an annuity under which periodic income payments are delayed following the annuity purchase until some date in the future, often for a period of many years. Unlike a deferred annuity, an immediate annuity is one in which the first periodic income payment is due one income payment interval after the date the annuity was purchased. Thus, if the income will be paid monthly, the first payment will be received after one month; if the income will be paid semi-annually, the first payment will be received after 6 months.

A qualified annuity is an annuity that is included in a qualified plan or individual retirement account. Its tax treatment is generally determined by the nature of the plan in which it is included. Accordingly, if contributions to the plan are made on a before-tax basis, any contribution to an annuity contained in the plan is also made on a before-tax basis. A nonqualified annuity is an annuity that is purchased outside of a qualified plan or individual retirement account.

2.4.3.1 Nonqualified Annuity

Premiums that are paid for a nonqualified annuity contract are non-deductible, regardless of the type of annuity purchased. Interest credited to the cash value of an annuity is tax-deferred until distributed.

The taxability of a distribution from the cash value of a nonqualified annuity varies, depending on whether or not the distribution is considered:

- An amount not received as an annuity; or
- An amount received as an annuity, i.e., in periodic income payments.

Amounts not received as an annuity are distributions resulting from annuity surrenders, withdrawals and loans. Amounts received as an annuity are annuity distributions made as periodic payments. Although annuity contracts owned by natural persons enjoy deferred taxation of earnings, the earnings are not tax free. When the contract's cash value is distributed as *an amount not received as an annuity,* i.e., by surrender of the contract, by an annuity loan, or by withdrawal, any earnings on the contract are subject to taxation as ordinary income and are deemed to be distributed before any nontaxable premiums are distributed.

Payments received as periodic payments—either at the annuity starting date in a deferred annuity or upon purchase of an immediate annuity—are known as amounts received as an annuity and are generally taxed under the annuity rules. Under the annuity rules, distributions of the purchaser's investment in the contract are received in equal tax-free amounts over the payment period, and the balance of the periodic payment is ordinary income. When the taxpayer's entire investment in the contract has been fully recovered, all further periodic payments are taxable in their entirety.

In order to help assure that annuities are used for long-term accumulation and not for short-term investment purposes, the tax code prescribes a tax penalty for premature distributions. The tax penalty for premature distributions is equal to 10% of the distribution *that is includible in the recipient's income*. However, the tax penalty does not apply to any of the following:

- Payments made on or after the individual becomes age 59½;
- Payments attributable to the individual's becoming disabled;
- Payments allocable to investment in the contract before August 14, 1982;
- Payments made on or after the contract owner's death;
- Payments made under an immediate annuity contract;

- Payments made from an employer-purchased annuity upon the termination of a qualified employee plan; and
- Payments that are part of a series of substantially equal periodic payments made for the life or life expectancy of the individual or the joint lives or joint life expectancies of the individual and his or her designated beneficiary.

2.5 Individual Retirement Accounts

Individual retirement arrangements (IRAs), qualified plans and annuity contracts enjoy certain tax benefits, including tax deferral of gain, while funds are being accumulated within the plans. Accordingly, with some exceptions, distributions from these tax-favored plans are generally taxable as ordinary income.

An individual retirement account (IRA) is a personal retirement savings plan, funded by an annuity or a trust, provides for tax-deferral of earnings and may permit either tax-deductible contributions or tax-free qualified distributions. Unless the taxpayer is age 50 or older by the end of the year, the total contribution to all IRAs made for the year cannot exceed the lesser of $7,000 or the individual's compensation includable in gross income. If the taxpayer is age 50 or older by the end of 2024, a maximum additional contribution—a catch-up contribution—of $1,000 may be made.

Individual retirement accounts are fundamentally of two types:

- Traditional IRAs that may permit tax-deductible contributions and generally taxable distributions, and
- Roth IRAs whose contributions are not deductible but whose qualified distributions are entirely tax-free.

2.5.1 Traditional IRAs – Contributions & Distributions

Contributions to traditional IRAs are normally fully tax-deductible to a taxpayer unless the taxpayer or the taxpayer's spouse is an active participant in an employer-sponsored qualified plan and has a modified adjusted gross income in excess of a specified amount for his or her filing status. The specified amount tends to increase each year. The specified amounts for 2024 are shown in the following chart:

Taxpayer's Filing Status	2024 Applicable Dollar Amount	Phase-Out Income Range	Completely Phased-Out
Married filing jointly, qualifying surviving spouse	$123,000	$123,000 - $143,000	$143,000
Single, head of household (HOH)	$77,000	$77,000 - $87,000	$87,000
Unemployed spouse of active participant	$230,000	$230,000 – $240,000	$240,000
Married filing separately*	$0	$0 - $10,000	$10,000

*Not subject to cost-of-living adjustment

Distributions from traditional IRAs to which no after-tax contributions have been made are fully taxable as ordinary income. Traditional IRA distributions of after-tax contributions are received tax-free as a return of basis on a pro rata basis, and the remainder of the distribution is taxable.

2.5.1.1 Premature Distributions

In order to ensure that traditional IRAs are used for the purpose for which they were designed—to accumulate retirement savings—Congress imposed a limitation on their liquidity by specifying a penalty for premature distributions. Usually, in order to avoid a premature distribution penalty, the taxpayer must be at least age 59½ before receiving a distribution from an IRA.

The premature distribution penalty is equal to 10 percent of the amount of the distribution that is includible in the taxpayer's gross income. In many cases, because all contributions were deductible, the amount of the traditional IRA distribution that would be includible in gross income is the total amount of the distribution.

2.5.1.1.1 Premature Distributions Avoiding Tax Penalty

Although, tax penalties generally apply to IRA distributions before age 59 ½, there are certain premature distributions to which the 10 percent penalty tax doesn't apply. Those distributions include distributions:

- Made after a terminally-ill diagnosis;
- Made to correct an excess distribution;
- Made following a federally-declared disaster;
- Made at the taxpayer's death;
- Attributable to the taxpayer's disability;
- Made for medical care to the extent allowable as a medical expense deduction;
- Made for the payment of health insurance premiums by unemployed taxpayers;
- Made to pay qualified higher education expenses for the taxpayer, his or her spouse, child or grandchild;
- Considered "first-time homebuyer distributions" up to a lifetime maximum of $10,000;
- That are part of a series of substantially equal periodic payments made for the life of the taxpayer or the joint lives of the taxpayer and his or her beneficiary; or
- That are qualified birth or adoption distributions not exceeding $5,000.

2.5.1.2 Required Distributions during Owner's Lifetime

The Internal Revenue Code requires that minimum distributions from a traditional IRA begin at age 73 for taxpayers attaining age 72 after 2022 and age 73 before January 1, 2033. Accordingly, traditional IRA holders may defer receipt of their first RMD until April 1st of the year following their 73rd birthday. RMDs are further delayed to age 75 for an individual who becomes age 74 after December 31, 2032. The date on which RMDs must commence is known as the "required beginning date." Lifetime distributions no longer need to be taken from a Roth IRA.

In an apparent anomaly, RMDs from designated Roth accounts during the lifetime of the account holder were required prior to 2024. Beginning in 2024, RMDs from designated Roth accounts are no longer required during the holder's lifetime. RMDs required from a designated Roth account for 2023 may be delayed until April 1, 2024. However, such RMDs are unaffected by the change in law. Therefore, designated Roth RMDs required in 2023 must still be taken, even if deferred until April 1, 2024.

2.5.2 Roth IRAs

Roth IRAs differ from traditional IRAs in providing their most significant tax benefits when funds are distributed rather than when contributed as is the case in a traditional IRA. A Roth IRA provides income tax deferral of gain before distribution and may provide tax-free distribution of earnings. It does not provide for contribution deductibility, however.

A "qualified" distribution from a Roth IRA is one that is made no earlier than the fifth year following the year for which the owner made his or her first Roth IRA contribution and:

- The taxpayer is age 59 ½ or older;
- The distribution is a qualified first-time homebuyer distribution;
- The taxpayer is disabled; or
- The distribution is made to a beneficiary on or after the taxpayer's death.

There is an additional tax advantage on distributions that Roth IRA owners enjoy, even when the distribution isn't a qualified distribution: a nonqualified distribution—one that fails to meet the requirements to be a qualified distribution—from a Roth IRA receives FIFO tax treatment under which all contributions are deemed to be distributed tax free before any earnings are distributed.

2.5.2.1 Limits on Roth IRA Contributions

The maximum amount an individual can contribute to a Roth IRA is the same as a contribution that could be made to a traditional IRA: that is $7,000 (in 2024) or, if he or she is age 50 or older, $8,000. The maximum contribution that may be made to a Roth IRA is reduced, based on the individual's modified adjusted gross income, according to the following formula:

$$\text{Contribution reduction} = \frac{\text{MAGI – applicable dollar amount}}{\text{\$15,000 (\$10,000 if joint or married filing separate return)}} \times \text{Maximum contribution}$$

The "applicable dollar amount" in the Roth IRA formula is based on the individual's filing status, as shown in the following chart:

Federal Income Tax Filing Status	Applicable Dollar Amount (2023)	Applicable Dollar Amount (2024)
Single & head of household	$138,000	$146,000
Married, filing a joint return	$218,000	$230,000
Married, filing separately	$0	$0

2.5.2.2 Non-Qualified Roth IRA Distributions of Gain before 59 ½ Subject to Tax Penalty

It was noted earlier that a premature distribution—one made prior to the owner's age 59 ½—from a traditional IRA would result in a 10 percent tax penalty. The 10 percent premature distribution tax penalty is based on the amount that must be reported as a taxable distribution. The same is true of a Roth IRA.

Just as in the case of a traditional IRA, however, the penalty for a distribution of earnings before age 59½ from a Roth IRA is waived if the distribution is:

- Made after a terminally-ill diagnosis, i.e., diagnosed with a disease that is expected to result in death within 84 months;
- Made to correct an excess distribution;
- Made following a federally-declared disaster;
- Attributable to the IRA owner's death or disability;
- Made for medical care to the extent allowable as a medical expense deduction;
- Made by unemployed taxpayers for the payment of health insurance premiums;
- Used to pay qualified educational expenses;
- A qualified first-time homebuyer distribution;
- Part of a series of substantially equal periodic payments made for the life or life expectancy of the taxpayer or of the taxpayer and a designated beneficiary; or
- A qualified birth or adoption distribution not exceeding $5,000.

2.5.2.3 No Required Roth IRA Lifetime Distributions

Unlike ***traditional*** IRAs, Roth IRAs are not subject to required minimum distribution (RMD) rules during the owner's lifetime. Funds contributed to and accumulated within a Roth IRA can remain in the account as long as the owner wishes, even after age 73. However, required minimum distributions must be made following the owner's death.

2.5.3 IRA Rollover Per-Year Limit

Taxpayers are permitted to rollover an existing IRA to another IRA of the same type directly, in a trustee-to-trustee transfer. Rollover of an IRA to another IRA, regardless of whether it is direct or indirect, is not subject to trustee tax withholding. Trustee-to-trustee transfers from one IRA to another IRA, are not subject to the one-per-year limit and may be made at any time.

Alternatively, taxpayers may withdraw funds from an IRA and deposit them in another (or the same) IRA within 60 days of the distribution without having to recognize any income. This withdrawal and deposit treated as a rollover may be done once in any one-year period. A

taxpayer making such an IRA rollover must contribute 100% of the amount within 60 days of distribution to the new IRA or recognize income on the amount not timely deposited.

2.6 Reporting and Taxability of Unemployment Compensation

The term **unemployment compensation** includes any amount received under an unemployment compensation law of the United States or of a state. Accordingly, all the following benefits are considered unemployment compensation:

- Benefits paid by a state or the District of Columbia from the Federal Unemployment Trust Fund;
- State unemployment insurance benefits;
- Railroad unemployment compensation benefits;
- Disability payments from a government program paid as a substitute for unemployment compensation;
- Trade readjustment allowances under the Trade Act of 1974;
- Unemployment assistance under The Disaster Relief and Emergency Assistance Act of 1974;
- Unemployment assistance under the Airline Deregulation Act of 1978 Program; and
- Benefits from a private fund exceeding voluntary contributions to it made by the taxpayer.

2.6.1 Unemployment Compensation Taxable

Recipients of unemployment compensation are generally required to include all such compensation in income for tax purposes. The taxpayer should receive a Form 1099–G showing (in box 1) the total unemployment compensation paid. In most cases, the total amount of unemployment compensation shown should be entered on line 7 of Form 1040, Schedule 1.

In some cases—those involving certain governmental unemployment compensation programs to which the taxpayer contributed and unemployment compensation that was repaid—not all of the amount received during the year should be included as unemployment compensation. Let's consider each of these cases.

2.6.1.1 Nondeductible Contributions to Governmental Unemployment Compensation Plan

If the taxpayer made nondeductible contributions to a governmental unemployment compensation program, the amounts received by the taxpayer under the program are not includible as unemployment compensation until the taxpayer has received an amount equal to his or her entire contribution tax-free. In contrast, if the taxpayer deducted all his or her contributions to the program, the entire amount received under the program would be includible in the taxpayer's income.

2.6.1.2 Repayment of Unemployment Compensation

If the taxpayer repaid employment compensation received in 2024 in the same year, the tax preparer should subtract the amount repaid from the total amount of unemployment compensation received and enter the difference on line 7 of Form 1040, Schedule 1. On the dotted line next to the entry, enter "repaid" and the amount repaid by the taxpayer.

If the amount of unemployment compensation repaid during the year was more than $3,000, the taxpayer may take a tax credit for the year of repayment. In order to take a tax credit for repayment the taxpayer must have believed that he or she had an unrestricted right to the unemployment compensation at the time it was received. Pursuant to tax law prior to 2018, a taxpayer who repaid unemployment compensation received and included in income in a prior year of $3,000 or less, could deduct the amount repaid on Form 1040 Schedule A as a miscellaneous deduction. However, beginning in 2018 the taxpayer may not deduct the repayment from income in the year repaid.

2.7 Alimony – Pre 2019 and Post 2018 Divorce Agreements

Under the tax code before TCJA passage, alimony (but **not** child support) is deductible by the payer and included in the income of the recipient for tax purposes. Under the TCJA, that tax treatment continues only for alimony payments made pursuant to a divorce or separation agreement entered into on or before December 31, 2018. Thus, alimony payments made in 2018 are deductible to the payer and includible in the recipient's income.

However, under TCJA, §11051, alimony payments will no longer be tax-deductible to the payer or includible in the income of the recipient if made under:

a) A divorce or separation agreement entered into after December 31, 2018; or
b) A divorce or separation agreement entered into on or before December 31, 2018 but modified after that date if the modified agreement specifically provides that the provisions of the Tax Cuts and Jobs Act of 2017 will apply.

Alimony payments made under a divorce or separation agreement entered into on or before December 31, 2018 but paid after that date—with the exception of such payments made under a modified agreement described in b) above—will continue to be tax-deductible to the payer and includible in the income of the recipient.

2.8 Schedule C, Profit or Loss from Business (Sole Proprietorship)

Schedule C (Form 1040), Profit or Loss From Business, is the supplemental form attached to Forms 1040, 1040NR or 1041 and used to calculate the net profit or loss in a sole proprietorship.

A self-employed taxpayer is one who:

- Carries on a trade or business as a sole proprietor;
- Is an independent contractor;
- Is a member of a partnership; or
- Is in business for himself or herself in any other way.

2.8.1 Income & Expenses Defined

If there is a connection between any income the taxpayer receives and the taxpayer's business, the income is business income. A connection exists if it is clear that the payment of income would not have been made if the taxpayer did not have the business. Income from work the taxpayer performs on the side in addition to his or her regular job can be business income. It includes amounts the taxpayer received in his or her business that were properly shown on Forms 1099-NEC as nonemployee compensation in box 1 of the form.

The amount of time spent carrying on the activity is unimportant for tax purposes. Thus, an individual is considered self-employed if the person spends all his or her working hours as a self-employed individual or works as a self-employed person only in addition to other duties performed as an employee. Regardless of the amount of time a taxpayer spends in a self-employed activity, the taxpayer must file a tax return if his or her gross income is at least as much as the filing threshold for the individual's filing status and age. In addition, the taxpayer must also file Form 1040 Schedule SE, Self-Employment Tax, if:

- Net earnings from self-employment, excluding church employee income, were $400 or more; or
- The taxpayer had church employee income of $108.28 or more.

If the taxpayer is self-employed, his or her gross income includes:

- The amount on Schedule C (Form 1040), Profit or Loss From Business;
- The amount on Schedule C–EZ (Form 1040), Net Profit From Business; and
- The amount on Schedule F (Form 1040), Profit or Loss From Farming.

Gross income from self-employment is equal to the following (Schedule C, Part I):

1. Gross receipts or sales	$
2. Returns and allowances	$
3. Subtract line 2 from line 1	$
4. Cost of goods sold	$
5. Gross profit (subtract line 4 from line 3)	$
6. Other income	$
7. Gross income (add lines 5 & 6)	$

The total gross income minus the total business expenses equals the net profit or loss from the business activity. The taxpayer's net profit or loss should be entered on:

- Schedule SE, line 2; and
- Form 1040, Schedule 1, line 3 Business income or (loss).

However, if some of the investment in the self-employed activity is not at risk, the taxpayer must attach IRS Form 6198, and his or her loss may be limited.

Business expenses are the costs of operating the taxpayer's business. These expenses are costs the taxpayer does not have to capitalize or include in the cost of goods sold but can deduct in the current year.

In order to be deductible, a business expense must be:

- Ordinary, i.e., one that is common and accepted in the taxpayer's field of business, and
- Necessary[6], i.e., one that is helpful and appropriate for the taxpayer's business.

However, if any expense is partly for business and partly personal, the personal part of the expense must be separated from the business part. The personal part is not deductible.

2.8.2 Business vs. Hobby

Schedule C (Form 1040) is used to report a taxpayer's income or loss from a ***business*** operated or ***profession*** practiced as a sole proprietor. It is not used in connection with a taxpayer's hobby. An activity qualifies as a business if:

- The taxpayer's primary purpose for engaging in it is for income or profit; and
- The taxpayer is involved in the activity with continuity and regularity rather than sporadically.

The IRS presumes that an activity engaged in by a taxpayer is carried on for a profit if:

- It makes a profit during at least three of the last five tax years, including the current year; or
- It primarily involves breeding, showing, training or racing horses ***and*** it makes a profit in at least two of the last seven years.

To determine if an activity engaged in by the taxpayer is a business or hobby, the following factors should be considered:

- Does the time and effort put into the activity indicate the taxpayer intended to make a profit?
- Does the taxpayer depend on income from the activity?
- If the activity results in losses, are the losses due to circumstances beyond the taxpayer's control, or did they occur in the start-up phase of the business?
- Has the taxpayer changed methods of operation to improve profitability?
- Does the taxpayer or his/her advisors have the knowledge needed to carry on the activity as a successful business?
- Has the taxpayer made a profit in similar activities in the past?
- Does the activity make a profit in some years?
- Can the taxpayer expect to make a profit in the future from the appreciation of assets used in the activity?

A hobby, for tax purposes, is an activity **not** engaged in for profit or income. Any income from a hobby is reported on Form 1040 as "Other income." However, because of the loss of the miscellaneous itemized deductions as a result of passage of the Tax Cuts and Jobs Act, hobby expenses not exceeding hobby income—at least through 2025—are no longer deductible.

2.8.3 Business Use of a Home

In addition to these expenses incurred in the self-employed business, a taxpayer who uses a portion of his or her home in which to conduct the self-employed activity may also include certain expenses for business use of the home.

[6] An expense does not have to be indispensable to be considered necessary.

Although certain exceptions apply, qualifying for a home-office deduction for business use of a taxpayer's home generally requires that the taxpayer use part of his or her home:

- Exclusively and regularly as the principal place of business unless the space is used for the storage of inventory or product samples or as a daycare facility, in which case the requirement for exclusive use does not apply;
- Exclusively and regularly as a place where the taxpayer meets or deals with patients, clients or customers in the normal course of a trade or business;
- On a regular basis for certain storage use;
- For rental use; or
- As a daycare facility.

If the part of the taxpayer's home used is a separate structure, qualifying for a home-office deduction for its use requires that the separate structure be used exclusively and regularly in connection with the taxpayer's trade or business. However, the structure does not have to be the taxpayer's principal place of business or where he or she meets patients, clients, or customers.

2.8.3.1 Methods of Figuring the Home-Office Deduction

If a taxpayer qualifies for a home-office deduction by meeting the requirements, the next step is to figure the amount of tax deduction for which he or she qualifies. Two methods are available to calculate the home-office deduction:

- The actual expense method; and
- The simplified method.

2.8.3.1.1 Actual Expense Method

The actual expense method of figuring a home-office deduction uses the actual expenses incurred by the taxpayer as the basis for determining the deduction allowable for business use of the taxpayer's home. Bear in mind when using the actual expense method to figure the home-office deduction that a taxpayer cannot deduct expenses for the business use of a home incurred during any part of the year he or she did not use the home for business purposes. Thus, a taxpayer who begins using part of his or her home for business purposes beginning on July 1st of the year and who qualifies for a home-office deduction cannot consider expenses for the period prior to July 1st. Instead, the taxpayer may consider only those expenses for the period July 1 through December 31 in figuring the allowable deduction.

When using the actual expense method for figuring the home-office deduction for a client, a tax return preparer must determine:

- The nature of the expense, i.e., whether the expense is –
    - A direct expense,
    - An indirect expense, or
    - An unrelated expense; and
- The percentage of the home used for business purposes.

2.8.3.1.1.1 Nature of the Expense

When determining the nature of the taxpayer's expense, expenses are placed into one of the following three categories:

- Direct expenses;
- Indirect expenses; and
- Unrelated expenses.

Direct expenses are expenses applicable to and affecting only the business part of the taxpayer's home. These expenses are normally deductible in full, subject to any applicable deduction limit. (See **Deduction Limit** below.)

Indirect expenses are those expenses the taxpayer incurs for keeping up and running his or her entire home. Such indirect expenses are deductible under the home-office deduction ***only*** in an amount based on the percentage of the taxpayer's home used for business purposes. Similar to direct expenses, the deduction of indirect expenses is subject to the applicable deduction limit.

The third category of taxpayer expenses—expenses that are unrelated—are expenses applicable only to the parts of the taxpayer's home that are not used for business purposes. These unrelated expenses are not deductible.

2.8.3.1.1.2 Percentage of the Home Used for Business

Although direct expenses attributable to business purposes are deductible under the home-office deduction irrespective of the percentage of the home actually used by the taxpayer for business purposes, indirect expenses are not. Instead, indirect expenses are deductible under the permitted home-office deduction only in an amount equal to the total of such indirect expenses multiplied by the percentage of the home used for business.

2.8.3.1.1.3 Calculating Percentage of Home Used for Business

A taxpayer is permitted to use any reasonable method to determine the percentage of his or her home used for business purposes. Two methods commonly used for determining the applicable percentage of a home for purposes of the home-office deduction are:

1. Dividing the square footage of the home used for business purposes by the total square footage of the home; or
2. Dividing the number of rooms used for business by the total number of rooms in the taxpayer's home.

Determining the percentage of a taxpayer's home used for business purposes by dividing the number of rooms used for business by the total number of rooms in the house should be used only if the rooms in the house are all of approximately the same size. Hallways and bathrooms are excluded in determining square footage or number of rooms in calculating percentage of home used for business.

2.8.3.1.1.4 Deductible Expenses for Home-Office Deduction

Expenses that are deductible under the home-office deduction fall into two categories and include the following:

- Expenses that are deductible by the taxpayer whether or not the taxpayer uses the home for business purposes, i.e. they are deductible by all homeowners; and
- Expenses that are deductible by the taxpayer only if the taxpayer uses the home for business purposes.

2.8.3.1.1.5 Expenses Deductible by All Homeowners

Expenses that are deductible by all homeowners, whether or not the home is used for business purposes, include the following:

- Real estate taxes, within prescribed limits;
- Deductible mortgage interest; and
- Casualty losses from a federally-declared disaster.

If the taxpayer qualifies for the home-office deduction, these amounts should be multiplied by the percentage of the home used for business purposes to figure the taxpayer's total deduction for business use of the home.

2.8.3.1.1.6 Expenses Deductible only by Taxpayers Using a Home for Business

In addition to those expenses that are deductible by all homeowners, many additional expenses are deductible by homeowners who use their homes for business purposes. These are expenses that would not normally be deductible by the homeowner except for the home's business use.

Principal among those expenses that are deductible by a homeowner who uses the home for business purposes, in an amount determined by the percentage of the home used for business, are the following:

- Depreciation, a deduction designed to reflect the wear and tear on the portion of the taxpayer's home used for business –
    - If the home was used for business in years before the current year, the taxpayer should continue using the same method of depreciation used in those prior years, or

    - If the home was placed in use for business purposes in the current year, the business part of the home should be depreciated as nonresidential business property under the modified accelerated cost recovery system (MACRS);
- Insurance premium for insurance covering the business part of the home only for the current tax year;
- Rent paid for the use of unowned property used in the taxpayer's trade or business calculated by multiplying the total rent payments for the period the home was used for business by the percentage of the home used for business purposes.;
- Repairs –
    - Deductible entirely if the repair costs are direct expenses, or
    - Deductible in part if the repair costs are indirect expenses in an amount equal only to the cost of repairs multiplied by the percentage of the home used as a home office;
- Security system maintenance and monitoring expenses –
    - Business part of costs of installation of the security system (based on percentage of home used for business) is depreciable, and
    - Business part of expenses to maintain and monitor the system is deductible if the security system protects all the doors and windows in the taxpayer's home; and
- Expenses for utilities and services, deductible in an amount equal to the expenses incurred for the utilities and services multiplied by the percentage of business use.

Although these expenses are deductible by a taxpayer using his or her home for business purposes, it is important to keep in mind that only the ***business percentage*** of these expenses is deductible.

2.8.3.1.1.7 Deduction Limit

The home-office deduction is not unlimited. Instead, if a taxpayer uses the actual expense method for claiming a home-office deduction, the deduction of otherwise nondeductible expenses—expenses such as insurance, utilities and depreciation allocable to the business—is limited to the taxpayer's gross income from the business use of the home minus the sum of the following:

1. The business portion of expenses the taxpayer could deduct even if he or she did not use the home for business purposes. Such expenses include eligible mortgage interest, real estate taxes (not exceeding prescribed limits) and net qualified disaster losses allowable as itemized deductions on Schedule A (Form 1040); and
2. The business expenses that relate to the business activity carried on in the home but not to the home itself. Such expenses include the costs of business telephone, supplies and equipment depreciation. (A self-employed taxpayer should not include the deductible one half of self-employment tax in the business expenses that must be subtracted from gross income.)

In applying the deduction limit to a taxpayer's home-office deduction, the depreciation deduction should be taken last. If the taxpayer's home-office deduction in any year is reduced by the deduction limit, the taxpayer may carry over the excess to the next year in which he or she uses the actual expense method in claiming a home-office deduction. The carried-over expenses are subject to the deduction limit for the year to which they are carried over, whether or not the taxpayer lives in the same home during that year.

2.8.3.1.2 Simplified Method

Instead of using the actual expense method of determining a taxpayer's home-office deduction, a simplified method—available for years beginning January 1, 2013—may be used. When calculating the home-office deduction using the simplified method, the deduction is equal to the area of the taxpayer's home used for a qualified business use (not exceeding 300 square feet) multiplied by the prescribed rate. The current prescribed rate is $5, but the Internal Revenue Service and the Treasury Department may update the prescribed rate from time to time.

Election of the simplified method is irrevocable for the year made. The taxpayer's election of whether to use the actual expense method or simplified method is one that is made each year. The election to use the simplified method to figure the home-office deduction must be made on a ***timely filed***, original federal income tax return.

In addition to the expense deduction for business use of a home calculated using the simplified method, business expenses not related to the taxpayer's use of a home are also deductible.

2.8.3.1.2.1 Depreciation and Actual Expenses Related to Use of Home not Deductible

If a taxpayer elects to use the simplified method of determining the home-office deduction, neither depreciation nor any actual expenses other than those not related to use of the home, may be deducted. (Business expenses not related to the taxpayer's use of the home continue to be deductible.)

2.8.3.1.2.2 No Deduction of Actual Expense Carryover for Simplified Method Users

If a taxpayer used the actual expense method to figure the home-office deduction in a previous year and has an expense carryover because the deduction was limited in that year, no portion of the carried-over amount may be deducted in any year in which the taxpayer uses the simplified method. In such a case, the taxpayer will continue to carry over the disallowed amount to the next year in which he or she uses actual expenses to figure the home-office deduction.

2.8.3.1.2.3 Expenses Deductible Irrespective of Business Use

The expenses that would be deductible by a taxpayer whether or not claiming a home-office deduction are treated differently, depending on whether the actual expense method or simplified method is used. Unlike the expense treatment under the actual expense method of expenses that are deductible irrespective of business use of the taxpayer's home—expenses such as mortgage interest, real estate taxes and casualty losses—such expenses must be treated as personal expenses by a taxpayer using the simplified method of determining the home-office deduction.

2.8.3.1.2.4 Special Rules Applicable to Simplified Method

Special rules apply to a taxpayer using the simplified method to determine the home-office deduction under certain circumstances. Those special rules are applicable in the case of:

- **Shared use of a home** - If a taxpayer shares his or her home with someone else who also uses the home in a business that qualifies for the home-office deduction, each user must make his or her own election as to the method used for calculating the deduction;
- **Multiple qualified business uses** - If a taxpayer conducts multiple businesses that qualify for the home-office deduction, the taxpayer's election to use the simplified method applies to all of the taxpayer's qualified business uses of that home;
- **Multiple homes** - A taxpayer who uses more than one home for business purposes can use the simplified method of calculating the home-office deduction for only one of the homes; and
- **Part year use or area changes** - A taxpayer may have a qualified business use only for part of the taxable year or may change the square footage of the home office during the year. In either case, the deduction for the home office is based on the average monthly allowable square footage used. To calculate the average monthly allowable square footage, the tax return preparer must add the amount of allowable square feet used by the taxpayer each month and divide the sum by 12. The preparer cannot take more than 300 square feet into account for any one month. Furthermore, if the taxpayer's qualified business use was for less than 15 days in any month, the preparer must use zero for that month.

2.8.3.1.2.5 Gross Income Limitation

Somewhat similar to the deduction limit applicable to the actual expense method for determining the home-office deduction, a gross income limitation applies to the home-office deduction available under the simplified method. Under the gross income limitation applicable to the simplified method, a taxpayer's home-office deduction is limited to an amount equal to the taxpayer's gross income derived from the qualified business use of the home reduced by the business deductions that are unrelated to the use of the taxpayer's home.

If the business deductions unrelated to the use of the taxpayer's home are greater than the gross income the taxpayer derived from the qualified business use, the home-office deduction for business use of the home is disallowed.

2.8.4 Recordkeeping Requirements

Although the law generally does not require that a self-employed taxpayer use any ***specific type*** of recordkeeping system, documents supporting the taxpayer's gross receipts, amounts paid for inventory and business expenses should be maintained for as long as they are material to the

administration of tax law. If the self-employed taxpayer is involved in multiple businesses he or she should keep a complete and separate set of records and supporting documents for each business.

However, whether the taxpayer has a single business or multiple businesses, the records should include a summary of business transactions and show the following for the business:

- Gross receipts;
- Deductions; and
- Credits.

The supporting documents include sales slips, paid bills, invoices, receipts, deposit slips and canceled checks.

2.8.4.1 Gross Receipts

The documents supporting a self-employed taxpayer's gross receipts that should be kept for as long as they are material to the administration of tax law include:

- Cash register tapes;
- Bank deposit slips;
- Receipt books;
- Invoices;
- Credit card charge slips; and
- Form(s) 1099.

2.8.4.2 Inventory

Not all self-employed taxpayers maintain an inventory. However, if a self-employed taxpayer buys items for resale to customers, the supporting documents should show the amount paid and that the payment was for inventory. Such supporting documents include:

- Canceled checks;
- Cash register tape receipts;
- Credit card sales slips; and
- Invoices.

2.8.4.3 Expenses

Documents supporting a self-employed taxpayer's expenses—the cost incurred by the taxpayer, other than the cost of inventory, to carry on the business—should be kept as long as needed. In most cases, supporting documents should be kept for the later of 3 years following the date the taxpayer's original tax return was filed or 2 years following the date any tax payment was made. Such documents should show a) the amounts paid, and b) that the amounts paid were for business expenses.

Documents that should be kept to support a self-employed taxpayer's expenses include:

- Canceled checks;
- Cash register tapes;
- Account statements;
- Credit card sales slips;
- Invoices; and
- Petty cash slips for small cash payments.

2.8.5 Entertainment Expenses

The TCJA, §13304, disallows a deduction for expenses incurred by a taxpayer after December 31, 2017 and before January 1, 2026, despite their being directly related to the taxpayer's trade or business, with respect to:

- Activities normally considered to be entertainment, amusement or recreation;
- Club dues or fees for any club organized for the purpose of –
    - business,
    - pleasure,
    - recreation, or
    - any other social purpose; or

- A facility used in connection with any of those activities.

In short, a taxpayer can no longer take a tax deduction for any expense related to activities generally deemed entertainment, amusement, or recreation. However, the taxpayer can continue to deduct 50% of the cost of meals for themselves and or employees provided the food or beverages are not considered lavish or extravagant.

2.8.5.1 Exceptions to Food and Beverage Expenses

Taxpayers are generally permitted to deduct 50% of the expenses for food and beverages paid or incurred in conducting their trade or business as well as the expenses for food and beverages provided by the taxpayer on the taxpayer's premises primarily for employees. However, the 50% limitation on the deduction of an employer's food and beverage expenses does not apply to any expenses if:

- The expenses are treated as compensation;
- The expenses, other than those treated as compensation, are for services performed by the taxpayer for another person under a reimbursement or other expense allowance arrangement;
- The expenses are for recreational, social or similar activities primarily for the benefit of employees other than highly compensated employees;
- The expenses are for goods, services and facilities made available by the taxpayer to the general public;
- The expenses are for goods or services sold by the taxpayer in a bona fide transaction for adequate compensation; or
- The expenses are includable in the gross income of a non-employee recipient.

2.8.6 Section 179 Expense Limits

The Tax Cuts and Jobs Act (TCJA) increased the amount a business is permitted to expense rather than being required to depreciate and made further enhancements under Code Section 179 with respect to section 179 property the taxpayer places in service in tax years beginning after December 31, 2017. Under the TCJA:

- The dollar limitation on the value of property that may be expensed in the year in which it is placed in service is $1,220,000 (2024);
- The phaseout threshold for a taxpayer's ability to expense eligible property is $3,050,000 (2024);
- The definition of Code Section 179 property is expanded to include –
    - depreciable tangible personal property used principally to furnish lodging, such as –
        - furniture,
        - appliances, and
        - other equipment for use in the living quarters, and
    - certain improvements to nonresidential real property, including –
        - roofs,
        - heating, ventilation and air-conditioning property,
        - fire protection and alarm systems, and
        - security systems.

It is important to note that improvements will not qualify if they are attributable to other than the building's interior. So, improvements attributable to:

- Enlarging the building;
- The internal structural framework of the building; or
- An escalator or elevator

… do not qualify for immediate expensing.

The cost of any sport utility vehicle (SUV) that may be taken into account under Section 179 cannot exceed $30,500.

2.8.7 Depreciation

Depreciation is an annual income tax deduction that allows the taxpayer to recover the cost or other basis of certain property, referred to as "depreciable property," over the period of time the property is used. It is an allowance for the wear and tear, deterioration, or obsolescence of the property. The taxpayer can depreciate most types of tangible property (except land), such as buildings, machinery, vehicles, furniture, and equipment. The taxpayer also can depreciate certain intangible property, such as patents, copyrights, and computer software.

To be depreciable, the property must meet all the following requirements:

- It must be property the taxpayer owns;
- It must be used in the taxpayer's business or income-producing activity;
- It must have a determinable useful life; and
- It must be expected to last more than one year.

2.8.7.1 Bonus Depreciation

Prior tax law permitted businesses to take a tax deduction—generally referred to as first-year bonus depreciation—equal to 50% of qualified properties' adjusted basis (see **Qualified Property** below). In addition, under prior tax law, the bonus depreciation arrangement was scheduled to end for qualified property purchased and placed in service before January 1, 2020.

The TCJA, §13201, both extended bonus depreciation and increased it. Under the enhanced bonus depreciation provisions of the TCJA, a business may take a 100% first year tax deduction equal to the adjusted basis of qualified property purchased and placed in service after September 27, 2017 and before January 1, 2023. The bonus depreciation percentage for qualified property purchased before September 28, 2017 and placed in service before January 1, 2018 continues to be 50%.

Property eligible for 100% bonus depreciation was expanded under the TCJA to include used qualified property acquired and placed in service after September 27, 2017 provided that all the following conditions apply:

- The property was not used by the taxpayer at any time before its acquisition;
- The property was not acquired by the taxpayer from a related party;
- The taxpayer did not acquire the property from a component member of a controlled group of corporations;
- The taxpayer's basis of the acquired used property is not figured by reference to the adjusted basis of the property in the hands of the seller or transferor; and
- The taxpayer's basis of the used property is not figured under the provision for deciding basis of property acquired from a decedent.

The 100% expensing permitted under the TCJA declines by 20% each year for qualified property purchased and placed in service after December 31, 2022. Accordingly, the bonus depreciation deduction is reduced to:

- 80% for property purchased and placed in service during 2023;
- 60% for property purchased and placed in service during 2024;
- 40% for property purchased and placed in service during 2025; and
- 20% for property purchased and placed in service during 2026.

The bonus depreciation under the TCJA ends after 2026.

2.8.7.1.1 Qualified Property

The term "qualified property," as it is used in connection with bonus depreciation, means property having a recovery period of 20 years or less as well as property which is:

- Computer software;
- A qualified film or television production; or
- A qualified live theatrical production.

2.8.7.2 Luxury Auto Depreciation Limits

The additional "bonus" first-year depreciation deduction does not apply to a passenger car placed in service by the taxpayer if the taxpayer:

- Did not use the passenger automobile more than 50% for business purposes;
- Elected out of the additional first-year depreciation deduction for the class of property including passenger automobile;
- Acquired the passenger automobile used and the acquisition of it failed to meet the acquisition requirements of section 168(k)(2)(e)(ii); or
- Acquired the passenger automobile before September 28, 2017 and placed it in service after 2019.

The luxury auto depreciation limits applicable to passenger automobiles acquired after September 27, 2017 and placed in service during calendar year 2024 are as shown below:

Year	Limits When 1st Year Bonus Depreciation Deduction Applies	Limits When no 1st Year Bonus Depreciation Deduction Applies
Placed in service	$20,400	$12,400
2	$19,800	$19,800
3	$11,900	$11,900
4 and later	$7,160	$7,160

A "luxury vehicle" is a four-wheeled vehicle regardless the cost of the vehicle, used mostly on public roads, and which has an unloaded gross weight of no more than 6,000 pounds. It includes vehicles not normally considered "luxury" vehicles on the basis of their price.

2.8.7.3 Listed Property Updates

The term "listed property," as used in the tax law, is personal property used in a business which can also be used for personal purposes. Because listed property can have application for both personal and business uses, a taxpayer taking a tax deduction as a business expense must have sufficient evidence to prove the property's use in the business and the amount/date of the expense. Thus, property considered listed property is subject to increased documentation and scrutiny.

Under prior tax law, listed property included:

- Passenger automobiles;
- Other property used as a means of transportation;
- Any property generally used for purposes of entertainment, recreation or amusement; and
- Computers and related peripheral equipment.

Under the TCJA, computers and related peripheral equipment are no longer considered listed property subject to heightened substantiation requirements. This change applies to property placed in service after December 31, 2017. All other types of property considered listed property under prior law, however, continue to be listed property.

Deductions for listed property generally are subject to special rules and limits with respect to:

- Deductions for employees;
- Business use; and
- Passenger automobile limits and rules.

2.8.7.3.1 Deduction for Employees

If the taxpayer's use of the property is not for the taxpayer's employer's convenience or is not required as a condition of the taxpayer's employment, the taxpayer cannot deduct depreciation or rent expenses for the use of the property as an employee.

2.8.7.3.2 Business-use Requirement

If the property is not used more than half the time for qualified business use, the taxpayer cannot claim the section 179 deduction or a special depreciation allowance. In addition, the taxpayer must figure any depreciation deduction under the Modified Accelerated Cost Recovery System (MACRS) using the straight line method over the ADS recovery period. The taxpayer may also have to

recapture (include in income) any excess depreciation claimed in previous years. A similar inclusion amount applies to certain leased property.

2.8.7.3.3 Passenger Automobile Limits and Rules

Annual limits apply to depreciation deductions (including section 179 deductions and any special depreciation allowance) for certain passenger automobiles. The taxpayer can continue to deduct depreciation for the unrecovered basis resulting from these limits after the end of the recovery period.

2.9 Capital Gains and Losses

Most assets owned by a taxpayer for personal purposes, pleasure or investment are referred to as "capital assets," and the sale or exchange of a capital asset may result in a capital gain or loss. If the transaction involves personal use property, in contrast to property held for investment, any gain realized upon the sale of the property is a capital gain; however, any loss that results from the sale of personal use property cannot be deducted. If the sale or trade of investment property results in a gain or loss, such gain or loss is generally a capital gain or loss.

2.9.1 Short-Term and Long-Term Capital Gains and Losses

If a taxpayer sells or trades investment property, the capital gain or loss that results may be either a short-term capital gain/loss or a long-term capital gain/loss. The critical factor in determining whether a gain or loss is a short-term or long-term capital gain or loss is the length of the period of time the asset was owned by the taxpayer.

If the capital asset was owned by the taxpayer for longer than one year before the asset was sold or traded, any gain or loss on the transaction is a long-term capital gain or loss. In contrast, the sale or trade of a capital asset owned by the taxpayer for one year or less before being sold or traded would result in a short-term capital gain or loss.

2.9.2 Reporting Capital Gains and Losses

Capital gains and losses are reported on Schedule D, Capital Gains and Losses, attached to the taxpayer's IRS Form 1040 or Form 1040NR. However, before completing Schedule D, one or more IRS Forms 8949, *Sales and Other Dispositions of Capital Assets*, normally need to be completed and attached to the IRS Form 1040 or 1040NR along with Schedule D.

Note that a taxpayer may be able to combine certain transactions and report the totals directly on Schedule D, lines 1a (short-term transactions) or 8a (long-term transactions) rather than using IRS Form 8949. The transactions which may be reported directly on Schedule D are transactions for which the taxpayer:

- Received a Form 1099-B showing that basis was reported to the IRS and does not show a nondeductible wash sale loss in box 5; ***and***
- Does not need to make any adjustments to –
    - the basis or type of gain or loss reported on Form 1099-B, or
    - the taxpayer's gain or loss.

2.9.2.1 IRS Form 8949, Sales and Other Dispositions of Capital Assets

IRS Form 8949 is used to report sales and exchanges of capital assets. If the taxpayer received Form 1099-B or 1099-S, the proceeds shown on that form should be reported on IRS Form 8949 in column (d). Additionally, if the Form 1099-B shows that the cost or other basis was reported to the IRS, the basis shown on the form should be reported on IRS Form 8949 in column (e), making any correction or adjustment to either amount in Form 8949, column (g). The reason for the adjustment or correction needs to be indicated by placing the appropriate code or codes (contained in the instructions to IRS Form 8949) in column (f).

If all Forms 1099-B received by the taxpayer show that basis was reported to the IRS ***and*** no correction or adjustment is required, the taxpayer may not need to file Form 8949; instead, the totals may be entered directly on Schedule D, lines 1a or 8a, as appropriate (discussed above). The taxpayer needs to file as many Forms 8949 as required to report all transactions.

2.9.2.2 Schedule D

Schedule D provides a summary of the transactions reported on IRS Form 8949 in addition to certain other information. Thus, if an IRS Form 8949 is completed for the taxpayer, each of the columns (d), (e) and (h) should be totaled and the totals for all Forms 8949 should be shown in Schedule D on the following lines:

- 1a, 1b, 2 and 3 for short-term capital gains and losses; and
- 8a, 8b, 9 and 10 for long-term capital gains and losses.

In addition, any distribution of net realized ***long-term*** capital gains from a mutual fund should be shown on line 13. (Distributions of net realized ***short-term*** capital gains are shown on Form 1099-DIV issued by the mutual fund as ordinary dividends.) Schedule D should then be completed.

If the amount shown on Schedule D, line 16 is a loss, the smaller of the following should be entered on Form 1040 or Form 1040NR, "Capital gain or (loss)":

- The loss shown on line 16; or
- $3,000 ($1,500 if married filing separately).

If the amount shown on Schedule D, line 16 is a gain, enter the amount of the gain on Form 1040 or Form 1040NR.

2.10 Standard Deduction Eligibility

The standard deduction is an alternative available to taxpayers choosing not to itemize actual deductions on their income tax returns. The general rule with respect to deductions is that a taxpayer may choose to take a standard deduction or itemize his or her deductions. Although that general rule applies in the case of most taxpayers, certain taxpayers are ineligible to take the standard deduction and must itemize.

Taxpayers who are ineligible to take the standard deduction are the following:

- Taxpayers whose filing status is "married filing separately" and whose spouse itemizes deductions;
- Taxpayers who are filing a tax return for a short tax year due to a change in their annual accounting period; and
- Taxpayers who were nonresident aliens or dual-status aliens during the year.

2.10.1 Standard Deduction Amounts

The standard deductions for 2024 are:

- $29,200 for married couples whose filing status is "married filing jointly" and surviving spouses;
- $14,600 for singles and married couples whose filing status is "married filing separately"; and
- $21,900 for taxpayers whose filing status is "head of household."

A taxpayer who can be claimed as a dependent is generally limited to a smaller standard deduction, regardless of whether the individual is actually claimed as a dependent. For 2024 returns, the standard deduction for a dependent is the greater of:

- $1,300; or
- The dependent's earned income from work for the year plus $450 (but not more than the standard deduction amount, generally $14,600), if greater.

2.10.2 Standard Deduction for Blind and Senior Taxpayers

Elderly and/or blind taxpayers receive an additional standard deduction amount added to the basic standard deduction. The additional standard deduction for a blind taxpayer—a taxpayer whose vision is 20/200 or poorer with glasses/contact lenses or whose field of vision is 20 degrees or less—and for a taxpayer who is age 65 or older at the end of the year is:

- $1,550 for married individuals; and
- $1,950 for singles (other than a surviving spouse) and heads of household.

The additional standard deduction for taxpayers who are both age 65 or older at year-end and blind is double the additional amount for a taxpayer who is blind (but not age 65 or older) or age 65 (but not blind).

2.10.3 Standard Deduction Summary

	2024	
Filing Status	Standard	Blind/Age 65+ add
Married filing jointly & surviving spouses	$29,200	$1,550
Unmarried (other than surviving spouses)	$14,600	$1,950
Married filing separately	$14,600	$1,950
Head of household	$21,900	$1,950
Dependent	$1,300 or earned income + $450	

2.11 Itemized Deductions Schedule A

The various Schedule A itemized deductions include deductions for:

- Medical and dental expenses;
- State and local taxes;
- Home mortgage interest;
- Charitable contributions;
- Casualty losses; and
- Moving expenses.

Let's consider each of these deductions and their required recordkeeping and documentation.

2.11.1 Medical and Dental Expenses

If the taxpayer itemizes deductions for a taxable year on Schedule A, the taxpayer may be able to deduct expenses paid that year for medical and dental care for the taxpayer, spouse, and dependents. Such expenses include payments for the diagnosis, cure, mitigation, treatment, or prevention of disease, or payments for treatments affecting any structure or function of the body.

The deductible amount is equal to the total medical expenses exceeding 7.5% of the taxpayer's adjusted gross income. Figure the amount the taxpayer is allowed to deduct on Schedule A (Form 1040).

2.11.2 State and Local Tax Deduction

State and local taxes paid by an itemizing taxpayer have generally been a deductible item on the taxpayer's federal income tax return without limit. The TCJA limits the federal income tax deduction for state and local taxes to $10,000 ($5,000 for married taxpayers filing separately) beginning in 2018.

2.11.3 Home Mortgage Interest and Home Equity Loans

Under tax law in effect prior to the passage of the TCJA, the home mortgage interest deduction was limited to home mortgage interest paid on mortgage debt—debt secured by a taxpayer's residence—falling into three categories:

1. Mortgages taken out before October 13, 1987, called "grandfathered debt";
2. Mortgages taken out by the taxpayer (or spouse if married filing a joint return) after October 13, 1987 to buy, build or improve the taxpayer's home, i.e., "acquisition debt," but only if the total of such mortgages plus any grandfathered debt was $1 million or less ($500,000 or less if married filing separately) throughout the year; and

3. Mortgages taken out by the taxpayer (or spouse if married filing a joint return) after October 13, 1987 that were home equity debt, i.e., any indebtedness (other than acquisition indebtedness) secured by a qualified residence, but only if the total of such mortgages was $100,000 or less ($50,000 or less if married filing separately) and totaled no more than the fair market value of the taxpayer's home reduced by 1 and 2 above.

The dollar limits for mortgages in the second and third categories apply to the combined mortgages on the taxpayer's main home and any second home.

The TCJA made the following changes to the existing home mortgage interest deduction for taxable years 2018 through 2025:

- Interest paid on home equity indebtedness—home equity loans and lines of credit, in other words—incurred after December 15, 2017 is not tax-deductible ***unless used to buy, build or substantially improve the taxpayer's home that secures the loan***;
- Interest paid on acquisition debt incurred after December 15, 2017, less any acquisition debt incurred on or before December 15, 2017, is limited to interest paid on total acquisition indebtedness but only if the total of such mortgages is $750,000 or less ($375,000 or less if married filing separately); and
- Interest paid on acquisition debt incurred on or before December 15, 2017 is limited to interest paid on acquisition indebtedness of $1,000,000 or less ($500,000 or less if married filing separately).

2.11.3.1 Indebtedness Refinancing

The tax treatment of refinanced existing mortgage debt is treated, for purposes of the applicable dollar limits, as incurred on the date the original indebtedness was incurred, but ***only to the extent*** the amount of the indebtedness resulting from the refinancing does not exceed the amount of the refinanced indebtedness.

2.11.4 Charitable Contributions

Charitable contributions are contributions made in cash or property to, or for the use of, churches and governments and to other organizations that have applied to the IRS and been approved to become qualified organizations. A contribution made to an individual, regardless of how needy the individual, is not a charitable contribution for which a tax deduction may be taken. The maximum amount of charitable contribution a taxpayer is permitted to deduct in any year may be limited by the taxpayer's contribution base—in most cases the contribution base is an amount equal to the taxpayer's adjusted gross income—and further limited depending on the type of property contributed. However, any charitable contribution exceeding the applicable tax deduction limit may be carried over to the following five years.

2.11.4.1 60% AGI Limit for Cash Contributions

The TCJA increased the limit on a taxpayer's deductible charitable cash contributions from 50% under prior tax law to 60% of the taxpayer's contribution base for qualified organizations to which the 50% limit normally applies. The increased limitation for cash contributions applies to contributions made in any taxable year beginning after December 31, 2017 and before January 1, 2026.

2.11.4.2 Contemporaneous Written Acknowledgement

Donors making charitable gifts of $250 or more are required to obtain a contemporaneous written acknowledgment of the gift from the charitable organization in order to substantiate the gift for tax purposes. Under prior law, an alternative form of charitable gift substantiation permitted the charitable organization to file a document with the IRS that contained detailed information concerning the donor and the donor's gift rather than requiring the donor to obtain a contemporaneous written acknowledgement of the gift.

The TCJA eliminates the exception to a contemporaneous written acknowledgment of a donor's gift, effective for gifts made after December 31, 2016***.*** (Note: The effective date of the elimination of the exception to a contemporaneous written acknowledgment is retroactive to gifts made on and after 2016.)

2.11.4.2.1 Content and Timing of Contemporaneous Written Acknowledgement

In order to meet the requirements of the TCJA with respect to a contemporaneous written acknowledgment of a charitable gift, the acknowledgment should contain the following information:

- The amount of cash and a description of any property other than cash contributed;
- Whether the organization receiving the gift provided any goods or services in return for the gift; and
- A description and a good-faith estimate of the value of any goods or services given by the donor or, if the goods and services received by the donor consist solely of intangible religious benefits, a statement to that effect.

A written acknowledgment of a charitable gift is considered "contemporaneous" only if it is obtained by the donor on or before the ***earlier of***:

- The date the taxpayer files a tax return for the taxable year in which the contribution was made, or
- The due date, including extensions, for filing the tax return for the taxable year in which the contribution was made.

2.11.5 Casualty Loss Deduction

The tax treatment of personal casualty losses and thefts is changed under the TCJA. Pursuant to the TCJA, the itemized deduction for personal casualty and theft losses is temporarily limited in tax years 2018 through 2025 solely to losses attributable to federally-declared disasters.

In addition, casualty loss rules are revised for net disaster losses occurring in 2016 and 2017. Under the revision, the limitation applicable to each casualty is increased from the previous $100 to $500 for an individual who has a net disaster loss for tax years beginning in 2016 or 2017. However, the 10% of AGI limitation for such taxpayers is waived.

A federally–declared disaster means any disaster that is subsequently determined by the president of the United States to warrant assistance by the federal government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act. Casualty losses are reported on Form 4684, *Casualties and Thefts.*

2.11.5.1 Special Rules for Qualified Disaster-Related Personal Casualty Losses

In recognition of the taxpayers who recently experienced qualified disaster-related casualty losses but who do not itemize deductions, the Taxpayer Certainty and Disaster Tax Relief Act part of the Consolidated Appropriations Act, 2021 authorizes an increase of the standard deduction for such taxpayers equal to the taxpayer's net disaster loss. The "net disaster loss," for purposes of the standard deduction increase, means the excess of qualified disaster-related personal casualty losses over personal casualty gains.

A personal casualty gain is the recognized gain from any involuntary conversion of property. For example, such a gain could occur if a homeowner whose residence, insured for $300,000 but valued for tax purposes at $250,000, was destroyed. If the homeowner received $300,000 in insurance proceeds, he or she would have experienced a personal casualty gain of $50,000 ($300,000 - $250,000 = $50,000). The gain experienced would constitute taxable income and would reduce the net disaster loss.

If the taxpayer in the example was married and filed a federal income tax return as married filing jointly, the taxpayer's 2024 standard deduction (which would normally be $29,200) is increased by the amount of the net disaster loss from $29,200 to $79,200 ($29,200 + $50,000 = $79,200). Although the $100 floor on the casualty claim is increased to $500, the requirement that only the amount of the claimed loss that exceeds 10% of the taxpayer's adjusted gross income is eliminated.

2.11.6 Moving Expense Deduction

Many taxpayers change their residence each year, and many of those taxpayer relocations involve new jobs. Prior law permitted a taxpayer to deduct moving expenses by car provided the new location was at least 50 miles farther from the taxpayer's former home than the former main job location.

However, except in the case of military relocations, the TCJA has suspended the moving expense deduction and made any moving expense reimbursement taxable income.

2.11.6.1 Moving Expenses in Active Military Relocations

The inclusion of reimbursed moving expenses in the recipient's gross income does not apply to active military relocations meeting certain criteria. In the case of a military relocation, the taxpayer's move must be pursuant to a military order and involve a permanent change of station. If those criteria are met, no paid or incurred moving and storage expenses:

- Furnished in kind, or
- For which reimbursement or allowance is provided to the service member, spouse or dependents

…are includible in gross income or reported.

In addition, if the moving expenses paid or incurred in connection with a military relocation are furnished or reimbursed (or an allowance is provided) to the service member's spouse and dependents to move:

- To a location other than the one to which the service member moves, or
- From a location other than the one from which the service member moves

…such expenses are likewise neither includible in gross income nor reported.

2.11.7 Recordkeeping and Documentation of Deductions

The IRS advises that the length of time a taxpayer should keep a document, including the documentation of deductions, depends on the action, expense, or event which the document records. As a general rule, taxpayers must keep records that support an item of income, deduction or credit shown on a tax return until the period of limitations for that tax return runs out. The period of limitations is the period of time in which the:

- Taxpayer can amend his or her tax return in order to claim a credit or refund, or
- IRS can assess additional tax.

The period of limitations applicable to income tax returns is as shown in the chart below:

Action, Event or Expense Recorded	Duration of Recordkeeping Requirement*
Records generally related to income tax returns	Three years after the later of: • The tax return due date, or • The date the return was filed
Claim for credit or refund after taxpayer filed an income tax return	The later of: • 3 years after the taxpayer filed the original tax return, or • 2 years after the date the taxpayer paid the tax
Claim for a loss from worthless securities or bad debt deduction	Seven years
If taxpayer failed to report income that should have been reported *and* it is more than 25% of gross income shown on the return	Six years
If taxpayer did not file a return	Indefinitely
If taxpayer filed a fraudulent return	Indefinitely
Employment tax records	At least 4 years after the later of the date: • The tax becomes due, or • The tax is paid

*Years shown generally refer to the period after the return was filed.

2.12 Tax Credit Eligibility

The U.S. tax code provides for a substantial number of tax credits, generally designed to meet various socially-desirable objectives. Tax credits are categorized as:

- Refundable tax credits that are treated as having been withheld from the taxpayer's income and payable to the taxpayer regardless of income tax liability; and
- Nonrefundable tax credits that are payable to the taxpayer only to the extent of any income tax liability.

Among the most frequently-claimed tax credits are:

1. Child tax credit
2. Credit for other dependents
3. Child and dependent care tax credit
4. Education tax credit
5. Earned income tax credit

Let's consider each of them.

2.12.1 Child Tax Credit

The child tax credit for 2024 is limited to no more than $2,000 for each qualifying child, i.e., a child who, in addition to meeting other requirements, is under the age of 17 by the end of the year. If the child meets the requirements—and the taxpayer's modified adjusted gross income (MAGI) does not exceed specified amounts—the taxpayer may claim the tax credit in an amount not exceeding his or her federal income tax liability.

- An eligible child is a child younger than age 17 by the end of 2024;
- The maximum credit is $2,000 per child;
- The credit is non-refundable; and
- The credit is not available in advance.

The Child Tax Credit is a nonrefundable credit that may reduce the taxpayer's tax up to $2,000 for each of the taxpayer's qualifying children. Since the Child Tax Credit is a nonrefundable tax credit, it is available in full only to taxpayers whose income tax liability is at least as great as the credit.

In addition to having a tax liability, a taxpayer must also have a qualifying child or children to be eligible for a Child Tax Credit. A qualifying child, for purposes of the Child Tax Credit, is a child who:

- Is the taxpayer's son, daughter, stepchild, foster child, brother, sister, stepbrother, stepsister, or a descendent of any of them;
- Was under age 17 at the end of the tax year;
- Did not provide more than one half of his or her own support during the year;
- Lived with the taxpayer for more than half of the year;
- Is claimed as a dependent on the taxpayer's return;
- Does not file a joint return for the year, or files it only as a claim for refund; and
- Was a U.S. citizen, a U.S. national, or a resident of the United States.

2.12.1.1 Child Tax Credit Phaseout and Nonrefundable Amounts

Although the maximum amount of Child Tax Credit a taxpayer may claim for each qualifying child is $2,000, that amount may be reduced if:

- The amount of the tax liability shown on the taxpayer's Form 1040, Form 1040-SR or Form 1040-NR is less than the credit; or
- The taxpayer's modified adjusted gross income[7] is more than –
    - $400,000 if married filing jointly, or
    - $200,000 if filing as other than married filing jointly.

-

The Child Tax Credit is $2,000 but is reduced by $50 for each $1,000 (or fraction) by which the taxpayer's MAGI exceeds the above threshold amounts (see 2.12.2.1 below).

2.12.1.2 Social Security Number Requirement

No Child Tax Credit is allowed to a taxpayer with respect to any qualifying child unless the taxpayer includes on the tax return the Social Security number of that child, issued:

- Before the due date of the taxpayer's tax return;
- To a U.S. citizen, or
- To an alien at the time of U.S. admission for permanent residence or under a law permitting engagement in U.S. employment, or
- To an alien at the time of a change in status permitting engagement in U.S. employment.

However, a qualifying child for whom no Child Tax Credit is allowed solely because of the taxpayer's failure to include a Social Security number may qualify for a partial Child Tax Credit, called the Credit for Other Dependents, discussed next.

Return to Child Tax Credit Due Diligence at 3.5.4

2.12.2 Credit for Other Dependents

A taxpayer may be eligible for a Credit for Other Dependents (ODC) of up to $500 with respect to:

- A dependent other than a child—a dependent parent or sibling, for example; and
- A qualifying child for whom a credit is disallowed solely because the taxpayer failed to include the child's Social Security number on the tax return for the taxable year.

The ODC is in addition to the credit for child and dependent care expenses and the Earned Income Tax Credit and is limited to no more than $500 for each dependent who qualifies.

Qualifying for the ODC requires that the person meet all the following conditions:

- The person must be claimed as a dependent on the taxpayer's income tax return;
- The person cannot be used by the taxpayer to claim the Child Tax Credit (CTC) or the Additional Child Tax Credit (ACTC); and
- The person must be –
    - a U.S. citizen,
    - a U.S. national, or
    - a U.S. resident alien.

2.12.2.1 Limits on the CTC and ODC

The maximum credit available to a taxpayer as a Child Tax Credit (CTC) or credit for other dependents (ODC) may be reduced if the taxpayer's:

- Tax liability for the year is less than the total of both credits (If the taxpayer has no tax liability for the year neither credit may be taken); or
- Modified adjusted gross income (MAGI) is more than the following threshold amounts –
    - $400,000 if married filing jointly, or
    - $200,000 if any other filing status applies.

If the taxpayer's MAGI exceeds these amounts for his or her filing status, the available credit is reduced by $50 for each $1,000 (or fraction) by which the taxpayer's MAGI exceeds the threshold amount.

The taxpayer's MAGI, for purposes of the CTC and ODC, is the taxpayer's AGI plus the following amounts, if applicable:

- Any amount excluded from income because of the exclusion of income from Puerto Rico;
- Any amount shown on line 45 or line 50 of IRS Form 2555, Foreign Earned Income; and
- Any amount shown on line 15 of IRS Form 4563, Exclusion of Income for Bona Fide Residents of American Samoa.

2.12.2.2 Claiming CTC and ODC

In order to claim the CTC or ODC, the taxpayer must meet the following requirements:

- The taxpayer must file Form 1040, Form 1040–SR or Form 1040–NR and include the name and TIN of each dependent for whom the taxpayer is claiming the CTC or ODC;
- The taxpayer must file Form 8862, Information to Claim Certain Refundable Credits After Disallowance, if applicable;
- The taxpayer must enter a timely issued TIN (for both spouses if married filing jointly);
- The taxpayer must enter the required Social Security number for each claimed qualifying child under 17 in column (2) and check the Child Tax Credit box in column (4) of the tax return; and
- The taxpayer must enter the timely issued TIN for the ODC claimed dependent in column (2) and check the Credit for Other Dependents box in column 4 of the tax return.

2.12.3 Additional Child Tax Credit

The Additional Child Tax Credit (ACTC), unlike the Child Tax Credit (CTC), is a refundable tax credit meaning that the taxpayer may claim the credit even though he or she has no federal income tax liability. The ACTC— a tax credit that may not exceed a maximum amount of $1,700 (2024) per qualifying child—is available only to taxpayers who receive less than the full amount of the CTC. (Note: only the CTC may be used to figure the amount of any ACTC that can be claimed by a taxpayer; the ODC is not taken into account for purposes of figuring the ACTC.)

A taxpayer that files IRS Form 2555, Foreign Earned Income, is ineligible to claim the ACTC.

2.12.4 Child and Dependent Care Credit

Internal Revenue Code § 21 offers assistance, in the form of the child and dependent care credit, to taxpayers responsible for child and dependent care who are, or are seeking to become, gainfully employed. ARPA made various changes to the Child and Dependent Care Tax Credit effective only for 2021, including making the credit refundable, increasing the percentage from 35% to 50% of eligible expenses, increasing the maximum eligible expenses on which the credit is based to $4,000 for one qualifying individual ($8,000 for two or more qualifying individuals), changing the threshold income at which credit reduction begins from $15,000 to $125,000, and changing the maximum possible credit reduction to less than 20% for household incomes exceeding $400,000.

The tax credit for 2024 is a percentage of the taxpayer's work-related child and dependent care expenses not to exceed $3,000 for one qualifying person and $6,000 for two or more qualifying persons. It is further subject to an earned income limit. The amount of work-related expenses used to figure the credit cannot be greater than:

- A single taxpayer's earned income for the year; or
- The smaller of a married taxpayer's or spouse's earned income for the year, unless an exception applies.

The applicable percentage is based on the taxpayer's adjusted gross income, up to 35% of such expenses. However, the percentage of the expenses is reduced for taxpayers whose adjusted gross income exceeds specified dollar amounts and is limited to 20% for taxpayers with adjusted gross incomes of $43,000 or more.

2.12.4.1 Eligible Care Recipients Limited to Qualifying Persons

The tax credit for child and dependent care expenses is limited to a portion of those expenses incurred and paid for the care of a qualifying person. A qualifying person is:

- The taxpayer's qualifying dependent child under age 13;
- The taxpayer's spouse who –
  - Was not physically or mentally able to care for himself or herself, and
  - Lived with the taxpayer for more than half the year; or
- A person who is not physically or mentally able to care for himself or herself, lived with the taxpayer for more than half the year and –
  - Was the taxpayer's dependent, or

- Would have been the taxpayer's dependent except for certain specified reasons.

2.12.4.2 Eligible Taxpayers

A taxpayer eligible for the child and dependent care credit must have paid child and dependent care expenses for the care of a qualifying person during the year in order to work or to look for work. In addition, the taxpayer must have earned income during the year; if the taxpayer and spouse are filing jointly, both must have earned income during the year unless an exception applies because the spouse is a student or unable to care for him or herself.

An eligible unmarried taxpayer's filing status may be single, head of household, or qualifying surviving spouse; if the taxpayer is married, he or she must file a joint return unless an exception applies. IRS Form 2441, *Child and Dependent Care Expenses*, must be completed and attached to the taxpayer's tax return.

Generally, married persons must file a joint return to claim the credit. If the taxpayer's filing status is married filing separately and all of the following apply, the taxpayer is considered unmarried for purposes of claiming the credit on Form 2441:

- The taxpayer lived apart from the taxpayer's spouse during the last 6 months of the tax year;
- The taxpayer's home was the qualifying person's main home for more than half of the tax year; and
- The taxpayer paid more than half of the cost of keeping up that home for the tax year.

If the taxpayer meets all the requirements to be treated as unmarried and is otherwise eligible to claim the credit, the taxpayer generally can take the credit or the exclusion. If the married taxpayer filing separately doesn't meet all the requirements to be treated as unmarried, the credit generally cannot be taken.

2.12.5 Education Credits

Two tax credits, the American Opportunity Credit and the Lifetime Learning Credit, are available to assist taxpayers in offsetting the costs of higher education. They are both claimed on Form 8863, *Education Credits (American Opportunity and Lifetime Learning Credits).* Although these tax credits have certain similarities they also differ from one another in several respects.

2.12.5.1 American Opportunity Credit

A taxpayer whose income does not exceed certain limits may be able to claim an American Opportunity Tax Credit of up to $2,500 for qualified education expenses paid for *each eligible student*, part of which is a refundable credit. Thus, the maximum American opportunity credit for any taxpayer is equal to $2,500 *times* the number of eligible students.

The American opportunity credit is available only for the first four years of postsecondary education during which time the student must be pursuing a degree or other recognized credential. The following is an overview of the credit:

Maximum credit	Up to $2,500 credit per eligible student (taxpayer, spouse or dependent)
Income limitations	Credit will be reduced if taxpayer's MAGI exceeds $80,000 ($160,000 MFJ) and will fully phase out at $90,000 ($180,000 MFJ).
Credit type	40% of credit may be refundable; balance nonrefundable
Eligible education years	Available only for first four years of postsecondary education
Maximum tax years	Available only for four tax years per eligible student
Degree requirement	Must be pursuing a degree or other recognized education credential
Enrollment status	Must be enrolled at least half-time for at least one academic period beginning during the tax year
Qualified expenses	Tuition, required enrollment fees and course materials the student needs for a course of study as a condition of enrollment or attendance. Room & board not a qualified expense.

Drug convictions	Student must not have been convicted of a felony for controlled substance possession or distribution
Academic periods	Payments made during the tax year for academic periods beginning during the tax year or in the first three months of the following year

2.12.5.1.1 Figuring the American Opportunity Credit

The maximum amount of the American opportunity credit for each eligible student is $2,500 and is equal to the sum of:

- 100% of the first $2,000 of qualified education expenses paid by the taxpayer for the eligible student; plus
- 25% of the next $2,000 of qualified education expenses the taxpayer paid for the eligible student.

Thus, in order to claim the full $2,500 American opportunity credit for each eligible student, the taxpayer must have paid at least $4,000 of qualified education expenses. (100% x $2,000 = $2,000; $25% x $2,000 = $500; $2,000 + $500 = $2,500) However, a taxpayer's American opportunity credit may be reduced based on his or her MAGI.

2.12.5.2 Lifetime Learning Credit

Taxpayers may also reduce their federal income tax liability by claiming the Lifetime Learning Tax Credit. A taxpayer whose income does not exceed certain limits may be able to claim a nonrefundable lifetime learning tax credit of up to $2,000 per return.

The following is an overview of the Lifetime Learning Tax Credit:

Maximum credit	Up to $2,000 credit per return
Income limitations (2024)	Credit will be reduced if taxpayer's MAGI exceeds $80,000 ($160,000 MFJ) and will fully phase out at $90,000 ($180,000 MFJ).
Credit type	Credit is nonrefundable, i.e., it is limited to the amount of taxpayer's federal income tax liability
Eligible education years	Available for all years of postsecondary education and for courses to acquire or improve job skills
Maximum tax years	Available for an unlimited number of tax years
Degree requirement	Student not required to be pursuing a degree or other recognized credential
Enrollment status	Available for one or more courses
Qualified expenses	Tuition, required enrollment fees (and course materials, i.e. books, supplies and equipment the student needs for a course of study only if paid to the institution)
Drug convictions	Felony drug convictions do not disqualify
Academic periods	Payments made during the tax year for academic periods beginning during the tax year or in the first three months of the following year

2.12.5.2.1 Figuring the Lifetime Learning Credit

The maximum annual amount of Lifetime Learning Tax Credit a taxpayer may claim is $2,000 per return. The credit is equal to 20% of the first $10,000 of qualified education expenses paid for all eligible students but may be reduced if the taxpayer's MAGI exceeds an income threshold of $80,000 ($160,000 for a joint return).

Return to Education Tax Credits Due Diligence at 3.5.3

2.12.6 Earned Income Tax Credit

The Earned Income Tax Credit (EITC) is a refundable tax credit for certain lower-income working taxpayers who meet income, filing status and other requirements. Eligibility to claim the credit requires, among other things, that the taxpayer have an earned income and also have an adjusted gross income (AGI) that is below a specified level, have no excluded foreign income or have investment income exceeding $11,600 (2024). The applicable maximum AGI level generally changes annually. The rules that apply to claiming the EITC fall into three categories: a) rules that apply to everyone, b) rules that apply if the taxpayer has a qualifying child, and c) rules that apply if the taxpayer does not have a qualifying child.

If the taxpayer meets all the rules applicable to his or her claiming EITC, the amount of EITC for which the taxpayer is eligible is determined using EITC Worksheet A—for taxpayers who were not self-employed, not a member of the clergy, not a church employee who files Schedule SE, nor a statutory employee filing Schedule C—or EITC Worksheet B for those taxpayers who can be included in one of those categories. Worksheets A and B may be found in the IRS Instructions for Form 1040.

2.12.6.1 Adjusted Gross Income Limits

To meet the rule concerning adjusted gross income limits, a taxpayer must have an AGI that is less than the maximum amount for his or her filing status and number of qualifying children. The applicable AGI limits generally change each year and, for 2024, are as shown in the following chart:

2024 EITC Income Limits

Children	Married Filing Jointly	Phaseout Range Married Filing Jointly	Other Than Married Filing Jointly*	Phaseout Range Other Than Married Filing Jointly*
3 or more qualifying children	$66,819	$29,640 - $66,819	$59,899	$22,720 - $59,899
2 qualifying children	$62,688	$29,640 - $62,688	$55,768	$22,720 - $55,768
1 qualifying child	$56,004	$29,640 - $56,004	$49,084	$22,720 -$49,084
No qualifying children	$25,511	$17,250 - $25,511	$18,591	$10,330 - $18,591

*There are specific exceptions for the Married Filing Separately filing status. .

2.12.6.2 Valid Social Security Number Required

In order to claim the EITC, the taxpayer—and spouse, if filing a joint return—must also have a valid social security number issued by the Social Security Administration. In addition, if a qualifying child is listed on Schedule EITC the child must also have a valid social security number. A social security card stating "Not valid for employment" is not sufficient for purposes of the EITC.

(Note: if a child was born and died during the year, no social security number is required for the child. In such a case, a tax preparer should attach a copy of the child's birth certificate, death certificate, or hospital records showing a live birth to the taxpayer's return.)

A taxpayer using an ITIN is ineligible for the Earned Income Tax Credit (EITC) since qualifying for EITC requires that the claimant, spouse and qualifying child or children generally must possess valid work related Social Security numbers. In addition, a child must be a U.S. citizen, U.S. national or U.S. resident to be considered a "qualifying child" for purposes of the Child Tax Credit.

Under Internal Revenue Code § 32(c)(1)(F), no Earned Income Tax Credit was permitted to an otherwise eligible individual with one or more qualifying children if no qualifying child was taken into account due to a failure to meet the existing identification requirements. ARPA, § 9622, eliminates this restriction by providing that a taxpayer with a qualifying child who fails to meet the Earned Income

Tax Credit identification requirements (that is, the ***child*** fails to meet the identification requirements) will, nonetheless, be eligible for a childless Earned Income Tax Credit. This provision is effective for years beginning after December 31, 2020.

2.12.6.3 Tax Filing Status

A taxpayer who is otherwise eligible to claim the EITC may have a tax filing status of single, married filing jointly or head of household. If the taxpayer is married, he or she must normally file a joint return to claim the EITC. However, there is a special rule for separated spouses to claim the EITC. The special rule requires that if the taxpayer is married, not filing as Married Filing Jointly, had a qualifying child who lived with the taxpayer for more than half of 2024 and either of the following applies:

- The taxpayer lived apart from their spouse for the last 6 months of 2024, or
- The taxpayer is legally separated according to their home state law under a written separation agreement or a decree of separate maintenance and did not reside in the same household as their spouse at the end of 2024.

2.12.6.3.1 Separated Spouses

Internal Revenue Code § 32(d) requires that otherwise eligible married individuals file a joint tax return in order to claim the Earned Income Tax Credit. The American Rescue Plan Act (ARPA), § 9623, effectively eliminates this requirement for a separated spouse by a special rule, effective for taxable years beginning after December 31, 2020, providing that the individual will not be treated as married, for purposes of the credit, if he or she meets the following requirements:

- The individual is married and does not file a joint tax return for the year;
- The individual resides with a qualifying child for more than one half of the taxable year; and
- Either of the following is true –
    - during the last six months of the taxable year, the individual does not have the same principal place of abode as the individual's spouse, or
    - the individual has a separation agreement with respect to the individual's spouse and is not a member of the same household by the end of the taxable year.

2.12.6.4 Citizenship or Residency

If the taxpayer (or spouse, if married) was a nonresident alien for any part of the tax year, the taxpayer cannot claim the EITC unless the taxpayer's filing status is married filing jointly. (Such filing status is available only if one spouse is a U.S. citizen or resident alien and chooses to treat the nonresident spouse as a U.S. resident. It is important to keep in mind that making the election to treat the nonresident spouse as a U.S. resident will cause the worldwide income of both spouses to be subject to U.S. taxation.)

If the taxpayer or spouse was a nonresident alien for any part of the year and the taxpayer's filing status is other than married filing jointly, the EITC is not available.

2.12.6.5 EITC Rules That Apply Only if the Taxpayer Has a Qualifying Child

If the taxpayer meets all the EITC eligibility rules applicable to all filers—the rules just discussed—then proceed to the next step. The appropriate next step depends on whether or not the taxpayer has a qualifying child. We will turn our attention now to the rules that apply to a taxpayer who has met the EITC rules that apply to everyone ***and*** has a qualifying child.

In addition to meeting the EITC rules that apply to everyone, a taxpayer who has a qualifying child must meet certain other rules in order to be eligible to receive the EITC. The rules that a taxpayer with a qualifying child must also meet are:

1. The relationship, age, residence and joint return tests;
2. The qualifying child of more than one person rule; and
3. The qualifying child of another taxpayer rule.

2.12.6.6 EITC Rules That Apply if Taxpayer Does Not Have a Qualifying Child

A taxpayer may claim the EITC without a qualifying child, provided the taxpayer meets all the rules that apply to everyone and all the following rules that apply to taxpayers without qualifying children. The EITC rules applicable to a taxpayer with no qualifying child are:

1. The age rule - at least age 25 but less than age 65 at the end of the tax year;
2. The dependent of another person rule;
3. The qualifying child of another taxpayer rule; and
4. The main home rule.

Return to EITC Due Diligence Requirements at 3.5.2

2.13 Energy Credits

2.13.1 Modified Energy Efficient Home Improvement Credit

The Inflation Reduction Act modifies IRC § 25C (formerly titled Nonbusiness Energy Property) by renaming the section "Energy Efficient Home Improvement Credit" and provides for a substantially increased and broadened nonrefundable tax credit for various tax-efficient home improvements. A tax credit is available in an amount equal to 30 percent of the sum of the amounts paid or incurred during the taxable year, subject to additional limitations, by the taxpayer for qualified energy efficiency improvements that include:

- Installation of qualified energy efficiency improvements, including –
  - energy efficient windows and skylights, and
  - doors; and
- Energy audits.

In addition, the provision makes tax credits available for amounts paid or accrued for the installation of qualified energy property. Since these tax credits are subject to separate limitations, they will be examined separately.

2.13.2 Qualified Energy Efficiency Improvements

The term "qualified energy efficiency improvements" means any energy efficient building envelope component, provided:

- The component is installed in or on a dwelling unit—a term that includes a manufactured home conforming to Federal Manufactured Home Construction and Safety Standards—located in the United States and owned and used by the taxpayer as the taxpayer's principal residence;
- The original use of the component commences with the taxpayer; and
- The component reasonably can be expected to remain in use for at least 5 years.

2.13.2.1 Energy Efficient Building Envelope Component

The term "building envelope component," as used with reference to the energy efficient home improvement credit, means:

- Any insulation material or system specifically and primarily designed to reduce the heat loss or gain of a dwelling unit when installed in or on the dwelling unit;
- Exterior windows (including skylights); and
- Exterior doors.

Specifically, the term "energy efficient building envelope component," as used with respect to the energy efficient home improvement tax credit, means a building envelope component meeting:

- In the case of an exterior window or skylight, Energy Star most efficient certification requirements;
- In the case of an exterior door, applicable Energy Star requirements; and

- In the case of any other component, the prescriptive criteria for the component established by the most recent International Energy Conservation Code standard in effect as of the beginning of the calendar year which is 2 years prior to the calendar year in which the component is placed in service.

In short, an energy efficient building envelope component means a building envelope component meeting the following requirements:

Component	**Certification/Standard Required**
Exterior window or skylight	Energy Star most efficient certification requirements
Exterior door	Applicable Energy Star requirements
Other components	The prescriptive criteria for such component established by the most recent International Energy Conservation Code standard in effect as of the beginning of the calendar year which is 2 years prior to the calendar year in which such component is placed in service

2.13.2.2 Tax Credit Limitations

The credit allowed for individual clean energy and efficiency incentives in any taxable year is generally limited to no more than $1,200. However, limits also apply separately for:

- Windows, for which the maximum credit allowed with respect to any taxpayer for any taxable year shall not exceed $600 in the aggregate for all exterior windows and skylights;
- Doors, for which the credit allowed with respect to any taxpayer for any taxable year doesn't exceed—
    - $250 in the case of any exterior door, and
    - $500 in the aggregate with respect to all exterior doors.
- Home energy audits, for which the amount of the credit allowed shall not exceed $150.

  No credit is allowed for home energy audits unless the taxpayer includes with the taxpayer's tax return such information or documentation as the Secretary may require.

For example, suppose a taxpayer in any year replaced five windows costing $450 apiece and three exterior doors after receiving a home energy audit report. The most expensive exterior door cost $900, and the total cost of the other two doors was $1,200. The home energy audit cost $250. The 30% limitation is applied to the total paid for the windows, and, in the case of the exterior doors, is first applied to the most expensive door purchased, which is then further limited to no more than $250. The 30% limitation is then applied to the other exterior doors. The applicable limits reduce the total credit to $1,175, as illustrated below.

Energy Efficient Building Envelope Component	**Expenditure**	**30% Limitation**	**Dollar Limitation**	**Credit**
5 windows @$450	$2,250	$650	$600	$600
3 exterior doors • $900 X 1 = $900 • $600 x 2 = $1,200	 $900 $1,200	 $270 $360	 $250 $---- $500	 $500
Home energy audit @$250	$250	$75	$150	$75
Total	$4,600			$1,175

In addition to providing increased, albeit limited, tax credits for purchasing qualifying energy-efficient windows and doors, IRA § 13301 also authorizes larger tax credits for installing specific types of home heating units referred to as "qualified energy property," discussed in the following section (see **Qualified Energy Property** below).

2.13.3 Qualified Energy Property

The term "qualified energy property" refers to property consisting of heat pumps and heat pump water heaters, biomass stoves and boilers meeting prescribed standards. The non-refundable tax credit allowed for heat pump and heat pump water heaters, biomass stoves and boilers meeting specified requirements is 30 percent if purchased and installed between January 1, 2023 and December 31, 2032, limited to no more than $2,000.

2.13.3.1 Heat Pumps and Heat Pump Water Heaters

Qualified energy property includes any of the following meeting or exceeding the highest efficiency tier (not including any advanced tier) established by the Consortium for Energy Efficiency in effect as of the beginning of the calendar year in which the property is placed in service:

- An electric or natural gas heat pump water heater;
- An electric or natural gas heat pump;
- A central air conditioner; and
- A natural gas, propane, or oil water heater.

2.13.3.2 Biomass Stoves and Boilers

Biomass stoves and boilers meeting a specified rating and other requirements are also deemed to be qualified energy property. A biomass stove is a stove that burns biomass fuel— agricultural crops and trees, wood, wood waste and residues (including wood pellets), plants, grasses, residues, and/or fibers—to heat a home or heat water.

Thus, a biomass stove or boiler that:

- Uses the burning of biomass fuel to heat a taxpayer's residence in the United States, or to heat water for use in such a dwelling unit, and
- Has a thermal efficiency rating of at least 75 percent (measured by the higher heating value of the fuel)

…is considered qualified energy property.

2.13.3.3 Oil Furnace and Hot Water Boilers

An oil furnace or hot water boiler meeting specified requirements is also deemed to be qualified energy property. Accordingly, any oil furnace or hot water boiler is considered qualified energy property if:

- Placed in service after December 31, 2022, and before January 1, 2027 and –
  - meets or exceeds 2021 Energy Star efficiency criteria, and
  - is rated by the manufacturer for use with fuel blends at least 20 percent of the volume of which consists of an eligible fuel, or
- Placed in service after December 31, 2026, and —
  - achieves an annual fuel utilization efficiency rate of not less than 90, and
  - is rated by the manufacturer for use with fuel blends at least 50 percent of the volume of which consists of an eligible fuel.

2.13.3.4 Panelboard, Circuity Replacements, or Improvements

An improvement to, or replacement of, a panelboard[8], sub-panelboard, branch circuits, or feeders is considered qualified energy property and eligible for a tax credit provided it:

- Is installed in a manner consistent with the National Electric Code;
- Has a load capacity of not less than 200 amps;
- Is installed in conjunction with—
  - any qualified energy efficiency improvements, or

[8] A panelboard is a component of an electrical distribution system that divides an electrical power feed into branch circuits, while providing a protective circuit breaker or fuse for each circuit, in a common enclosure.

    - any qualified energy property for which a credit is allowed under this section for expenditures with respect to such property; and
- Enables the installation and use of qualified energy efficiency improvements or qualified energy property for which a credit is allowed.

2.13.3.5 Residential Energy Property Expenditures

In general, the term "residential energy property expenditures" means expenditures made by the taxpayer for qualified energy property:

- Installed on or in connection with a taxpayer's residence in the United States; and
- Originally placed in service by the taxpayer.

Residential energy property expenditures include expenditures for labor costs allocable to the preparation, assembly, or original installation of the property, for which the maximum credit allowed with respect to any taxpayer for any taxable year is limited to no more than $600.

2.13.3.6 Eligible Fuel

As used with respect to qualified energy property discussed above—specifically in connection with oil furnaces or hot water boilers—the term "eligible fuel" means:

- Biodiesel and renewable diesel (within the meaning of section 40A); and
- Second generation biofuel (within the meaning of section 40).

2.13.3.7 Home Energy Audits

A home energy audit, as the term is used with respect to the energy efficient home improvement credit, means an inspection and written report concerning a dwelling unit located in the United States and owned or used by the taxpayer as the taxpayer's principal residence that:

- Identifies the most significant and cost-effective energy efficiency improvements with respect to the dwelling unit and includes an estimate of the energy and cost savings with respect to each such improvement; and
- Is conducted and prepared by a home energy auditor that meets the certification or other requirements specified by the Secretary.

According to the U.S. Department of Energy, a home assessor performing a home energy audit will gather information and may use various pieces of equipment to detect sources of energy loss, such as blower doors, infrared cameras, furnace efficiency meters, and surface thermometers to identify correctible energy loss. Assessors then produce a report including characterizations of a client's home and actions that can be taken to reduce the home's energy use while increasing comfort of the living space. Common home energy assessor recommendations include:

- Conduct whole-home air sealing to reduce air leakage and drafts;
- Add insulations to the home's attic, foundation, or walls to prevent heat loss;
- Seal and insulate ducts in unconditioned spaces;
- Remove or repair any parts of the home with internal moisture or mold to improve air quality and reduce deterioration;
- Improve the efficiency of heating, cooling, and hot water equipment; and
- Install home ventilation, smart thermostats, LEDs, smart power strips, ENERGY STAR appliances, solar PV, an electric vehicle charger, and other efficient technologies that improve home performance.

2.13.4 Subsidized Energy Financing

The intent of the energy efficient home improvement credit is to provide a tax credit equal to a percentage of taxpayers' energy-efficient expenditures to encourage them to implement various energy saving home projects. When calculating the tax credit, do not take into account taxpayer expenditures that are made from subsidized energy financing. Subsidized energy financing means

financing provided under a federal, state, or local program a principal purpose of which is to provide subsidized financing for projects designed to conserve or produce energy.

2.13.5 Tax Credits Reduce Taxpayer's Basis

If an energy-efficient home improvement credit is allowed for a taxpayer's expenditure, the taxpayer's basis in the property is reduced by the amount of the credit allowed.

2.13.6 Product Identification Number Required

No energy-efficient home improvement credit is allowed with respect to any item of property placed in service after December 31, 2024, unless:

- The item is produced by a qualified manufacturer; and
- The taxpayer includes the qualified product identification number to specified property items for taxpayers to report on Form 5695 in order to claim the credit for tax years beginning 2025.

2.13.6.1 Qualified Manufacturer/Identification Number

The term "qualified manufacturer" means a manufacturer that enters into an agreement with the Secretary pursuant to which it will:

- Assign a product identification number to each item of specified property it produces using a methodology that ensures the number is unique to each item;
- Label the item with a number in the manner the Secretary provides; and
- Make periodic written reports to the secretary of the product identification numbers assigned and include information the Secretary requires.

The term "qualified product identification number" means the product identification number assigned to the item by the qualified manufacturer.

2.13.7 Effective Dates

Although the amendments made by IRA § 13301 generally apply to property placed in service after December 31, 2022, the tax credits for qualified energy efficiency improvements, residential energy property expenditures, and home energy audits are effective for property placed in service after December 31, 2021.

2.13.8 Modifications to the Residential Clean Energy Property Credit

The Inflation Reduction Act made several important changes to the energy efficient home improvement credit for taxpayers who make qualified energy efficient improvements to their homes. Modifications to the credit include extending the credit, applying a phaseout, and specifying disallowed and allowed expenditures such as battery storage technology.

2.13.8.1 Extension of the Credit

Prior to the passage of the Inflation Reduction Act, the credit would be allowed with respect to property placed in service no later than December 31, 2023. As a result of passage of the Inflation Reduction Act, the credit is allowed with respect to property placed in service no later than December 31, 2034. Therefore, the credit currently applies with respect for property placed in service after December 31, 2021, and before January 1, 2035. The applicable percentage rate phases down as the date in which property placed in service approaches December 31, 2034.

2.13.8.1.1 Credit Phaseout

Beginning in 2023, there is no longer a lifetime limit applicable to the credit. Accordingly, a taxpayer may claim the maximum Residential Clean Energy Property Credit allowed every year that eligible improvements are made. However, a credit phaseout will apply as follows:

- 30 percent in the case of property placed in service after December 31, 2016, and before January 1, 2020;

- 26 percent in the case of property placed in service after December 31, 2019, and before January 1, 2022;
- 30 percent in the case of property placed in service after December 31, 2021, and before January 1, 2033;
- 26 percent in the case of property placed in service after December 31, 2032, and before January 1, 2034; and
- 22 percent in the case of property placed in service after December 31, 2033, and before January 1, 2035.

2.13.8.1.2 Battery Storage Technology Expenditures

The Inflation Reduction Act defines and provides a tax credit for qualified battery storage technology expenditures for battery storage technology that:

- Is installed in connection with a dwelling unit located in the United States and used as a residence by the taxpayer, and
- Has a capacity of not less than 3 kilowatt hours.

Furthermore, expenditures for labor costs for the installation of the property including piping and/or wiring to interconnect the property to the dwelling are eligible for the credit.

2.14 New Clean Vehicle Credit

The provision of the IRA authorizing the nonrefundable tax credit for the purchase or lease of a new electric vehicle—a provision generally effective for vehicles placed in service after December 31, 2022 and not later than December 31, 2032—provides for a maximum tax credit of $7,500.

Eligibility for the tax credit is contingent on meeting various requirements including:

- Battery component and critical materials requirements;
- Battery capacity and recharging specifications;
- Maximum purchaser income requirements;
- Manufacturer's suggested retail price (MSRP) maximums; and
- Vehicle compliance with applicable safety and air quality requirements.

2.14.1 New Clean Vehicle Tax Credit Requirements

The amount of the tax credit for purchase of a new clean vehicle is equal to the total amount determined based on two factors:

1. The critical minerals used in the battery from which the EV draws electricity, a factor that may account for a maximum credit of $3,750; and
2. The battery components, a manufacture/assembly factor that may account for a maximum credit of $3,750.

Further credit eligibility requires that, as of January 1st, 2024, the:

- Critical mineral component percentages are required to be domestically produced or extracted increased from 40% in 2023 to 50% in 2024.
- The qualifying percentage of North American battery components for a vehicle to receive the tax credit increased from 50% in 2023 to 60% in 2024.

2.14.2 Manufacturer's Suggested Retail Price Affects Tax Credit Eligibility

The new EV tax credit is not available for a vehicle with a manufacturer's suggested retail price (MSRP) in excess of the following:

Class of Vehicle	Manufacturer's Suggested Retail Price
Vans	$80,000
Sport utility vehicles	$80,000
Pickup trucks	$80,000
Other vehicles	$55,000

2.14.3 Income-Based EV Tax Credit Limitations

The tax credit available with respect to an EV meeting the definition of a new clean vehicle may be limited based on the taxpayer's modified adjusted gross income (MAGI). Pursuant to the income limitation, no previously-owned vehicle tax credit is available if the taxpayer's MAGI for the current or prior taxable year exceeds the threshold amount which is:

- $300,000 in the case of a joint return or a surviving spouse;
- $225,000 in the case of a head of household; and
- $150,000 in the case of any other taxpayer.

2.14.4 Transfer of Credit

Tax credits, with certain exceptions, are generally taken at the time a taxpayer's return is filed, and a taxpayer eligible for the clean vehicle tax credit may choose to take the credit at that time. However, a taxpayer may elect to transfer the clean vehicle tax credit to an eligible entity, i.e., the dealer who sold the vehicle to the taxpayer, and receive the credit at the time of purchase of the vehicle in cash or in the form of a partial payment or down payment. A transferred credit does not result in includible income to the purchaser and is not deductible by the dealer.

2.14.5 Special Rules Applicable to New Clean Vehicle Credit

Various rules and requirements apply to a new clean vehicle tax credit, including the following:

- Basis is reduced by the tax credit allowable;
- No double credit is permitted. Thus, the amount of any deduction or other credit allowable under this chapter is reduced by the amount of clean vehicle credit allowed;
- No clean vehicle credit is allowable for vehicles used outside the U.S.;
- Clean vehicle tax credits may be recaptured if the vehicle ceases to be eligible for the credit;
- No clean vehicle tax credit is allowed if the taxpayer elects not to have the credit apply to the vehicle;
- A vehicle is ineligible for a clean vehicle credit unless it complies with –
    - the applicable provisions of –
        - the Clean Air Act for the make and model year of the vehicle, or
        - the air quality provisions of State law if adopted under a Clean Air Act waiver, and
    - the motor vehicle safety provisions of sections 30101 through 30169 of title 49, United States Code;
- Only one clean vehicle credit is permitted per vehicle, based on its VIN, including any vehicle for which the taxpayer elected to transfer the credit. Accordingly, if the credit has been transferred, it may not also be taken by the transferring taxpayer; and
- No clean vehicle tax credit is allowed unless the taxpayer includes the vehicle identification number (VIN) of the vehicle on the tax return for the taxable year.

2.14.6 Previously-Owned Clean Vehicle Credit

The provision of the IRA authorizing the nonrefundable tax credit for the purchase of a previously-owned electric vehicle applies to the purchase of a used electric vehicle whose model year is 2 or more years earlier than the calendar year in which the taxpayer acquires it and provides for a nonrefundable tax credit not exceeding the lesser of 30% of the sale price or $4,000. The maximum price of a previously-owned clean vehicle on which the credit is authorized is $25,000.

2.14.7 Income-Based EV Tax Credit Limitations

The tax credit available with respect to an EV meeting the definition of a previously-owned clean vehicle may be limited based on the taxpayer's modified adjusted gross income (MAGI). Pursuant to the income limitation, no previously-owned vehicle tax credit is available if the taxpayer's MAGI for the current or prior taxable year exceeds the threshold amount which is:

- $150,000 in the case of a joint return or a surviving spouse taxpayer;
- $112,500 in the case of a head of household taxpayer; and

- $75,000 in the case of any other taxpayer.

2.14.8 Transfer of Credit

Similar to a clean new vehicle credit transfer, a taxpayer may elect to transfer the previously-owned vehicle tax credit to an eligible entity, i.e., the dealer who sold the vehicle to the taxpayer, and receive the credit at the time of purchase of the vehicle in cash or in the form of a partial payment or down payment on the vehicle. A transferred credit does not result in includible income to the purchaser and is not deductible by the dealer. The transfer of credit provision applies only to previously-owned vehicles acquired after December 31, 2023.

2.14.9 Special Rules Applicable to a Previously-Owned Clean Vehicle

As in the case of new clean vehicles, various rules and requirements apply to a previously-owned clean vehicle tax credit, including the following:

- Basis is reduced by the tax credit allowable;
- No double credit is permitted. Thus, the amount of any deduction or other credit allowable under this chapter is reduced by the amount of previously-owned vehicle credit allowed;
- No previously-owned vehicle credit is allowable for vehicles used outside the U.S.;
- Previously-owned vehicle tax credits may be recaptured if the vehicle ceases to be eligible for the credit;
- No previously-owned vehicle tax credit is allowed if the taxpayer elects not to have the credit apply to the vehicle;
- A vehicle is ineligible for a previously-owned vehicle credit unless it complies with –
    - the applicable provisions of –
        - the Clean Air Act for the make and model year of the vehicle, or
        - the air quality provisions of State law if adopted under a Clean Air Act waiver, and
    - the motor vehicle safety provisions of sections 30101 through 30169 of title 49, United States Code;
- Only one clean vehicle credit is permitted per vehicle, based on its VIN, including any vehicle for which the taxpayer elected to transfer the credit. Accordingly, if the credit has been transferred, it may not also be taken by the transferring taxpayer;
- No clean vehicle tax credit is allowed unless the taxpayer includes the vehicle identification number (VIN) of the vehicle on the tax return for the taxable year.

2.14.10 Rev. Proc. 2023-33

As already noted, the Inflation Reduction Act (IRA) authorizes tax credits for the purchase of new and used (previously-owned) electric vehicles and enables purchasing taxpayers to realize those credits at the time of buying the vehicle by transferring them to the seller who then reduces the price charged by the amount of the transferred credit. IRS Revenue Procedure 2023-33[9] addresses various procedures and requirements implementing the provisions of the IRA including those for the transfer of the new or previously-owned clean vehicle credit from the taxpayer who elects to transfer such credit to an eligible entity. Additionally, it supersedes sections 5.01 and 6.03 of Rev. Proc. 2022-42 with respect to the method and timing of submission of written agreements by manufacturers to the IRS. These procedures apply to transfers of credits after December 31, 2023.

Among the additional procedures and requirements outlined in the Revenue Procedure are those applicable to the:

- Manufacturer, seller and dealer registration through the energy credits online portal;
- Timing and requirements of disclosures to taxpayers electing to transfer the tax credit;
- Disclosure obligation of taxpayers electing to transfer the tax credit;
- Manufacturer written agreement and reports;

[9] IRS Rev. Proc. 2023-33 may be accessed at https://www.irs.gov/pub/irs-drop/rp-23-33.pdf

- Seller reports;
- Information required for advance payments to registered dealers;
- Registered dealer recordkeeping obligations; and
- Suspension and/or revocation of registered dealer eligibility to participate in the advance payment program.

2.15 Overview Topics

2.15.1 Tax Treatment of Virtual Currency

The term "virtual currency" refers to a digital representation of value not issued by any public authority but which may be, nonetheless, accepted as a means of payment between persons. It functions as a medium of exchange and/or a store of value although it doesn't have status as legal tender. Such virtual currency having an equivalent value in real currency is referred to as "convertible" virtual currency. The IRS in Notice 2014–21[10] describes how existing general tax principles apply to transactions using virtual currency, and a brief description of that application follows:

- **Virtual Currency Treated as Property** – The general tax principles applicable to property transactions apply to transactions using virtual currency.
- **Virtual Currency Not Treated as Currency** – Current U.S. tax law does not treat virtual currency as currency that could generate foreign currency gain or loss for tax purposes.
- **Virtual Currency as Payment** – U.S. taxpayers receiving virtual currency as payment for goods or services must include the fair market value of the virtual currency in U.S. dollars received in computing their gross income.
- **Virtual Currency Basis** – The basis of virtual currency received by a taxpayer as payment for goods and services is its fair market value in U.S. dollars as of the date of receipt.
- **Virtual Currency Fair Market Value** – Transactions using virtual currency must be reported in U.S. dollars, and taxpayers are required to determine the fair market value of virtual currency in U.S. dollars as of the date of payment or receipt.
- **Gain or Loss on Exchange of Virtual Currency** – If the fair market value of property received by a taxpayer in exchange for virtual currency exceeds the taxpayer's adjusted basis of the virtual currency the taxpayer has taxable gain. Similarly, the taxpayer has a loss if the fair market value of the property received is less than the adjusted basis of virtual currency exchanged.
- **Type of Gain or Loss Realized** – The character of the gain or loss realized on the sale or exchange of virtual currency generally depends on whether the virtual currency is a capital asset in the hands of the taxpayer. Thus, a taxpayer will generally realize capital gain or loss on the sale or exchange of virtual currency that is a capital asset in the hands of the taxpayer. In contrast, inventory and other property held mainly for sale to customers in a trade or business are examples of property that is not a capital asset.
- **Mining Virtual Currency** – A taxpayer who successfully "mines" virtual currency will realize gross income for tax purposes upon receipt of the virtual currency to the extent of its fair market value as of the date of receipt.
- **Virtual Currency Mining as a Trade or Business** – If a taxpayer's "mining" of virtual currency constitutes a trade or business and the activity is not undertaken as an employee, the net earnings from self-employment resulting from the mining activity constitute self-employment income subject to the self-employment tax.
- **Virtual Currency Received by Independent Contractors for Performing Services** – Generally, self-employment income includes all gross income derived by an individual from any trade or business carried on by the individual as other than an employee. Accordingly, the fair market value of the virtual currency received for services performed as an independent contractor, measured in U.S. dollars as of the date of receipt, constitutes self-employment income subject to self-employment tax.
- **Virtual Currency Paid to an Employee** – Generally, the medium in which remuneration for services is paid is immaterial to the determination of whether the remuneration constitutes wages for employment tax purposes. Thus, the fair market value of virtual currency paid as

[10] Notice 2014-21 may be accessed at https://www.irs.gov/pub/irs-drop/n-14-21.pdf.

wages is subject to federal income tax withholding, Federal Insurance Contributions Act (FICA) tax and Federal Unemployment Tax Act (FUTA) tax and must be reported on Form W-2, Wage and Tax Statement.

- **Information Reporting of Virtual Currency Payment** – A payment made using virtual currency is subject to information reporting to the same extent as any other payment made in property. So, a person who in the course of a trade or business makes a payment of fixed and determinable income using virtual currency with a value of more than $600 to a U.S. nonexempt recipient in a taxable year is required to report the payment to the IRS and to the payee.
- **Information Reporting of Virtual Currency Payments to Independent Contractors** – Generally a person who in the course of a trade or business makes a payment of $600 or more in a taxable year to an independent contractor for the performance of services must report that payment to the IRS and to the payee on Form 1099–NEC; when that payment is in virtual currency, it should be reported using the fair market value in U.S. dollars as of the date of payment.
- **Virtual Currency Payments Subject to Backup Withholding** – Payments made using virtual currency are subject to backup withholding to the same extent as other payments made in property. So, a payor must backup withhold from a payment of virtual currency if a TIN is not obtained prior to payment or if the payor receives notification from the IRS that backup withholding is required.
- **Third-Party Settlement Organizations (TPSO)** – A third-party settlement organization (TPSO)— an organization that contracts with a substantial number of unrelated merchants to settle payments between them and their customers—must report payments made to a merchant on Form 1099-K, *Payment Card And Third-Party Network Transactions*, if the gross amount of payments made to the merchant exceeds $600, regardless of the number of transactions.
- **Penalties for Incorrect Tax Treatment of Virtual Currency Transactions** – Failure to treat a virtual currency transaction in a way consistent with IRS notice 2014–21 will subject a taxpayer to penalties for failure to comply with tax laws.

IRS Notice 2023-34[11] modifies previous IRS Notice 2014-21 by revising a sentence in the Background section to remove the statement that virtual currency does not have legal tender status in any jurisdiction following the 2021 announcement by El Salvador that it would begin accepting Bitcoin as legal tender. It also explains that the answers to the frequently asked questions (FAQs) set forth in section 4 of Notice 2014-21 are unaffected by the revision.

The modification states that "In certain contexts, virtual currency may serve one or more of the functions of "real" currency -- i.e., the coin and paper money of the United States or of any other country that is designated as legal tender, circulates, and is customarily used and accepted as a medium of exchange in the country of issuance -- but the use of virtual currency to perform "real" currency functions is limited."

2.15.2 Alternative Minimum Tax (AMT)

Imposition of an alternative minimum tax was designed to ensure that at least a minimum amount of tax is paid by higher-income taxpayers who enjoy significant tax savings through the use of certain tax deductions, exemptions, losses and credits. Absent the alternative minimum tax, such taxpayers could conceivably avoid federal income tax liability completely despite their high income level. After various tax-preference items are added back to the taxpayer's income, the applicable alternative minimum taxable income (AMTI) exemption, discussed below, is subtracted.

2.15.2.1 Alternative Minimum Tax Exemption Amount Increased

The tax code provides for an AMTI exemption for purposes of determining the alternative minimum tax amount. The amount of the AMTI exemption varies according to the taxpayer's filing status and the tax year. The applicable AMTI exemption amounts[12] for 2024 are as follows:

[11] Notice 2023-34 may be accessed at https://www.irs.gov/pub/irs-drop/n-23-34.pdf

[12] AMTI exemption amounts are indexed for inflation.

Filing Status	Threshold for Phaseout of Exemption Amount	Complete Phaseout Amount	Alternative Minimum Taxable Income Exemption
Single or Head of Household	$609,350	$952,150	$85,700
Married Filing Jointly & Qualifying Surviving Spouse	$1,218,700	$1,751,900	$133,300
Married Filing Separately	$609,350	$875,950	$66,650
Estates and Trusts	$99,700	$219,300	$29,900

The AMTI exemption amount is reduced (but not below zero) by 25 percent of the amount by which the taxpayer's alternative minimum taxable income exceeds the phaseout threshold.

2.15.3 QBI Deduction

The Tax Cuts and Jobs Act of 2017 added a tax deduction—frequently referred to as the section 199A deduction or QBI deduction—of up to 20% of qualified business income derived from a qualified trade or business. The total of 20% of the qualified business income and 20% of the REIT and PTP income is referred to as the "combined qualified business income amount."

The deduction is generally equal to the ***lesser*** of:

1. The combined qualified business income amount; and
2. 20% of the taxpayer's taxable income reduced by the taxpayer's net capital gain.

2.15.3.1 Qualified REIT Dividend

The term "qualified REIT dividend" means any dividend from a real estate investment trust received during the taxable year which is neither a capital gain dividend nor qualified dividend income.

2.15.3.2 Qualified Publicly Traded Partnership Income

The term "qualified publicly traded partnership income" means, with respect to any qualified trade or business of a taxpayer, the sum of A and B where:

A is the net amount of the taxpayer's allocable share of each qualified item of income, gain, deduction, and loss from a publicly traded partnership which is not treated as a corporation; and

B is any gain recognized by the taxpayer upon disposition of its interest in the partnership to the extent such gain is treated as an amount realized from the sale or exchange of property other than a capital asset.

2.15.3.3 Deduction Eligibility

Taxpayers who may be eligible for the deduction are those who operate a business as a sole proprietorship or under a pass-through entity, i.e., a partnership, a limited liability company (LLC) taxed as a partnership or an S corporation. Accordingly, individuals, trusts and estates with qualified business income, qualified REIT dividends or qualified PTP income may qualify for the deduction. Income earned as an employee or through a C Corporation, however, is ineligible for the deduction.

Furthermore, eligibility for the pass-through deduction authorized by the TCJA does not require that the taxpayer itemize tax deductions. Accordingly, eligibility for the pass-through deduction is unaffected by the taxpayer's election to itemize deductions or take the standard deduction.

2.15.3.4 Pass-Through Deduction Generally Limited to Qualified Trade or Business

The deduction of up to 20% of a pass-through business' qualified business income, depending upon the amount of qualified business income and other factors affecting it, may reduce the taxpayer's income tax liability significantly. However, the "other factors" that may affect the deduction include:

- Whether the business is a qualified trade or business;

- The taxpayer's taxable income; and
- If the business owner's taxable income exceeds the applicable threshold –
    - The amount of W-2 wages paid; and
    - The value of qualified property.

2.15.3.4.1 Qualified Trade or Business

A qualified trade or business, as the term is used with respect to the pass-through deduction, means any trade or business ***other than***:

- A specified service trade or business (SSTB);
- Any trade or business where the principal asset is the reputation or skill of one or more of its employees or owners; or
- The trade or business of performing services as an employee. (In other words, an employee of a trade or business would not be considered a "qualified trade or business" whose income from such employment would qualify for the pass-through deduction.)

2.15.3.4.1.1 Exception for Specified Service Trade or Business

The rule cited just above that disqualifies specified service trades or businesses from being considered qualified trades or businesses eligible for the pass-through deduction does not apply to individuals whose taxable income is less than the threshold amount[13]. The threshold amount and phase-in range are as shown in the chart below:

Taxpayer's Filing Status	2024 Threshold Amount	Phase-In Range
Married filing jointly	$383,900	$100,000
Married filing separately	$191,950	$50,000
Single & head of household filers	$191,950	$50,000

However, the pass-through deduction is not available for specified service trades or businesses if the taxpayer's taxable income is equal to or greater than the applicable threshold amount plus $100,000 in the case of a taxpayer filing a joint tax return or the applicable threshold amount plus $50,000 for all other taxpayers.

For specified service trades or businesses of taxpayers whose taxable income falls within the phase-in range, i.e., between the threshold amount and $100,000 or $50,000 more than the threshold amount, as appropriate, the deduction may be reduced by being subject to a phase-in. Under the phase-in reduction, only the applicable percentage of qualified business income, W-2 wages and unadjusted basis immediately after acquisition (UBIA) of qualified property held by the trade or business is taken into account in determining the § 199A deduction. Thus, if an individual's taxable income is above the threshold amount but within the phase-in range then the taxpayer must calculate an applicable percentage that limits the QBI, W-2 wages, and UBIA of qualified property from an SSTB used to calculate the individual's § 199A deduction.

2.15.3.5 IRS Forms for Qualified Business Income Deduction – 8995 & 8995-A

The IRS created two forms for use in determining the appropriate amount of pass-through deduction available to taxpayers owning eligible trades or businesses who have:

- Qualified business income (QBI);
- Qualified real estate investment trust (REIT) dividends; or
- Qualified publicly traded partnership (PTP) income or loss.

Determining which of the forms to use to figure the deduction is based on whether the taxpayer's taxable income is greater than the applicable threshold or the taxpayer is a patron in a specified agricultural or horticultural cooperative. The IRS also added a worksheet to the instructions for each form that provides a method to track and compute your clients' previously disallowed losses or deductions to be included in your qualified business income deduction calculation for the year allowed.

[13] The threshold amount is annually adjusted for inflation.

Samples of both Forms 8995 and 8995-A are provided below. Let's briefly consider each of them.

2.15.3.5.1 Qualified Business Income Deduction Simplified Computation - Form 8995

Form 8995,[14] Qualified Business Income Deduction Simplified Computation, permits a taxpayer or preparer to compute the pass-through deduction for a taxpayer whose taxable income doesn't exceed the applicable threshold amount and who is not a patron in a specified agricultural or horticultural cooperative. (Cooperatives are not eligible for the deduction. Instead, cooperatives provide the necessary information to their patrons on Form 1099-PATR to help eligible patrons to figure their deduction.)

Thus, in addition to not being a patron in a specified agricultural or horticultural cooperative, a taxpayer eligible to use Form 8995 in connection with 2024 income is one who has QBI, qualified REIT dividends and/or qualified PTP income or loss and whose taxable income does **NOT exceed**:

- $383,900 if married filing a joint tax return (MFJ);
- $191,950 if married filing a separate return (MFS); or
- $191,950 with any other filing status.

2.15.3.5.2 Qualified Business Income Deduction - Form 8995-A

Form 8995-A,[15] Qualified Business Income Deduction, permits a taxpayer or preparer to compute the pass-through deduction for a taxpayer whose taxable income exceeds the applicable threshold amount or who is a patron in a specified agricultural or horticultural cooperative.

So, in contrast to taxpayers eligible to use Form 8995, a taxpayer eligible to use Form 8995-A in connection with 2024 income is one who has QBI, qualified REIT dividends and/or qualified PTP income or loss and who is either a patron in a specified agricultural or horticultural cooperative **or** whose taxable income **exceeds**:

- $383,900 if married filing a joint tax return (MFJ);
- $191,950 if married filing a separate return (MFS); or
- $191,950 with any other filing status.

[14] IRS Form 8995 may be accessed at https://www.irs.gov/pub/irs-pdf/f8995.pdf
[15] IRS Form 8995-A may be accessed at https://www.irs.gov/pub/irs-pdf/f8995a.pdf

Form **8995**

Department of the Treasury
Internal Revenue Service

Qualified Business Income Deduction Simplified Computation

► **Attach to your tax return.**

► **Go to *www.irs.gov/Form8995* for instructions and the latest information.**

OMB No. 1545-0123

Attachment Sequence No. **55**

Name(s) shown on return

Your taxpayer identification number

1	(a) Trade, business, or aggregation name	(b) Taxpayer identification number	(c) Qualified business income or (loss)
i			
ii			
iii			
iv			
v			

2	Total qualified business income or (loss). Combine lines 1i through 1v, column (c)	2		
3	Qualified business net (loss) carryforward from the prior year	3	( )	
4	Total qualified business income. Combine lines 2 and 3. If zero or less, enter -0-	4		
5	Qualified business income component. Multiply line 4 by 20% (0.20)			5
6	Qualified REIT dividends and publicly traded partnership (PTP) income or (loss) (see instructions)	6		
7	Qualified REIT dividends and qualified PTP (loss) carryforward from the prior year	7	( )	
8	Total qualified REIT dividends and PTP income. Combine lines 6 and 7. If zero or less, enter -0-	8		
9	REIT and PTP component. Multiply line 8 by 20% (0.20)			9
10	Qualified business income deduction before the income limitation. Add lines 5 and 9			10
11	Taxable income before qualified business income deduction	11		
12	Net capital gain (see instructions)	12		
13	Subtract line 12 from line 11. If zero or less, enter -0-	13		
14	Income limitation. Multiply line 13 by 20% (0.20)			14
15	Qualified business income deduction. Enter the lesser of line 10 or line 14. Also enter this amount on the applicable line of your return ►			15
16	Total qualified business (loss) carryforward. Combine lines 2 and 3. If greater than zero, enter -0-			16 ( )
17	Total qualified REIT dividends and PTP (loss) carryforward. Combine lines 6 and 7. If greater than zero, enter -0-			17 ( )

Form **8995-A**

Department of the Treasury
Internal Revenue Service

Qualified Business Income Deduction

▶ Attach to your tax return.
▶ Go to *www.irs.gov/Form8995A* for instructions and the latest information.

OMB No. 1545-0123

Attachment Sequence No. **55A**

Name(s) shown on return

Your taxpayer identification number

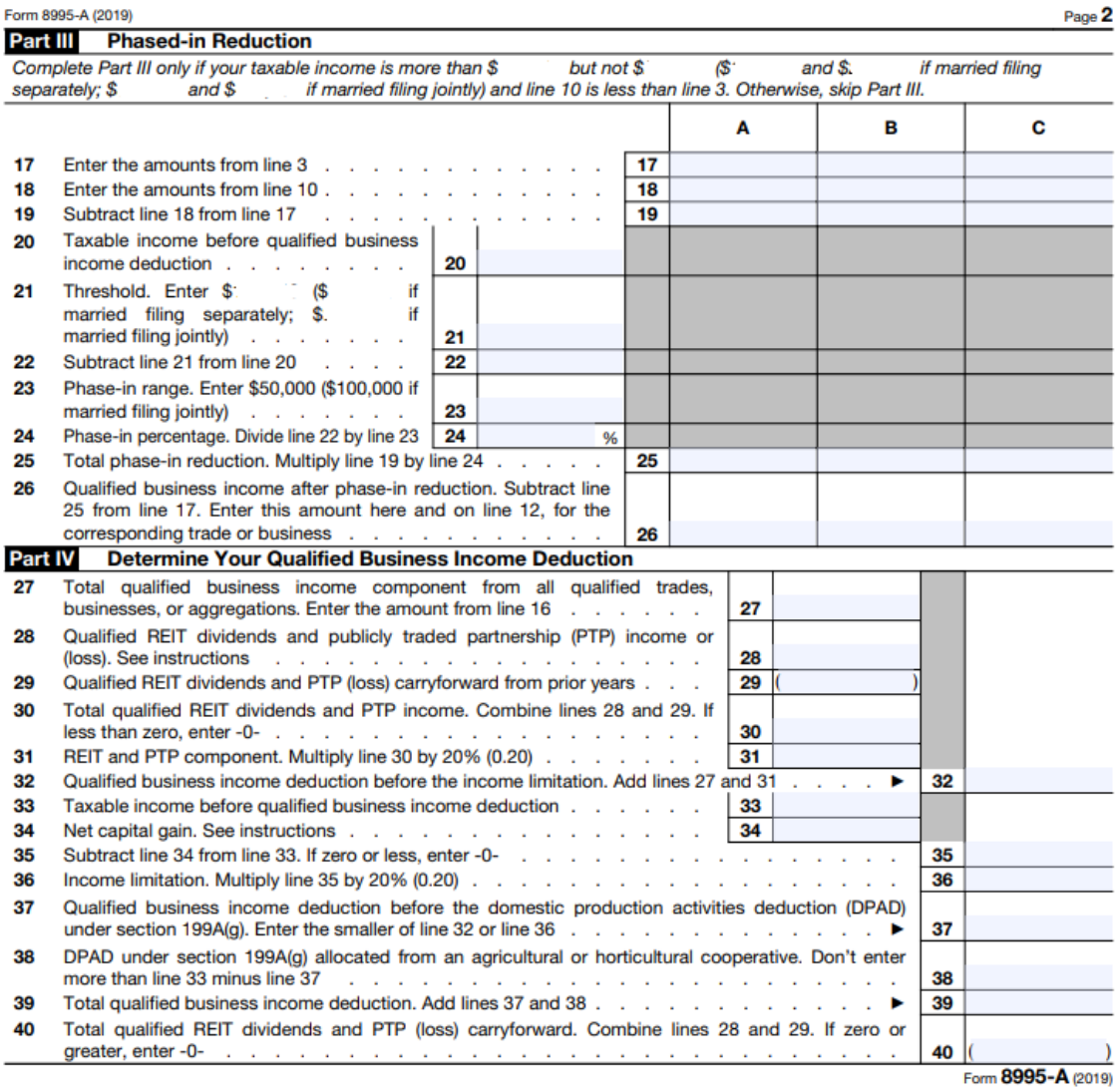
Part I Trade, Business, or Aggregation Information

Complete Schedules A, B, and/or C (Form 8995-A), as applicable, before starting Part I. Attach additional worksheets when needed. See instructions.

1	(a) Trade, business, or aggregation name	(b) Check if specified service	(c) Check if aggregation	(d) Taxpayer identification number	(e) Check if patron
A		☐	☐		☐
B		☐	☐		☐
C		☐	☐		☐

Part II Determine Your Adjusted Qualified Business Income

			A	B	C
2	Qualified business income from the trade, business, or aggregation. See instructions	2			
3	Multiply line 2 by 20% (0.20). If your taxable income is $ or less ($ if married filing separately; $ if married filing jointly), skip lines 4 through 12 and enter the amount from line 3 on line 13	3			
4	Allocable share of W-2 wages from the trade, business, or aggregation	4			
5	Multiply line 4 by 50% (0.50)	5			
6	Multiply line 4 by 25% (0.25)	6			
7	Allocable share of the unadjusted basis immediately after acquisition (UBIA) of all qualified property	7			
8	Multiply line 7 by 2.5% (0.025)	8			
9	Add lines 6 and 8	9			
10	Enter the greater of line 5 or line 9	10			
11	W-2 wage and qualified property limitation. Enter the smaller of line 3 or line 10	11			
12	Phased-in reduction. Enter the amount from line 26, if any. See instructions	12			
13	Qualified business income deduction before patron reduction. Enter the greater of line 11 or line 12	13			
14	Patron reduction. Enter the amount from Schedule D (Form 8995-A), line 6, if any. See instructions	14			
15	Qualified business income component. Subtract line 14 from line 13	15			
16	Total qualified business income component. Add all amounts reported on line 15 ▶	16			



Form 8995-A (2019) Page 2

Part III Phased-in Reduction

Complete Part III only if your taxable income is more than $ but not $ ($ and $ if married filing separately; $ and $ if married filing jointly) and line 10 is less than line 3. Otherwise, skip Part III.

				A	B	C
17	Enter the amounts from line 3		17			
18	Enter the amounts from line 10		18			
19	Subtract line 18 from line 17		19			
20	Taxable income before qualified business income deduction	20				
21	Threshold. Enter $ ($ if married filing separately; $ if married filing jointly)	21				
22	Subtract line 21 from line 20	22				
23	Phase-in range. Enter $50,000 ($100,000 if married filing jointly)	23				
24	Phase-in percentage. Divide line 22 by line 23	24	%			
25	Total phase-in reduction. Multiply line 19 by line 24		25			
26	Qualified business income after phase-in reduction. Subtract line 25 from line 17. Enter this amount here and on line 12, for the corresponding trade or business		26			

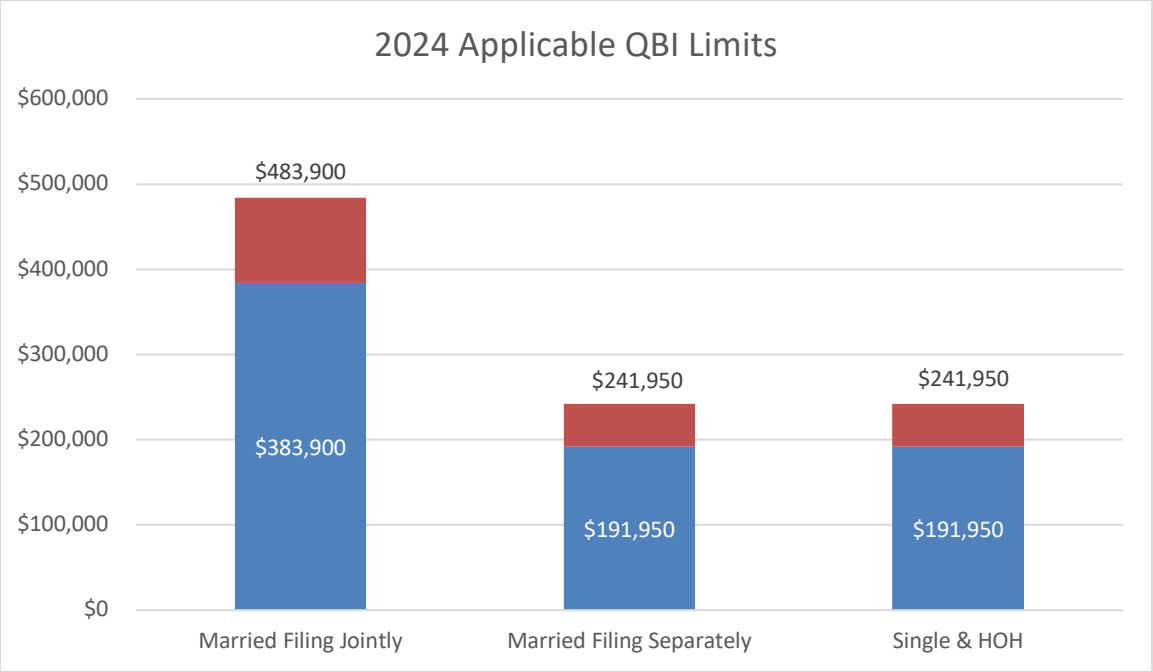
Part IV Determine Your Qualified Business Income Deduction

27	Total qualified business income component from all qualified trades, businesses, or aggregations. Enter the amount from line 16	27		
28	Qualified REIT dividends and publicly traded partnership (PTP) income or (loss). See instructions	28		
29	Qualified REIT dividends and PTP (loss) carryforward from prior years	29	( )	
30	Total qualified REIT dividends and PTP income. Combine lines 28 and 29. If less than zero, enter -0-	30		
31	REIT and PTP component. Multiply line 30 by 20% (0.20)	31		
32	Qualified business income deduction before the income limitation. Add lines 27 and 31 ▶		32	
33	Taxable income before qualified business income deduction	33		
34	Net capital gain. See instructions	34		
35	Subtract line 34 from line 33. If zero or less, enter -0-		35	
36	Income limitation. Multiply line 35 by 20% (0.20)		36	
37	Qualified business income deduction before the domestic production activities deduction (DPAD) under section 199A(g). Enter the smaller of line 32 or line 36 ▶		37	
38	DPAD under section 199A(g) allocated from an agricultural or horticultural cooperative. Don't enter more than line 33 minus line 37		38	
39	Total qualified business income deduction. Add lines 37 and 38 ▶		39	
40	Total qualified REIT dividends and PTP (loss) carryforward. Combine lines 28 and 29. If zero or greater, enter -0-		40	( )

Form **8995-A** (2019)

2.15.3.6 Taxable Income Threshold

Graphically represented, the applicable thresholds and phase-in ranges are as depicted in the following chart:



2.15.3.7 Pass-Through Deduction for Qualified Trade or Business Owners

For a pass-through business owner whose taxable income exceeds the applicable threshold, two additional limitations come into play: wages paid and business investment. Somewhat similar to SSTBs, these limits begin to phase-in when the business owner's taxable income exceeds the applicable threshold and apply in full when the business owner's taxable income exceeds the applicable threshold plus $50,000 ($100,000 for married taxpayers filing jointly). If the applicable phase-in range is $100,000 and the taxpayer's taxable income is $60,000 greater than the threshold amount, the reduction in the W-2 wages and UBIA would be 60%. ($60,000 ÷ $100,000 = .60)

The section 199A pass-through deduction is determined for qualified trade or business owners with taxable income for the taxable year that exceeds the threshold amount by adding the QBI component—an amount equal to 20% of the qualified business income modified by the wage and investment limitations—(see **QBI Component Calculation** below) and the qualified REIT dividend/qualified PTP income component. That sum is then compared to 20 percent of the amount by which the individual's taxable income exceeds net capital gain. The lesser of these two amounts is the individual's section 199A deduction.

2.15.3.7.1 QBI Component Calculation

Notice that when the taxpayer's taxable income exceeds the threshold amount, computation of the pass-through deduction changes by the addition of the term "QBI *component,*" a term that considers both the QBI and the wage and business investment limitations. The W-2 wage and UBIA of qualified property limitations begin phasing in for those owners of pass-through qualified trades or businesses whose taxable income exceeds the applicable threshold and are fully phased-in when the business owner's taxable income equals the sum of the threshold *plus* the applicable phase-in range. Only after the QBI component is computed can the business owner whose taxable income exceeds the threshold determine the pass-through deduction.

2.15.3.7.2 Qualified Property

Qualified property plays a part in the calculation of the pass-through deduction for business owners whose taxable income exceeds the applicable threshold.

The term "qualified property," as used with respect to the pass-through deduction, means tangible property:

- Subject to depreciation under IRC §167;
- Held by and available for use in a qualified trade or business at the close of the taxable year;
- Held at any point during the taxable year in the production of qualified business income; and
- The depreciable period (defined later) for which has not ended before the close of the taxable year.

2.15.3.7.2.1 UBIA of Qualified Property

The abbreviation UBIA simply means unadjusted basis immediately after acquisition and, in the context of the § 199A pass-through deduction, refers to qualified property. The term "qualified property" means, with respect to any trade or business, tangible property of a character subject to the allowance for depreciation under § 167(a):

- Held by, and available for use in, the trade or business at the close of the taxable year,
- Used at any point during the taxable year in the trade or business's production of QBI, and
- The depreciable period for which has not ended before the close of the taxable year.

The term "depreciable period" means, with respect to qualified property of a trade or business, the period beginning on the date the property was first placed in service and ending on the later of:

- The date that is 10 years after the date first placed in service, or
- The last day of the last full year in the applicable recovery period that would apply to the property under § 168(c), regardless of any application of § 168(g), i.e., alternative depreciation system for certain property.

2.15.3.8 Rental Real Estate Safe Harbor

As discussed in Revenue Procedure 2019-38, a safe harbor is available to individuals and owners of pass through entities. Under the safe harbor, a rental real estate enterprise will be treated as a trade or business for purposes of the QBI deduction. Taxpayers may still treat rental real estate that doesn't meet the requirements of the safe harbor as a trade or business for purposes of the QBI deduction if it is a section 162 trade or business.

Solely for the purposes of section 199A, a rental real estate enterprise will be treated as a trade or business if the following requirements are satisfied during the taxable year with respect to the rental real estate enterprise:

(A) Separate books and records are maintained to reflect income and expenses for each rental real estate enterprise;
(B) For taxable years beginning on or after January 1st 2023, in any three of the five consecutive taxable years that end with the taxable year (or in each year for an enterprise held for less than five years), 250 or more hours of rental services are performed per year with respect to the rental real estate enterprise; and
(C) The taxpayer maintains contemporaneous records, including time reports, logs, or similar documents, regarding –
  (i) hours of all services performed;
  (ii) description of all services performed;
  (iii) dates on which such services were performed; and
  (iv) who performed the services.

The records must be made available for inspection at the request of the IRS. The contemporaneous records requirement will not apply to taxable years beginning prior to January 1, 2019

2.15.4 Kiddie Tax – Unearned Income of Minor Children

The kiddie tax was introduced as part of the Tax Reform Act of 1986 and was intended to discourage parents from placing investments in their children's names rather than in their own in hopes of reducing their income taxes. Under the kiddie tax provisions in the prior law, all of the child's unearned income exceeding the applicable threshold was taxed in the parent's marginal tax rate, i.e., the highest tax rate applied to the last dollar the parents earned. No preferential tax rate for capital gains or qualified dividends applied to the kiddie tax.

The SECURE Act, signed into law on December 20, 2019 repealed the provision of the TCJA addressing the unearned income of children. Effective for taxable years beginning after December 31, 2019, any income subject to the Kiddie Tax is taxable at the child's parents' marginal tax rate.

2.15.4.1 Kiddie Tax Applicability

The law imposing the Kiddie Tax is applicable to the unearned income of children 18 years old or younger (ages 19 to 24 if dependent full-time students). For taxable years beginning in 2024, the amount of unearned income used to reduce the net unearned income reported on the child's return subject to the Kiddie Tax is $1,300. This $1,300 amount is the same as the amount provided in IRC section 63(c)(5)(A), as adjusted for inflation. The same $1,300 amount is used for purposes of IRC section 1(g)(7) to determine whether a parent may elect to include a child's gross income in the parent's gross income and to calculate the "kiddie tax."

For example, one of the requirements for the parental election is that a child's gross income is more than $1,300 but less than 10 times that amount, i.e., $13,000.

2.15.5 Section 529 Plans

Qualified tuition programs are programs authorized under IRC section 529 and offered by each of the 50 states and the District of Columbia under which a taxpayer may contribute funds for the purpose of paying a designated beneficiary's qualified education expenses. A qualified tuition program may take one of two forms:

- A prepaid tuition plan; or
- A college savings plan.

Under a prepaid tuition plan a taxpayer pays now for future education, allowing a taxpayer to lock in the costs of attending college. A college savings plan, unlike a prepaid tuition plan, doesn't permit a taxpayer to purchase future education. Instead, a taxpayer contributing to a college savings plan invests money into a special account established for a designated beneficiary. Under federal guidelines, the contributions made to a qualified tuition program for any beneficiary cannot be more than the amount required to provide for the beneficiary's qualified education expenses. Contributions may only be made in cash and are considered noncharitable gifts.

Earnings on the funds invested in a college savings plan are tax-deferred and may be entirely tax-free if used to pay qualified education expenses at any eligible educational institution without the need to recognize any income.

Before passage of the TCJA, an eligible educational institution at which a distribution for expenses of enrollment or attendance would be considered "qualified education expenses" under a §529 Tuition Savings Plan included an educational institution eligible to participate in a student aid program administered by the U.S. Department of Education such as a:

- College;
- University;
- Vocational school; or
- Other post-secondary educational institution.

However, elementary and secondary school expenses were not considered qualified education expenses. The TCJA broadens the definition of qualified education expenses by authorizing an annual qualified distribution of contributions made after 12/31/17 (and income on such contributions) of up to $10,000 from all of a taxpayer's §529 plans for elementary or secondary school tuition. Such schools may be:

- Public;
- Private; or
- Religious.

The SECURE Act expands the definition of *qualified higher education expense* applicable to distributions made after December 31, 2018 to include:

- Expenses for fees, books, supplies, and equipment required for the participation of a designated beneficiary in an apprenticeship program; and

- Principal or interest paid on a qualified education loan of the designated beneficiary or a sibling of the designated beneficiary in an amount not exceeding $10,000 in the aggregate; the deduction otherwise allowable for education loan interest is reduced (but not below zero) by the amount of the distributions treated as a qualified higher education expense. (The term "sibling" means a brother, sister, stepbrother, or stepsister.)

Beginning in 2024, the SECURE Act 2.0 amends the existing tax law to provide for a limited penalty-free rollover from a §529 plan to a Roth IRA. Under the Act, a designated beneficiary may rollover funds from a §529 plan to a Roth IRA subject to the following rules:

- The §529 plan must have been in force at least 15 years at the time of the rollover;
- The amount distributed in any year cannot be greater than the total amount contributed to the §529 plan—along with the earnings on those contributions—before the five-year period ending on the date of distribution;
- The rolled over amount must be paid in a direct trustee-to-trustee transfer to a Roth IRA maintained for the benefit of the designated beneficiary;
- The amount rolled over in any year cannot exceed the amount to which the designated beneficiary was eligible to contribute to a Roth IRA, less the amount contributed to all IRAs for the taxable year; and
- The total amount rolled over from a §529 plan for all years to a Roth IRA cannot exceed $35,000.

College savings plan funds also may be rolled over to an Achieving a Better Life Experience (ABLE) account, discussed next.

2.15.6 Achieving a Better Life Experience (ABLE) Account

In 2014, legislation called the Achieving a Better Life Experience Act of 2014—better known as the ABLE Act—became law. The ABLE Act permits individuals with significant disabilities who are younger than age 26 at the time of onset of disability and who are receiving benefits under SSI and/or SSDI to establish a tax-deferred ABLE account, referred to as a 529A Savings Plan, to provide tax-free distributions to meet the additional expenses associated with living with a disability.

2.15.6.1 Tax-Deferred Account

An ABLE account is a tax-advantaged account to which a designated beneficiary (who is also the account owner) and others may make after-tax cash contributions not exceeding applicable limits for the purpose of meeting the designated beneficiary's qualified disability expenses. Earnings on the amount contributed to the ABLE account are tax-deferred. A designated beneficiary is limited to only one ABLE account.

2.15.6.2 ABLE Account Distributions

If a designated beneficiary takes a distribution from an ABLE account for purposes of meeting qualified disability expenses, the distribution not exceeding those expenses is tax-free. Any distribution in excess of qualified disability expenses is taxable as ordinary income and subject to a tax penalty equal to 10% of the amount of such distribution includable in income.

A "qualified disability expense" is any expense related to the designated beneficiary as a result of living a life with disabilities, and includes expenses for:

- Education,
- Housing,
- Transportation,
- Employment training and support,
- Assistive technology,
- Personal support services,
- Healthcare,
- Financial management and administrative services, and
- Other expenses that help improve health, independence and/or quality of life.

Distributions from ABLE accounts are reported on Form 1099-QA, *Distributions from ABLE Account.*

2.15.6.3 ABLE Account Contributions

Cash contributions to an ABLE account may be made by the designated beneficiary and others. The maximum amount of annual contribution to the account, in total, is generally limited to the annual gift tax exclusion amount ($18,000 in 2024).

Rollovers from a section 529 plan count toward the annual contribution limit. For example, the $18,000 annual contribution limit would be met by parents contributing $10,000 to their child's ABLE account and rolling over $8,000 from a 529 plan to the same ABLE account. Rollover amounts and other contributions made to an ABLE account are reported on Form 5498-QA, *ABLE Account Contribution Information,* box 1 and 2.

2.15.6.4 TCJA Changes to ABLE Accounts

The TCJA made three important changes to ABLE accounts:

1. Additional annual contributions are permitted;
2. A designated beneficiary is permitted to claim the saver's credit for contributions made to the account; and
3. Rollovers from §529 Tuition Savings Plans to ABLE accounts are permitted.

Let's briefly examine the nature of these changes.

2.15.6.4.1 Additional Designated Beneficiary Contributions Permitted

Under the provisions of the TCJA, a designated beneficiary who meets the special rules related to the contribution limit may make an additional contribution, after the overall limitation on contributions is reached. The maximum additional contribution that may be made by a designated beneficiary is an amount not exceeding the designated beneficiary's compensation includable in gross income for the taxable year or the poverty line for a one-person household for the calendar year preceding the calendar year in which the taxable year begins. (The federal poverty line for a one-person household for other than Alaska and Hawaii is $14,580 for 2023 and $15,060 for 2024.)

The special rules applicable to the increased contribution limit apply to a designated beneficiary who is an employee with respect to whom no contribution is made for the taxable year:

- To a defined contribution plan;
- To a 403(b) Tax Sheltered Annuity plan; or
- To a §457(b) deferred compensation plan.

2.15.6.4.2 Saver's Credit

The retirement savings contribution credit—better known as the saver's credit—is available to designated beneficiaries of ABLE accounts and to taxpayers who make a wide range of retirement plan contributions. To be eligible to claim the saver's credit, the taxpayer must be:

1. Age 18 or older,
2. Not claimed as a dependent on another person's return, and
3. Not a student.

If all other criteria are met, the contributions made to an ABLE account are treated in the same manner as contributions to other qualifying retirement plans and IRAs.

The tax credit is a *nonrefundable* credit that is limited to the applicable percentage of the taxpayer's eligible contribution; the credit cannot exceed $1,000 per taxpayer. A nonrefundable tax credit is a tax credit that is limited by the individual's tax liability and acts to reduce the amount of federal income tax payable. If a taxpayer has no income tax liability or has an income tax liability that is less than the tax credit, a nonrefundable tax credit will not result in a payment of any amount in excess of the taxpayer's tax liability from the federal government.

The percentage of the contribution (not exceeding a contribution of $2,000) available to the taxpayer as a tax credit, up to a $1,000 maximum tax credit, depends upon the individual's adjusted gross income and income tax filing status. The applicable percentages for 2024 contributions are as shown below:

Adjusted Gross Income						
Joint Return		Head of Household Return		All Other Status		Applicable Percentage for Tax Credit
Over	Not over	Over	Not over	Over	Not over	
$0	$46,000	$0	$34,500	$0	$23,000	50%
$46,000	$50,000	$34,500	$37,500	$23,000	$25,000	20%
$50,000	$76,500	$37,500	$57,375	$25,000	$38,250	10%

2.15.7 Discharge of Student Loan Indebtedness

Certain student loans provide for cancellation of indebtedness if the person receiving the loan works for a specified period of time in identified professions and/or in underserved areas. Under prior tax law, student loan indebtedness canceled as a result of such a provision was not included in the taxpayer's gross income if the loan was made by:

- Federal, state or local government;
- A tax-exempt public benefit corporation that has assumed control of a state, county or municipal hospital; or
- Certain educational institutions.

Additionally, relief is also provided when the federal loans are discharged by the Department of Education under the Closed School or Defense to Repayment discharge process, or where the private loans are discharged based on settlements of certain types of legal causes of action against nonprofit or other for-profit schools and certain private lenders. This includes, but is not limited to, schools owned by Corinthian College Inc. or American career Institute Inc. Student loan indebtedness discharged in other cases was normally included in the individual debtor's gross Income for tax purposes.

The TCJA expanded the tax-free nature of student loan forgiveness when the loan indebtedness is discharged after December 31, 2017 and before January 1, 2026 because of the student's:

- Death; or
- Total and permanent disability.

In addition, the American Rescue Plan Act provides for the exclusion from income of the partial or complete discharge—effective after December 31, 2020 and before January 1, 2026—of certain loans for postsecondary education made, insured or guaranteed by:

- The U.S.;
- A state, territory or possession of the U.S.;
- The District of Columbia; or
- Certain educational institutions.

Thus, ARPA modifies the tax treatment of student loan forgiveness occurring in 2021 through 2025. Pursuant to the act, no amount of student loan forgiveness taking place in years 2021 through 2025 that would be includible in income except for passage of ARPA is includible in income, provided the loan discharge is not made on account of services performed.

2.15.8 Net Operating Loss (NOL)

An individual taxpayer incurs a net operating loss (NOL) if certain tax-deductible expenses exceed taxable revenues for the year. The amount of the NOL is equal to the amount of loss incurred in the current year and, under prior tax law, could generally be carried back to the two prior tax years (carrybacks), up to five or 10 years for specified liability losses and certain disaster losses, or carried forward for up to 20 future years (carryforwards) to offset taxable income in those years. When using an NOL carryover, the taxpayer's taxable income could not be less than zero.

Under the TCJA, the NOL two-year carryback and certain special extended carryback provisions are repealed for tax years after December 31, 2017. An exception, however, applies to losses incurred in the trade or business of farming to which a two-year carryback is applicable. Also, the 20 year carryforward limitation under the prior law is repealed except for insurance companies other than life insurance companies, and NOLs may be carried forward indefinitely for losses arising in tax years beginning after December 31, 2017.

Additionally, unlike the maximum NOL carryover under prior law that could equal 100% of the taxpayer's taxable income, the NOL deduction arising in tax years beginning after December 31, 2017 under the TCJA is limited to no more than 80% of the individual taxpayer's taxable income (without regard to the NOL deduction). Although the 80% of taxable income limit applies to NOL carrybacks and carryforwards attributable to losses arising in tax years after 2017, NOL carrybacks and carryforwards that arose in prior years are not subject to the 80% limitation.

2.15.9 Premium Tax Credit

The taxpayer's expected contribution, as the term is used with respect to the health insurance premium tax credit, is a specified percentage of the taxpayer's household income. The income percentages, based on the taxpayer's household income as a percentage of the federal poverty level, are as shown in the table below:

In the case of household income (expressed as a percent of poverty line) within the following income tier:	The initial premium percentage is—	The final premium percentage is—
Up to 150%	0.0%	0.0%
150% up to 200%	0.0%	2.0%
200% up to 250%	2.0%	4.0%
250% up to 300%	4.0%	6.0%
300% up to 400%	6.0%	8.5%
400% and higher	8.5%	8.5%

As can be seen from the above chart, applicable taxpayers whose household income is 150% of the federal poverty level or less will not normally be required to pay any premium when purchasing a health plan whose premium does not exceed the premium for a benchmark plan through an ACA marketplace. Those applicable taxpayers with household income exceeding 150% of the federal poverty level but less than 400% will have an expected contribution of gradually increasing percentages up to 8.5% for such a plan, and those taxpayers with household incomes of 400% or more of the federal poverty level will have expected contributions of 8.5% of household income.

2.15.9.1 Federal Poverty Level

The federal government's poverty level is based on the amount of income received in a year relative to annually-published poverty guidelines that generally increase annually to account for the higher prices for goods and services that result from inflation.

The 2024 federal poverty guidelines are as shown in the chart below:

HHS Poverty Guidelines			
Persons in family/household	**48 Contiguous States and D.C.**	**Alaska**	**Hawaii**
1	$15,060	$18,810	$17,310
2	$20,440	$25,540	$23,500
3	$25,820	$32,270	$29,690
4	$31,200	$39,000	$35,880
5	$36,580	$45,730	$42,070
6	$41,960	$52,460	$48,260
7	$47,340	$59,190	$54,450
8	$52,720	$65,920	$60,640
For each additional person add	$5,380	$6,730	$6,190

2.15.9.2 Amount of the Credit

The amount of the tax credit for an eligible taxpayer is generally equal to the difference between the premium for the benchmark plan and the taxpayer's expected contribution, a contribution that increases as the taxpayer's income increases. The amount of the credit is capped at the premium for the plan chosen. Thus, the tax credit will never be larger than the premium for the plan.

Tax Credit = Benchmark Plan Premium - Taxpayer's Expected Contribution

2.15.9.3 Benchmark Plan

The "benchmark plan," as the term is used in connection with the insurance premium tax credit, is the second-lowest-cost plan that would cover the family at the silver level of coverage. The PPACA defines[16] such a silver level plan as one "designed to provide benefits that are actuarially equivalent to 70 percent of the full actuarial value of the benefits provided under the plan." In other words, the plan pays at least 70 percent of covered charges after any applicable deductible amount.

2.15.9.4 Taxpayer's Expected Contribution

The taxpayer's expected contribution, as the term is used with respect to the premium tax credit, is a specified percentage of the taxpayer's household income. The applicable percentage of the taxpayer's household income in 2024 increases – from 0.0% of income for families at less than 150% of the federal poverty level to 8.5% of income for families at 400% or more of the federal poverty level – as the taxpayer's income increases. The amount a family actually pays for coverage will be less than the expected contribution if the family chooses a plan that is less expensive than the benchmark plan.

2.15.9.5 Additional Tax Limitation

Under the ACA, taxpayers who are granted advanced subsidies are required to reconcile the advanced credit when filing their federal tax return, and, in the case of overpayment, a limitation on repayment is applied to those whose household income was less than 400% of the federal poverty line. The limitation for 2024 is as shown in the chart below:

If the household income (expressed as a percent of poverty line) is:	Limitation Amount for Unmarried Individuals (other than surviving spouses or heads of households)	Limitation Amount for All Other Taxpayers
Less than 200%	$375	$750

[16] Affordable Care Act §1302(d)(1)(B).

If the household income (expressed as a percent of poverty line) is:	Limitation Amount for Unmarried Individuals (other than surviving spouses or heads of households)	Limitation Amount for All Other Taxpayers
At least 200% but less than 300%	$950	$1,900
At least 300% but less than 400%	$1,575	$3,150

2.15.10 Employee Fringe Benefits

Under the tax law prior to the passage of the Tax Cuts and Jobs Act of 2017 (TCJA), employers could offer their employees various commuting benefits that were tax-deductible to the employer. These benefits, referred to in the tax law as "qualified transportation fringes," include transportation in a commuter highway vehicle in connection with travel between the employee's residence and place of employment, any transit pass, qualified parking and qualified bicycle commuting reimbursement.

Under the TCJA, the following changes are made to these employee fringe benefits for tax years after December 31, 2017:

- No tax deduction will be allowed an employer for any expense incurred for providing any transportation or for any payment or reimbursement to an employee in connection with travel between the employee's residence and place of employment except as necessary for ensuring the employee's safety.
- Although qualified bicycle commuting reimbursements will continue to be tax-deductible, within applicable limits, to the employer providing them, employees' exclusion of qualified bicycle commuting reimbursements from income for tax purposes is suspended for taxable years beginning after December 31, 2017 and before January 1, 2026. Accordingly, bicycle commuting reimbursements, if provided by an employer, will be includable in the employee's income.

For taxable years beginning in 2024, the monthly limitation with respect to the aggregate fringe benefit exclusion amount for transportation in a commuter highway vehicle and any transit pass is $315. The monthly limitation amount for qualified parking is $315.

2.15.11 Depreciation of Rental Property

Generally, when a taxpayer pays for a purchased item intended to be used to help produce income, the cost of the purchased item is tax-deductible. In many cases, the entire cost is deductible in the year the item is purchased. Consider, for example, the purchase of office supplies and similar products used in a business whose cost is immediately deductible. Certain other property, including income-producing rental property, is deductible only in part each year over its useful life; in other words, it is depreciated rather than expensed.

In the case of depreciable property, the amount that may be deducted from a taxpayer's income each year is affected by three factors:

1. The taxpayer's basis in the property;
2. The property's recovery period (a duration assumed to be its useful life); and
3. The depreciation method used by the taxpayer.

After briefly looking at the nature of depreciable rental property, we will examine the three factors.

2.15.11.1 Depreciable Rental Property

For a taxpayer to be able to depreciate property, several requirements must be met. Those requirements are:

- The taxpayer must own the property;
- The taxpayer must use the property in the taxpayer's business or income-producing activity, such as rental property;
- The property must have a determinable useful life—it must decay, wear out, or in some other way have its value exhausted; and
- The property must be expected to last more than one year.

Some property, however, cannot be depreciated. The two important categories of non-depreciable property are:

1. Land; and
2. Excepted property, including –
    - property placed in service and taken out of service in the same year, and
    - equipment used to build capital improvements.

2.15.11.1.1 Beginning and Ending Depreciation

The taxpayer begins to depreciate rental property at the time it is placed in service for the production of income. Depreciation ends on the earlier of the date the taxpayer has:

- Fully recovered the property's basis; or
- Taken the property out of service.

Although property placed in service in a personal activity cannot be depreciated while being used in the personal activity, property changed from personal use to use in the taxpayer's business or for the production of income can be depreciated. In the case of such a change from personal to business use, the property is considered placed in service on the date of the change.

2.15.11.2 Depreciable Property Basis

The depreciable basis of property used in a rental activity is its "adjusted basis." ***Adjusted basis*** is the cost or other basis of the property when acquired by the taxpayer, adjusted (up and/or down) for certain items occurring before the taxpayer placed it in service in the rental activity.

The taxpayer's basis of purchased property is normally its cost. Cost, for purposes of depreciation, includes:

- The amount paid in cash for the property by the taxpayer;
- The amount of any debt obligation (including unreimbursed real estate taxes[17] owed by the seller) assumed by the taxpayer in return for the property;
- The amount paid by the taxpayer in other property;
- The amount paid by the taxpayer in services provided to the seller;
- Any sales tax charged on the purchase (unless the taxpayer deducted state and local general sales taxes as an itemized deduction on schedule A);
- Freight charges paid by the taxpayer to obtain the property;
- Any installation and testing charges paid by the taxpayer with respect to the property; and
- Certain amounts paid incident to the purchase of real property, including –
    - abstract fees,
    - charges for installing utility services,
    - legal fees,
    - recording fees,
    - survey costs,
    - transfer taxes,
    - title insurance fees, and
    - any amounts owed by the seller the purchaser has agreed to pay, such as back taxes, interest, mortgage fees, sales commissions, etc.

[17] If taxes owed by the seller are assumed by the buyer, such taxes cannot be deducted as taxes paid.

Sometimes property title is transferred to a taxpayer in other than a traditional sale. The taxpayer's cost cannot be used as the basis for purposes of depreciation in such cases, including property received by the taxpayer:

- In return for services performed by the taxpayer, in which case the taxpayer's basis is equal to the amount included in income by the taxpayer;
- In exchange for other property, in which case the taxpayer's basis is equal to the exchanged property's FMV;
- As a gift or inheritance, in which the donee's basis is equal to the donor's adjusted basis; or
- From a spouse or from a former spouse in a divorce settlement, in which the recipient spouse's basis is equal to the transferor spouse's adjusted basis.

2.15.11.3 Recovery Period

The MACRS recovery period applicable to rental property depends on the type of property being rented and the depreciation system being used. Such property first placed in service during 2018 generally falls into one of the following classes:

- Five-year property, a property class that includes –
  - computers and peripheral equipment,
  - office machinery,
  - automobiles and light trucks,
  - appliances, carpeting and furniture used in a residential rental real estate activity;
- Seven-year property, a property class that includes –
  - office furniture and equipment, and
  - any property that doesn't have a class life that has not been designated by law as being in any other class;
- 15 year property, a property class that includes roads, fences and shrubbery; and
- Residential rental property, a property class that includes any real property that is a rental building or structure for which 80% or more of the gross rental income for the tax year is from dwelling units.

Residential rental property depreciated under the Alternative Depreciation System (ADS) is 30 years if placed in service after 2017. The recovery period applicable to residential rental property placed in service prior to 2018 and depreciated under ADS is 40 years. In contrast, the recovery period for residential rental property depreciated under GDS is 27.5 years.

In general, the recovery period is somewhat longer for certain types of property under ADS than under GDS and is as shown in the chart below:

	MACRS Recovery Period	
Type of Property	**General Depreciation System**	**Alternative Depreciation System**
Computers and their peripheral equipment	5 years	5 years
Office machinery, such as:		
• Typewriters • Calculators • Copiers	5 years	6 years
Automobiles	5 years	5 years
Light trucks	5 years	5 years
Appliances, such as:		
• Stoves • Refrigerators	5 years	9 years
Carpets	5 years	9 years
Furniture used in rental property	5 years	9 years

Office furniture and equipment, such as: • Desks • Files	7 years	10 years
Any property that doesn't have a class life and that hasn't been designated by law as being in any other class	7 years	12 years
Roads	15 years	20 years
Shrubbery	15 years	20 years
Fences	15 years	20 years
Residential rental property (buildings or structures) and structural components such as furnaces, waterpipes, venting, etc.	27.5 years	30 years
Additions and improvements, such as a new roof	The same recovery period as that of the property to which the addition or improvement is made, determined as if the property were placed in service at the same time as the addition or improvement.	

2.15.11.4 Depreciation Method

Most business and investment property that was placed in service after 1986 is depreciated using the MACRS. MACRS consists of two systems:

1. The General Depreciation System (GDS); and
2. The Alternative Depreciation System (ADS).

Unless the taxpayer elects to use ADS or is required by law to use ADS, a taxpayer must use GDS. The straight line method of depreciation is used for a taxpayer electing to use ADS, and such a taxpayer must make the election in the first year residential rental property and nonresidential real property is placed in service; once made, the taxpayer cannot revoke the election.

The IRS provides MACRS percentage tables in Publication 527 that a preparer may use to compute annual depreciation. Although complete tables may be found in Publication 946, the first few years of a residential rental property 27.5–year GDS percentage table with a mid-month convention is shown below:

	Use the row for the month of the taxable year placed in service.					
	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**
Jan.	3.485%	3.636%	3.636%	3.636%	3.636%	3.636%
Feb.	3.182	3.636	3.636	3.636	3.636	3.636
March	2.879	3.636	3.636	3.636	3.636	3.636
Apr.	2.576	3.636	3.636	3.636	3.636	3.636
May	2.273	3.636	3.636	3.636	3.636	3.636
June	1.970	3.636	3.636	3.636	3.636	3.636
July	1.667	3.636	3.636	3.636	3.636	3.636
Aug.	1.364	3.636	3.636	3.636	3.636	3.636
Sept.	1.061	3.636	3.636	3.636	3.636	3.636
Oct.	0.758	3.636	3.636	3.636	3.636	3.636
Nov.	0.455	3.636	3.636	3.636	3.636	3.636
Dec.	0.152	3.636	3.636	3.636	3.636	3.636

2.15.11.5 Special Depreciation Allowance

Some properties used in connection with residential real property activities may qualify for a special depreciation allowance. This allowance is figured before you figure the taxpayer's regular depreciation deduction.

2.15.11.5.1 How to figure the Special Depreciation Allowance.

Figure the special depreciation allowance by multiplying the depreciable basis of the property by the applicable percentage. To figure the depreciable basis, subtract from the business/investment portion of the cost or other basis of the property any credits and deductions allocable to the property. For credits and deductions that affect the depreciable basis, see section 1016 and Pub. 946.

2.15.11.5.2 Election not to Take the Special Depreciation Allowance

The taxpayer can elect, for any class of property, not to deduct any special depreciation allowances for all property in the class placed in service during the tax year. To make an election, attach a statement to the return indicating what election the taxpayer is making and the class of property for which the election is being made. The election must be made separately by each person owning qualified property (for example, by the partnerships, by the S corporation, or for each member of a consolidated group by the common parent of the group).

2.15.11.5.2.1 When to Make Election

Generally, the taxpayer must make the election on a timely filed tax return (including extensions) for the year in which the taxpayer placed the property in service. However, if the taxpayer timely filed the return for the year without making the election, the taxpayer can still make the election by filing an amended return within 6 months of the due date of the original return (not including extensions). Attach the election statement to the amended return. On the amended return, write "Filed pursuant to section 301.9100-2."

2.15.11.5.3 Revoking an Election

Once the taxpayer elects not to deduct a special depreciation allowance for a class of property, the election cannot be revoked without IRS consent. A request to revoke the election is a request for a letter ruling. If the taxpayer elects not to have any special depreciation allowance apply, the property placed in service after 2015 will not be subject to an alternative minimum tax adjustment for depreciation.

2.16 Tax Withholding and Estimated Tax Payments

Despite the annual due date for filing tax returns, federal income tax is a pay-as-you-go tax; thus, the tax is due and payable at the time income is received by the taxpayer. Two methods are used by the federal government to collect income taxes and facilitate the pay-as-you-go nature of the tax:

- Tax withholding; and
- Estimated tax payments.

When the taxpayer's tax return is prepared, credit is taken for the income tax withheld and any estimated tax payments made.

2.16.1 Tax Withholding

Income tax is withheld from the salaries and wages of most employees and may also be withheld from certain other income, such as pensions, bonuses, tips, taxable fringe benefits, sick pay, unemployment compensation and gambling winnings. The amount withheld is paid to the IRS on behalf of the taxpayer.

2.16.1.1 Form W-4

The amount of income tax withheld by an employer from a taxpayer's regular pay depends on the amount earned by the taxpayer and spouse, if any, in the payroll period and the information provided by the taxpayer to his or her employer on IRS Form W–4. The taxpayer-provided information includes whether to withhold at the single, head of household, or married rate, whether the taxpayer holds multiple jobs at a time and/or the taxpayer's spouse is employed, the number of dependents claimed,

whether an additional withholding amount is requested, and whether an exemption from withholding is claimed.

Information previously provided by the taxpayer to his or her employer on Form W-4 may change during the year. Although a taxpayer can submit a new W-4 at any time, the taxpayer is ***required*** to provide the employer with a new Form W-4 within 10 days following any change that would affect withholding. If events during the current year will increase required withholding for the following year, the taxpayer must provide the employer with a new Form W-4 by December 1 of the current year; if the event affecting withholding occurs in December of the current year, a new Form W-4 must be submitted within 10 days following the event. For example, if the taxpayer claims exemption, but later the situation changes so that the taxpayer will have to pay income tax after all, the taxpayer must file a new Form W-4 within 10 days after the change. If the taxpayer claims exemption in 2024 but expects to owe income tax for 2025, the taxpayer must file a new Form W-4 by December 1, 2024.

Usually, the tax withheld from the taxpayer's wages by his or her employer will closely approximate the taxpayer's tax liability. However, in some cases tax may be under withheld because the taxpayer has more than one job, is married and has a working spouse, receives nonwage income, or for some other reason. Since the taxpayer should try to have withholding match his or her actual income tax liability in order to avoid interest and/or penalties, the taxpayer should provide the employer with a new Form W-4 to change the amount of withholding if too little tax is likely to be withheld.

Taxpayers who hold more than one job at a time or who are married filing jointly with a working spouse may choose to use the multiple jobs worksheet, included in the Form W-4 instructions, or use the estimator to determine the correct amount of withholding. Taxpayers should consider using the estimator, found at www.irs.gov/W4App, if they:

- Expect to work only part of the year;
- Have dividend or capital gain income, or are subject to additional taxes, such as Additional Medicare Tax;
- Have self-employment income; or
- Prefer the most accurate withholding for multiple job situations.

Income taxes are also withheld from an employee's tips (indirectly by withholding from the employee's regular pay), taxable fringe benefits and sick pay

2.16.1.2 Exemption from Withholding

A taxpayer may claim an exemption from income tax withholding if both the following situations apply:

1. The taxpayer had a right to a refund of all federal income tax withheld because of having no tax liability in the current year; and
2. The taxpayer expects a refund of all federal income tax withheld in the next year because of having no income tax liability.

2.16.1.3 Penalties

In addition to possibly being required to pay interest and penalties for being under withheld, a taxpayer may be subject to a penalty of $500 if both the following apply:

- The taxpayer made statements on Form W-4 that reduced the amount of tax withheld; and
- The taxpayer had no reasonable basis for those statements at the time Form W-4 was prepared.

A criminal penalty may also apply for willfully supplying false or fraudulent information on the form or for willfully failing to supply information that would increase the amount withheld. The penalty upon conviction can be a fine of up to $1,000 or imprisonment for up to one year, or both

2.16.1.4 Withholding from Nonwage Income

Although a taxpayer is generally required to have income tax withheld from his or her gambling winnings, a taxpayer may also have income tax withheld from other types of nonwage income. Accordingly, a taxpayer may have income tax withheld from:

- Pensions and annuities by requesting withholding using Form W-4P, Withholding Certificate for Periodic Pension or Annuity Payments or Form W-4R, Withholding Certificate for Nonperiodic Payments and Eligible Rollover Distributions; and
- Unemployment compensation and federal payments, such as Social Security benefits by requesting withholding using Form W-4V, Voluntary Withholding Request.

If the taxpayer chooses not to have income tax withheld from nonwage income, he or she may have to pay estimated tax.

Note that Form W-4P, Withholding Certificate for Periodic Pension or Annuity Payments (previously titled Withholding Certificate for Pension or Annuity Payments), has been updated for 2024 to include updates to the deduction worksheet for inflation adjustments for 2024. Additionally, Step 2: (a) of Form W-4P introduces the taxpayer to an online tax withholding estimator with a link to www.irs.gov/W4App. The withholding tax estimator allows taxpayers to determine the most accurate withholding for self-employment income.

2.16.2 Estimated Tax

The payment of estimated taxes is the method used to pay tax on income that is not subject to income tax withholding. Thus, it is used to pay both income tax and self-employment tax as well as other taxes and amounts reported on the taxpayer's tax return. If the taxpayer does not pay enough tax, either through withholding or by paying estimated tax (or a combination of both), he or she may be subject to a penalty.

2.16.2.1 Requirement to Pay Estimated Tax

The general rule with respect to the payment of estimated taxes requires that a taxpayer pay estimated tax if both of the following apply:

1. The taxpayer expects to owe at least $1,000 for the year after subtracting withholding and refundable credits; and
2. The taxpayer expects withholding plus refundable credits to be less than the smaller of –
   a. 90% of the tax to be shown on the current year's tax return, or
   b. 100% of the tax shown on the previous year's tax return (provided the return covers all 12 months).

However, a taxpayer may avoid paying estimated tax if:

- The taxpayer receives a salary or wages and asks his or her employer to take more tax out of earnings; or
- All the following conditions apply –
    - The taxpayer had no tax liability for the previous year,
    - The taxpayer was a U.S. citizen or resident alien for the whole year, and
    - The taxpayer's previous tax year covered a 12-month period.

Estimated tax payments are generally due in four installments. Although an installment may be due on the following business day if the normal due date falls on a weekend or legal holiday, the estimated tax payment due dates are April 15, June 15, September 15 and January 15.

Estimated income taxes may be paid using any of the following methods:

- Crediting an overpayment of tax on the previous year's tax return to the current year's estimated tax;
- Payment of the estimated tax by direct transfer from the taxpayer's bank account, making payment by use of a credit or debit card, by using a pay-by-phone system, or via the Internet; or
- Remitting a payment using a check or money order along with a payment voucher Form 1040-ES.

2.17 Balance Due and Refund Options

After the taxpayer's income tax liability, if any, is determined and the tax return prepared, the taxpayer will usually have paid more or less income tax than owed. Accordingly, the taxpayer will

either be required to pay an additional tax amount or will be due a tax refund. The taxpayer has several options in either case.

2.17.1 Payment of Income Tax Owed

If the taxpayer has paid less income tax than due—through employer withholding, the payment of estimated taxes, or both—several methods are available to him or her to pay any amount owed. When paying the taxes owed, no estimated tax payment for the following year should be included; such estimated tax should be paid separately.

A taxpayer may make income tax payments:

- Online or by telephone using a –
  - Direct transfer from the taxpayer's bank account, or
  - Credit or debit card;
- By check or money order; or
- In cash.

Individuals wishing to take advantage of the cash payment option should visit the IRS.gov payments page, select the cash option in the "Other Ways You Can Pay" section of the web page and follow the instructions:

- Taxpayers will receive an email from ACI Payments, Inc. (acipayonline.com) confirming their information.
- Once the IRS has verified the information, the Cash Processing Company sends the taxpayer an email with a link to the payment code and instructions.
- Individuals may print the payment code provided or send it to their smart phone.
- The retail store listed in the Cash Processing Company's email provides a receipt after accepting the cash. The receipt is confirmation of the taxpayer's payment and should be kept for the taxpayer's records. The payment usually posts to the taxpayer's account within two business days.
- Payment frequency and amount limits and fees apply.

2.17.2 Refunds

Taxpayers who are due a tax refund also have several choices with respect to its receipt. The options available to a taxpayer owed a refund include that the refund:

- Be applied to the taxpayer's estimated tax for the following year;
- Be deposited to a prepaid debit card;
- Be sent to him or her in a check; or
- Be direct deposited to one account (See Limit on Direct Deposit Refunds below).

Additional options may be selected by using Form 8888, Allocation of Refund, directing a refund:

- Be deposited into two or three accounts at a bank or other financial institution (such as a mutual fund, brokerage firm, or credit union) in the United States. (See **Limit on Direct Deposit Refunds** below)
- Be credited to a TreasuryDirect® online account in order to buy U.S. Treasury marketable securities or savings bonds; or
- Be deposited directly to a traditional, Roth or SEP IRA, HSA, or Archer MSA.

If the taxpayer is due an income tax refund but has not paid certain amounts owed, the refund may be used to pay any past-due amounts. Thus, a tax refund may be used to pay:

- Past-due federal income taxes;
- Federal debts, such as student loans;
- State income taxes;
- Child and spousal support payments; and
- State unemployment compensation debt.

2.17.2.1 Limit on Direct Deposit Refunds

As a way to combat fraud and identity theft, the IRS implemented certain refund procedures designed to offer additional protection. Under the refund procedures, the IRS will limit the number of refunds electronically deposited into a single financial account—a bank savings or checking account, for example—or pre-paid debit card to three per calendar year. Any refunds in excess of three will be made as a paper refund check and will be mailed to the taxpayer.

Although this procedural change is not expected to affect many taxpayers, it may affect families in which the parent's and children's refunds are deposited into a family-held bank account. Such taxpayers should make other deposit arrangements or expect to receive paper refund checks. Tax return preparers are prohibited from negotiating client refund checks or accepting such payments in an account owned or controlled by the preparer. No direct deposits of tax refunds should be requested to an account not in the taxpayer's name.

2.18 Federal Income Tax Return Filing Due Dates and Filing for Extensions

The due date for filing a federal income tax return depends on whether the taxpayer uses the calendar year or a fiscal year. In addition, the applicable due date may be extended. Such extensions are available:

- Under an automatic extension;
- If the taxpayer is outside the United States; or
- If the taxpayer is serving in a combat zone.

2.18.1 Calendar Year and Fiscal Year Taxpayers

For taxpayers who use the calendar year, the due date for filing the federal income tax return is generally April 15th of the year following the end of the calendar year for which the tax return is being filed. The federal income tax returns for taxpayers who use a fiscal year, i.e., a year ending on the last day of any month except December, are due by the 15th day of the fourth month after the close of the taxpayer's fiscal year. For example, the federal income tax return of a taxpayer whose fiscal year ends on June 30th is due on the following October 15th. A taxpayer's failure to file a timely income tax return may subject the taxpayer to a failure-to-file penalty and interest.

An exception to the usual federal income tax filing due dates applies to nonresident aliens who do not earn wages subject to U.S. income tax withholding. The federal income tax return of a nonresident-alien taxpayer who does not earn wages subject to such withholding is:

- June 15th for calendar year taxpayers; or
- The 15th day of the 6th month after the end of the taxpayer's fiscal year for fiscal year taxpayers.

The federal income tax return of a decedent, i.e., a taxpayer who died during the year, must be filed by the decedent's representative. The return is due by the 15th day of the fourth month after the end of the decedent's normal tax year.

2.18.2 Extensions of Time to File

A taxpayer may be able to get an extension of the time to file his or her federal income tax return. However, despite obtaining an extension of the time to file, any tax due must generally be paid by the regular due date. Failure to pay any tax due by the regular date will result in the imposition of interest and possible penalties on the unpaid amount from the date due until the date actually paid.

A taxpayer may qualify for an extension of time to file:

- Under an automatic extension;
- If the taxpayer is outside the United States; or
- The taxpayer is serving in a combat zone.

2.18.2.1 Automatic Extension of Time to File

A taxpayer who is unable to file a federal income tax return by the normal due date may be able to get an automatic six-month extension of the time to file. The automatic extension may be obtained by:

- Using IRS e-file; or
- Filing a paper form.

An automatic six-month extension of the time to file a federal income tax return may be obtained by timely filing IRS form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return.[18] The application for automatic extension is considered timely filed if filed by the due date for the taxpayer's income tax return. A representation of that form is shown below:

Form **4868** Department of the Treasury Internal Revenue Service (99)	**Application for Automatic Extension of Time To File U.S. Individual Income Tax Return** **For calendar year 20XX, or other tax year beginning ,20XX, ending ,20**	OMB No. 1545-0074 20**XX**

Part I **Identification**			Part II **Individual Income Tax**	
1 Your name(s) (see instructions)			4 Estimate of total tax liability for 20XX 5 Total 20XX payments	$_____ _____
Address (see instructions)			6 **Balance due**. Subtract line 5 from line 4 (see instructions) 7 Amount you're paying (see instructions)	_____ _____
City, town, or post office	State	ZIP Code	8 Check here if you're "out of the country" and a U.S. citizen or resident (see instructions)	☐
2 Your social security number	3 Spouse's social security number		9 Check here if you file Form 1040NR and didn't receive wages as an employee subject to U.S. income tax withholding	☐

When the taxpayer's income tax return is subsequently filed, enter any payment made when the application for extension was filed on Schedule 3 (Form 1040), line 10, i.e., on the line stating "Amount paid with request for extension to file.

2.18.2.2 Individuals Outside the United States

A taxpayer is allowed an automatic two-month extension, without filing Form 4868, to file the federal income tax form ***and pay any federal income tax due*** if:

- The taxpayer is a U.S. citizen or resident, and
- On the due date of the taxpayer's return, he or she is –
    - Living outside the United States and Puerto Rico, and the taxpayer's main place of business or post of duty is outside the United States and Puerto Rico, or
    - In the military or naval service on duty outside the United States and Puerto Rico.

If the taxpayer files a joint return, only one spouse needs to qualify in order to take advantage of this automatic extension. However, if the taxpayer and spouse file separate returns, the automatic extension applies only to the spouse who qualifies. To obtain the automatic extension, the taxpayer simply needs to attach a statement to his or her federal income tax return explaining what situation qualified him or her for the extension. Although a taxpayer who meets the criteria for an automatic two-month extension may defer payment of any federal income tax due, if the tax due is paid after the regular due date, interest—but no penalties—will be charged from the regular due date until the date the tax is paid.

If the taxpayer cannot file his or her federal income tax return within the automatic two-month extension period, the taxpayer may be able to get an additional four-month extension by filing IRS Form 4868 and checking the box on line eight of the form.

[18] IRS Form 4868 and its instructions may be accessed at https://www.irs.gov/pub/irs-pdf/f4868.pdf

2.18.2.3 Individuals Serving in a Combat Zone

Individuals serving in a combat zone receive a substantial deferral with respect to their income tax returns. The due date for filing the taxpayer's federal income tax return, paying any tax owed, and filing a claim for refund is automatically extended if the taxpayer serves in a combat zone. The deferral applies to:

- Members of the Armed Forces;
- Merchant marines serving aboard vessels under the operational control of the Department of Defense;
- Red Cross personnel;
- Accredited correspondents; and
- Civilians under the direction of the Armed Forces in support of the Armed Forces.

For taxpayers who serve in a combat zone, the deadline for filing the federal income tax return, paying any taxes due, and filing a claim for refund is extended for at least 180 days after the later of:

- The last day the taxpayer is in a combat zone or the last day the area qualifies as a combat zone; or
- The last day of any continuous qualified hospitalization for injury from service in the combat zone.

In addition to the 180 day extension, the taxpayer's deadline for filing the income tax return is also extended by the number of days the taxpayer had left to take action with the IRS when entering the combat zone.

Domain 3 – Practices, Procedures & Professional Responsibility

Introduction

Tax return preparers are held to a high standard of conduct in their preparation of clients' income tax returns. Their failure to maintain that standard may subject them to financial, reputational and other penalties. The following textual material addresses certain of those standards and the applicable penalties for failing to maintain them.

Domain 3 Learning Objectives

When you have completed the domain 3 text, you should be able to:

- Identify the red flags indicating possible tax-related identity theft and suggested assistance to its victims;
- Understand the laws and regulations requiring privacy and security of taxpayer data and the best practices tax preparers may implement to help assure it;
- Describe the purpose of individual taxpayer identification numbers, their effect on tax credits and how to renew them;
- Recognize the penalties applicable to a tax return preparer under Title 26;
- Identify the due diligence requirements imposed on tax return preparers with respect to claiming head of household filing status, EITC, CTC and AOTC;
- Understand the e-file requirements; and
- Recognize the Annual Filing Season Program requirements.

3.1 Tax Related Identity Theft (Publication 5199)

All types of identity theft leave their mark on unsuspecting victims and account for losses well into the millions of dollars. The filing of a tax return may also place a client at risk for identity theft.

Tax-related identity theft usually occurs when someone uses a stolen Social Security number to file a tax return claiming a fraudulent refund. Thieves may also use stolen Employer Identification Numbers to create false Forms W-2 to support refund fraud schemes.

The IRS has created and published Publication 5199[19], Tax Preparer Guide to Identity Theft, which identifies the various warning signs of identity theft and suggests additional identity theft-prevention resources for preparers. Among the identified warning signs for individual clients that the client's Social Security number has been compromised, putting him or her at risk, are the following:

- A client's return is rejected and IRS reject codes indicate the taxpayer's Social Security number has already been used;
- The client notices activity on or receives IRS notices regarding a tax return after all tax issues have been resolved, refund paid or account balances have been paid; and
- An IRS notice indicates the client received wages from an employer unknown to the client.

To prevent filing returns with stolen identities, tax preparers should ask taxpayers not known to them to provide two forms of identification—preferably forms of identification containing the individual's picture—that include the taxpayer's name and current address. In addition, tax return preparers must confirm the identities and Social Security numbers of taxpayers, spouses and dependents.

Preparers should require taxpayers to show the Social Security cards for themselves, their spouses and dependents and should take special care to ensure that they transcribe all Social Security numbers correctly. Furthermore, the Social Security number entered on the IRS Form W-2, Wage and Tax Statement must be identical to the taxpayer's Social Security number on the Social Security card

[19]Publication 5199 may be accessed at http://www.irs.gov/pub/irs-pdf/p5199.pdf.

provided by the taxpayer. Tax return preparers should enter the Social Security number exactly as shown on the Form W-2 provided to them by taxpayers.

In order to minimize Social Security number-related rejects, it is important to verify taxpayer Social Security numbers and names before submitting a return to the IRS.

3.1.1 Assisting Victims of Identity Theft

You should take the following steps if a client's SSN is compromised and they suspect or know they're a victim of tax-related identity theft:

- Respond promptly to IRS notices; and
- Complete Form 14039, Identity Theft Affidavit, if –
    - the IRS rejected the client's e-file return and the reject code indicates a duplicate filing under their SSN, or
    - you're instructed to do so.

Attach Form 14039 to the client's paper return and mail it according to the instructions. The form allows the IRS to put an indicator on the client's tax records for questionable activity. Clients should continue to file returns and pay taxes, even if the filing must be done on paper while the IRS researches their case.

If you or your client previously contacted the IRS and didn't get a resolution, call the IRS for specialized assistance at 800-908-4490. (The IRS has teams ready to assist individuals who are victims of tax-related identity theft.) Information about how IRS identity theft victim assistance works is available at irs.gov/idtVictimAssistance.

3.2 Safeguarding Taxpayer Data (Publication 4557)

We live in a dangerous time with respect to the theft of information about ourselves. We see evidence of it repeatedly as major retailers suffer severe business declines when it becomes known that their computer data has been compromised and our credit card and other personal information has been exposed. According to Javelin Strategy & Research[20], a research-based advisory firm, identity fraud scams in 2023 accounted for losses of $43 billion.

Tax preparers, frequently required to warehouse sensitive personal information needed to prepare clients' tax returns, are increasingly being targeted for data theft. Unsurprisingly, safeguarding taxpayer data—defined as any information obtained or used in the preparation of a tax return—is an important IRS priority. Safeguarding that data is a legal responsibility and needs to be an equally important priority for tax preparers.

3.2.1 Laws and Regulations Requiring Privacy/Security

Various federal laws have been passed and regulations promulgated to safeguard taxpayer data. Principal among those laws and regulations are the:

- FTC Safeguards Rule under which professional tax preparers are required to ensure the security and confidentiality of customer records and information. The Rule requires that tax preparers develop, implement and maintain an information security program. Such a program should contain –
    - Administrative safeguards,
    - Technical safeguards, and
    - Physical safeguards;
- Sarbanes-Oxley Act of 2002 (17 CFR Parts 232, 240 and 249) section 404, applicable to all SEC reporting companies having a market capitalization in excess of $75 million, that requires companies to preserve records and data from destruction, loss, unauthorized alteration or other misuse;
- FTC Financial Privacy Rule requiring professional tax preparers to give customers privacy notices explaining the preparer's information collection and sharing practices;

[20] 2024 Identity Fraud Study: Resolving the Shattered Identity Crisis | Javelin (javelinstrategy.com) .

- IRC §301.7216 and IRC §6713 that impose criminal and monetary penalties, respectively, on preparers who make unauthorized disclosures or uses of information provided to them by taxpayers; and
- Internal Revenue Procedure 2007-40 that requires authorized IRS e-file providers to have security systems in place to prevent unauthorized access to taxpayer accounts and personal information.

3.2.2 Best Practices to Safeguard Data

The IRS publication 4557 available to tax preparers titled "Safeguarding Taxpayer Data: A Guide for your Business" can help preparers understand and meet their obligations with respect to safeguarding taxpayer data. It provides various checklists and other information preparers should consult that address:

- Administrative activities;
- Facilities security;
- Personnel security;
- Information systems security;
- Computer systems security;
- Media security;
- Certifying information systems for use; and
- Reporting incidents.

In addition, the publication provides a list of resources (Appendix A) that may be accessed for additional information and guidance on various data-security concerns, including:

- Writing effective financial privacy notices;
- Complying with the Safeguards Rule;
- How to safely dispose of taxpayer data; and
- Reducing risks to your computer systems.

The IRS has also made available other information specifically for tax professionals concerning identity theft and creating a data-security plan. Online providers also must follow the six security and privacy standards in Publication 1345, Handbook for Authorized IRS e-file Providers of Individual Income Tax Returns.[21]

The IRS has mandated six security, privacy, and business standards to supplement the Gramm-Leach-Bliley Act to better serve taxpayers and protect their information collected, processed and stored by Online Providers of individual income tax returns. The first five standards continue to apply to Online Providers, while Standard number six, "Reporting of Security Incidents," is now mandated for all Providers.

Extended Validation SSL Certificate

Online Providers of individual income tax returns must have a valid and current Extended Validation Secure Socket Layer (SSL) certificate using TLS 1.2 or later and minimum 2048-bit RSA/128-bit AES.

External Vulnerability Scan

Online Providers of individual income tax returns must contract with an independent third-party vendor to run weekly external network vulnerability scans of all their "system components" in accordance with the applicable requirements of the Payment Card Industry Data Security Standards (PCIDSS). All scans must be performed by a scanning vendor certified by the Payment Card Industry Security Standards Council and listed on their current list of Approved Scanning Vendors (ASV). In addition, Online Providers of individual income tax returns whose systems are hosted must ensure that their host complies with all applicable requirements of the PCIDSS. For the purposes of this standard, "system components" is defined as any network component, server, or application that is included in or connected to the taxpayer data environment. The taxpayer data environment is that part of the network that has taxpayer data or sensitive authentication data. If scan reports reveal vulnerabilities,

[21] Publication 1345 may be accessed at https://www.irs.gov/pub/irs-pdf/p1345.pdf

action must be taken to address the vulnerabilities in line with the scan report's recommendations. Retain weekly scan reports for at least one year. The ASV and the host (if present) must be in the United States.

Information Privacy and Safeguard Policies

This standard applies to Authorized IRS e-file Providers participating in Online Filing of individual income tax returns that own or operate a website through which taxpayer information is collected, transmitted, processed or stored. These Providers must have a written information privacy and safeguard policy consistent with the applicable government and industry guidelines and including the following statement: "we maintain physical, electronic and procedural safeguards that comply with applicable law and federal standards." 5In addition, Providers' compliance with these policies must be certified by a privacy seal vendor acceptable to the IRS.

Protection Against Bulk Filing of Fraudulent Income Tax Returns

This standard applies to Online Providers of individual income tax returns that own or operate a website through which taxpayer information is collected, transmitted, processed or stored. These Online Providers must implement effective technologies to protect their website against bulk filing of fraudulent income tax returns. Taxpayer information must not be collected, transmitted, processed or stored otherwise.

Public Domain Name Registration

This standard applies to Online Providers of individual income tax returns that own or operate a website through which taxpayer information is collected, transmitted, processed or stored. These Online Providers must have their website's domain name registered with a domain name registrar that is in the United States and accredited by the Internet Corporation for Assigned Names and Numbers (ICANN). The domain name must be locked and not be private.

Reporting of Security Incidents

Authorized IRS e-file Providers of individual income tax returns must report security incidents to the IRS as soon as possible but not later than the next business day after confirmation of the incident. For the purposes of this standard, an event that can result in an unauthorized disclosure, misuse, modification, or destruction of taxpayer information (e.g., breach) must be considered a reportable security incident. Providers with multiple roles must follow instructions for submitting incident reports at "Instructions for Reporting Security Incidents." Those that are EROs only must contact their local stakeholder liaison by following the instructions at "Data Theft Information for Tax Professionals." In addition, if the Provider's website is the cause of the incident, the Provider must cease collecting taxpayer information via their website immediately upon detection of the incident and until the underlying causes of the incident are successfully resolved.

3.3 Individual Taxpayer Identification Numbers

Individual Taxpayer Identification Numbers (ITINs) are tax processing numbers issued by the IRS to individuals who:

- Are required to have a U.S. taxpayer identification number;
- Do not have a Social Security number; **and**
- Are NOT eligible to obtain a Social Security number from the Social Security Administration.

ITINs are used only for federal tax reporting and are not intended to serve any other purpose.

Effective January 1, 2018, the deduction for personal exemptions was suspended for tax years 2018 through 2025 by the Tax Cuts and Jobs Act. For tax years after December 31, 2017, spouses and dependents are not eligible for an ITIN or to renew an ITIN unless they are claimed for an allowable tax benefit or they file their own tax return. Spouses and dependents must be listed on an attached U.S. federal tax return and include the schedule or form that applies to the allowable tax benefit. Dependents claimed for an allowable tax benefit must prove U.S. residency unless from Canada or Mexico. An allowable tax benefit includes a spouse filing a joint return, Head of Household (HOH) filing status, the American Opportunity Tax Credit (AOTC) Form 8863, Premium Tax Credit (PTC) Form 8962, Credit for Other Dependents (ODC), and Child and Dependent Care Credit (CDCC) Form 2441.

ITIN applicants who submit a Form W-7 based on the HOH filing status must be listed as a dependent on an attached tax return as a qualifying child or a qualifying relative. A dependent applicant must prove U.S. residency unless from Canada or Mexico.

If Form W-7 is submitted to claim ODC, the dependent applicants must be listed on an attached tax return with the "Credit for other dependents" box checked next to their name and prove U.S. residency or be a U.S. National. A dependent applicant from Canada or Mexico is not eligible for an ITIN if the only allowable tax benefit claimed is ODC unless they prove U.S. residency

3.3.1 Who Needs an ITIN?

As discussed in Publication 1915,[22] the IRS issues ITINs to foreign nationals and others who have federal tax reporting or filing requirements and who don't qualify for a Social Security number. ITINs are issued to help individuals comply with the U.S. tax laws, and to provide a means for the IRS to efficiently process and account for tax returns and payments for those not eligible for Social Security numbers. They are issued regardless of immigration status, because both resident and nonresident aliens may have a U.S. filing or reporting requirement under the Internal Revenue Code. ITINs do not serve any purpose other than federal tax reporting.

An ITIN does not:

- Authorize work in the U.S.
- Provide eligibility for Social Security benefits
- Qualify a dependent for Earned Income Tax Credit Purposes

Your client will need an ITIN if he or she does not have one and:

- Does not have an SSN and is ineligible to obtain one, and
- Has a requirement to furnish a federal tax identification number or file a federal tax return, and is in one of the following categories –
    - Nonresident alien who is required to file a U.S. tax return,
    - U.S. resident alien who is (based on days present in the United States) filing a U.S. tax return,
    - Dependent or spouse of a U.S. citizen/resident alien,
    - Dependent or spouse of a nonresident alien visa holder,
    - Nonresident alien claiming a tax treaty benefit, or
    - Nonresident alien student, professor or researcher filing a U.S. tax return or claiming an exception.

All individuals must have a tax purpose for requesting an ITIN, whether or not a U.S. Federal income tax return is submitted to the IRS with Form W-7.

3.3.2 ITIN Renewals

Before passage of the PATH Act, ITINs generally remained in effect until and unless the taxpayer applied for and received a Social Security number (SSN); the PATH Act changed that approach, and ITINs may now expire.

If your client's ITIN wasn't included on a U.S. federal tax return at least once in the last three consecutive tax years, his or her ITIN expired on December 31, of the third consecutive tax year. ITINs with middle digits (the fourth and fifth positions) "70," through "88" have expired. In addition, ITINs with middle digits "90," "91," "92," "94," "95," "96," "97," "98," or "99," IF assigned before 2013, have also expired.

If your client previously submitted a renewal application and it was approved, no renewal is required. Otherwise, the client should submit:

- a completed Form W-7, Application for IRS Individual Taxpayer Identification Number,

[22] Pub 1915 may be accessed at https://www.irs.gov/pub/irs-pdf/p1915.pdf

- a US federal tax return, and
- all required identification documents to the IRS.

If your client's ITIN is only being used on information returns for reporting purposes, the client's ITIN does not need to be renewed at this time. However, in the future, if the client needs to use the ITIN to file a U.S. federal tax return, the client will need to renew the ITIN at that time.

Effective January 1, 2022, ITIN holders must submit a Form W-7, Application for IRS Individual Taxpayer Identification Number, and usually must attach a U.S. federal tax return, to renew their expired ITIN, along with the required documentation. A renewing taxpayer must attach a U.S. federal tax return unless eligible for one of the five exceptions involving:

- Third party withholding on passive income;
- Wages, salary, compensation and honoraria payments with tax treaty benefits claimed; scholarships, fellowships and grants with tax treaty benefits claimed; scholarships, fellowships and grants – no tax treaty benefits claimed; or gambling winnings with tax treaty benefits claimed;
- Third party reporting of mortgage interest;
- Third party withholding – disposition by a foreign person of united states real property interest; or
- A non-U.S. representative of a foreign corporation who needs to obtain an ITIN for the purpose of meeting their e-filing requirements.

The exceptions are explained more fully in the Instructions for Form W-7 and in Publication 1915, Understanding Your IRS Individual Taxpayer Identification Number (ITIN).

3.4 Preparer Penalties

Professional tax preparers are expected to demonstrate a high level of competence, diligence and ethical behavior in their preparation of taxpayers' tax returns and are penalized for their failure to meet those expectations. The penalties that may be imposed under Title 26 for various preparer failures are as follows:

Scenario	Per Return or Claim for Refund	Maximum Penalty
Failure to furnish copy of tax return to taxpayer (§ 6695(a))	$60	$31,500
Failure to sign taxpayer's return (§ 6695(b))	$60	$31,500
Failure to furnish identifying number (§ 6695(c))	$60	$31,500
Failure to retain a copy or list of a return or claim (§ 6695(d))	$60	$31,500
Failure to file correct information returns (§ 6695(e))	$60 per return and item in return	$31,500
Negotiation of a check issued to a taxpayer (§ 6695(f))	$635 per check	No limit
Failure to be diligent in determining eligibility for head of household filing status, Child Tax Credit, American Opportunity Tax Credit, and Earned Income Tax Credit (§ 6695(g))	$635 per failure	No limit
Unauthorized disclosure or use of information furnished for, or in connection with, the preparation of a return (§ 6713)	$250	$10,000

In addition, tax preparer penalties may also be imposed for the following:

Scenario	Penalty

Understatement of taxpayer's liability due to unreasonable positions (§ 6694(a))	Greater of $1,000 or 50% of income derived by preparer with respect to the return or claim for refund.
Understatement of taxpayer's liability due to willful or reckless conduct (§ 6694(b))	Greater of $5,000 or 75% of income derived by preparer with respect to the return or claim for refund.
Aiding and abetting understatement of a taxpayer's tax liability (§ 6701)	$1,000 ($10,000 if the conduct relates to a corporation's tax return)
Fraud and false statements (§ 7206)	Guilty of a felony; upon conviction, a fine of $100,000 ($500,000 in the case of a corporation), imprisonment of not more than three years or both, together with costs of prosecution.

3.5 Due Diligence in Tax Preparation

Due diligence is the care and attention to detail appropriate to the subject to which it refers. Thus, due diligence with respect to tax preparation is the care and attention to detail required of each preparer in his or her preparation of taxpayers' tax returns. Not surprisingly, the tax issues that create the greatest amount of confusion and resultant errors are the ones that require the highest level of diligence. Among the tax preparation topics responsible for a significant level of errors are:

- Qualifying for head of household (HOH) filing status; and
- Claiming the –
    - Child tax credit (CTC),
    - Credit for Other Dependents (ODC),
    - Education tax credits (AOTC), and
    - Earned income tax credit (EITC).

Filing as head of household and claiming the refundable tax credits are each governed by different eligibility rules. In order to avoid errors, it is important to take the following three steps:

1. Know the tax law for filing as head of household and claiming each refundable credit including its eligibility rules;
2. Remember that your software is not a substitute for your knowledge of the tax law; and
3. Follow the Due Diligence Must Do's.

In addition, the due diligence requirements require the preparer to meet four standards in preparing a tax return claiming head of household filing status, the EITC, American Opportunity Tax Credit, Credit for Other Dependents, or the Child Tax Credit. Those requirements call for the preparer to:

1. Complete and submit the Paid Preparer's Due Diligence Checklist, IRS Form 8867;
2. Complete the applicable worksheet;
3. Know the law relative to claiming the credit or filing status and, by interviewing and asking questions, the taxpayer; and
4. Document and maintain appropriate records related to preparation of the tax return, including keeping the following records for 3 years:
    - A copy of form 8867,
    - The applicable worksheet(s) or your own worksheet(s) for any credits claimed,
    - Copies of any documents provided by the taxpayer on which you relied to determine the taxpayer's eligibility for the credit(s) and/or HOH filing status and to figure the amount(s) of the credit(s),
    - A record of how, when, and from whom the information used to prepare Form 8867 and the applicable worksheet(s) was obtained, and
    - A record of any additional information you relied upon, including questions you asked and the taxpayer's responses, to determine the taxpayer's eligibility for the credit(s) and/or HOH filing status and to figure the amount(s) of the credit(s).

The various questions posed on Form 8867, Paid Preparer's Due Diligence Checklist, act as memory-joggers and identify areas about which the tax preparer should obtain information from the taxpayer when filing as Head of Household, or claiming the Earned Income Tax Credit, the Child Tax Credit, the

Credit for Other Dependents or the American Opportunity Tax Credit. (Note: Satisfying the due diligence requirement may require filing multiple IRS Forms 8867.)

Treasury Regulations prescribe the due diligence requirements a paid tax return preparer must meet with respect to completion and submission of IRS form 8867. According to the regulations, a paid tax return preparer is required to complete the form based on information provided by the taxpayer to the tax return preparer or otherwise reasonably obtained by the preparer and provide the completed form for submission as follows:

- In the case of a ***signing tax return preparer who electronically files*** the tax return or claim for refund, the completed Form 8867 must be electronically filed with the tax return or refund claim;
- In the case of a ***signing tax return preparer who does not file the tax return or claim for refund electronically***, the completed Form 8867 must be provided to the taxpayer for inclusion when filing the tax return or claim for refund; and
- In the case of a ***non-signing tax return preparer***, the completed Form 8867 must be provided to the taxpayer in electronic or non-electronic format for inclusion when filing the tax return or claim for refund.

Pay particular attention to the important eligibility issues to avoid errors with respect to filing HOH and claiming EITC, CTC, ODC or AOTC. In every case, make sure your client has the documents needed to show the IRS if audited.

3.5.1 Head of Household Filing Status

A taxpayer who is eligible may find head of household (HOH) filing status advantageous when compared to filing as single or married filing separately, including:

- Possible eligibility for the Earned Income Tax Credit and dependent care credit;
- Higher income limits at which various tax credits are reduced;
- A lower tax rate; and
- A higher standard deduction.

However, eligibility to file as HOH is limited to those taxpayers who meet the qualification requirements. Those requirements are as follows:

- The taxpayer must be either unmarried or considered unmarried on the last day of the tax year;
- The taxpayer must have paid more than half the cost of keeping up the taxpayer's home for the tax year; and
- A qualifying person must live with the taxpayer in the taxpayer's home for more than half the tax year, not counting temporary absences for school, illness, business, vacation or military service.

Let's consider each of these requirements.

3.5.1.1 Taxpayer Considered Unmarried

To be considered unmarried on the last day of the tax year, the:

- Taxpayer must file a separate tax return, i.e., other than married filing jointly;
- Taxpayer must have paid more than half the cost of keeping up the taxpayer's home for the tax year;
- Taxpayer's spouse must not have lived in the taxpayer's home during the last six months of the tax year;
- Taxpayer's home must be the main home for the taxpayer's child, stepchild or foster child for more than half of the tax year; and
- Taxpayer must be able to claim the child.

3.5.1.1.1 Required Marriage Test Supporting Documents

The supporting documents required to substantiate the taxpayer's meeting the marriage test depends upon whether the taxpayer is:

- Single,

- Divorced or legally separated, or
- Married but not living with spouse during last 6 months of the tax year.

If the taxpayer is single, no documents supporting the taxpayer's meeting the marriage test need to be obtained.

If the taxpayer is divorced or legally separated, photocopies of the following documents should be obtained:

- Entire divorce decree;
- Separate maintenance decree; or
- Separation agreement.

If the taxpayer is married but did not live with the taxpayer's spouse during the last six months of the tax year, obtain photocopies of documents verifying the taxpayer did not live with his or her spouse during the last six months of the year. Appropriate documents include:

- A lease agreement;
- Utility bills;
- A letter from a clergy member, or
- A letter from social services.

All such documents obtained by the paid preparer should be retained by the preparer as verification that supports his or her decision for the filing.

3.5.1.2 Keeping up the Taxpayer's Home

A taxpayer is keeping up a home only if the taxpayer pays more than half the cost of its upkeep for the year. The cost of keeping up a home includes:

- Rent;
- Mortgage interest (***but not principal payments***);
- Real estate taxes;
- Insurance on the home;
- Repairs;
- Utilities; and
- Food eaten in the home.

The cost of keeping up a home doesn't include the cost of clothing, education, medical treatment, vacations, life insurance, or transportation for any member of the household.

3.5.1.2.1 Required Keeping Up a Home Test Supporting Documents

The tax preparer should obtain the following supporting documents to substantiate the taxpayer's meeting the keeping up a home test including:

- Rent receipts;
- Utility bills;
- Grocery receipts;
- Property tax bills;
- Mortgage interest statement;
- Upkeep and repair bills;
- Property insurance statement; and
- Other household bills.

All such documents obtained by the paid preparer should be retained by the preparer as verification that supports his or her decision for the filing.

3.5.1.3 Qualifying Person

A person is a qualifying person for purposes of the taxpayer's filing as head of household if the person is the taxpayer's:

- Qualifying child (such as a son, daughter, or grandchild who lived with the taxpayer more than half the year) if –
    - Single, or

    - Married and the taxpayer can claim him or her as a dependent;
- Qualifying relative who is the taxpayer's father or mother and the taxpayer can claim the relative as a dependent;
- Qualifying relative other than the taxpayer's father or mother (such as a grandparent, brother, or sister) who lived with the taxpayer more than half the year, and is related to the taxpayer in one of the following ways –
    - The taxpayer's brother, sister, half-brother, half-sister, stepbrother, or stepsister,
    - The taxpayer's stepfather or stepmother,
    - A son or daughter of the taxpayer's brother or sister,
    - A son or daughter of the taxpayer's half-brother or half-sister,
    - A brother or sister of the taxpayer's father or mother, or
    - The taxpayer's son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law.

Note: Neither the taxpayer's mother or father is required to live with the taxpayer in order for the taxpayer to qualify for HOH filing status based on the relative.

3.5.1.4 Qualifying Child

A child is considered a qualifying child if both the taxpayer and child satisfy five tests:

- The child must be the taxpayer's son, daughter, stepchild, foster child, brother, sister, half-brother, half-sister, stepbrother, stepsister, or a descendant of any of them.
- The child must be (a) under age 19 at the end of the year and younger than the taxpayer (or the taxpayer's spouse if filing jointly), (b) under age 24 at the end of the year, a student, and younger than the taxpayer (or the taxpayer's spouse if filing jointly), or (c) any age if permanently and totally disabled.
- The child must have lived with the taxpayer for more than half of the year.
- The child must not have provided more than half of his or her own support for the year.
- The child isn't filing a joint return for the year (unless that joint return is filed only to claim a refund of withheld income tax or estimated tax paid).

3.5.1.4.1 Required Qualifying Person Test Supporting Documents

The tax preparer should obtain and retain the supporting documents needed to substantiate the taxpayer's meeting the qualifying person test including, as appropriate:

- Birth certificate or other official document of birth;
- Marriage certificate;
- Letter from an authorized adoption agency;
- Letter from the authorized placement agency; or
- Applicable court document.

In order to show that both the taxpayer and the taxpayer's child lived together for more than half of the year, obtain:

- School, medical, day care, or social service records; or
- A letter on the unofficial letterhead from a school, medical provider, social service agency, or place of worship that shows –
    - Names,
    - Common address, and
    - Dates.

Note: If the taxpayer furnishes a letter from a relative who provides the taxpayer's day care services, the preparer should obtain at least one additional letter.

3.5.1.5 Common Head of Household Errors

Common errors involving head of household filing status include the following:

- Both parents file as head of household, using the same child as a qualifying child;
- Both parents file as head of household, claiming that they each provided more than half the cost of upkeep for the same home;

- The taxpayer claims head of household status but did not pay for more than half the cost of keeping up a home (for example, the parent is living with a grandparent or the other parent paid for the cost of the home);
- The taxpayer is divorced and lives with his or her ex-spouse in the same home and both file as head of household;
- The taxpayer is married and the taxpayer's spouse lived in the taxpayer's house for one or more days during the last six months of the tax year;
- The taxpayer is married and lives with his or her spouse who does not work (for example income below the IRS filing threshold);
- A qualifying child did not live with the taxpayer for more than half of the tax year;
- The qualifying child was age 19 or older (or, if a student, age 24 or older) as of the last day of the tax year;
- The qualifying child was age 19-23 and a student, but was an enrolled on less than a full-time basis;
- The qualifying child was age 19-23 and a full-time student, but only for four or fewer months during the tax year (for example, the child enrolled in college starting in September after a gap year);
- The child provided more than half of his or her own support during the tax year; or
- The child filed a joint federal income tax return with his or her spouse.

IRS Form 886-H-HOH may be accessed to help ensure the necessary supporting documents to prove head of household filing status have been obtained. Complete and submit the Paid Preparer's Due Diligence Checklist, IRS Form 8867.

3.5.2 Earned Income Tax Credit

The eligibility requirements for the earned income tax credit may be found in this document at 2.12.6. Click on eligibility requirements to review them before proceeding.

3.5.2.1 EITC Due Diligence Requirements

In addition to completing and submitting IRS Form 8867, Paid Preparer's Due Diligence Checklist, the due diligence requirements require the preparer to:

- Compute the applicable Earned Income Tax Credit using a worksheet—either Worksheet A or B, as applicable;
- Know the law relative to claiming the Earned Income Tax Credit and his or her client; and

Maintain appropriate records related to preparation of the tax return.

3.5.2.2 Most Common EITC Errors

The most common EITC errors are:

- ***Claiming EITC for a child who does not meet the qualifying child requirements*** – To help avoid errors involving qualifying child requirements make sure you find out if the child –
    - Lived with your client for more than half the year,
    - Is related to him or her, and
    - Meets the age test.

  Thus, you must ask the client how long the child lived with your client, at what address, and did anyone else live with the child for more than half the year. Also, find out how the child is related to the client, i.e., by blood, by marriage or by law. To determine if the age test is met for an older child, determine if the child is a student or permanently and totally disabled.
- ***Filing as single or head of household when married*** – To avoid errors with respect to filing status, ask questions to find out if your client –
    - Is married under state law, including common law, or
    - Was ever married.

  If your client is married, make sure your client did not live with his or her spouse at any time during the last six months of the year.

- ***Incorrectly reporting income or expenses*** – To avoid errors involving the incorrect reporting of income or expenses, consider the following:
    - Does the Form W-2 look similar to the Forms W-2 of other clients who have the same employer?
    - Is your client saying they own a business but not claiming any business expenses? In such a case, ask enough questions to make sure your client has a true business and claims all income and deducts all allowable expenses.

3.5.3 Education Tax Credits

The eligibility requirements for the education tax credits may be found in this document at 2.12.5 Click on eligibility requirements to review them before proceeding.

In addition to completing and submitting IRS Form 8867, Paid Preparer's Due Diligence Checklist, when the American Opportunity Tax Credit is claimed, the due diligence requirements require the preparer to:

- Complete the AOTC Credit Limit Worksheet and Adjusted Qualified Education Expenses Worksheet found in the instructions to Form 8863, Education Credits;
- Document the inquiries made of the taxpayer; and
- Obtain substantiation for the claimed AOTC, such as –
    - Form 1098-T, and/or
    - Receipts for qualified tuition and related expense.

3.5.3.1 Most Common AOTC Errors

The most common AOTC errors are:

- ***Claiming AOTC for a student who didn't attend an eligible educational institution*** - The AOTC is for post-secondary education, which may include education at a college, university or technical school. It does not include a high school. To be an eligible institution, the school must be able to participate in the student aid program administered by the U.S. Department of Education (note: they don't have to participate but must be eligible to participate).
- ***Claiming AOTC for a student who didn't pay qualifying college expenses*** – Ask questions to ensure the educational expenses were paid or considered paid by –
    - Your client,
    - Your client's spouse or
    - The dependent student claimed on the tax return.
- ***Claiming AOTC for a student for too many years*** - The AOTC is only available for the first four years of post-secondary education and your client can only claim it for four tax years per eligible student. This limitation includes any year(s) your client claimed the Hope Credit.

3.5.4 Child Tax Credit

The eligibility requirements for the Child Tax Credit may be found in this document at **2.12.1** Click on eligibility requirements to review them before proceeding.

In addition to completing and submitting IRS Form 8867, Paid Preparer's Due Diligence Checklist, when the Child Tax Credit is claimed, due diligence requires the preparer to:

- Complete the Child Tax Credit and Credit for Other Dependents worksheet found in the instructions to Form 1040;
- Document the inquiries made of the taxpayer; and
- Determine that each qualifying person for the CTC/ACTC/ODC is the taxpayer's dependent who is a citizen, national or resident of the United States;
- Determine that all children for whom the taxpayer is claiming the CTC/ACTC reside with the taxpayer;

If not all children for whom the taxpayer is claiming the credit reside with the taxpayer inquire whether there is an active Form 8332, Release/Revocation of Claim to Exemption for Child by Custodial Parent, or a similar statement in place? (Must be attached to the return if applicable)

3.5.4.1 Most Common CTC/ACTC/ODC Errors

The most common CTC/ACTC/ODC errors involve:

- ***Claiming the CTC/ACTC for a child who does not meet the age requirement*** - The child must be under the age of 17 at the end of 2024.
- ***Claiming the CTC/ACTC/ODC for a child or other person who doesn't meet dependency requirements*** - The child must be claimed as a dependent on your client's return and meet all the eligibility rules for a dependent.
- ***Claiming the CTC/ACTC for a child who does not meet the residency requirement*** - The child must be a U.S. citizen, U.S. national or a resident alien and the child must have lived with your client for more than half the year. If the qualifying child uses an ITIN, Individual Taxpayer Identification Number, the child must meet the substantial presence test to qualify.

3.6 Compliance with E-file Procedures

Section 6011(e)(3) of the Internal Revenue Code requires specified tax return preparers to electronically file certain federal income tax returns that they prepare and file for individuals, trusts, or estates.

3.6.1 Affected Tax Return Preparers

A tax preparer generally required to electronically file federal income tax returns is one who reasonably expects to file 11 or more covered returns in a calendar year. The returns that are "covered" under the e-file requirement are income tax returns on individuals, trusts or estates, such as Forms 1040 and 1041.

The requirement to e-file does not apply to individuals who do not meet the definition of "tax return preparer" under the Internal Revenue Code, such as an individual who provides tax assistance under a Volunteer Income Tax Assistance (VITA) program, a person who merely prepares a return of the employer by whom employed or a person who prepares a return as a fiduciary.

3.6.2 Timing of Taxpayer Signature

Both taxpayers and paid preparers are required to sign an electronic income tax return. Taxpayers must sign individual income tax returns electronically under one of two methods:

- Self-Select PIN method requires taxpayers to provide their prior year adjusted gross income (AGI) amount or prior year PIN for use by the IRS to authenticate the taxpayer; or
- Practitioner PIN method.

Regardless of the method used, taxpayers must agree by signing an IRS e-file signature authorization containing the PIN *after reviewing the completed return*.

3.6.3 Timing of Filing

A return is considered filed by a tax return preparer when the preparer submits the return to the IRS either electronically or in paper form. When received by the IRS, the return is automatically checked by computers for errors and missing information. If the return cannot be processed, it is returned to the originating transmitter to clarify any needed information. Within 48 hours of electronically sending the return to the IRS, the IRS sends an acknowledgment to the transmitter stating that the return is accepted for processing. The notice is proof of filing and assurance that the IRS has the return information.

3.6.4 Recordkeeping

A tax return preparer who originates the electronic submission of returns to the IRS must make various records easily accessible until the end of the calendar year. The required records must be kept

at the business address from which the preparer originated the return or at a location that allows the tax return preparer to readily access the material if requested by the IRS.

The records that must be retained are:

- A copy of Form 8453, U.S. Individual Income Tax Transmittal for an IRS e-file Return, and supporting documents not included in the electronic records submitted to the IRS;
- Copies of Forms W-2, W-2G and 1099-R;
- A copy of signed IRS e-file consent to disclosure forms;
- A complete copy of the electronic portion of the return that can be readily and accurately converted into an electronic transmission that the IRS can process; and
- The acknowledgement files for IRS-accepted returns.

Forms 8878 and 8879, IRS e-file Signature Authorization forms, must be available to the IRS for three years from the due date of the return or the IRS received date, whichever is later. Preparers may electronically image and store all paper records they are required to retain for IRS e-file.

3.6.5 Prohibited Filing with Pay Stub

If a taxpayer is unable to secure and provide a correct Form W-2, W-2G, or 1099-R, the return may be electronically filed after Form 4852 is completed. This is the only time that information from pay stubs is allowed.

3.6.6 Proper Handling of Rejects

E-file rejects identify problems that usually lead to IRS correspondence and slow down processing of tax returns. This e-file feature enables preparers to correct mistakes before returns are processed, decreasing overall processing time and shortening the time it takes to receive a refund. If the reject is for a simple mistake, the preparer should correct the error and resubmit the return electronically. This usually solves the problem.

However, you may not be able to correct some rejects. For example, if the return rejects because an exemption has been claimed on another taxpayer's return, check that the Social Security number of the exemption was entered correctly on the return. If the SSN is correct, you will not be able to file this return electronically unless the exemption is removed from the return. If you believe the taxpayer is entitled to claim the exemption, it is not necessary to remove the exemption, but the return must be filed on paper. Attach Form 8948, Preparer Explanation for Not Filing Electronically, to the paper return; check box 4 and enter the reject code number. The number of attempts to resolve is zero.

There are other situations where the reject may or may not be corrected but it takes one or more tries to resolve. When this happens, the return must be filed on paper. Attach Form 8948 to the paper return and check box 4; enter the reject code number and the number of attempts you made to resolve the reject before deciding that the error could not be fixed. Preparers generally learn from experience when trying to resolve an error is no longer productive.

Some reject conditions permit returns to be e-filed without correcting the error. If you encounter a reject that you try to resolve but cannot and this option is available, submit the return electronically.

3.7 Annual Filing Season Program Requirements

The annual filing season program is a voluntary program designed to encourage non-credentialed tax return preparers to participate in continuing education courses. After successfully completing the program, the preparer:

1. Will receive a Record of Completion that may be displayed by the preparer; and
2. Will be included, if desired, in a public database on IRS.gov that taxpayers may use when searching for a qualified tax return preparer.

The searchable public database—known as the Directory of Federal Tax Return Preparers with Credentials and Select Qualifications—includes the name, type of credential possessed and location of:

- Attorneys,
- Certified public accountants (CPAs),
- Enrolled agents (EAs),

- Enrolled retirement plan agents (ERPAs),
- Enrolled actuaries, and
- Individuals who have received an Annual Filing Season Program Record of Completion.

Participation in the Annual Filing Season Program (AFSP) requires that a tax return preparer:

- Possess an active Preparer Tax Identification Number (PTIN) for the year of participation;
- Have completed all required continuing education credits from an IRS-approved CE provider no later than December 31st of the year prior to the year of participation;
- Obtain an Annual Filing Season Program—Record of Completion from the IRS for the year of participation; and
- Consent to abide by the duties and restrictions relating to practice before the IRS contained in subpart B and section 10.51 of Treasury Department Circular No. 230 for the entire period covered by the Record of Completion.

Information on acquiring and maintaining a PTIN may be obtained at IRS Tax Professional PTIN System.

The AFSP also requires that tax return preparers have either 15 or 18 hours of continuing education from an IRS-approved continuing education provider.

Tax return preparers requiring 15 hours of continuing education include:

- Anyone who passed the Registered Tax Return Preparer test administered by the IRS between November 2011 and January 2013;
- Return preparers who are active registrants of the –
    - Oregon Board of Tax Practitioners,
    - California Tax Education Council (CTEC), and/or
    - Maryland State Board of Individual Tax Preparers;
- Tax practitioners who have passed the Special Enrollment Exam (SEE) Part I within the past three years;
- VITA volunteers; and
- Other accredited tax-focused credential-holders of –
    - The Accreditation Council for Accountancy and Taxation's Accredited Business Accountant/Advisor (ABA), and
    - Accredited Tax Preparer (ATP) programs.

All other Annual Filing Season Program participants must have 18 hours of continuing education.

The types of continuing education required for AFSP participants needing 15 or 18 hours of continuing education are as shown in the chart below:

Category	15-Hour Continuing Education Requirement	18-Hour Continuing Education Requirement
Federal Tax Law	10 hours	10 hours
Federal Tax Law Updates	3 hours	Not required
Annual Federal Tax Refresher	Not required	6 hours
Ethics	2 hours	2 hours
Total	15 hours	18 hours

Additional information concerning the Annual Filing Season Program may be obtained in IRS Publication 5227, and IRS Publication 5646.

3.7.1. Consent to Adhere to Circular 230 Requirements

As part of the requirements that must be met to participate in the Annual Filing Season Program, a tax ***preparer must sign the Circular 230 Consent statement that can be accessed in the tax preparer's PTIN account*** at IRS Tax Professional PTIN System. More information about the Annual Filing Season Program is available on IRS.gov here: https://www.irs.gov/tax-professionals/annual-filing-season-program.

By signing the Circular 230 Consent statement, the participant consents to the following:

I agree to abide by the duties and restrictions relating to practice before the IRS in subpart B and section 10.51 of Treasury Department Circular No. 230 for the entire period covered by the Record of Completion.

I understand that failing to comply with the duties and restrictions relating to practice before the IRS in these sections may result in the revocation of my Annual Filing Season Program—Record of Completion, and I may be prohibited from participating in the Annual Filing Season Program in the future.

3.7.1.1 Tax Return Preparer Duties and Restrictions

By signing the Circular 230 Consent statement, an AFSP participant agrees to abide by the duties and restrictions relating to:

Topic	Circular 230 Section Number
Required response to IRS request for information	§10.20
Knowledge of client omissions	§10.21
Requirement for practitioner accuracy	§10.22
Prompt disposition of pending matters	§10.23
Assistance from or to disbarred or suspended persons and former IRS employees	§10.24
Practice by former government employees, their partners and associates	§10.25
Prohibition against acting as a notary as to matters administered by the IRS	§10.26
Fees	§10.27
Return of client records	§10.28
Conflicting interests	§10.29
Solicitation of business	§10.30
Negotiation of checks issued to a taxpayer	§10.31
Unauthorized practice of law	§10.32
Adherence to best practices for tax advisors	§10.33
Maintaining standards with respect to tax returns and other documents	§10.34
Practitioner competence	§10.35
Adoption of and adherence to procedures to ensure compliance	§10.36
Requirements for written advice	§10.37
Incompetence and disreputable conduct	§10.51

3.7.2 AFSP Participants' Limited Representation Rights

A return preparer who is not an attorney, CPA, or enrolled agent and who does not participate in the Annual Filing Season Program will only be permitted to prepare tax returns. The return preparer will not be permitted to represent clients before the IRS except in regard to returns prepared by the return preparer before January 1, 2016.

Participants in the Annual Filing Season Program, however, have limited representation rights. Pursuant to those limited representation rights, AFSP participants may represent clients whose returns they prepared and signed:

- Involving initial audits;
- Regarding customer service matters; and
- Before the Taxpayer Advocate Service.

Note: To have limited representation rights for any return or claim for refund prepared and signed after December 31, 2015, return preparers must participate in the Annual Filing Season Program in both **the year of return preparation and the year of representation**.

Glossary

Adjustment to income	An adjustment to income is a deduction that reduces a taxpayer's income to arrive at the adjusted gross income. It is also called an "above the line" deduction, meaning it is taken above the line on the tax form for adjusted gross income.
American opportunity credit	The American opportunity credit is an education tax credit available only for the first four years of postsecondary education during which time the student must be pursuing a degree or other recognized credential.
Capital asset	A capital asset includes everything owned by a taxpayer and used for personal purposes, pleasure, or investment.
Capital gains and losses	A capital gain or loss is the gain or loss sustained by a taxpayer on a sale or trade of a capital asset.
Child and dependent care tax credit	The child and dependent care credit is a nonrefundable tax credit available to a taxpayer who pays someone for the care of a qualifying person while the taxpayer is working or looking for work.
Child tax credit	The Child Tax Credit is a credit of up to $2,000 for each qualifying child.
Credit for Other Dependents	The Credit for Other Dependents is a credit a taxpayer may claim for dependent other than a child or for a qualifying child for whom a credit is disallowed solely because the taxpayer failed to include the child's Social Security number on the tax return for the taxable year.
Deduction	A dollar amount that reduces the taxpayer's taxable income.
Dependent	A dependent is a taxpayer's qualifying child or qualifying relative.
Dividend	A dividend is a distribution of money, stock, or other property paid to a taxpayer by a corporation or by a mutual fund.
Earned income tax credit	The Earned Income Tax Credit—usually referred to simply as "EIC" or "EITC"—is a refundable tax credit for certain lower-income working taxpayers who meet income, filing status and other requirements.
Estimated tax payment	Estimated tax payments are amounts paid quarterly by a taxpayer to the state and local governments to cover income taxes on amounts not subject to tax withholding.
Filing status	Filing status refers to one of the five statuses a taxpayer falls into and depends on whether the taxpayer is single or married and on the taxpayer's family situation. It is determined on the last day of the taxpayer's tax year, which is December 31 for most taxpayers.
Health insurance premium tax credit	A tax credit available to individuals who meet specified income, coverage and other criteria to enable them to purchase a qualified health plan through the Health Insurance Marketplace.
Interest	Interest is the fee paid by a borrower to a taxpayer for the use of money. Interest is normally taxable to the receiving taxpayer.
Lifetime learning credit	The Lifetime Learning Credit is an education tax credit available for all years of postsecondary education as well as for courses to acquire or improve job skills.
Pass-through deduction	A deduction authorized by the Tax Cuts and Jobs Act of 2017 equal to 20% of qualified business income available to businesses organized as other than regular corporations

Pension	An income received from an employer-sponsored qualified retirement plan.
Roth IRA	A Roth IRA is a personal retirement savings plan, funded by an annuity or trust/custodial account, which provides income tax deferral and may provide tax-free distribution of earnings. It does not provide for contribution deductibility.
Self-employment income	Self-employment income is income earned by a taxpayer in business for himself or herself.
Standard deduction	The standard deduction is a dollar amount that reduces the taxpayer's taxable income. It is a benefit that eliminates the need for many taxpayers to itemize actual deductions, such as medical expenses, charitable contributions, and taxes, on Schedule A (Form 1040).
Student loan interest deduction	The student loan interest deduction is a special deduction allowed for interest payments made on a student loan used solely to pay higher education expenses up to a maximum deduction of $2,500.
Tax credit	A dollar amount that directly reduces the taxpayer's tax liability.
Tax Cuts and Jobs Act of 2017 (TCJA)	Tax reform legislation that, among other things, authorized a pass-through deduction, generally lowered taxes for individuals and businesses, temporarily suspended exemptions and increased standard deductions.
Tax withholding	Tax withholding is the employer's retention of funds from an employee's salary or wages and paid to the government to pay the Income tax due.
Traditional IRA	A traditional IRA is a personal retirement savings plan, funded by an annuity or a trust that meets certain requirements, which may permit tax-deductible contributions and tax-deferral of earnings.

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Appendix A

References to Applicable Standards and Best Practices for Safeguarding Taxpayer Data

Resource	Available at…
"Getting Noticed: Writing Effective Financial Privacy Notices"	https://iapp.org/resources/article/getting-noticed-writing-effective-financial-privacy-notices/
"Information Compromise and the Risk of Identity Theft: Guidance for Your Business"	https://www.ftc.gov/tips-advice/business-center/guidance/data-breach-response-guide-business.
"FTC Facts for Business: Financial Institutions and Customer Information: Complying with the Safeguards Rule"	https://www.ftc.gov/business-guidance/resources/ftc-safeguards-rule-what-your-business-needs-know
FTC Disposal Rule (2005) – "FTC Business Alert: Disposing of Consumer Report Information? Rule Tells How"	https://www.ftc.gov/tips-advice/business-center/guidance/disposing-consumer-report-information-rule-tells-how.
"Security Check: Reducing Risks to Your Computer Systems"	https://www.ftc.gov/tips-advice/business-center/guidance/security-check-reducing-risks-your-computer-systems.
NIST SP 800-18, Guide for Developing Security Plans for Federal Information Systems: Provides guidance on developing an Information Security Plan and includes a sample plan in Appendix A.	http://dx.doi.org/10.6028/NIST.SP.800-18r1.
NIST SP 800-53, Recommended Security Controls for Federal Information Systems and Organizations	http://dx.doi.org/10.6028/NIST.SP.800-53r4.
NIST SP 800-61 Revision 2, Computer Security Incident Handling Guide	https://nvlpubs.nist.gov/nistpubs/SpecialPublications/NIST.SP.800-61r2.pdf
NIST SP 800-30 Revision 1, Guide for Conducting Risk Assessments	http://dx.doi.org/10.6028/NIST.SP.800-30r1

Appendix B

Specified Service Trade or Business

The list of Specified Service Trades or Businesses, as amplified by IRS final regulations, includes trades or businesses involving the performance of services in one or more of the following fields:

- **Health** - the performance of services in the field of health means the provision of medical services by individuals such as physicians, pharmacists, nurses, dentists, veterinarians, physical therapists, psychologists, and other similar healthcare professionals performing services in their capacity as such.

  The performance of services in the field of health does not include the provision of services not directly related to a medical services field, even though the services provided may purportedly relate to the health of the service recipient.

- **Law** - the performance of services in the field of law means the performance of legal services by individuals such as lawyers, paralegals, legal arbitrators, mediators, and similar professionals performing services in their capacity as such.

  The performance of services in the field of law does not include the provision of services that do not require skills unique to the field of law.

- **Accounting** - the performance of services in the field of accounting means the provision of services by individuals such as accountants, enrolled agents, return preparers, financial auditors, and similar professionals performing services in their capacity as such.
- **Actuarial science** - the performance of services in the field of actuarial science means the provision of services by individuals such as actuaries and similar professionals performing services in their capacity as such.

- **Performing arts** - the performance of services in the field of the performing arts means the performance of services by individuals who participate in the creation of performing arts, such as actors, singers, musicians, entertainers, directors, and similar professionals performing services in their capacity as such.

  The performance of services in the field of performing arts does not include the provision of services that do not require skills unique to the creation of performing arts, such as the maintenance and operation of equipment or facilities for use in the performing arts. Similarly, the performance of services in the field of the performing arts does not include the provision of services by persons who broadcast or otherwise disseminate video or audio of performing arts to the public.

- **Consulting** - the performance of services in the field of consulting means the provision of professional advice and counsel to clients to assist the client in achieving goals and solving problems. Consulting includes providing advice and counsel regarding advocacy with the intention of influencing decisions made by a government or governmental agency and all attempts to influence legislators and other government officials on behalf of a client by lobbyists and other similar professionals performing services in their capacity as such.

  The performance of services in the field of consulting does not include the performance of services other than advice and counsel, such as sales (or economically similar services) or the provision of training and educational courses. For purposes of the preceding sentence, the determination of whether a person's services are sales or economically similar services will be based on all the facts and circumstances of that person's business. Such facts and circumstances include, for example, the manner in which the taxpayer is compensated for the services provided.

  Performance of services in the field of consulting does not include the performance of consulting services embedded in, or ancillary to, the sale of goods or performance of services on behalf of a trade or business that is otherwise not an SSTB (such as typical services provided by a building contractor) if there is no separate payment for the consulting services.

Services within the fields of architecture and engineering are not treated as consulting services.

- **Athletics** - the performance of services in the field of athletics means the performance of services by individuals who participate in athletic competition such as athletes, coaches, and team managers in sports such as baseball, basketball, football, soccer, hockey, martial arts, boxing, bowling, tennis, golf, skiing, snowboarding, track and field, billiards, and racing.

  The performance of services in the field of athletics does not include the provision of services that do not require skills unique to athletic competition, such as the maintenance and operation of equipment or facilities for use in athletic events. Similarly, the performance of services in the field of athletics does not include the provision of services by persons who broadcast or otherwise disseminate video or audio of athletic events to the public.

- **Financial services** - the performance of services in the field of financial services means the provision of financial services to clients including managing wealth, advising clients with respect to finances, developing retirement plans, developing wealth transition plans, the provision of advisory and other similar services regarding valuations, mergers, acquisitions, dispositions, restructurings (including in title 11 or similar cases), and raising financial capital by underwriting, or acting as a client's agent in the issuance of securities and similar services. This includes services provided by financial advisors, investment bankers, wealth planners, retirement advisors, and other similar professionals performing services in their capacity as such.

  Solely for purposes of section 199A, the performance of services in the field of financial services does not include taking deposits or making loans, but does include arranging lending transactions between a lender and borrower.

- **Brokerage services** - the performance of services in the field of brokerage services includes services in which a person arranges transactions between a buyer and a seller with respect to securities (as defined in section 475(c)(2)) for a commission or fee.

  This includes services provided by stock brokers and other similar professionals, but does not include services provided by real estate agents and brokers, or insurance agents and brokers.

- **Investing and investment managemen**t - the performance of services that consist of investing and investment management refers to a trade or business involving the receipt of fees for providing investing, asset management, or investment management services, including providing advice with respect to buying and selling investments.

  The performance of services of investing and investment management does not include directly managing real property.

- **Trading** - the performance of services that consist of trading means a trade or business of trading in securities (as defined in section 475(c)(2)), commodities (as defined in section 475(e)(2)), or partnership interests. Whether a person is a trader in securities, commodities, or partnership interests is determined by taking into account all relevant facts and circumstances, including the source and type of profit that is associated with engaging in the activity regardless of whether that person trades for the person's own account, for the account of others, or any combination thereof.

- **Dealing in securities, partnership interests or commodities** – the performance of services that consist of –

  - dealing in securities means regularly purchasing securities from and selling securities to customers in the ordinary course of a trade or business or regularly offering to enter into, assume, offset, assign, or otherwise terminate positions in securities with customers in the ordinary course of a trade or business. Solely for purposes of the preceding sentence, the performance of services to originate a loan is not treated as the purchase of a security from the borrower in determining whether the lender is dealing in securities.

  - dealing in partnership interests means regularly purchasing partnership interests from and selling partnership interests to customers in the ordinary course of a trade or

business or regularly offering to enter into, assume, offset, assign, or otherwise terminate positions in partnership interests with customers in the ordinary course of a trade or business.

- dealing in commodities means regularly purchasing commodities from and selling commodities to customers in the ordinary course of a trade or business or regularly offering to enter into, assume, offset, assign, or otherwise terminate positions in commodities with customers in the ordinary course of a trade or business. Solely for purposes of the preceding sentence, gains and losses from qualified active sales* are not taken into account in determining whether a person is engaged in the trade or business of dealing in commodities.

- **Any trade or business where the principal asset is the reputation or skill of one or more of its employees or owners** - the term any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners means any trade or business that consists of any of the following:
  - a trade or business in which a person receives fees, compensation, or other income for endorsing products or services,
  - a trade or business in which a person licenses or receives fees, compensation, or other income for the use of an individual's image, likeness, name, signature, voice, trademark, or any other symbols associated with the individual's identity, or
  - receiving fees, compensation, or other income for appearing at an event or on radio, television, or another media format.

*The term qualified active sale means the sale of commodities in the active conduct of a commodities business as a producer, processor, merchant, or handler of commodities if the trade or business is as an active producer, processor, merchant or handler of commodities. A hedging transaction is treated as a qualified active sale. The sale of commodities held by a trade or business other than in its capacity as an active producer, processor, merchant, or handler of commodities is not a qualified active sale. For example, the sale by a trade or business of commodities that were held for investment or speculation would not be a qualified active sale.