

American Tax Club, Inc.
(AMERITAX)

2022

Annual Federal Tax Refresher Course
(AFTR)

Annual Filing Season Program (AFSP)

Domain 2 – Part 1: General Review of Tax Return Preparation

Domain 2 of the Annual Federal Tax Refresher (AFTR) Course reviews important concepts and guidelines to preparing individual tax returns.

Objectives

After completing Domain 2 Part 1, participants should be able to:

- List types of taxable income
- Distinguish income that is not taxable
- Recall filing requirements for Schedule B

2.1 Taxability of Earnings Income Overview

A tax return preparer must be able to determine all sources of taxable and nontaxable income. This includes items such as wages, salaries, interest, business income, dividends, Social Security benefits, and pension distributions.

You are generally taxed on income that is available to you, regardless of whether it is actually in your possession.

Income is considered to be either taxable or nontaxable depending on the source of income.

For tax purposes, it is important to differentiate among the various terms used to refer to income. Basic definitions of income include:

- **Gross Income:** All income in the form of money, property, and services not exempt from tax.
- **Earned Income:** Salaries, wages, tips, professional fees, self-employment income, taxable scholarships and grants, and other amounts received as pay for work the taxpayer performs.

- Investment Income: Generally, all income other than salaries, wages, and other amounts received as pay for work actually done.

Investment income includes taxable interest, dividends, capital gains, rental and royalty income, non-qualified annuities., and certain distributions from trusts.

Examples of Taxable and Nontaxable Income

Taxable income includes (but is not limited to):

- Wages, salaries, bonuses, and commissions
- Partnership income
- IRA distributions
- Awards
- Military pay
- Interest
- Severance pays
- Hobby income
- Pensions
- Gambling winnings
- Unemployment compensation
- Dividends
- Asset Dispositions
- Tips and gratuities
- Rewards
- Alimony (finalized before 2019)
- Virtual Currency Transactions

Nontaxable income includes (but is not limited to):

- Child support
- Alimony (finalized or amended after 2018)
- Dividends on life insurance
- Federal tax refunds
- Temporary Assistance for Needy Families (TANF)
- Certain Veterans' benefits
- Welfare payments
- Rental allowance of clergy
- Worker's compensation
- Gifts and bequests.

Employee Compensation Form W-2

Pay an employee received as wages, salaries, tips, and other earnings is considered taxable income. All employed taxpayers should receive Form W-2 from their employer showing the pay received for their services.

Pay is included on line 1 of Form 1040 or 1040-SR. Even if the taxpayer doesn't receive a Form W-2, pay should be included in gross income. If services are performed (not as an independent contractor), and the employer did not withhold Social Security and Medicare taxes from the pay, the taxpayer must file Form 8919, Uncollected Social Security and Medicare Tax on Wages, with the Form 1040 or 1040-SR. These wages must be included on line 1 of Form 1040 or 1040-SR. See Form 8919 for more information.

Advance Commissions and Other Earnings

Cash-method taxpayers who receive advance commissions or other amounts for services to be performed in the future must include them in income for the year received. Accrual-method taxpayers do not have to report income in the year it was received but should report it the year earned.

If unearned commissions or other amounts are repaid in the same year received, reduce the amount included in income by the repayment. If repaid in a later tax year, the repayment can be deducted as an itemized deduction on Schedule A (Form 1040 or 1040-SR), Other Itemized Deductions, line 16, or the taxpayer may be able to take a credit for the repayment, if it is over \$3,000.

Bonuses and Awards

Bonuses or awards received for outstanding work are included in income and should be shown on Form W-2. Bonuses and awards include prizes such as vacation trips for meeting sales goals. If the prize or award received is goods or services, include the fair market value of the goods or services in income. Bonuses or awards are not taxable until received or made available to the taxpayer.

Employee Achievement Award

Per the Tax Cuts & Jobs Act of 2017, if the taxpayer received tangible personal property (other than cash, gift certificates & cards, tickets, vacations, meals, lodging, stocks, bonds, securities, or other equivalent items) as an award for length of service or safety achievement, its value can generally be excluded from income; however, the amount excluded is limited to the employer's cost and cannot be more than \$1,600 for qualified plans (\$400 for awards that are not qualified plan awards) for all such awards received during the year.

The exclusion does not apply to the following awards:

- A length-of-service award if received for fewer than five years of service or if the taxpayer received another length-of-service award during the year or the previous four years
- 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

Severance Pay

Include in income amounts received as severance pay and any payment for the cancellation of an employment contract.

Accrued Leave Payment

A federal employee who receives a lump-sum payment for accrued annual leave when he or she retires or resigns must have these payments included in Form W-2 as wages.

If the taxpayer resigns from one agency and is employed by another agency, the lump-sum annual leave payment may have to be partially repaid to the second agency. Reduce gross wages by the amount repaid in the same tax year the taxpayer received the payment. Attach to the tax return a copy of the receipt or statement given by the agency repaid to explain the difference between the wages on the return and the wages on Form W-2.

Sick Pay

Pay received from employers while the employee is sick or injured is part of salary or wages. Include in income sick-pay benefits received from any of the following payors:

- A welfare funds

- A state sickness or disability fund
- An association of employers or employees
- An insurance company, if employer paid for the plan

NOTE: If the taxpayer paid premiums on an accident or health insurance policy, the benefits received under the policy are not taxable. This includes some state funds paid for with taxes on employee income, paid by employees.

Military Pay

Payments received as a member of a military service generally are taxed as wages except for retirement pay, which is taxed as a pension. Allowances generally are not taxed.

Differential Wage Payments

Any payment made by an employer to an individual, who is an active duty member of the uniformed services for more than 30 days, which represents all or a portion of the wages the individual would have received from the employer for that period, are treated as wages. The payments are subject to income tax withholding but not FICA or FUTA taxes.

Military Retirement Pay

If the retirement pay is based on age or length of service, it is taxable and must be included in income as a pension on lines 5a and 5b of Form 1040 or 1040-SR. Do not include in income the amount of any reduction in retirement or retainer pay to provide a survivor annuity for a spouse or children under the Retired Serviceman's Family Protection Plan or the Survivor Benefit Plan.

Veterans' Benefits

Do not include in income any veterans' benefits paid under any law, regulation, or administrative practice administered by the Department of Veterans Affairs (VA).

Tip Income

All tips received are income and are subject to federal income tax. Include in gross income all tips received directly, charged tips paid by the employer, and the share of any tips received under a tip-splitting or tip pooling arrangement. The value of noncash tips, such as tickets, passes, or other items of value, is also income and subject to tax.

Tip Recordkeeping

Taxpayers who receive tips should keep a daily record. If using an electronic system provided by the employer to record daily tips, taxpayers should get a paper copy of this record.

Recording tips ensures the taxpayer can accurately report tips to the employer, accurately report tips on his or her tax return, and prove the tip income, if the return is ever questioned.

The taxpayer should use the record to track the following on a daily basis:

- Cash tips from customers or from other employees
- Tips from customers who leave a tip through electronic settlement or payment. This includes credit and debit cards, gift cards, or any other electronic payment method.
- The value of any noncash tips received, such as tickets, passes, or other items of value
- Tip amounts received from other employees paid out through tip pools, tip splitting, or other arrangements

Tips Reported to Employer

Taxpayers can use Form 4070A, Employee's Daily Record of Tips to keep track of daily tip activity. Form 4070, Employee's Report of Tips to Employer, is used to report tips monthly to the employer, unless the employer provides a different method of reporting. Tip reports must be submitted to employers by the 10th of the next month (or the next weekday that is not a Saturday, Sunday, or legal holiday).

Taxpayers should follow these guidelines for reporting tips to employers:

- Report only cash, check, debit card, and credit card tips received
- For tip-splitting or tip-pooling arrangements, report only the tips received and retained
- All tips received from other employees must be reported
- Tips paid out to other employees can be deducted
- It's not necessary to report the value of any noncash tips, tickets, or passes to the employer
- If the total of tips for any one month from any one job is less than \$20, the tips do not need to be reported

Taxpayers who do not report tips are subject to a penalty equal to 50% of the Social Security and Medicare taxes or railroad retirement tax owed on the unreported tips. The penalty amount is in addition to taxes owed. If the taxpayer's regular pay is not enough for the employer to withhold all the taxes owed on the pay or the reported tips, taxpayers have until the close of the calendar year to pay the rest of the taxes.

Tips on Tax Return

Tips are reported as wages on Form 1040 or 1040-SR, line 1.

All tips received during the year must be reported on the tax return, including both cash tips and noncash tips. Tips reported to the employer

by the taxpayer for the tax year are included in the wages shown in box 1 of Form W-2. Add to the amount in box 1 any tips not reported to the employer.

If the employer could not collect all the Social Security and Medicare taxes or railroad retirement tax owed on tips reported for the year, the uncollected taxes are shown in box 12 of Form W-2 (codes A and B). These amounts must be reported as other tax on the return.

To report these uncollected taxes, file a return even if the taxpayer would not have to otherwise file. Include the taxes in the total tax amount on Form 1040 or 1040-SR, Schedule 2, line 13.

Allocated Tips

Allocated tips are shown separately in box 8 of Form W-2. These tips are not included in box 1 with wages and reported tips.

All allocated tips must be reported on the tax return, including both cash and non-cash tips. Any tips the taxpayer reported to the employer are included in box 1 of the W-2. Any unreported tips, plus allocated tips from box 8, must be added to wages on Form 1040 or 1040-SR, line 1.

No income, Social Security, or Medicare taxes are withheld on allocated tips. Complete Form 4137 and include the allocated tips on line 1 of the form.

Example:

Valentina began working at the First Star Restaurant on June 30 and received \$10,000 in wages during the year. Valentina kept a daily tip record showing that his tips for June were \$18 and his tips for the rest of the year totaled \$7,000. He was not required to report his June tips to his employer, but he reported all of the rest of his tips to his employer as required.

Valentina's Form W-2 from First Star Restaurant shows \$17,000 (\$10,000 wages plus \$7,000 reported tips) in box 1. Add the \$18 of unreported tips to that amount and report \$17,018 as wages on his tax return.

2.2 Schedule B: Interest, Dividends, Foreign Accounts and Trusts

In general, interest received or credited to an account is taxable; however, there are some exceptions. In addition to keeping any forms showing the amount of interest income received, taxpayers should keep a record of all sources of interest and amounts received during the year.

Interest income is generally not subject to regular withholding; however, it may be subject to backup withholding to ensure that income tax is collected on the income. Under backup withholding, the payor of interest must withhold, as income tax, 28% of the amount paid.

Reporting Interest

Interest income is generally reported on Form 1099-INT or a similar statement by banks, savings and loans, and other payers of interest. This form shows the amount of interest received during the year. If backup withholding is deducted from interest, Form 1099-INT shows the amount withheld as "Federal income tax withheld."

All taxable interest income must be reported, even if the taxpayer didn't receive Form 1099-INT.

Reportable interest income also may be shown on Form 1099-OID, Original Issue Discount.

If a taxpayer received any federally tax-exempt interest such as from municipal bonds, it should be reported on line 2a on Form 1040 or 1040-SR.

General Rules for Interest

Individual Retirement Arrangements (IRAs)

Interest on a Roth IRA generally is not taxable. Interest on a traditional IRA is tax-deferred and generally not included in income until withdrawals are made from the IRA.

Beneficiary of an Estate or Trust

Interest received as a beneficiary of an estate or trust is generally taxable income. The taxpayer should receive Schedule K-1 (Form 1041), Beneficiary's Share of Income, Deductions, Credits, etc., from the fiduciary.

Exempt Interest Dividends

Exempt-interest dividends received from mutual funds or other regulated investment companies are not included in taxable income. Basis is not reduced for distributions that are exempt-interest dividends. Exempt interest dividends are shown in box 12 of Form 1099-DIV.

Although exempt-interest dividends are not taxable, these dividends must be reported if the taxpayer is required to file a tax return. This is an information-reporting requirement and does not change the exempt interest dividends into taxable income. Report exempt-interest dividends on Form 1040, line 2a.

Interest on VA Dividends

Interest on insurance dividends left on deposit with the VA is not taxable. This includes interest paid on dividends on converted United States Government Life Insurance and on National Service Life Insurance policies.

Taxable Interest

Taxable interest includes interest received from bank accounts, loans made to others, and other sources.

Dividends That Are Actually Interest

Certain distributions commonly called dividends are actually interest. Report as interest so-called “dividends” on deposits or on share accounts in:

- Cooperative banks
- Credit unions
- Domestic building and loan associations
- Domestic savings and loan associations
- Federal savings and loan associations
- Mutual savings banks

Money Market Funds

Money market funds pay dividends and are offered by nonbank financial institutions, such as mutual funds and stock brokerage houses. Generally, amounts received from money market funds should be reported as dividends, not as interest.

Gift for Opening an Account

Report as interest the value of non-cash gifts or services received for making deposits or for opening an account in a savings institution.

For deposits of less than \$5,000, gifts or services valued at more than \$10 must be reported as interest. For deposits of \$5,000 or more, gifts or services valued at more than \$20 must be reported as interest. The value is determined by the cost to the financial institution.

Example:

Jessica and her husband Nick each open a savings account. Jessica deposits \$3,500.00 and receives a cup valued at \$15.00. Nick deposits \$5,800 and receives another pen and leather-bound notebook valued at \$40.00. Both Jessica and Nick must report the value of the gifts received.

Certificates of Deposit (Deferred Interest Accounts)

Interest is usually paid at fixed intervals of one year or less during the term of the account. Include this interest in income when it's received or when the interest is entitled to be received without receiving a substantial penalty. The same is true for accounts that mature in one year or less and pay interest in a single payment at maturity.

If interest is deferred for more than one year, see "Original Issue Discount (OID)," later in this course.

- If penalized for early withdrawal, report the total amount of interest paid or credited to the account during the year, without subtracting the penalty.
- If money is borrowed to invest in a certificate of deposit, still report the total interest earned on the certificate in income. Taxpayers who itemize can deduct the interest paid as investment interest, up to the amount of the net investment income.

Interest on Tax Refunds

Interest received on tax refunds is taxable income.

Interest on Condemnation Award

If the condemning authority pays interest to compensate for a delay in payment of an award, the interest is taxable.

Installment Sale Payments

If a contract for the sale or exchange of property provides for deferred payments, it also usually provides for interest payable with the deferred

payments. That interest is taxable when it's received. If the installment sales contract doesn't provide for adequate stated interest, part of the stated principal may be recharacterized as unstated interest or original issue discount for tax purposes, even if you have a loss. You must use the applicable federal rate (AFR) to figure the amount of stated principal recharacterized as unstated interest or original issue discount.

The AFRs are published monthly in the Index of Applicable Federal Rates (AFR) Rulings.

Interest on Annuity Contracts

Accumulated interest on annuity contracts sold before maturity is taxable.

Usurious Interest

Usurious interest is interest charged at an illegal rate. This is taxable as interest unless state law automatically changes it to a payment on the principal.

U.S. Savings Bonds

If the taxpayer is using the accrual method of accounting, interest from U.S. savings bonds must be reported each year as it accrues. Taxpayers cannot postpone reporting interest until it's received or until the bonds mature. If using the cash method of accounting (as most individual taxpayers do), U.S. savings bond interest is generally reported when it's received.

Series H and HH Bonds

Series HH Bonds were issued at face value. Interest is paid twice a year by direct deposit to the taxpayer's bank account. If using the cash method, report interest on these bonds as income on the taxpayer's return the year it was received.

Series I Bonds

Series I bonds were first offered in 1998. These inflation-indexed bonds are issued at their face amount with a maturity period of 30 years. The face value plus all accrued interest is payable at maturity. The interest rate is a combination of a fixed rate plus a variable inflation rate (adjusted semi-annually in May and November).

Series EE and Series I Bonds

Interest on series EE and series I bonds is payable when the bonds are redeemed. The difference between the purchase price and the redemption value is taxable interest.

Series EE bonds

Series EE bonds were first offered in January 1980 and have a maturity period of 30 years.

- Before July 1980, series E bonds were issued. The original 10-year maturity period of series E bonds has been extended to 40 years for bonds issued before December 1965 and 30 years for bonds issued after November 1965.
- Paper series EE and series E bonds are issued at a discount. The face value is payable at maturity.
- Electronic series EE bonds are issued at their face value. The face value plus accrued interest is payable at maturity.

Owners of paper series EE bonds can convert them to electronic bonds. These converted bonds do not retain the denomination listed on the paper certificate but are posted at their purchase price (with accrued interest).

Taxpayers using the cash method of reporting income should report the interest on series EE, series E, and series I bonds using one of the following two methods:

Method 1 - Postpone reporting the interest until the year the bond is cashed or disposed of or the year of maturity, whichever is earlier.

NOTE: Series EE bonds issued in 1983 matured in 2013. If method 1 has been used, the taxpayer generally must report the interest on these bonds on the 2013 return. The last series E bonds were issued in 1980 and matured in 2010. If using method 1, generally the interest should have been reported on the 2010 return.

Method 2 - Choose to report the increase in redemption value as interest each year.

Choose the same reporting method for all series EE, series E, and series I bonds being reported for the taxpayer. If method 2 is not chosen, method 1 must be used.

Example:

Laine owns a \$500.00 U.S. Series EE Savings Bond. She paid \$250.00 for the bond. When the bond matures, Laine will receive \$500.00. At the end of the first year, the bond is worth \$265.00.

Laine can report interest income in one of two ways. She can:

a) Report \$250.00 of interest income only once when the bond matures.

This is the difference between the \$500.00 value at maturity and the \$250.00 she paid for the bond.

b) Report \$15.00 of interest income at the end of the first year.

This is the increase in value at the end of year (\$265.00 minus \$250.00); Laine would report interest income each year until maturity.

Changing Reporting Options (Series EE and Series I)

Change from Method 1

If changing the method of reporting the interest from method 1 to method 2, it is not necessary to get permission from the IRS. In the year of change, report all interest accrued to date and not previously reported for all the bonds.

Once the method has changed to where the interest is reported each year, all series EE, series E, and series I bonds must be reported this way on all future returns, unless permission is granted to change (explained next).

Change from Method 2

To change from Method 2 to Method 1, permission must be granted by the IRS. Permission is requested by either filing Form 3115, Application for Change in Accounting Method, or by submitting a statement to the IRS.

Submitted statements must include the following criteria:

- “131” typed or printed at the top of the page
- Taxpayer’s name and SSN located under the “131”
- The year of change (both the beginning and ending dates)
- The identification of savings bonds for which the change is being requested

The taxpayer must also agree to (a) report all interest on any bonds acquired during or after the year of change when the interest is realized upon disposition, redemption, or final maturity, whichever is earliest, and (b) report all interest on the bonds acquired before the year of change when the interest is realized upon disposition, redemption, or final maturity, whichever is earliest, with the exception of the interest reported in prior tax years.

The statement must be attached to the tax return for the year of change, and the return must be filed by the due date (including extensions). If necessary, an amended return can be filed.

Bonds with Co-Owners

If a U.S. savings bond is issued in the names of co-owners, such as the taxpayer and a child, or the taxpayer and spouse, interest on the bond is generally taxable to the co-owner who bought the bond.

If funds of one taxpayer are used to purchase the bond, taxes must be paid on the interest. This is true even if the taxpayer let the other co-owner redeem the bond and keep all the proceeds. Under these circumstances, the co-owner who redeemed the bond will receive a Form 1099-INT at the time of redemption and must provide the other co-owner with another Form 1099-INT showing the amount of interest from the bond taxable to them.

If each co-owner contributes part of the bond's purchase price, the interest is generally taxable to each co-owner, in proportion to the amount each paid.

If the taxpayer and spouse live in a community property state and hold bonds as community property, one-half of the interest is considered received by each of them. If filing separate returns, each taxpayer generally must report one-half of the bond interest.

If the taxpayer bought series E, series EE, or series I bonds entirely with his or her own funds and had them reissued in a co-owner's name or beneficiary's name alone, include in gross income for the year of reissue all interest earned on these bonds not previously reported; but, if the bonds were reissued in the taxpayer's name alone, the interest accrued does not have to be reported at that time. This same rule applies when bonds (other than bonds held as community property) are transferred between spouses or incident to divorce.

If the co-owners contributed funds to buy series E, series EE, or series I bonds jointly and later had the bonds reissued in one co-owner's name alone, taxpayers must include in gross income for the year of reissue the share earned on the bonds not previously reported.

The former co-owner does not have to include in gross income at the time of reissue his or her share of the interest earned that was not reported before the transfer. This interest, however, as well as all interest earned after the reissue, is income to the former co-owner.

This income-reporting rule also applies when the bonds are reissued in the name a former co-owner and a new co-owner. In this scenario, the new co-owner reports his or her share of the interest earned after the transfer. If bonds that a taxpayer and a co-owner bought jointly are reissued to each separately in the same proportion as his or her contribution to the purchase price, neither co-owner has to report at that time the interest earned before the bonds were reissued.

Bonds Transferred to a Trust

Taxpayers who own series E, series EE, or series I bonds and transfer them to a trust, giving up all rights of ownership, must include in income for that year the interest earned to the date of transfer if it's not already been reported. If, however, the taxpayer is considered the owner of the trust and if the increase in value both before and after the transfer continues to be taxable to him or her, the reporting of interest earned each year can be deferred. In this case, include the total interest in income in the year the taxpayer cashes or disposes of the bonds or the year the bonds finally mature, whichever is early.

Example:

Tina and Betty spent an equal amount to buy a \$1,000.00 series EE savings bond as co-owners. They both postpone reporting interest on the bond. Later, they have the bond reissued as two \$500.00 bonds, one in

each of their names. At that time, neither Tina nor Betty has to report the interest earned to the date of reissue.

Form 1099-INT for U.S. Savings Bonds Interest

When a bond is cashed, the bank or other payor that redeems it must give the taxpayer Form 1099-INT if the interest part of the payment received is \$10 or more. Box 3 of Form 1099-INT should show the interest as the difference between the amounts received and the amount paid for the bond; however, Form 1099-INT might show more interest than what has to be included on the income tax return.

Examples of when can be more interest on the 1099-INT than what must be reported include:

- a) The taxpayer chose to report the increase in the redemption value of the bond each year. The interest shown on form 1099-INT will no be reduced by amounts previously include in income.
- b) The taxpayer received the bond from a decedent. The interest show on the Form 1099-INT will not be reduced by any interest reported by the decedent before death, or on the decedent's final return, or by the estate on the estate's income tax return.
- c) Ownership of the bond was transferred. The interest shown on Form 1099-INT will not be reduced by interest that accrued before the transfer.
- d) The taxpayer was named as a co-owner, and the other co-owner contributed funds to by the bond. The interest shown on Form 1099-INT will not be reduced by the interest portion of the amount received as nominee for the other co-owner.

If a taxpayer received the bond in a taxable distribution from a retirement or profit-sharing plan, the interest shown on Form 1099-INT will not be reduced by the interest portion of the amount taxable as a distribution from the plan and not taxable as interest.

Education Savings Bond Program

All or part of the interest received on the redemption of qualified U.S. savings bonds during the year can be excluded if the taxpayer paid qualified higher educational expenses during the same year. This exclusion is known as the Education Savings Bond Program. Married Filing Separately taxpayers do not qualify for this exclusion.

Form 8815, Exclusion of Interest from Series EE and I US Savings Bonds Issued After 1989 is used to figure the exclusion and must be attached to Form 1040 or 1040-SR.

Taxpayers can take the exclusion if all four of the following apply.

1. Taxpayer cashed qualified U.S. savings bond in current tax year that were issued after 1989.
2. Taxpayer paid qualified higher education expenses in the current year for self, spouse, or dependents.
3. The filing status on the current year return is any status other than married filing separately.
4. The taxpayer's modified adjusted gross income (MAGI) in 2022 is less than \$100,800 if single or head of household, or qualifying widow; \$158,650 if married filing jointly.

Modified AGI, for purposes of this exclusion, is adjusted gross income figured before the interest exclusion, and modified by adding back any:

- Foreign earned income exclusion
- Foreign housing exclusion and deduction
- Exclusion of income for bona fide residents of American Samoa
- Exclusion for income from Puerto Rico

- Exclusion for adoption benefits received under an employer's adoption assistance program
- Deduction for tuition and fees
- Deduction for student loan interest
- Deduction for domestic production activities

What makes the bond qualified?

The U.S. savings bond is a series EE bond issued after 1989 or a series I bond

- The bond is issued either in the taxpayer's name (sole owner) or in the taxpayer and spouse's names (co-owners)
- The taxpayer is at least 24 years old before the bond's issue date
Any individual (including a child) can be the beneficiary of the bond. Qualified Higher Education Expenses

Qualified higher education expenses are tuition and fees required for the taxpayer, the spouse, or their dependent (if claimed as an exemption) to attend an eligible educational institution.

Qualified expenses include any contribution made to a qualified tuition program or to a Coverdell education savings account.

Qualified expenses do not include expenses for room and board or for courses involving sports, games, or hobbies that are not part of a degree or certificate granting program.

Eligible Educational Institutions

Eligible educational institutions include most public, private, and nonprofit universities, colleges, and vocational schools that are accredited and eligible to participate in student aid programs run by the U.S. Department of Education.

Reduction for Certain Benefits

Qualified higher educational expenses must be reduced by all of the following tax-free benefits:

- Tax-free part of scholarships and fellowships
- Expenses used to figure the tax-free portion of distributions from a Coverdell ESA
- Expenses used to figure the tax-free portion of distributions from a qualified tuition program
- Any tax-free payments (other than gifts or inheritances) received for educational expenses, such as veterans' educational assistance benefits, qualified tuition reductions, or employer-provided educational assistance
- Any expense used in figuring the American Opportunity and Lifetime Learning credits

If the total proceeds (interest and principal) from the qualified U.S. savings bonds redeemed during the year are not more than the adjusted qualified higher educational expenses for the year, the taxpayer might be able to exclude all of the interest.

If the proceeds are more than the expenses, the taxpayer might be able to exclude only part of the interest.

Use Form 8815 to determine the maximum excludable amount, including MAGI limitations. Divide the qualified higher education expenses by the proceeds received during the year then multiply that amount by the interest.

Example:

Andy and Bonnie cashed a qualified series EE U.S. savings bond and received \$8,000, \$5,000 which was principal and \$3,000 was interest. During the tax year, they paid \$4,000 of their son's college tuition. They are not claiming an education credit for that amount, their MAGI is within limits, and their son does not have any tax-free educational assistance. They can exclude \$1,500 of interest and must pay tax on the remaining \$1,500 interest.

<p>Interest x (Qualified expenses ÷ Proceeds received during the year)</p>

<p>= amount to exclude from income</p>

<p>\$3,000 × (\$4,000 ÷ \$8,000) = \$1,500</p>

<p>\$3,000 - \$1,500 (amount of interest to exclude) = \$1,500</p>

Reporting Interest Income on Non-Savings Bonds

The reporting of interest income depends on the taxpayer and the method used to report income. Most individuals use the cash method of income reporting; however, some do use the accrual method.

Cash Method

In general, interest income is reported in the year it is actually or constructively received.

Income is constructively received when it is credited to the taxpayer's account or made available to them.

Accrual Method

Interest income is reported when it is earned, not when it is received. Interest is earned over the term of the debt instrument.

Example:

In August of 2019, Joe loaned Terry \$3,500 at 10%, compounded annually. The note stated that principal and interest would be due on August 31, 2021. In 2020, Joe received \$4,222.20 (\$3,500 principal and \$722.20 of interest). If using the cash method, include in income on the 2021 return the \$722.20 interest Joe received that year.

If Joe is using the accrual method, include the interest as it is earned.

For example, in 2019 - \$350; 2020 - \$244.26; and 2021 - \$127.94.

Generally, report all taxable interest income on Form 1040 or 1040-SR, line 2b.

Schedule B

If Schedule B, Interest and Ordinary Dividends, is required, list each player's name and the amount of interest income received from each payer on line 1. If Form 1099-INT or Form 1099- OID is received from a brokerage firm, list the brokerage firm as the payer.

When reporting interest income, complete Schedule B if filing Form 1040 or 1040-SR and any of the following are true:

- Taxable interest income or ordinary dividends is more than \$1,500
- Taxpayer is claiming the interest exclusion under the Education Savings Bond Program from series EE, or I U.S. savings bonds issued after 1989
- Taxpayer received interest from a seller-financed mortgage, and the buyer used the property as a home
- Taxpayer received accrued interest from a bond
- Taxpayer received, as a nominee, interest or ordinary dividends that actually belongs to someone else

- Taxpayer is reporting interest income of less than the amount shown on a Form 1099 due to amortizable bond premium
- Taxpayer is reporting OID in an amount less than the amount shown on Form 1099-OID
- Taxpayer had a financial interest in, or signature authority over, a financial account in a foreign country or received a distribution from, or were a grantor of, or transferor to, a foreign trust

Reporting Tax-Exempt Interest

Total all tax-exempt interest and exempt-interest dividends from all sources as shown in box 8 of Form 1099-INT. For tax-exempt OID on tax-exempt bonds, use box 2 of Form 1099-OID and box 11 of Form 1099-OID. Also include any exempt-interest dividends from a mutual fund or other regulated investment company, as reported in box 11 of Form 1099-DIV. Amounts from box 13, Form 1099-INT are bond premiums on tax-exempt bonds. Bond premiums generally reduce the amount reported on line 2a. Report the net total on line 2a of Form 1040 or 1040- SR.

Box 9 on Form 1099-INT shows the tax-exempt interest subject to the alternative minimum tax on Form 6251, Alternative Minimum Tax—Individuals. It is already included in the amount in box 8. Do not add the amount in box 9 to, or subtract from, the amount in box 8.

Dividend Income

Dividends are distributions of money, stock, or other property paid to a person by a corporation or by a mutual fund. Distributions can consist of cash, more stock, stock rights, other property, or services.

Dividends can be classified as ordinary or qualified. Ordinary dividends are taxable as ordinary income. Qualified dividends meeting certain requirements are taxed at lower capital gains rates.

Most corporations and mutual funds distribute Form 1099-DIV, Dividends and Distributions, to show the distributions made during the year and any tax withheld from the dividend income.

If another person receives distributions as a nominee for the taxpayer, that person will provide a Form 1099-DIV to the taxpayer, which will show distributions received on his or her behalf.

General Rules for Dividend Income Backup Withholding

Dividend income is generally not subject to regular withholding but could be subject to backup withholding to ensure that income tax is collected on the income. Under backup withholding, the payer of dividends must withhold as income tax 24% of the amount paid.

Beneficiaries of an Estate or Trust

Dividends and other distributions received as a beneficiary of an estate or trust are generally taxable income. The taxpayer should receive Schedule K-1 (Form 1041), Beneficiary's Share of Income, Deductions, Credits, etc., from the fiduciary. Schedule K-1 and its instructions discuss how and where to report this income.

Stock Certificate in Two or More Names

If two or more persons hold stock as joint tenants, tenants by the entirety, or tenants in common, each person's share of any dividends from the stock is determined by local law.

Dividends on Stock Sold

If stock is sold, exchanged, or otherwise disposed of after a dividend is declared but before it is paid, the owner of record (usually the payee shown on the dividend check) must include the dividend in income.

Dividends Received in January

If a mutual fund (or other regulated investment company) or real estate investment trust (REIT) declares a dividend (including any exempt interest dividend or capital gain distribution) in October, November, or December that is payable to shareholders of record on a date in one of those months but actually pays the dividend during January of the next calendar year, the dividend is considered received on December 31. Report the dividend in the year it was declared.

Ordinary Dividends

Ordinary dividends are the most common type of distribution from a corporation or a mutual fund. These distributions are paid out of earnings and profits and are ordinary income to the taxpayer and are not capital gains. Ordinary dividends are shown in box 1a of Form 1099-DIV.

Qualified Dividends

Qualified dividends are the ordinary dividends subject to the same 0%, 15%, or 20% maximum tax rate that applies to net capital gains. Qualified dividends should be shown in box 1b of Form 1099-DIV. The tax rate depends on adjusted gross income.

To qualify for the 0%, 15%, or 20% maximum rate, all of the following requirements must be met.

- The dividends must have been paid by a U.S. corporation or a qualified foreign corporation
- The dividends are not of the type listed later under Dividends that are not Qualified Dividends
- The holding period is met

The taxpayer must have held the stock for more than 60 days during the 121-day period that begins 60 days before the ex-dividend date. The

exempt dividend date is the first date following the declaration of a dividend on which the buyer of a stock is not entitled to receive the next dividend payment. Instead, the seller will get the dividend.

When counting the number of days, the taxpayer held the stock, include the day the stock was disposed of, but not the day it was acquired.

In the case of preferred stock, the taxpayer must have held the stock more than 90 days during the 181-day period that begins 90 days before the ex dividend date if the dividends are due to periods totaling more than 366 days. If the preferred dividends are due to periods totaling less than 367 days, the holding period in the previous paragraph applies.

When determining whether the taxpayer met the holding periods, do not count any day during which any of the following conditions are met:

- The taxpayer had the option to sell, was under a contractual obligation to sell, or had made (and not closed) a short sale of substantially identical stock or securities
- The taxpayer was a grantor (writer) of an option to buy substantially identical stock or securities
- The taxpayer's risk of loss is diminished by holding one or more other positions in substantially similar or related property

Dividends that are Not Qualified Dividends

The following dividends are not qualified dividends, even if shown in box 1b of Form 1099-DIV:

- Capital gain distributions
- Dividends paid on deposits with mutual savings banks, cooperative banks, credit unions,

U.S. building and loan associations, U.S. savings and loan associations, federal savings and loan associations, and similar financial institutions (Report these amounts as interest income)

- Dividends from a corporation that is a tax-exempt organization or farmer's cooperative during the corporation's tax year in which the dividends were paid or during the corporation's previous tax year.
- Dividends paid by a corporation on employer securities held on the date of record by an employee stock ownership plan (ESOP) maintained by that corporation.
- Dividends on any share of stock to the extent the person is obligated (whether under a short sale or otherwise) to make related payments for positions in substantially similar or related property.
- Payments in lieu of dividends, but only if it's known or if there is reason to know the payments are not qualified dividends.
- Payments shown in Form 1099-DIV, box 1b, from a foreign corporation to the extent of knowing or having reason to know that the payments are not qualified dividends.

Capital Gain Distributions

Capital gain distributions (also called capital gain dividends) are paid to or credited to an account by mutual funds (or other regulated investment companies) and real estate investment trusts (REITs). These distributions are shown in box 2a of Form 1099-DIV.

Report capital gain distributions as long-term capital gains.

Other Distributions

Taxpayers could receive any of the following distributions during the year.

Exempt-Interest Dividends

Exempt-interest dividends received from mutual funds or other regulated investment companies are not included in taxable income. Exempt interest dividends should be shown in box 12 of Form 1099-DIV. While not taxable, these dividends must be reported on the return.

Exempt-interest dividends paid from specified private activity bonds may be subject to the alternative minimum tax. These are reported in box 13 of Form 1099-DIV.

Dividends on Insurance Policies

Insurance policy dividends the insurer keeps and uses to pay the taxpayer's premiums are not taxable; however, the interest that is paid or credited on dividends left with the insurance company must be reported as taxable interest income. Dividends on an insurance contract (other than a modified endowment contract) distributed to the taxpayer are a partial return of the premiums paid. Do not include in gross income until distributions are more than the total of all net premiums paid for the contract.

Report any taxable distributions from insurance policies on Schedule 1, line 8z.

Dividends on Veterans' Insurance

Neither dividends received on veterans' insurance policies nor interest on dividends left with the Department of Veterans Affairs is taxable.

Patronage Dividends

Generally, patronage dividends received from a cooperative organization are included in income. Do not include in income patronage dividends received on property bought for personal use, or capital assets or depreciable property bought for business use. The basis (cost) of the items bought, however, must be reduced. If the dividend is more than the adjusted basis of the assets, report the excess as income.

Alaska Permanent Fund Dividends

Do not report these amounts as dividends. Instead, report these amounts on Schedule 1, line 8f.

Reporting Dividend Income

Both Ordinary and Qualified Dividends are normally reported on Form 1099-DIV. Qualified dividends are ordinary dividends that are qualified to be taxed under capital gains rates. The qualified dividend amount will never be greater than the ordinary dividend amount reported on the same 1099-DIV.

Report the total qualified dividends on line 3a of Form 1040 or 1040-SR. Ordinary dividends are reported on line 3b.

A taxpayer who owns stock on which he or she received \$10 or more in dividends and other distributions, should receive Form 1099-DIV. Regardless of whether or not a 1099-DIV is received, the taxable dividend income must be reported.

Complete Schedule B, Part II, and attach it to Form 1040 or 1040-SR, if either of the following is true:

- Ordinary dividends (Form 1099-DIV, box 1a) total more than \$1,500
- The taxpayer received, as a nominee, dividends that belonged to someone else Do not include any of the following on line 3a:
 - Qualified dividends received as a nominee
 - Dividends on stock for which the holding period was not met
 - Dividends on any share of stock to the extent the taxpayer is obligated (whether under a short sale or otherwise) to make related payments for positions in substantially similar or related property
 - Payments in lieu of dividends, but only if known or there is reason to know that the payments are not qualified dividends
 - Payments shown in Form 1099-DIV, box 1b, from a foreign corporation to the extent it is known or there is reason to know, that the payments are not qualified dividends

Other Income

Taxable State and Local Refunds

Taxpayers must report all items of income received in the form of money, property and services, unless tax law states otherwise. Some income received is taxable, some income may be partly taxed, and some income can be excluded from being taxed.

Taxable Refunds, Credits, or Offsets of State and Local Taxes

If a taxpayer received a state or local income tax refund (or credit or offset) in the tax year, it must generally be included in income if it was deducted as an itemized deduction in an earlier tax year. The taxpayer should receive Form 1099-G, Certain Government Payments, reporting amounts from the payer.

None of the state tax refund is taxable if the taxpayer did not itemize in the prior tax year or elected to deduct state and local general sales taxes instead of income taxes.

Use the State and Local Income Tax Refund Worksheet (found in Form 1040 or 1040-SR instructions) to determine if the state or local refund is taxable. Taxable amounts should be reported on Schedule 1, line 1.

If choosing to deduct for a tax year either state and local income taxes or state and local general sales taxes, then the maximum amount to include in income is limited to the excess of the tax chosen to be deducted for that year over the tax not chosen to be deducted for that year. In general, if sales tax was deducted in prior year, instead of state and local income tax, the 1099-G payments will not be taxable.

Bartering

Bartering is an exchange of property or services. The fair market value of property or services received in bartering is included in income. If the parties involved agree upon the value of the services, that value is accepted as fair market value unless the value can be shown to be otherwise.

Generally, this income is reported on Schedule C, Profit or Loss from Business; however, if the barter involves an exchange of something other than services, another form or schedule may have to be used.

If you exchanged property or services through a barter exchange, you should expect to receive a Form 1099-B (or a similar statement). Box 13 will show the value of cash, property, services, credits or scrip you received from bartering.

Canceled Debt

Generally, if a debt owed is canceled or forgiven, other than as a gift or bequest, the cancelled amount must be included in income.

If the debt is a nonbusiness debt, report the canceled amount on Schedule 1, line 8c.

If it is a business debt, report the amount on Schedule C if non-farm. Use Schedule F, Profit or Loss from Farming, if the debt is farm debt and the taxpayer is a farmer.

Personal vehicle repossession. If you had a personal vehicle repossessed and disposed of by the lender during the year, you will need to determine your gain or nondeductible loss on the disposition.

If the lender also canceled all or part of the remaining amount of the loan, you may be able to exclude the canceled debt from income if the cancellation occurred in a title 11 bankruptcy case or you were insolvent immediately before the cancellation. You should read Bankruptcy or Insolvency under Exclusions in chapter 1 to see if you can exclude the canceled debt from income under one of those provisions.

Nonbusiness credit card debt cancellation. If you had a nonbusiness credit card debt canceled, you may be able to exclude the canceled debt from income if the cancellation occurred in a title 11 bankruptcy case or you were insolvent immediately before the cancellation. You should read Bankruptcy or Insolvency under Exclusions in chapter 1 to see if you can exclude the canceled debt from income under one of those provisions.

Form 1099-C

If a federal government agency, financial institution, or credit union cancels or forgives a debt of \$600 or more, the taxpayer will receive Form 1099-C, Cancellation of Debt. The amount of the canceled debt is shown in box 2.

If any interest is forgiven and included in the amount of canceled debt in box 2, the amount of interest is also shown in box 3. Whether or not to include the interest portion of the canceled debt in income depends on whether the interest would be deductible if the taxpayer paid it.

If the interest would not be deductible (such as interest on a personal loan), include in income the amount from Form 1099-C, box 2.

If the interest would be deductible (such as on a business loan), include in income the net amount of the canceled debt (the amount shown in box 2 less the interest amount shown in box 3).

Repayment of Canceled Debt

If the canceled amount is included in income, and later the taxpayer pays the debt, a claim for refund can be filed for the year the amount was included in income.

Other cancelled debts can include the following:

- Discounted mortgage loans
- Mortgage relief upon sale or other disposition
- Stockholder debt

Discounted Mortgage Loans

If a financial institution offers a discount for the early payment of a mortgage loan, the amount of the discount is canceled debt and the canceled amount must be included in income.

Mortgage Relief Upon Sale or Other Disposition

If a taxpayer is personally liable for a mortgage (recourse debt), and is relieved of the mortgage, a gain or loss may be realized on the fair market value of the property. To the extent the mortgage discharge exceeds the fair market value of the property, it is income from discharge of indebtedness unless it qualifies for exclusion, discussed later. The income is reported on Schedule 1, line 8c. For taxpayers not personally liable for a mortgage (nonrecourse debt) relieved of mortgage debt (such as through foreclosure), that relief is included in the amount realized. There could be a taxable gain if the amount realized exceeds the adjusted basis in the property. Report any gain on nonbusiness property as a capital gain.

Stockholder Debt

If a corporation cancels or forgives a stockholder's debt, the canceled debt is a constructive distribution that is generally dividend income to the stockholder. If the stockholders cancel a debt owed by the corporation, the stockholder (taxpayer) does not recognize the income. The canceled debt is considered a contribution to the capital of the corporation equal to the amount of debt principal canceled.

Exceptions

There are several exceptions to the inclusion of canceled debt in income. Exceptions are considered before applying exclusions.
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Student loans – Public Service Certain student loans contain a provision that all or part of the debt incurred to attend the qualified educational institution will be canceled if the student works for a certain period of time in certain public service professions for any of a broad class of employers. The canceled amount is not included in income if this provision is part of a loan made by a qualifying institution.

Student Loans. Death or Disability of the Student – For tax years 2018 through 2025, student loan debts cancelled by the death or disability of the student are excluded from gross income.

Deductible debt. The cancellation of a debt is not considered income if the payment of the debt would be deductible (for taxpayers using the cash method of accounting only).

Price reduced after purchase. If the seller reduces the amount of debt owed for property purchased, the reduced amount is not included in income. The reduction is treated as a purchase price adjustment and reduces the basis in the property.

Gifts & Bequests. The cancellation of a debt is not considered income if the lender is treating the cancellation as a gift.

Excluded Debt

For cancelled debt excluded from income under the following provisions, the associated tax attributes (basis, losses, credits, etc.) must be reduced. Report these on Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness.

Do not include a canceled debt in gross income in any of the following situations:

- The debt is canceled in a bankruptcy case under title 11 of the U.S. Code.
- The debt is canceled when the taxpayer is insolvent immediately prior to cancellation (exclude only up to the amount by which the taxpayer is insolvent).
- The debt is qualified farm debt and is canceled by a qualified person.
- The debt is qualified real property business debt.
- VThe debt is qualified principal residence indebtedness.

Life Insurance Proceeds

Life insurance proceeds paid upon the death of an insured are not taxable unless the policy was turned over for a price. If the policy was transferred to you for cash or other valuable consideration, the exclusion for the proceeds is limited to the sum of the consideration you paid, additional premiums you paid, and certain other amounts. This is true even if the proceeds were paid under an accident or health insurance policy or an endowment contract.

However, interest income received as a result of life insurance proceeds may be taxable.

- Lump-sum payment - If death benefits are paid in a lump sum or other than at regular intervals, include in income only the amount of benefits that are more than the amount payable at the time of the insured person's death. If the benefit payable at death is not specified, include in income the benefit payments that are more than the present value of the payments at the time of death.
- Installment payments – If life insurance proceeds are received in installments, exclude part of each installment from income. To determine the excluded part, divide the amount held by the insurance company by the number of installments to be paid. Include anything over this excluded part in income as interest.

NOTE: If insurance proceeds are paid because of the death of a spouse before October 23, 1986, and those payments are received in installments, exclude up to \$1,000 a year of the interest included in the installments, even if the taxpayer remarries.

Surrender of Policy for Cash

If a life insurance policy is surrendered for cash, include in income any proceeds that are more than the cost of the life insurance policy. Taxpayers

should receive Form 1099-R showing the total proceeds and the taxable part. Report these amounts on lines 5a and 5b of Form 1040 or 1040-SR.

Accelerated Death Benefits

Certain amounts paid as accelerated death benefits under a life insurance contract or viatical settlement before the insured's death are excluded from income if the insured is terminally or chronically ill.

- Accelerated death benefits are fully excludable if the insured is a terminally ill individual.
- If the insured is a chronically ill individual who is not terminally ill, accelerated death benefits paid on the basis of costs incurred for qualified long-term care services are fully excludable.

The exclusion does not apply to any amount paid to a person (other than the insured) who has an insurable interest in the life of the insured because the insured is a director, officer, or employee of the person, or has as a financial interest in the person's business.

Public Safety Officer Killed in the Line of Duty

The survivor of a public safety officer killed in the line of duty may be able to exclude from income certain amounts received.

For more information, see Publication 559, Survivors, Executors, and Administrators.

Recoveries

A recovery is a return of an amount either taken as a deduction or a credit in an earlier year. The most common recoveries are refunds, reimbursements, and rebates of deductions itemized on Schedule A. A taxpayer can also have a recovery on previously deducted bad debts or a previously claimed tax credit.

Include a recovery in income the year it's received up to the amount by which the deduction or credit taken for the recovered amount reduced the taxpayer's tax in the earlier year. Any increase to an amount carried over to the current year that resulted from the deduction or credit is considered to have reduced tax in the earlier year.

Mortgage Interest Refund

If the taxpayer received a refund or credit of mortgage interest paid in an earlier year, the amount is shown in box 4 of Form 1098, Mortgage Interest Statement. Do not subtract the refund amount from the interest paid in the current tax year. Certain rules may require it to be included in income.

- Interest on recovery - Interest on any of the amounts recovered must be reported as interest income in the year received. For example, report any interest received on state or local income tax refunds on Form 1040 or 1040-SR, line 2b.
- Recovery and expense in same year - If the refund or other recovery and the expense occur in the same year, the recovery reduces the deduction or credit and is not reported as income.
- Recovery for two or more years - If the taxpayer received a refund or other recovery that is for amounts paid in two or more separate years, allocate, on a pro rata basis, the recovered amount between the years in which it was paid. Information on allocating these amounts can be found in the Recoveries section of Publication 525.

Itemized Deduction Recoveries

Generally, the full amount recovered from a prior year Schedule A deduction must be included in income the year it is received.

Enter state or local income tax refunds on Schedule 1, line 1, and the total of all other recoveries as other income on Schedule 1, line 8z.

Only the amount of itemized deductions that is more than the standard deduction is subject to the recovery rule, unless the taxpayer is required to itemize deductions. If the total deductions on the earlier year return was not more than the total income for that year, include in income this year the lesser of the recoveries or the amount by which the itemized deductions exceeded the standard deduction.

If the taxpayer could claim an additional standard deduction for certain taxes or a net disaster loss, increase the standard deduction for that year.

Recovery Limited to Deduction

Do not include in income any amount of a recovery that is more than the amount deducted in the earlier year. The amount to include in income is limited to the smaller of either the amount deducted on Schedule A (Form 1040 or 1040-SR), or the amount recovered.

Rents from Personal Property

If the taxpayer rents out personal property, such as equipment or vehicles, the income and expenses required to be reported depends on:

- Whether or not the rental activity is a business
- Whether or not the rental activity is conducted for profit

If the primary purpose of renting the property is to produce income or profit and the taxpayer is involved in the rental activity with continuity and regularity, the rental activity is a business. The income and expenses are reported on Schedule C.

If the taxpayer is not in the business of renting personal property, report the rental income on Schedule 1, line 8k. Include the rental expenses in the total amount entered on Schedule 1, line 24b.

Royalties

Royalties from copyrights, patents, and oil, gas, and mineral properties are taxable as ordinary income.

In most cases, royalties are reported in Part I of Schedule E; however, if the taxpayer holds an operating oil, gas, or mineral interest or is in business as a self-employed writer, inventor, artist, etc., report income and expenses on Schedule C.

Welfare and Other Public Assistance Benefits

Governmental benefit payments from a public welfare fund (based upon need, such as payments due to blindness), should not be included in income.

Payments from a state fund for the victims of crime should not be included in the victims' incomes if they are in the nature of welfare payments. Do not deduct medical expenses that are reimbursed by such a fund. Also, include in income any welfare payments that are compensation for services or that are obtained fraudulently.

Alternative Trade Adjustment Assistance (ATAA) Payments

Payments received from a state agency under the Demonstration Project for Alternative Trade Adjustment Assistance for Older Workers (ATAA) must be included in income. The amount to include in income is located on Form 1099-G and should be reported on Schedule 1, line 8z.

Persons with Disabilities

Include in income compensation received for services performed unless the compensation is otherwise excluded. Do not, however, include in income the value of goods, services, and cash received for training and rehabilitation because of a disability. Excludable amounts include payments for transportation and attendant care, such as interpreter

services for the deaf, reader services for the blind, and services to help individuals with an intellectual disability do their work.

Disaster Relief Grants

Do not include post-disaster grants received under the Disaster Relief and Emergency Assistance Act in income if the grant payments are made to help the taxpayer meet necessary expenses or serious needs for medical, dental, housing, personal property, transportation, or funeral expenses.

Disaster Relief Payments

A qualified disaster is:

- A disaster which results from a terrorist or military action
- A federally declared disaster
- A disaster which results from an accident involving a common carrier
- Any event which is determined to be catastrophic by the Secretary of the Treasury or his or her delegate

Exclude from income all qualified disaster relief payments. Exclude payment amounts only to the extent any expense the payments pay for are not paid for by insurance or otherwise.

Other Miscellaneous Income

Home Affordable Modification Program (HAMP)

Benefits from Pay-for-Performance Success Payments under HAMP are not taxable. This program ended in 2016.

Mortgage Assistance Payments

Payments made under section 235 of the National Housing Act for mortgage assistance are not included in the homeowner's income. Interest

paid for the homeowner under the mortgage assistance program cannot be deducted.

Medicare

Medicare benefits received under title XVIII of the Social Security Act are not includible in the gross income of the individuals for whom they are paid. This includes basic (part A (Hospital Insurance Benefits for the Aged)) and supplementary (part B (Supplementary Medical Insurance Benefits for the Aged)).

Old-Age, Survivors, and Disability Insurance Benefits (OASDI)

OASDI payments under section 202 of title II of the Social Security Act are not includible in the gross income of the individuals to whom they are paid.

Nutrition Program for the Elderly

Food benefits received under the Nutrition Program for the Elderly are not taxable. If the taxpayer prepares and serves free meals for the program, include in income as wages the cash pay received, even if the taxpayer is also eligible for food benefits.

Activity Not for Profit

Include in income all payments received from an activity not expected to make a profit. For example, profit from a hobby or a farm operated mostly for recreation and pleasure.

Enter this income on Schedule 1, line 8i.

Campaign Contributions

Contributions are not income to a candidate unless they are diverted to his or her personal use. To be exempt from tax, the contributions must be spent for campaign purposes or kept in a fund for use in future campaigns. However, interest earned on bank deposits, dividends received on

contributed securities, and net gains realized on sales of contributed securities are taxable and must be reported on Form 1120-POL, U.S. Income Tax Return for Certain Political Organizations. Excess campaign funds transferred to an office account must be included in the officeholder's income on, Schedule 1, line 8, in the year transferred.

Child Support Payments

Child support payments are not reported as income on a return.

Court Awards and Damages

To determine if settlement amounts received must be included in income, consider the item that the settlement replaces. The character of the income as ordinary income or capital gain depends on the nature of the underlying claim.

Do not include in income compensatory damages for personal physical injury or physical sickness (whether received in a lump sum or installments).

Damages received for emotional distress due to a physical injury or sickness are not included in income. If the emotional distress is due to a personal injury that is not due to a physical injury or sickness (for example, employment discrimination or injury to reputation), include the damages in income, except for any damages received for medical care due to that emotional distress.

Fees for Services

Include all fees for services in income. Examples of these fees are amounts received for services performed as:

- A corporation director - Report these payments on Schedule C.
- An executor, administrator, or personal representative of an estate - Report fees on Schedule 1, line 8z. If the taxpayer is in the trade or

business of being an executor, report as self-employment income on Schedule C.

- A manager of a trade or business operated before declaring Chapter 11 bankruptcy - Report this income on Schedule 1, line 8.
- A notary public - Report these payments on Schedule C.

Gambling Winnings

Include gambling winnings in income on Schedule 1, line 8b. If itemizing deductions, deduct gambling losses for the year, but only up to the amount of the winnings.

NOTE: Winnings from lotteries and raffles are gambling winnings. In addition to cash winnings, include in income the fair market value of bonds, cars, houses, and other noncash prizes.

If the taxpayer received Form W-2G, Certain Gambling Winnings, showing the amount of gambling winnings and any tax taken out of them, include the amount from box 1 on Schedule 1, line 8b. Include the amount shown in box 4 on Form 1040 or 1040-SR, line 25c, as federal income tax withheld other forms.

Gifts and Inheritances

In most cases, property received as a gift, bequest, or inheritance is not included in income. If, however, the property produces income such as interest, dividends, or rents, that income is taxable. If property is given to a trust and the income from it is paid, credited, or distributed to the taxpayer, that income is also taxable. If the gift, bequest, or inheritance is the income from the property, that income is also taxable.

Jury Duty

Jury duty pay must be included in income on Schedule 1, line 8g. If the pay is turned over to the employer because the employer continues to pay

the taxpayer's salary while serving jury duty, deduct the amount turned over to the employer as an adjustment to income. Enter the amount repaid to the employer on Schedule 1, line 24a.

Medical Savings Accounts (MSAs)

In most cases, do not include in income amounts withdrawn from an Archer MSA or Medicare Advantage MSA if the money is used to pay for qualified medical expenses.

Generally, qualified medical expenses are those that are deductible on Schedule A, Itemized Deductions, which is covered in later in this course.

Prizes and Awards

The fair market value of prizes and awards is reported as income on Schedule 1, line 8h. If the prize is refused, its value does not need to be included in income.

Cash awards or bonuses given by an employer for good work generally must be included in income as wages. However, certain noncash employee achievement awards may be excluded from income.

There are exceptions for Pulitzer, Nobel, and similar prizes if the recipient directs the money to a tax-exempt charity BEFORE receiving it.

Foreign Accounts and Trusts Reporting Foreign Income

Generally, federal law requires U.S. citizens and resident aliens to report any worldwide income, including income from foreign bank accounts, trusts, and securities. In most cases, affected taxpayers must file Schedule B Part III with their federal tax return.

Schedule B Part III must be completed if one of the following applies:

- The taxpayer has over \$1,500 of taxable interest or ordinary dividends
- The taxpayer has a foreign account

- The taxpayer received a distribution from or was a grantor of, or a transferor to, a foreign trust

In addition to Schedule B, Part III certain taxpayers may also have to file Form 8938, Statement of Special Foreign Financial Assets.

Certain taxpayers, living in the United States, holding foreign financial assets with an aggregate value exceeding \$50,000 (\$100,000 MFJ) on the last day of the year, or more than \$75,000 (\$150,000 MFJ) at any time must file Form 8938 with their federal tax return. Different levels apply for taxpayers living outside the United States.

If a taxpayer does have a foreign account, he or she may be required to file Financial Crimes Enforcement Network (FinCEN) Form 114, Report of Foreign Bank and Financial Accounts (FBAR) to report financial interest or signature authority. United States persons with a financial interest in or signature authority over at least one financial account located outside of the United States and the aggregate value of all foreign financial accounts exceeding \$10,000 at any time during the calendar year are required to file an FBAR. Exceptions to filing requirements can be found in the FinCEN FBAR instructions.

FinCEN Form 114 (FBAR) is filed with the Financial Crime Enforcement Network (FinCEN) which is a bureau of the Department of Treasury. The FBAR must be filed on or before April 15 of the year following the calendar year being reported. There is normally an automatic extension until October 15th in most cases.

NOTE: Filing Form 8938 does not replace or affect a taxpayer's obligation to file FinCEN Form 114.

General Terms Concerning Foreign Income

A financial account includes, but is not limited to, these types of accounts maintained with a financial institution or other person performing the services of a financial institution:

- Securities
- Brokerage
- Savings
- Demand
- Checking
- Deposit
- Time deposit

A financial account also includes 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 foreign financial account is considered to be located in a foreign country if the account is physically located outside of the United States.

Signature authority is the authority of an individual to control the disposition of assets held in a foreign financial account by direct communication to the bank or other financial institution that maintains the financial account (certain exceptions apply).

Review question for Domain 2 Part 1 –

Belinda purchased a U.S. savings bond with her own money, but the bond was in both hers and her daughter's Lisa name. After the bond matured, Lisa redeemed the bond and kept all of the proceeds. Who should report the interest earned in the bond?

- a) Belinda
- b) Lisa
- c) Both Belinda and Lisa
- d) Neither Belinda nor Lisa

Review question for Domain 2 Part 1 – Answer keyword**a. Belinda**

Correct. Even if a U.S. savings bond has co-owners, the taxpayer who provided the funds to purchase the bond should report the interest, even if the other owner redeemed the bond.

b. Lisa

Incorrect. Luke would not report the interest because he did not buy the bond.

c. Both Belinda Lisa

Incorrect. If a savings bond is issued in the names of co-owners, the interest is generally reported only by the owner who purchased the bond.

d. Neither Belinda nor Lisa

Incorrect. Interest on a savings bond is usually reportable for the taxpayer who purchased the bond.