American Tax Club, Inc.

(AMERITAX)

2022

Annual Federal Tax Refresher Course

(AFTR)

Annual Filing Season Program (AFSP)

Domain 2 – Part 4: 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 4, participants should be able to:

- Recognize reporting requirements and taxable transactions involving virtual currency
- Recognize AMT exemption and phaseout amounts
- Define the Qualified Business Income (QBI) deduction
- Identify Kiddie Tax modifications
- Understand Section 529 Plans
- Understand Achieving a Better Life Experience (ABLE) accounts
- Recall when cancellation of student debt can be excluded from income
- Understand Net Operating Losses (NOL)
- Recognize Premium Tax Credit reporting requirements
- Identify Employee Fringe Benefits
- Understand depreciation of real property

2.13 **Overview Topics**

2.13.1 Virtual Currency

Virtual currency is a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value. In some

environments, it operates like “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 it does not have legal tender status in the U.S.

Cryptocurrency is a type of virtual currency that utilizes cryptography to validate and secure transactions that are digitally recorded on a distributed ledger, such as a blockchain.

Some examples of virtual currency include:

- Bitcoin (BTC)
- Ripple (XRP)
- Ethereum (ETH)

A transaction involving virtual currency includes:

- The receipt or transfer of virtual currency for free (without providing any consideration), including from an airdrop or following a hard fork
- An exchange of virtual currency for goods or services
- A sale of virtual currency
- An exchange of virtual currency for other property, including for another virtual currency
- Mining of virtual currency, resulting in receipt of virtual currency

On Forms 1040 and 1040-SR there is a question about the buying and selling and otherwise acquiring and disposing of virtual currency. The “Yes” box should be checked if the taxpayer, at any time during the tax year, received, sold, exchanged, or otherwise disposed of any financial interest in any virtual currency.

If taxpayers dispose of virtual currency during the year that was held as a capital asset, capital gains or losses should be calculated on Form 8949. If taxpayers receive virtual currency as compensation for services or dispose of virtual currency that was held for sale in a trade or business, it should be reported on the tax return on the applicable form, such as Schedule C. Any income or gain of virtual currency should be reported the same way taxpayers would report any other type of income.

IRS Notice 2014-21 states that virtual currency is treated as property for the purposes of federal income tax. General tax principles applicable to property transactions apply to transactions using virtual currency.

2.13.2 **Alternative Minimum Tax (AMT)**

The TCJA increased the alternative minimum tax (AMT) exemption amounts and raised the phaseout thresholds for exemptions. AMT exemptions are also permanently indexed for inflation.

For tax year 2022, the statutory exemption amounts are:

- $75,900 single or head of household
- $118,100 married filing jointly or qualifying widow(er)
- $59,050 married filing separately

The above AMT exemptions are reduced by 25% of the amount by which the taxpayer's Alternative Minimum Taxable Income (AMTI) exceeds certain phaseouts. The AMT exemption amount cannot be reduced below zero.

Phaseout amounts are:

- $1,079,800 married filing jointly or qualifying widow(er)
- $539,900 all other taxpayers

2.13.3 Qualified Business Income Deduction

The TCJA introduced a new deduction for noncorporate taxpayers for qualified business income (QBI). This new deduction is sometimes called the "Section 199A" deduction. It is effective for tax years beginning after December 31, 2017.

Under the new law, taxpayers are generally entitled to take a deduction of 20% of qualified business income earned from:

- sole proprietorships reported on Schedule C
- some trusts and estates
- S corporation or partnership
- Qualified rental real estate activity

QBI is defined as the net amount of items of income, gain, deduction, and loss with respect to the trade or business. Certain type of income regarded as investment-related are excluded from QBI, including:

- capital gains or losses
- dividends
- interest income
- employee compensation
- guaranteed payments to a partner

The QBI deduction is usually limited to the lesser of:

- 20% of qualified business income
- 20% of taxable income net of capital gains

If a taxpayer's income exceeds certain threshold amounts ($340,100 for a married filing joint return, $170,050 for other filing statuses) an additional limit is phased in based on:

- the greater of:

o 50% of total W-2 wages paid with respect to the qualified trade or business o Sum of 25% of W-2 wages paid with respect to the qualified trade or business plus 2.5% of unadjusted basis immediately after acquisition of all qualified property plus 25% of qualified REIT dividends and publicly traded partnership income

The phase in is complete for a taxpayer whose taxable income equals or exceeds $440,100 on a joint return or $220,050 for other filing statuses

Taxpayers in service-related businesses are eligible for the QBI deduction; however, for certain specified service trades or businesses the deduction is phased out if the taxpayer's taxable income exceeds $170,050 ($340,100 for married taxpayers filing jointly).

The QBI deduction is available for taxpayers regardless of whether they itemize deductions or take the standard deduction. The deduction reduces taxable income.

Certain dividend income from publicly traded partnerships and Real Estate Investments Trusts also qualifies for the QBI deduction.

There are many complexities involving the QBI deduction. Review IRC Section 199A and the full text of the TCJA for a full understanding of the deduction.

Individuals and eligible estates and trusts that have QBI use Form 8995 to figure the QBI deduction if:

- They have QBI,
- qualified REIT dividends, or
- qualified PTP income or loss (all defined later),
- Their 2022 taxable income before their QBI deduction is less than or equal to $170,050 if single, head of household, qualifying

widow(er), or are a trust or estate, $170,050 if married filing separately, or $340,100 if married filing jointly,

- They aren't a patron in a specified agricultural or horticultural cooperative.

Otherwise, use Form 8995-A, Qualified Business Income Deduction, to figure the QBI deduction.

2.13.4 **Kiddie Tax**

The SECURE Act restated the kiddie tax, which is the tax on certain children with unearned income, applied to the unearned income of any child who:

a) Was under age 19 at the end of the tax year (under age 24 for fulltime students)
b) Had at least one living parent at the end of the tax year
c) Had unearned income more than $2,300 in 2022
d) Didn't file a joint return

The unearned income of the child is taxed at their parents' marginal federal income tax rate (unless the child's rate is higher).

A child's earned income is still to be taxed according to his or her own individual tax bracket. For tax year 2022, the Kiddie Tax rule kicks in when a child's unearned income exceeds $2,300.

Use Form 8615, Tax for Certain Children Who Have Unearned Income, to report and pay tax with the child's tax return. Form 8615 must be filed for any child who meets all of the following conditions:

1. The child had more than $2,300 of unearned income.
2. The child is required to file a tax return.
3. The child either:

a. Was under age 18 at the end of 2022,

b. Was age 18 at the end of 2022 and didn't have earned income that was more than half of the child's support, or

c. Was a full-time student at least age 19 and under age 24 at the end of 2022 and didn't have earned income that was more than half of the child's support.

4. At least one of the child's parents was alive at the end of 2022.

5. The child doesn't file a joint return for 2022.

For these rules, the term "child" includes a legally adopted child and a stepchild. These rules apply whether or not the child is a dependent. These rules don't apply if neither of the child's parents were living at the end of the year.

Use Form 8814, Parents' Election to Report Child's Interest and Dividends, to report and pay tax with the parents' tax return.

2.13.5 **Section 529 Plans**

Qualified tuition programs, also known as "529" plans, provide a tax advantaged savings plan to encourage individuals to save for future education expenses. Anyone can make nondeductible contributions to a 529 plan on behalf of a designated beneficiary. Earnings on contributions generally accumulate tax-free. Distributions from a 529 plan used for the designated beneficiary's qualified education expenses are excludable from income.

Eligible expenses include:

- Tuition, fees, and expenses for books, supplies, and equipment required for enrollment in an eligible institution

- Tuition for enrollment or attendance at an elementary or secondary public, private, or religious school up to $10,000 per year
- Special needs services
- Room and board for a student enrolled at least half-time
- Computer and peripheral equipment, software, and internet access to be used by the beneficiary while enrolled at an eligible post-secondary school.

The SECURE Act expanded the benefits of the 529 plans adding student loan repayments and the cost of an apprenticeship as qualified expenses.

Principal and interest payments made toward a qualified education loan will be considered qualified 529 plan expenses; however, the portion of the payment designated for interest is not eligible for the student loan interest deduction if paid by distributions from a qualified tuition plan. The SECURE Act includes a lifetime limitation of $10,000 in qualified student loan repayments per 529 plan beneficiary and $10,000 for each of the beneficiary's siblings.

The new law also allows for tax-free distributions from 529 plans to pay for fees, books, supplies, and equipment for a registered apprenticeship program.

2.13.6 **ABLE accounts**

Achieving a Better Life Experience (ABLE) accounts are tax-advantaged savings plans for individuals with disabilities and their families. Regardless of state residency, eligible individuals can choose any state's program. Eligible individuals and their families will be allowed to establish ABLE savings accounts that will largely not affect their eligibility for SSI, Medicaid and means-tested programs such as FAFSA, HUD and SNAP/food stamp benefits.

Contributions made to ABLE accounts aren't tax deductible on a taxpayer's federal return, and distributions from ABLE accounts used for qualified disability expenses are generally not taxable.

Generally, the total annual contribution allowed by all participating individuals is the gift tax limit for the tax year. In 2022, that is $16,000. Only one ABLE account is allowed per disabled individual. Note the total limit over time that could be made to an ABLE account will be subject to the individual state and their limit for education-related 529 savings accounts.

The TCJA made some changes to ABLE accounts including a limitation increase for contributions made by the designated beneficiary of the ABLE account. After the overall limitation on contributions is reached, an ABLE account's designated beneficiary can contribute an additional amount up to the lesser of:

- the federal poverty line for a one-person household
- the individual's compensation for the taxable year

The designated beneficiary of an ABLE account can now claim the saver's credit for contributions to his or her ABLE account.

2.13.7 **Cancellation of Student Debt**

The TCJA provides that certain student loans that are discharged on account of death or total and permanent disability are excluded from gross income. This provision applies for debts discharged after December 31, 2017, through December 31, 2025.

In March 2021, the ARPA deemed student loan forgiveness to not be taxable for the period after December 31, 2020, through December 31, 2025, Student loan forgiveness should not be included in gross income as long as there is no provision for the student to provide any services to the

discharging lender. This exclusion applies to both partial and full discharge of loans.

2.13.8 **Net Operating Loss (NOL)**

The special rules in section 172 permitting 5-year carrybacks for 2018, 2019, and 2020 net operating losses (NOLs) added by the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) of 2020 have expired.

Generally, you can only carry NOLs arising in tax years ending after 2020 to a later year.

- The NOL deduction is limited to 80% of taxable income
- An NOL carryforward is adjusted to take into account the 80% limitation
- An NOL may be carried forward indefinitely.

Please note that there is an exception to the new no-carryback provision. Any part of an NOL that is derived from farming loss can be carried back two preceding tax years.

2.13.9 **Premium Tax Credit**

Under the Affordable Care Act, individuals must have minimum essential healthcare coverage, qualify for an exemption or pay a penalty. The TCJA made some considerable changes to those requirements.

For tax year 2018, the requirements of the original Affordable Care Act were still in place. Non- exempt individuals must have minimum essential health coverage or pay the “shared responsibility payment.” The individual shared responsibility payment is the greater of a percentage of household income in excess of filing threshold or a flat dollar amount with the payment capped at the cost of the national average premium for a bronze level plan through the marketplace.

For 2018, the penalties are the greater of:

- 2.5% of household income above filing threshold
- $695 per adult and $347.50 per child with a family maximum of $2,085

For tax years after 2018, the TCJA reduces the individual shared responsibility payment to $0.

Example:

In 2018, Julio, an unmarried man, does not have minimum essential coverage for any month and he does not qualify for an exemption. Julio has no dependents and will file his federal return with a filing status of single.

Julio's household income is $40,000 and his filing threshold is $12,000 (his standard deduction).

To determine Julio's individual shared responsibility payment, first calculate the penalty with percentage of income formula: 2.5% x ($40,000-$12,000) = $700. Then compare it to the flat dollar amount for Julio: $695.

Julio's annual national average for bronze-level coverage for 2018 is $3,355. Because $700 is greater than $695 and doesn't exceed the cost for the national bronze level plan, Julio's shared responsibility payment for 2018 is 700.

In 2022, Julio still does not have minimum essential coverage nor does he qualify for an exemption. His individual shared responsibility payment is $0 because of changes imposed by the TCJA.

Taxpayers who get their health insurance coverage through a Marketplace might be eligible for a premium tax credit. The premium tax credit is a refundable credit intended to help taxpayers with low or moderate income

pay for health insurance premiums. The credit can be paid in advance to the taxpayer's insurance company to lower monthly premiums or can be claimed on the taxpayer's tax return. If the advance payment is selected, the amount paid in advance will be reconciled on the tax return.

To be eligible for the premium tax credit, the taxpayer must generally meet all of the following requirements:

- Health insurance must be purchased through an eligible Health Insurance Marketplace.
- Taxpayer must not be eligible for coverage through an eligible employer or government plan.
- Income must be within certain limits.
- Taxpayer must not file as Married Filing Separately*.
- Taxpayer cannot be claimed as the dependent of another.

*Certain victims of domestic abuse may file as Married Filing Separately and still claim the premium tax credit. See Notice 2014-23 for criteria.

If an individual is eligible for the Premium Tax Credit, he or she can choose to either:

- Get the credit paid in advance directly to his or her insurance company
- Wait to get the credit when his or her tax return is filed

Getting the credit in advance can help lower the monthly premiums and out of pocket expenses. The amount of the credit determined during enrollment at the Marketplace is a projected amount. The actual amount and the credit will be calculated and reconciled on the tax return. If the amount paid in advance was too much, the difference will increase the amount the taxpayer owes, and the tax refund might be reduced or result in a balance due.

If the credit is not paid in advance, it still will be calculated on the tax return and the credit will increase the tax refund or lower the balance due.

Any individual who receives the Premium Tax Credit must file a federal return, even if not otherwise required to do so.

Individuals and families whose household income for the year is between 100% and 400% of the Federal Poverty Line (FPL) for the family size will generally be eligible for the premium tax credit if the other requirements are met.

If an individual was covered by a Marketplace plan at any time during the year, he or she will receive Form 1095-A after the end of the year of coverage reporting information about the coverage. The information on Form 1095-A should be used to reconcile the premium tax credit. In some cases, taxpayers may have received a portion of their premium tax credit in advance to help lower monthly premiums.

Since the premium tax credit is calculated on the tax return, many times the amount paid in advance, if any, is too low or too high. The difference between the premium tax credit calculated on the tax return and the amount paid in advance will affect the amount of the refund or balance due on the tax return. The premium tax credit is reconciled on Form 8962.

If an individual does not reconcile his or her premium tax credit on the tax return, he or she may lose eligibility for the premium tax credit until it is properly reconciled.

In March 2021, the ARPA expanded eligibility for the Premium Tax Credit to individuals with incomes higher than 400% of the FPL. This expansion is only for tax years 2021 and 2022.

Any taxpayer who has received or has been approved to receive unemployment compensation for any week beginning during 2021, the amount of household income is considered to be no greater than 133% of

the federal poverty line. This will generally mean the taxpayer is more likely to qualify for premium tax credit.

2.13.10 **Employee Fringe Benefits**

The TCJA alters the treatment of qualified transportation fringe provided by employers. No deduction will be allowed for amounts incurred or paid after December 31, 2017, for any expenses incurred for providing transportation, or any payment or reimbursement, to an employee of the taxpayer for travel between the employee's residence and place of employment, except as necessary for ensuring the employee's safety.

2.13.11 **Depreciation of Rental Property**

Recovery periods for certain real property improvements have been shortened by the TCJA. For property placed in service after December 31, 2017, the following classes of leasehold improvements have an abbreviated 15-year life with straight-line depreciation:

- qualified leasehold improvements
- qualified retail improvement property
- qualified restaurant property

These three categories are now classified as qualified improvement property. References to qualified leasehold, restaurant, and retail improvements have been eliminated from Section 168.

The TCJA also changes the ADS life of residential and nonresidential property. For residential rental property placed in service after December 31, 2017, the recovery period is shortened from 40 to 30 years. The recovery period for nonresidential rental property remains at 40 years.

Review question for Domain 2 Part 4:

Which is a taxable virtual currency transaction?

a) Buying cryptocurrency with US Dollars.
b) Gifting cryptocurrency in amounts less than the annual gift exclusion.
c) Exchange one cryptocurrency for another.
d) Transferring cryptocurrency from one wallet to another wallet with same owner.

Review question for Domain 2 Part 4 – Answer keywords

a. Buying cryptocurrency with US Dollars

Incorrect. Buying cryptocurrency with fiat currency is not a taxable transaction.

b. Gifting cryptocurrency in amounts less than the annual gift tax exclusion

Incorrect. As long as the amount of the cryptocurrency at the time of the gift is less than the annual gift exclusion ($16,000 in 2022), it is not taxable.

c. Exchange one cryptocurrency for another

Correct. Effectively you are selling one cryptocurrency and buying another with the proceeds. The gain or loss on sale of the first cryptocurrency must be calculated and reported. Depending on the length of time held, there will be a short term or long-term capital gain. The basis in the new cryptocurrency is the FMV at time of purchase.

d. Exchange one cryptocurrency for another

Incorrect. As long as the same cryptocurrency is held, changing the location of where it is held will not be a taxable event.