Adjustments to Income

This self-study course discusses some of the adjustments to income that you can deduct in figuring your adjusted gross income. Also discussed are contributions made to traditional individual retirement arrangements (IRAs), alimony you pay, student loan interest, and business expenses you pay as an Armed Forces reservist, a performing artist, or a fee-basis government official. Though this basic tax course does not require any prerequisites, its recommended target audience is for existing Enrolled Agents, however anyone may take this course. This course provides 5 CE credits in the IRS Federal Tax Law category.

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NOTICE

This course is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional advice and assumes no liability whatsoever in connection with its use. Since laws are constantly changing, and are subject to differing interpretations, we urge you to do additional research and consult appropriate experts before relying on the information contained in this course to render professional advice

Chapter 1: Individual Retirement Arrangements (IRAS)

Chapter Objectives
After completing this chapter, you should be able to:

- Recall the thresholds, requirements, and additional taxes related to individual retirement arrangements.

I. What's New

Traditional IRA contribution and deduction limit. The contribution limit to your traditional IRA for 2024 will be the smaller of the following amounts:

- $7,000, or
- Your taxable compensation for the year.

If you were age 50 or older before 2025, the most that can be contributed to your traditional IRA for 2024 will be the smaller of the following amounts:

- $8,000, or
- Your taxable compensation for the year.

Roth IRA contribution limit. If contributions on your behalf are made only to Roth IRAs, your contribution limit for 2024 will generally be the lesser of:

- $7,000, or
- Your taxable compensation for the year.

If you were age 50 or older before 2025 and contributions on your behalf were made only to Roth IRAs, your contribution limit for 2024 will generally be the lesser of:

- $8,000, or
- Your taxable compensation for the year.

However, if your modified adjusted gross income (AGI) is above a certain amount, your contribution limit may be reduced.

Modified AGI limit for traditional IRA contributions increased. For 2024, if you were covered by a retirement plan at work, your deduction for contributions to a traditional IRA is reduced (phased out) if your modified adjusted gross income (AGI) is:

- More than $123,000 but less than $143,000 for a married couple filing a joint return or a qualifying widow(er),
- More than $77,000 but less than $87,000 for a single individual or head of household, or
- Less than $10,000 for a married individual filing a separate return.

If you either lived with your spouse or file a joint return, and your spouse was covered by a retirement plan at work, but you were not, your deduction is phased out if your AGI is more than $230,000 but less than $240,000. If your AGI is $240,000 or more, you cannot take a deduction for contributions to a traditional IRA.

Modified AGI limit for Roth contributions. For 2024, your Roth IRA contribution limit is reduced (phased out) in the following situations.

- Your filing status is married filing jointly or qualifying widow(er) and your modified AGI is at least $230,000. You cannot make a Roth IRA contribution if your modified AGI is $240,000 or more.
- Your filing status is single, head of household, or married filing separately and you did not live with your spouse at any time in 2024, and your modified AGI is at least $146,000. You cannot make a Roth IRA contribution if your modified AGI is $161,000 or more.
- Your filing status is married filing separately, you lived with your spouse at any time during the year, and your modified AGI is more than -0-. You cannot make a Roth IRA contribution if your modified AGI is $10,000 or more.

II. Important Reminders

SECURE ACT AND SECURE ACT 2.0

Among the provisions of the SECURE Act, for tax years beginning after 2019, the age restriction on contributions to traditional IRAs was repealed, and the age requirement for taking RMDs was increased to 72 (from 70½). Subsequently, among the provisions of the SECURE Act 2.0, signed in December 2022, the age requirement for taking RMDs was increased to 73 for individuals who had not reached age 72 before January 1, 2023.

CORONAVIRUS AID, RELIEF, AND ECONOMIC SECURITY (CARES) ACT

The Coronavirus Aid, Relief, and Economic Security (CARES) Act made additional changes to IRAs and retirement plans. Among the changes are:

- The 10% early distribution penalty for those under 59½ does not apply for coronavirusrelated distributions received in 2020 up to $100,000. In addition, the early withdrawal penalty does not apply to qualified birth or adoption distributions up to $5,000.
- The tax on a coronavirus-related distribution can be spread over three years.
- A coronavirus-related distribution can be recontributed within three years.

Statement of required minimum distribution. If a minimum distribution is required from your IRA, the trustee, custodian, or issuer that held the IRA at the end of the preceding year must either report the amount of the required minimum distribution to you, or offer to calculate it for you. The report or offer must include the date by which the amount must be distributed. The report is due January 31 of the year in which the minimum distribution is required. It can be provided with the year-end fair market value statement that you normally get each year. No report is required for IRAs of owners who have died.

IRA interest. Although interest earned from your IRA is generally not taxed in the year earned, it is not tax-exempt interest. Do not report this interest on your tax return as tax-exempt interest.

Net Investment Income Tax. For purposes of the Net Investment Income Tax (NIIT), net investment income does not include distributions from a qualified retirement plan including IRAs (for example 401(a), 403(a), 403(b), 408, 408A, or 457(b) plans). However, these distributions are taken into account when determining the modified adjusted gross income threshold. Distributions from a nonqualified retirement plan are included in net investment income.

Form 8606. To designate contributions as nondeductible, you must file Form 8606, Nondeductible IRAs.

Tip

The term “50 or older” is used several times in this chapter. It refers to an IRA owner who is age 50 or older by the end of the tax year.

III. Introduction

An individual retirement arrangement (IRA) is a personal savings plan that offers you tax advantages to set aside money for your retirement.

This chapter discusses:

1. The rules for a traditional IRA (any IRA that is not a Roth or SIMPLE IRA), and
2. The Roth IRA, which features nondeductible contributions and tax-free distributions.

Simplified Employee Pensions (SEPs) and Savings Incentive Match Plans for Employees (SIMPLEs) are not discussed in this chapter.

IV. Traditional IRAs

In this chapter, the original IRA (sometimes called an ordinary or regular IRA) is referred to as a "traditional IRA." Two advantages of a traditional IRA are:

1. You may be able to deduct some or all of your contributions to it, depending on your circumstances, and
2. Generally, amounts in your IRA, including earnings and gains, are not taxed until they are distributed.

HOW MUCH CAN BE CONTRIBUTED?

There are limits and other rules that affect the amount that can be contributed and the amount you can deduct. These limits and some of the other rules are explained below.

General limit. For 2024, the most that can be contributed to your traditional IRA generally is the smaller of the following amounts:

1. $7,000 ($8,000 if you are 50 or older in 2024), or
2. Your taxable compensation (defined earlier) for the year.

This is the most that can be contributed regardless of whether the contributions are to one or more traditional IRAs or whether all or part of the contributions are nondeductible. (See Nondeductible Contributions, later.) Qualified reservist payments do not affect this limit.

Example 1

Betty, who is 34 years old and single, earned $24,000 in 2024. Her IRA contributions for 2024 are limited to $7,000.

Example 2

John, an unmarried college student working part time, earned $3,500 in 2024. His IRA contributions for 2024 are limited to $3,500, the amount of his compensation.

Kay Bailey Hutchison Spousal IRA limit. For 2024, if you file a joint return and your taxable compensation is less than that of your spouse, the most that can be contributed for the year to your IRA is the smaller of the following amounts:

1. $8,000 ($8,000 if you are 50 or older).
2. The total compensation includible in the gross income of both you and your spouse for the year, reduced by the following two amounts.
    a) Your spouse's contribution for the year to a traditional IRA.
    b) Any contribution for the year to a Roth IRA on behalf of your spouse.

This means that the total combined contributions that can be made for the year to your IRA and your spouse's IRA can be as much as $14,000 ($15,000 if only one of you is 50 or older, or $16,000 if both of you are 50 or older).

WHEN CAN CONTRIBUTIONS BE MADE?

As soon as you open your traditional IRA, contributions can be made to it through your chosen sponsor (trustee or other administrator). Contributions to a traditional IRA must be in the form of money (cash, check, or money order). Property cannot be contributed.

Contributions must be made by due date. Contributions can be made to your traditional IRA for a year at any time during the year or by the due date for filing your return for that year, not including extensions.

Designating year for which contribution is made. If an amount is contributed to your traditional IRA between January 1 and April 15, you should tell the sponsor which year (the current year or the previous year) the contribution is for. If you do not tell the sponsor which year it is for, the sponsor can assume, and report to the IRS, that the contribution is for the current year (the year the sponsor received it).

Filing before a contribution is made. You can file your return claiming a traditional IRA contribution before the contribution is actually made. Generally, the contribution must be made by the due date of your return, not including extensions.
Contributions not required. You do not have to contribute to your traditional IRA for every tax year, even if you can.

HOW MUCH CAN YOU DEDUCT?
Generally, you can deduct the lesser of:

- The contributions to your traditional IRA for the year, or
- The general limit (or the Kay Bailey Hutchison Spousal IRA limit, if it applies).

However, if you or your spouse was covered by an employer retirement plan, you may not be able to deduct this amount. See Limit If Covered by Employer Plan, later.
Trustees' fees. Trustees' administrative fees that are billed separately and paid in connection with your traditional IRA are not deductible as IRA contributions. You are also not able to deduct these fees as an itemized deduction.
Brokers' commissions. Brokers' commissions are part of your IRA contribution and, as such, are deductible subject to the limits.
Full deduction. If neither you nor your spouse was covered for any part of the year by an employer retirement plan, you can take a deduction for total contributions to one or more traditional IRAs of up to the lesser of:

1. $7,000 ($8,000 if you are 50 or older in 2024), or
2. 100% of your compensation.

This limit is reduced by any contributions made to a 501(c)(18) plan on your behalf.
Kay Bailey Hutchison Spousal IRA. In the case of a married couple with unequal compensation who file a joint return, the deduction for contributions to the traditional IRA of the spouse with less compensation is limited to the lesser of:

1. $7,000 ($8,000 if 50 or older in 2024), or
2. The total compensation includible in the gross income of both spouses for the year reduced by the following three amounts.
    a) The IRA deduction for the year of the spouse with the greater compensation.
    b) Any designated nondeductible contribution for the year made on behalf of the spouse with the greater compensation.
    c) Any contributions for the year to a Roth IRA on behalf of the spouse with the greater compensation.

This limit is reduced by any contributions to a 501(c)(18) plan on behalf of the spouse with the lesser compensation.
Covered by an employer retirement plan. If you or your spouse was covered by an employer retirement plan at any time during the year for which contributions were made, your deduction may be further limited. This is discussed later under Limit If Covered by Employer Plan. Limits on the amount you can deduct do not affect the amount that can be contributed. See Nondeductible Contributions, later.
Defined contribution plan. Generally, you are covered by a defined contribution plan for a tax year if amounts are contributed or allocated to your account for the plan year that ends with or within that tax year.
A defined contribution plan is a plan that provides for a separate account for each person covered by the plan. Types of defined contribution plans include profit-sharing plans, stock bonus plans, and money purchase pension plans.
Defined benefit plan. If you are eligible to participate in your employer's defined benefit plan for the plan year that ends within your tax year, you are covered by the plan. This rule applies even if you:

- Declined to participate in the plan,
- Did not make a required contribution, or

- Did not perform the minimum service required to accrue a benefit for the year.

A defined benefit plan is any plan that is not a defined contribution plan. Defined benefit plans include pension plans and annuity plans.

No vested interest. If you accrue a benefit for a plan year, you are covered by that plan even if you have no vested interest in (legal right to) the account or the accrual.

Limit If Covered by Employer Plan

If either you or your spouse was covered by an employer retirement plan, you may be entitled to only a partial (reduced) deduction or no deduction at all, depending on your income and your filing status. Your deduction begins to decrease (phase out) when your income rises above a certain amount and is eliminated altogether when it reaches a higher amount. These amounts vary depending on your filing status.

To determine if your deduction is subject to phaseout, you must determine your modified adjusted gross income (AGI) and your filing status. Then use Table 1-1 or 17-2 to determine if the phaseout applies.

TABLE 1-1. EFFECT OF MODIFIED AGI[1] ON DEDUCTION IF YOU ARE COVERED BY RETIREMENT PLAN AT WORK

If you are covered by a retirement plan at work, use this table to determine if your modified AGI affects the amount of your deduction.

IF your filing status is...	AND your modified AGI is...	THEN you can take...
single or head of household	$77,000 or less	a full deduction.
	more than $77,000 but less than $87,000	a partial deduction.
	$87,000 or more	no deduction.
married filing jointly or qualifying widow(er)	$123,000 or less	a full deduction.
	more than $123,000 but less than $143,000	a partial deduction.
	$143,000 or more	no deduction.
married filing separately[2]	less than $10,000	a partial deduction.
	$10,000 or more	no deduction.

[1]. Modified AGI (adjusted gross income). See Modified adjusted gross income (AGI).

[2]. If you did not live with your spouse at any time during the year, your filing status is considered Single for this purpose (therefore, your IRA deduction is determined under the "Single" column).

TABLE 1-2. EFFECT OF MODIFIED AGI[1] ON DEDUCTION IF YOU ARE NOT COVERED BY RETIREMENT PLAN AT WORK

If you are not covered by a retirement plan at work, use this table to determine if your modified AGI affects the amount of your deduction.

IF your filing status is...	AND your modified AGI is...	THEN you can take...
single, head of household or qualifying widow(er)	any amount	a full deduction.
married filing jointly or separately with a spouse who is not covered by a plan at work	any amount	a full deduction.
married filing jointly with a spouse who is covered by a plan at work	$230,000 or less	a full deduction.
	more than $230,000 but less than $240,000	a partial deduction.
	$240,000 or more	no deduction.
	less than $10,000	a partial deduction.

married filing separately with a spouse who is covered by a plan at work[2]	$10,000 or more	no deduction.

[1]. Modified AGI (adjusted gross income). See Modified adjusted gross income (AGI).
[2]. You are entitled to the full deduction if you did not live with your spouse at any time during the year.

If your spouse is covered. If you are not covered by an employer retirement plan, but your spouse is, and you did not receive any social security benefits, your IRA deduction may be reduced or eliminated entirely depending on your filing status and modified AGI as shown in Table 1-2.
Filing status. Your filing status depends primarily on your marital status. For this purpose, you need to know if your filing status is single or head of household, married filing jointly or qualifying widow(er), or married filing separately.
Lived apart from spouse. If you did not live with your spouse at any time during the year and you file a separate return, your filing status, for this purpose, is single.
Modified adjusted gross income (AGI). When filing Form 1040 or 1040-SR, refigure the amount on line 11 without taking into account any of the following amounts.

- IRA deduction.
- Student loan interest deduction.
- Foreign earned income exclusion.
- Foreign housing exclusion or deduction.
- Exclusion of qualified savings bond interest shown on Form 8815, Exclusion of Interest From Series EE and I U.S. Savings Bonds Issued After 1989.
- Exclusion of employer-paid adoption expenses shown on Form 8839, Qualified Adoption Expenses.

This is your modified AGI.
Both contributions for 2024 and distributions in 2024. If all three of the following occurred, any IRA distributions you received in 2024 may be partly tax free and partly taxable.

1. You received distributions in 2024 from one or more traditional IRAs.
2. You made contributions to a traditional IRA for 2024.
3. Some of those contributions may be nondeductible contributions.

If all three of the above occurred, you must figure the taxable part of the traditional IRA distribution before you can figure your modified AGI.

NONDEDUCTIBLE CONTRIBUTIONS
Although your deduction for IRA contributions may be reduced or eliminated, contributions can be made to your IRA up to the general limit or, if it applies, the Kay Bailey Hutchison Spousal IRA limit. The difference between your total permitted contributions and your IRA deduction, if any, is your nondeductible contribution.

Example
Mike is 30 years old and single. In 2024, he was covered by a retirement plan at work. His salary was $72,000. His modified AGI was $90,000. Mike made a $7,000 IRA contribution for 2024. Because he was covered by a retirement plan and his modified AGI was over $87,000, he cannot deduct his $7,000 IRA contribution. He must designate this contribution as a nondeductible contribution by reporting it on Form 8606, as explained next.

Form 8606. To designate contributions as nondeductible, you must file Form 8606.
You do not have to designate a contribution as nondeductible until you file your tax return. When you file, you can even designate otherwise deductible contributions as nondeductible.
You must file Form 8606 to report nondeductible contributions even if you do not have to file a tax return for the year.

Tax on earnings on nondeductible contributions. As long as contributions are within the contribution limits, none of the earnings or gains on those contributions (deductible or nondeductible) will be taxed until they are distributed.

Cost basis. You will have a cost basis in your IRA if there are nondeductible contributions. Your cost basis is the sum of the nondeductible contributions to your IRA minus any withdrawals or distributions of nondeductible contributions.

INHERITED IRAs

If you inherit a traditional IRA, you are called a beneficiary. A beneficiary can be any person or entity the owner chooses to receive the benefits of the IRA after he or she dies. Beneficiaries of a traditional IRA must include in their gross income any taxable distributions they receive.

Inherited from spouse. If you inherit a traditional IRA from your spouse, you generally have the following three choices. You can:

1. Treat it as your own IRA by designating yourself as the account owner.
2. Treat it as your own by rolling it over into your IRA, or to the extent it is taxable, into a:
    a) Qualified employer plan,
    b) Qualified employee annuity plan (section 403(a) plan),
    c) Tax-sheltered annuity plan (section 403(b) plan), or
    d) Deferred compensation plan of a state or local government (section 457 plan).
3. Treat yourself as the beneficiary rather than treating the IRA as your own.

Treating it as your own. You will be considered to have chosen to treat the IRA as your own if:

- Contributions (including rollover contributions) are made to the inherited IRA, or
- You do not take the required minimum distribution for a year as a beneficiary of the IRA.

You will only be considered to have chosen to treat the IRA as your own if:

- You are the sole beneficiary of the IRA, and
- You have an unlimited right to withdraw amounts from it.

However, if you receive a distribution from your deceased spouse's IRA, you can roll that distribution over into your own IRA within the 60-day time limit, as long as the distribution is not a required distribution, even if you are not the sole beneficiary of your deceased spouse's IRA.

Inherited from someone other than spouse. If you inherit a traditional IRA from anyone other than your deceased spouse, you cannot treat the inherited IRA as your own. This means that you cannot make contributions to the IRA and you cannot roll over any amounts out of the inherited IRA. However, you can make a trustee-to-trustee transfer as long as the IRA into which amounts are being moved is set up and maintained in the name of the deceased IRA owner for the benefit of you as beneficiary.

CAN YOU MOVE RETIREMENT PLAN ASSETS?

You can transfer, tax free, assets (money or property) from other retirement plans (including traditional IRAs) to a traditional IRA. You can make the following kinds of transfers.

- Transfers from one trustee to another.
- Rollovers.
- Transfers incident to a divorce.

Transfers to Roth IRAs. Under certain conditions, you can move assets from a traditional IRA or from a designated Roth account to a Roth IRA. You can also move assets from a qualified retirement plan to a Roth IRA. See Can You Move Amounts Into a Roth IRA? under Roth IRAs, later.

Trustee-to-Trustee Transfer

A transfer of funds in your traditional IRA from one trustee directly to another, either at your request or at the trustee's request, is not a rollover. This includes the situation where the current trustee issues a check to the new trustee but gives it to you to deposit. Because there is no distribution to you, the transfer is tax free. Because it is not a rollover, it is not affected by the 1-year waiting period required between rollovers, discussed later under Rollover From One IRA Into Another.

Rollovers
Generally, a rollover is a tax-free distribution to you of cash or other assets from one retirement plan that you contribute (roll over) to another retirement plan. The contribution to the second retirement plan is called a "rollover contribution."
Kinds of rollovers to a traditional IRA. You can roll over amounts from the following plans into a traditional IRA:

1. A traditional IRA,
2. An employer's qualified retirement plan for its employees,
3. A deferred compensation plan of a state or local government (section 457 plan), or
4. A tax-sheltered annuity plan (section 403 plan).

Time limit for making a rollover contribution. You generally must make the rollover contribution by the 60th day after the day you receive the distribution from your traditional IRA or your employer's plan.
The IRS may waive the 60-day requirement where the failure to do so would be against equity or good conscience, such as in the event of a casualty, disaster, or other event beyond your reasonable control.
Extension of rollover period. If an amount distributed to you from a traditional IRA or a qualified employer retirement plan is a frozen deposit at any time during the 60-day period allowed for a rollover, special rules extend the rollover period.

Rollover from One IRA Into Another
You can withdraw, tax free, all or part of the assets from one traditional IRA if you reinvest them within 60 days in the same or another traditional IRA. Because this is a rollover, you cannot deduct the amount that you reinvest in an IRA.
Waiting period between rollovers. Generally, if you make a tax-free rollover of any part of a distribution from a traditional IRA, you cannot, within a 1-year period, make a tax-free rollover of any later distribution from that same IRA. You also cannot make a tax-free rollover of any amount distributed, within the same 1-year period, from the IRA into which you made the tax-free rollover.
The 1-year period begins on the date you receive the IRA distribution, not on the date you roll it over into an IRA. Rules apply to the number of rollovers you can have with your traditional IRAs. See Application of one-rollover limitation, below.
Application of one-rollover limitation. You can make only one rollover from an IRA to another (or the same) IRA in any 1-year period, regardless of the number of IRAs you own. The limit applies by aggregating all of an individual's IRAs, including SEP and SIMPLE IRAs, as well as traditional and Roth IRAs, effectively treating them as one IRA for purposes of the limit. However, trustee-to-trustee transfers between IRAs are not limited and rollovers from traditional IRAs to Roth IRAs (conversions) are not limited.
Partial rollovers. If you withdraw assets from a traditional IRA, you can roll over part of the withdrawal tax free and keep the rest of it. The amount you keep will generally be taxable (except for the part that is a return of nondeductible contributions) and may be subject to the 10% additional tax on early distributions, discussed later under What Acts Result in Penalties or Additional Taxes.
Required distributions. Amounts that must be distributed during a particular year under the required distribution rules (discussed later) are not eligible for rollover treatment.
Inherited IRAs. If you inherit a traditional IRA from your spouse, you generally can roll it over, or you can choose to make the inherited IRA your own.

Rollover from Employer's Plan Into an IRA
You can roll over into a traditional IRA all or part of an eligible rollover distribution you receive from your (or your deceased spouse's):

1. Employer's qualified pension, profit-sharing or stock bonus plan,
2. Annuity plan,

3. Tax-sheltered annuity plan (section 403(b) plan), or
4. Governmental deferred compensation plan (section 457 plan).

Eligible rollover distribution. Generally, an eligible rollover distribution is any distribution of all or part of the balance to your credit in a qualified retirement plan except:

1. A required minimum distribution.
2. Hardship distributions.
3. Any of a series of substantially equal periodic distributions paid at least once a year over:
    a) Your lifetime or life expectancy,
    b) The lifetimes or life expectancies of you and your beneficiary, or
    c) A period of 10 years or more.
4. Corrective distributions of excess contributions or excess deferrals, and any income allocable to the excess, or of excess annual additions and any allocable gains.
5. A loan treated as a distribution because it does not satisfy certain requirements either when made or later (such as upon default), unless the participant's accrued benefits are reduced (offset) to repay the loan.
6. Dividends on employer securities.
7. The cost of life insurance coverage.

Transfers Incident to Divorce

If an interest in a traditional IRA is transferred from your spouse or former spouse to you by a divorce or separate maintenance decree or a written document related to such a decree, the interest in the IRA, starting from the date of the transfer, is treated as your IRA. The transfer is tax free.

Converting from Any Traditional IRA to a Roth IRA

Allowable conversions. You can withdraw all or part of the assets from a traditional IRA and reinvest them (within 60 days) in a Roth IRA. The amount that you withdraw and timely contribute (convert) to the Roth IRA is called a conversion contribution. If properly (and timely) rolled over, the 10% additional tax on early distributions will not apply.

Required distributions. You cannot convert amounts that must be distributed from your traditional IRA for a particular year (including the calendar year in which you reach age 73) under the required distribution rules (discussed later).

Income. You must include in your gross income distributions from a traditional IRA that you would have to include in income if you had not converted them into a Roth IRA. These amounts are included in income on your return for the year that you converted them from a traditional IRA to a Roth IRA. You do not include in gross income any part of a distribution from a traditional IRA that is a return of your basis, as discussed later.

If you must include any amount in your gross income, you may have to increase your withholding or make estimated tax payments.

Recharacterizations

You may be able to treat a contribution made to one type of IRA as having been made to a different type of IRA. This is called recharacterizing the contribution.

How to recharacterize a contribution. To recharacterize a contribution, you generally must have the contribution transferred from the first IRA (the one to which it was made) to the second IRA in a trusteeto-trustee transfer. If the transfer is made by the due date (including extensions) for your tax return for the year during which the contribution was made, you can elect to treat the contribution as having been originally made to the second IRA instead of to the first IRA. If you recharacterize your contribution, you must do all three of the following.

- Include in the transfer any net income allocable to the contribution. If there was a loss, the net income you must transfer may be a negative amount.

- Report the recharacterization on your tax return for the year during which the contribution was made.
- Treat the contribution as having been made to the second IRA on the date that it was actually made to the first IRA.

No recharacterizations of conversions made in 2018 or later. A conversion of a traditional IRA to a Roth IRA, and a rollover from any other eligible retirement plan to a Roth IRA, made in tax years beginning after December 31, 2017, cannot be recharacterized as having been made to a traditional IRA.

No deduction allowed. You cannot deduct the contribution to the first IRA. Any net income you transfer with the recharacterized contribution is treated as earned in the second IRA.

How do you recharacterize a contribution? To recharacterize a contribution, you must notify both the trustee of the first IRA (the one to which the contribution was actually made) and the trustee of the second IRA (the one to which the contribution is being moved) that you have elected to treat the contribution as having been made to the second IRA rather than the first. You must make the notifications by the date of the transfer. Only one notification is required if both IRAs are maintained by the same trustee. The notification(s) must include all of the following information.

- The type and amount of the contribution to the first IRA that is to be recharacterized.
- The date on which the contribution was made to the first IRA and the year for which it was made.
- A direction to the trustee of the first IRA to transfer in a trustee-to-trustee transfer the amount of the contribution and any net income (or loss) allocable to the contribution to the trustee of the second IRA.
- The name of the trustee of the first IRA and the name of the trustee of the second IRA.
- Any additional information needed to make the transfer.

Reporting a recharacterization. If you elect to recharacterize a contribution to one IRA as a contribution to another IRA, you must report the recharacterization on your tax return as directed by Form 8606 and its instructions. You must treat the contribution as having been made to the second IRA.

WHEN CAN YOU WITHDRAW OR USE IRA ASSETS?

There are rules limiting use of your IRA assets and distributions from it. Violation of the rules generally results in additional taxes in the year of violation. See What Acts Result in Penalties or Additional Taxes.

Early distributions tax. The 10% additional tax on distributions made before you reach age 59½ does not apply to contributions returned before the due date of the return. However, the distribution of interest or other income must be reported on Form 5329 and, unless the distribution qualifies as an exception to the age 59½ rule, it will be subject to this tax.

WHEN MUST YOU WITHDRAW IRA ASSETS? (REQUIRED MINIMUM DISTRIBUTIONS)

You cannot keep funds in your traditional IRA indefinitely. Eventually they must be distributed. If there are no distributions, or if the distributions are not large enough, you may have to pay a 25% (previously 50%) excise tax on the amount not distributed as required. See Excess Accumulations (Insufficient Distributions), later. The requirements for distributing IRA funds differ depending on whether you are the IRA owner or the beneficiary of a decedent's IRA.

Distributions not eligible for rollover. Amounts that must be distributed (required distributions) during a particular year are not eligible for rollover treatment.

IRA owners. If you are the owner of a traditional IRA, you must start receiving distributions from your IRA by April 1 of the year following the year in which you reach age 72 (73 if you did not reach age 72 before January 1, 2023). April 1 of the year following the year in which you reach age 72 (73 if applicable) is referred to as the required beginning date.

Distributions by the required beginning date. You must receive at least a minimum amount for each year starting with the year you reach age 72 (73 if you did not reach age 72 before January 1, 2023). If

you do not (or did not) receive that minimum amount in the year you became 72 (73 if applicable), then you must receive distributions for the year you become 72 (73 if applicable) by April 1 of the next year. If an IRA owner dies after reaching age 72 (73 if applicable), but before April 1 of the next year, no minimum distribution is required because death occurred before the required beginning date.

Caution!
Even if you begin receiving distributions before you attain age 72 (73 if applicable), you must begin calculating and receiving required minimum distributions by your required beginning date.

Distributions after the required beginning date. The required minimum distribution for any year after the year you turn 72 (73 if applicable) must be made by December 31 of that later year.
Beneficiaries. If you are the beneficiary of a decedent's traditional IRA, the requirements for distributions from that IRA generally depend on whether the IRA owner died before or after the required beginning date for distributions.

ARE DISTRIBUTIONS TAXABLE?
In general, distributions from a traditional IRA are taxable in the year you receive them.

Exceptions
Exceptions to distributions from traditional IRAs being taxable in the year you receive them are:

- Rollovers,
- Qualified charitable distributions, discussed later,
- Tax-free withdrawals of contributions, discussed earlier, and
- The return of nondeductible contributions, discussed later under Distributions Fully or Partly Taxable.

Qualified charitable distributions. A qualified charitable distribution (QCD) is generally a nontaxable distribution made directly by the trustee of your IRA to an organization eligible to receive tax-deductible contributions.
Ordinary income. Distributions from traditional IRAs that you include in income are taxed as ordinary income.
No special treatment. In figuring your tax, you cannot use the 10-year tax option or capital gain treatment that applies to lump-sum distributions from qualified retirement plans.

Distributions Fully or Partly Taxable
Distributions from your traditional IRA may be fully or partly taxable, depending on whether your IRA includes any nondeductible contributions.
Fully taxable. If only deductible contributions were made to your traditional IRA (or IRAs, if you have more than one), you have no basis in your IRA. Because you have no basis in your IRA, any distributions are fully taxable when received.
Partly taxable. If you made nondeductible contributions or rolled over any after-tax amounts to any of your traditional IRAs, you have a cost basis (investment in the contract) equal to the amount of those contributions. These nondeductible contributions are not taxed when they are distributed to you. They are a return of your investment in your IRA.
Only the part of the distribution that represents nondeductible contributions and rolled over after-tax amounts (your cost basis) is tax free. If nondeductible contributions have been made or after-tax amounts have been rolled over to your IRA, distributions consist partly of nondeductible contributions (basis) and partly of deductible contributions, earnings, and gains (if there are any). Until all of your basis has been distributed, each distribution is partly nontaxable and partly taxable.

IRA distributions delivered outside the United States. In general, if you are a U.S. citizen or resident alien and your home address is outside the United States or its possessions, you cannot choose exemption from withholding on distributions from your traditional IRA.

WHAT ACTS RESULT IN PENALTIES OR ADDITIONAL TAXES?

The tax advantages of using traditional IRAs for retirement savings can be offset by additional taxes and penalties if you do not follow the rules. There are additions to the regular tax for using your IRA funds in prohibited transactions. There are also additional taxes for the following activities.

- Investing in collectibles.
- Having unrelated business income.
- Making excess contributions.
- Taking early distributions.
- Allowing excess amounts to accumulate (failing to take required distributions).

There are penalties for overstating the amount of nondeductible contributions and for failure to file a Form 8606, if required.

Prohibited Transactions

Generally, a prohibited transaction is any improper use of your traditional IRA by you, your beneficiary, or any disqualified person.

Disqualified persons include your fiduciary and members of your family (spouse, ancestor, lineal descendant, and any spouse of a lineal descendant).

The following are examples of prohibited transactions with a traditional IRA.

- Borrowing money from it.
- Selling property to it.
- Using it as security for a loan.
- Buying property for personal use (present or future) with IRA funds.

Effect on an IRA account. Generally, if you or your beneficiary engages in a prohibited transaction in connection with your traditional IRA account at any time during the year, the account stops being an IRA as of the first day of that year.

Taxes on prohibited transactions. If someone other than the owner or beneficiary of a traditional IRA engages in a prohibited transaction, that person may be liable for certain taxes. In general, there is a 15% tax on the amount of the prohibited transaction and a 100% additional tax if the transaction is not corrected.

Investment in Collectibles

If your traditional IRA invests in collectibles, the amount invested is considered distributed to you in the year invested. You may have to pay the 10% additional tax on early distributions, discussed later.

Collectibles. These include:

- Artworks,
- Rugs,
- Antiques,
- Metals,
- Gems,
- Stamps,
- Coins,
- Alcoholic beverages, and
- Certain other tangible personal property.

Exception

Your IRA can invest in one, one-half, one-quarter, or one-tenth ounce U.S. gold coins, or one-ounce silver coins minted by the Treasury Department. It can also invest in certain platinum coins and certain gold, silver, palladium, and platinum bullion.

Early Distributions

You must include early distributions of taxable amounts from your traditional IRA in your gross income. Early distributions are also subject to an additional 10% tax.

Early distributions defined. Early distributions are amounts distributed from your traditional IRA account or annuity before you are age 59½.

Age 59½ rule. Generally, if you are under age 59½, you must pay a 10% additional tax on the distribution of any assets (money or other property) from your traditional IRA. Distributions before you are age 59½ are called early distributions.

The 10% additional tax applies to the part of the distribution that you have to include in gross income. It is in addition to any regular income tax on that amount.

Exceptions

There are several exceptions to the age 59½ rule. Even if you receive a distribution before you are age 59½, you may not have to pay the 10% additional tax if you are in one of the following situations.

- You have unreimbursed medical expenses that are more than 7.5% of your adjusted gross income.
- The distributions are not more than the cost of your medical insurance due to a period of unemployment.
- You are totally and permanently disabled.
- You have been certified as having a terminal illness.
- You are the beneficiary of a deceased IRA owner.
- You are receiving distributions in the form of a series of substantially equal periodic payments.
- The distributions are for your qualified higher education expenses.
- You use the distributions to buy, build, or rebuild a first home.
- The distribution is due to an IRS levy of the qualified plan.
- The distribution is a qualified reservist distribution.
- The distribution is a qualified birth or adoption distribution.
- The distribution is a qualified disaster distribution or qualified disaster recovery distribution.
- The distribution is a corrective distribution.

Additional 10% tax. The additional tax on early distributions is 10% of the amount of the early distribution that you must include in your gross income. This tax is in addition to any regular income tax resulting from including the distribution in income.

Nondeductible contributions. The tax on early distributions does not apply to the part of a distribution that represents a return of your nondeductible contributions (basis).

Excess Accumulations (Insufficient Distributions)

You cannot keep amounts in your traditional IRA indefinitely. Generally, you must begin receiving distributions by April 1 of the year following the year in which you reach age 72 (73 if you did not reach age 72 before January 1, 2023). The required minimum distribution for any year after you reach age 72 (73 if applicable) must be made by December 31 of that later year.

Tax on excess. If distributions are less than the required minimum distribution for the year, you may have to pay a 25% excise tax (and possibly 10% if the RMD is timely corrected within 2 years) for that year on the amount not distributed as required.

Note

The penalty for insufficient distributions was reduced in 2023 from 50% by the passage of the SECURE Act 2.0.

V. Roth IRAs

Regardless of your age, you may be able to establish and make nondeductible contributions to a retirement plan called a Roth IRA.

Contributions not reported. You do not report Roth IRA contributions on your return.

WHAT IS A ROTH IRA?

A Roth IRA is an individual retirement plan that, except as explained in this chapter, is subject to the rules that apply to a traditional IRA. It can be either an account or an annuity.

To be a Roth IRA, the account or annuity must be designated as a Roth IRA when it is opened. A deemed IRA can be a Roth IRA, Roth SEP IRA, or a Roth SIMPLE IRA.

Unlike a traditional IRA, you cannot deduct contributions to a Roth IRA. But, if you satisfy the requirements, qualified distributions (discussed later) are tax free. Contributions can be made to your Roth IRA at any age. You can leave amounts in your Roth IRA as long as you live.

WHEN CAN A ROTH IRA BE OPENED?

You can open a Roth IRA at any time. However, the time for making contributions for any year is limited. See When Can You Make Contributions, later under Can You Contribute to a Roth IRA.

CAN YOU CONTRIBUTE TO A ROTH IRA?

Generally, you can contribute to a Roth IRA if you have taxable compensation (defined later) and your modified AGI (defined later) is less than:

- $240,000 for married filing jointly, or qualifying surviving spouse,
- $161,000 for single, head of household, or married filing separately and you did not live with your spouse at any time during the year, and
- $10,000 for married filing separately and you lived with your spouse at any time during the year.

Is there an age limit for contributions? Contributions can be made to your Roth IRA regardless of your age.

Can you contribute to a Roth IRA for your spouse? You can contribute to a Roth IRA for your spouse provided the contributions satisfy the Kay Bailey Hutchison Spousal IRA limit (discussed in How Much Can Be Contributed? under Traditional IRAs), you file jointly, and your modified AGI is less than $240,000.

Compensation. Compensation includes wages, salaries, tips, professional fees, bonuses, and other amounts received for providing personal services. It also includes commissions, self-employment income, nontaxable combat pay, military differential pay, taxable alimony and separate maintenance payments, and taxable non-tuition fellowship and stipend payments.

Modified AGI. Your modified AGI for Roth IRA purposes is your adjusted gross income (AGI) as shown on your return with some adjustments.

How Much Can Be Contributed?

The contribution limit for Roth IRAs generally depends on whether contributions are made only to Roth IRAs or to both traditional IRAs and Roth IRAs.

Roth IRAs only. If contributions are made only to Roth IRAs, your contribution limit generally is the lesser of:

- $7,000 ($8,000 if you are 50 or older in 2024), or
- Your taxable compensation.

However, if your modified AGI is above a certain amount, your contribution limit may be reduced, as explained later under Contribution limit reduced.

Roth IRAs and traditional IRAs. If contributions are made to both Roth IRAs and traditional IRAs established for your benefit, your contribution limit for Roth IRAs generally is the same as your limit would be if contributions were made only to Roth IRAs, but then reduced by all contributions for the year to all IRAs other than Roth IRAs. Employer contributions under a SEP or SIMPLE IRA plan do not affect this limit.

This means that your contribution limit is generally the lesser of:

- $7,000 ($8,000 if you are 50 or older in 2024) minus all contributions (other than employer contributions under a SEP or SIMPLE IRA plan) for the year to all IRAs other than Roth IRAs, or
- Your taxable compensation minus all contributions (other than employer contributions under a SEP or SIMPLE IRA plan) for the year to all IRAs other than Roth IRAs.

However, if your modified AGI is above a certain amount, your contribution limit may be reduced, as explained next under Contribution limit reduced.

Contribution limit reduced. If your modified AGI is above a certain amount, your contribution limit is gradually reduced. Use Table 1-3 to determine if this reduction applies to you.

TABLE 1-3. EFFECT OF MODIFIED AGI ON ROTH IRA CONTRIBUTION

This table shows whether your contribution to a Roth IRA is affected by the amount of your modified adjusted gross income (modified AGI).

IF you have taxable compensation and your filing status is...	AND your modified AGI is...	THEN...
married filing jointly, or qualifying widow(er)	less than $230,000	you can contribute up to $7,000 ($8,000 if you are 50 or older in 2024).
	at least $230,000 but less than $240,000	the amount you can contribute is reduced as explained under Contribution limit reduced in Publication 590-A.
	$240,000 or more	you cannot contribute to a Roth IRA.
married filing separately and you lived with your spouse at any time during the year	zero (-0-)	you can contribute up to $7,000 ($8,000 if you are 50 or older in 2024).
	more than zero (-0-) but less than $10,000	the amount you can contribute is reduced as explained under Contribution limit reduced in Publication 590-A.
	$10,000 or more	you cannot contribute to a Roth IRA.
single, head of household, or married filing separately and you did not live with your spouse at any time during the year	less than $146,000	you can contribute up to $7,000 ($8,000 if you are 50 or older in 2024.
	at least $146,000 but less than $161,000	the amount you can contribute is reduced as explained under Contribution limit reduced in Publication 590-A
	$161,000 or more	you cannot contribute to a Roth IRA.

When Can You Make Contributions?

You can make contributions to a Roth IRA for a year at any time during the year or by the due date of your return for that year (not including extensions).

What If You Contribute Too Much?

A 6% excise tax applies to any excess contribution to a Roth IRA.

Excess contributions. These are the contributions to your Roth IRAs for a year that equal the total of:

1. Amounts contributed for the tax year to your Roth IRAs (other than amounts properly and timely rolled over from a Roth IRA or properly converted from a traditional IRA or rolled over from a qualified retirement plan, as described later) that are more than your contribution limit for the year, plus
2. Any excess contributions for the preceding year, reduced by the total of:
   a) Any distributions out of your Roth IRAs for the year, plus
   b) Your contribution limit for the year minus your contributions to all your IRAs for the year.

CAN YOU MOVE AMOUNTS INTO A ROTH IRA?

Conversions

You may be able to convert amounts from either a traditional, SEP, or SIMPLE IRA into a Roth IRA. You may be able to roll amounts over from a qualified retirement plan to a Roth IRA. You may be able to recharacterize contributions made to one IRA as having been made directly to a different IRA. You can roll amounts over from a designated Roth account or from one Roth IRA to another Roth IRA.

Conversion methods. You can convert amounts from a traditional IRA to a Roth IRA in any of the following three ways.

1. ***Rollover***. You can receive a distribution from a traditional IRA and roll it over (contribute it) to a Roth IRA within 60 days after the distribution.
2. ***Trustee-to-trustee transfer***. You can direct the trustee of the traditional IRA to transfer an amount from the traditional IRA to the trustee of the Roth IRA.
3. ***Same trustee transfer***. If the trustee of the traditional IRA also maintains the Roth IRA, you can direct the trustee to transfer an amount from the traditional IRA to the Roth IRA.

Same trustee. Conversions made with the same trustee can be made by redesignating the traditional IRA as a Roth IRA, rather than opening a new account or issuing a new contract.

Rollover from employer's plan into a Roth IRA. You can roll over into a Roth IRA all or part of an eligible rollover distribution you receive from your (or your deceased spouse's):

- Employer's qualified pension, profit-sharing or stock bonus plan,
- Annuity plan,
- Tax-sheltered annuity plan (section 403(b) plan), or
- Governmental deferred compensation plan (section 457 plan).

Any amount rolled over is subject to the same rules for converting a traditional IRA into a Roth IRA. Also, the rollover contribution must meet the rollover requirements that apply to the specific type of retirement plan.

Income. You must include in your gross income distributions from a qualified retirement plan that you would have had to include in income if you had not rolled them over into a Roth IRA. You do not include in gross income any part of a distribution from a qualified retirement plan that is a return of contributions (after-tax contributions) to the plan that were taxable to you when paid. These amounts are normally included in income on your return for the year you rolled them over from the employer plan to a Roth IRA.

Caution!

If you must include any amount in your gross income, you may have to increase your withholding or make estimated tax payments.

Converting from a SIMPLE IRA. Generally, you can convert an amount in your SIMPLE IRA to a Roth IRA under the same rules explained earlier under Converting from any traditional IRA to a Roth IRA.

However, you cannot convert any amount distributed from the SIMPLE IRA during the 2-year period beginning on the date you first participated in any SIMPLE IRA plan maintained by your employer.

Rollover from a Roth IRA
You can withdraw, tax free, all or part of the assets from one Roth IRA if you contribute them within 60 days to another Roth IRA. Most of the rules for rollovers explained under Rollover From One IRA Into Another under Traditional IRAs, earlier, apply to these rollovers.
Rollover from designated Roth account. A rollover from a designated Roth account can only be made to another designated Roth account or to a Roth IRA.

ARE DISTRIBUTIONS TAXABLE?
You do not include in your gross income qualified distributions or distributions that are a return of your regular contributions from your Roth IRA(s). You also do not include distributions from your Roth IRA that you roll over tax free into another Roth IRA. You may have to include part of other distributions in your income. See Ordering rules for distributions, later.
What are qualified distributions? A qualified distribution is any payment or distribution from your Roth IRA that meets the following requirements.

1. It is made after the 5-year period beginning with the first taxable year for which a contribution was made to a Roth IRA set up for your benefit, and
2. The payment or distribution is:
    a) Made on or after the date you reach age 59½,
    b) Made because you are disabled,
    c) Made to a beneficiary or to your estate after your death, or
    d) To pay up to $10,000 (lifetime limit) of certain qualified first-time homebuyer amounts.

Additional tax on distributions of conversion and certain rollover contributions within 5-year period. If, within the 5-year period starting with the first day of your tax year in which you convert an amount from a traditional IRA or rollover an amount from a qualified retirement plan to a Roth IRA, you take a distribution from a Roth IRA, you may have to pay the 10% additional tax on early distributions. You generally must pay the 10% additional tax on any amount attributable to the part of the amount converted or rolled over (the conversion or rollover contribution) that you had to include in income. A separate 5-year period applies to each conversion and rollover. See Ordering rules for distributions, later, to determine the amount, if any, of the distribution that is attributable to the part of the conversion or rollover contribution that you had to include in income.
Additional tax on other early distributions. Unless an exception applies, you must pay the 10% additional tax on the taxable part of any distributions that are not qualified distributions.
Ordering rules for distributions. If you receive a distribution from your Roth IRA that is not a qualified distribution, part of it may be taxable. There is a set order in which contributions (including conversion contributions) and earnings are considered to be distributed from your Roth IRA. Regular contributions are distributed first.
Must you withdraw or use Roth IRA assets? You are not required to take distributions from your Roth IRA at any age. The minimum distribution rules that apply to traditional IRAs do not apply to Roth IRAs while the owner is alive. However, after the death of a Roth IRA owner, certain of the minimum distribution rules that apply to traditional IRAs also apply to Roth IRAs.

CHAPTER 1: TEST YOUR KNOWLEDGE
The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter (assignment). They are included as an additional tool to enhance your learning experience and do not need to be submitted in order to receive CE credit.
We recommend that you answer each question and then compare your response to the suggested solutions on the following page(s) before answering the final exam questions related to this chapter (assignment).

1. An advantage of a traditional IRA is that generally the amounts in the account, including all earnings and gains, are which of the following:

A. always made up of fully deductible pre-tax contributions
B. never required to be withdrawn by the owner
C. excluded from all taxes by the person inheriting the account from a parent
D. not taxed until the funds are distributed

2. Which of the following statements is <u>not</u> correct regarding when or how contributions to your traditional IRA can be made for 2024:

A. between January 1st and April 15th an account holder can designate the tax year for the contribution
B. filing a tax return extension request will also extend the deadline for an IRA contribution for the same tax year
C. IRA contributions can be made at any age
D. IRA contributions can be skipped for some years and made during others

3. To designate nondeductible contributions made to a traditional IRA, you would need to complete and file which form:

A. Form 1099-R
B. Form 8606
C. Form W-2
D. Form W-4

4. If you inherit a traditional IRA from your spouse, which of the following is <u>not</u> a valid option for handling the account receipt:

A. treat it as your own by designating yourself as the account owner
B. treat required distributions received as additional contributions to your own IRA
C. treat it as your own by rolling it over into your traditional IRA
D. treat yourself as the beneficiary rather than treating the IRA as your own

5. In a typical situation, what is the required waiting period before tax-free IRA rollover funds can be moved tax-free again:

A. six months, starting from the date you receive the IRA distribution
B. one year, starting from the date you receive the IRA distribution
C. eighteen months, starting from the date you receive the IRA distribution
D. two years, starting from the date you receive the IRA distribution

6. You cannot deduct contributions to a Roth IRA <u>except</u> under which of the following situations:

A. after age 72 (73 if applicable)
B. after age 59 and before 72 (73 if applicable)
C. if you satisfy other requirements
D. never; Roth contributions are not deductible

7. What is the final date contributions can be made to a Roth IRA:

A. December 31 of the tax year
B. the due date of the return for that year (not including extensions)
C. the due date of the return for that year including extensions
D. December 31 of the year following the tax year

CHAPTER 1: SOLUTIONS AND SUGGESTED RESPONSES

Below are the solutions and suggested responses for the questions on the previous page(s). If you choose an incorrect answer, you should review the pages as indicated for each question to ensure comprehension of the material.

1.
   A. Incorrect. Depending upon the taxpayer's financial circumstances, not all contributions to traditional IRA accounts will be deductible against taxable income.
   B. Incorrect. Required distributions from traditional IRA accounts must begin upon the owner reaching the age of 72 (73 if the individual had not reached age 72 before January 1, 2023).
   C. Incorrect. Special rules apply to inherited IRAs, however, ultimately the new owner will pay tax on IRA assets once distributions begin.
   D. **CORRECT**. A major advantage of a traditional IRA is that contributions and earnings are not taxed until the funds are distributed.

2.
   A. Incorrect. An IRA account holder can designate the tax year for his or her contribution when it is made between January 1st and April 15th by telling the sponsor. If the tax year is not specified, the sponsor will assume that the reportable tax year equals the date of the receipt of the funds.
   B. **CORRECT**. Contributions can be made to your traditional IRA for a year at any time during the year or by the due date for filing your return for that year, but not including extensions.
   C. Incorrect. Contributions can be made to a traditional IRA for the year, regardless of the individual's age.
   D. Incorrect. Contributions are not required to be made each tax year to your existing traditional IRA account, even if you otherwise qualify that year.

3.
   A. Incorrect. The 1099-R document is issued by the payer of the IRA.
   B. **CORRECT**. Form 8606 must be completed and attached to your return if you made nondeductible contributions. Filing this form is required even if no tax return is due during that tax year.
   C. Incorrect. Form W-2 has no relationship to IRA contributions.
   D. Incorrect. Form W-4 has no relationship to IRA contributions.

4.
   A. Incorrect. Designating yourself as the account owner is one of three valid choices for handling an inherited IRA from your spouse.
   B. **CORRECT**. Utilizing required distributions to fund contributions to another IRA is not generally one of the three valid choices for handling an inherited IRA from a spouse.
   C. Incorrect. Rolling the IRA over into your own traditional IRA is one of three valid choices for handling an inherited IRA from a spouse.
   D. Incorrect. Treating yourself as the beneficiary rather than as owner of the inherited IRA is a valid option and complies with special rules applicable to spouse-inherited IRAs.

5.
   A. Incorrect. Typically, you must wait longer than six months before tax-free IRA rollover funds can be moved tax-free again.
   B. **CORRECT**. Typically, the waiting period before tax-free IRA rollover funds can be moved tax-free again is one year from the date you receive the IRA distribution. You also cannot make a tax-free rollover of any amount distributed, within the same 1-year period, from the IRA into

which you made the tax-free rollover. The 1-year period begins on the date you receive the IRA distribution, not on the date you roll it over into an IRA.

C. Incorrect. The waiting period before tax-free IRA rollover funds can be moved tax-free again is less than eighteen months from the date you receive the IRA distribution.
D. Incorrect. The waiting period before tax-free IRA rollover funds can be moved tax-free again is less than two years from the date you receive the IRA distribution.

6.

A. Incorrect. Contributions to Roth IRAs are never deductible, regardless of the account owner's age.
B. Incorrect. Contributions to Roth IRAs are never deductible, regardless of age.
C. Incorrect. There are no other requirements to satisfy which can make contributions to Roth IRAs deductible.
D. **CORRECT**. Contributions to Roth IRAs are not deductible, but if you satisfy the requirements, qualified distributions are tax free.

7.

A. Incorrect. Contributions can be made later than this date.
B. **CORRECT**. Excess contributions, if any, will be subject to an excise tax.
C. Incorrect. The due date for contributions does not allow for extensions of the return filing.
D. Incorrect. The due date is much earlier than the end of the following year.

Chapter 2: Alimony

Chapter Objective

After completing this chapter, you should be able to:

- Recognize what is and is not alimony.

I. Reminder

Nondeductibility of alimony. Generally, for divorce or separation agreements executed after December 31, 2018, you may no longer deduct an amount equal to the alimony or separate maintenance payments paid during the tax year, nor will the alimony or separate maintenance payments be included in the gross income of the recipient spouse.

II. Introduction

This chapter discusses the rules that apply if you pay or receive alimony. It covers the following topics:

- What payments are alimony,
- What payments are not alimony, such as child support, and
- Whether you must recapture the tax benefits of alimony. Recapture means adding back in your income all or part of a deduction you took in a prior year.

Alimony is a payment to or for a spouse or former spouse under a divorce or separation instrument. It does not include voluntary payments that are not made under a divorce or separation instrument.

For divorce or separation agreements executed before January 1, 2019, alimony is deductible by the payer and must be included in the spouse's or former spouse's income. Although this chapter is generally written for the payer of the alimony, the recipient can use the information to determine whether an amount received is alimony.

To be alimony, a payment must meet certain requirements. Different requirements apply to payments under instruments executed after 1984 and to payments under instruments executed before 1985. This chapter discusses the rules for payments under instruments executed after 1984.

Use Table 2-1 in this chapter as a guide to determine whether certain payments are considered alimony.

TABLE 2-1. ALIMONY REQUIREMENTS (INSTRUMENTS EXECUTED AFTER 1984 AND BEFORE 2019)

Payments ARE alimony if all of the following are true:	Payments are NOT alimony if any of the following are true:
Payments are required by a divorce or separation instrument.	Payments are not required by a divorce or separation instrument.
Payer and recipient spouse do not file a joint return with each other.	Payer and recipient spouse file a joint return with each other.
Payment is in cash (including checks or money orders).	Payment is: • Not in cash, • A noncash property settlement, • Spouse's part of community income, or • To keep up the payer's property.
Payment is not designated in the instrument as not alimony.	Payment is designated in the instrument as not alimony.
Spouses legally separated under a decree of divorce or separate maintenance are not members of the same household.	Spouses legally separated under a decree of divorce or separate maintenance are members of the same household.

Payments are not required after death of the recipient spouse.	Payments are required after death of the recipient spouse.
Payment is not treated as child support.	Payment is treated as child support.
These payments are deductible by the payer and includible in income by the recipient.	These payments are neither deductible by the payer nor includible in income by the recipient.

Definitions. The following definitions apply throughout this chapter.

Spouse or former spouse. Unless stated otherwise in the following discussions about alimony, the term "spouse" includes former spouse.

Divorce or separation instrument. The term "divorce or separation instrument" means:

1. A decree of divorce or separate maintenance or a written instrument incident to that decree,
2. A written separation agreement, or
3. A decree or any type of court order requiring a spouse to make payments for the support or maintenance of the other spouse. This includes a temporary decree, an interlocutory (not final) decree, and a decree of alimony pendente lite (while awaiting action on the final decree or agreement).

III. General Rules

For divorce or separation agreements executed after December 31, 2018, you may no longer deduct an amount equal to the alimony or separate maintenance payments paid during the tax year, nor will the alimony or separate maintenance payments be included in the gross income of the recipient spouse. For divorce or separation agreements executed before January 1, 2019, the following rules apply to alimony.

Payments not alimony. Not all payments under a divorce or separation instrument are alimony. Alimony does not include any of the following.

1. Child support.
2. Noncash property settlements.
3. Payments that are your spouse's part of community income.
4. Payments to keep up the payer's property.
5. Use of the payer's property.

Payments to a third party. Cash payments, checks, or money orders to a third party on behalf of your spouse under the terms of your divorce or separation instrument can be alimony if they otherwise qualify. These include payments for your spouse's medical expenses, housing costs (rent, utilities, etc.), taxes, tuition, etc. The payments are treated as received by your spouse and then paid to the third party.

Life insurance premiums. Alimony includes premiums you must pay under your divorce or separation instrument for insurance on your life to the extent your spouse owns the policy.

Payments for jointly-owned home. If your divorce or separation instrument states that you must pay expenses for a home owned by you and your spouse or former spouse, some of your payments may be alimony.

Mortgage payments. If you must pay all the mortgage payments (principal and interest) on a jointlyowned home, and they otherwise qualify, you can deduct one-half of the total payments as alimony. If you itemize deductions and the home is a qualified home, you can claim half of the interest in figuring your deductible interest. Your spouse must report one-half of the payments as alimony received. If your spouse itemizes deductions and the home is a qualified home, he or she can claim one-half of the interest on the mortgage in figuring deductible interest.

Taxes and insurance. If you must pay all the real estate taxes or insurance on a home held as tenants in common, you can deduct one-half of these payments as alimony. Your spouse must report one-half of these payments as alimony received. If you and your spouse itemize deductions, you can each claim one-half of the real estate taxes and none of the home insurance.

If your home is held as tenants by the entirety or joint tenants, none of your payments for taxes or insurance are alimony. But if you itemize deductions, you can claim all of the real estate taxes and none of the home insurance.

IV. Instruments Executed After 1984 And Before 2019

The following rules for alimony apply to payments under divorce or separation instruments executed after 1984, and before 2019.

Alimony requirements. A payment to or for a spouse under a divorce or separation instrument is alimony if the spouses do not file a joint return with each other and all the following requirements are met.

1. The payment is in cash.
2. The instrument does not designate the payment as not alimony.
3. The spouses are not members of the same household at the time the payments are made. This requirement applies only if the spouses are legally separated under a decree of divorce or separate maintenance.
4. There is no liability to make any payment (in cash or property) after the death of the recipient spouse.
5. The payment is not treated as child support.

Cash payment requirement. Only cash payments, including checks and money orders, qualify as alimony. The following do not qualify as alimony.

- Transfers of services or property (including a debt instrument of a third party or an annuity contract).
- Execution of a debt instrument by the payer.
- The use of the payer’s property.

Payments to a third party. Cash payments to a third party under the terms of your divorce or separation instrument can qualify as a cash payment to your spouse. See Payments to a third party under General Rules, earlier.

Also, cash payments made to a third party at the written request of your spouse qualify as alimony if all the following requirements are met.

1. The payments are in lieu of payments of alimony directly to your spouse.
2. The written request states that both spouses intend the payments to be treated as alimony.
3. You receive the written request from your spouse before you file your return for the year you made the payments.

Child support. A payment that is specifically designated as child support or treated as specifically designated as child support under your divorce or separation instrument is not alimony. The amount of child support may vary from time to time. Child support payments are not deductible by the payer and are not taxable to the recipient.

Specifically designated as child support. A payment will be treated as specifically designated as child support to the extent that the payment is reduced either:

1. On the happening of a contingency relating to your child, or
2. At a time that can be clearly associated with the contingency.

A payment may be treated as specifically designated as child support even if other separate payments are specifically designated as child support.

V. Recapture Rule

If your alimony payments decrease or end during the first 3 calendar years, you may be subject to the recapture rule. If you are subject to this rule, you have to include in income in the third year part of the alimony payments you previously deducted. Your spouse can deduct in the third year part of the alimony payments he or she previously included in income.

The 3-year period starts with the first calendar year you make a payment qualifying as alimony under a decree of divorce or separate maintenance or a written separation agreement. Do not include any time in which payments were being made under temporary support orders. The second and third years are the next 2 calendar years, whether or not payments are made during those years.

The reasons for a reduction or termination of alimony payments that can require a recapture include:

- A change in your divorce or separation instrument,
- A failure to make timely payments,
- A reduction in your ability to provide support, or
- A reduction in your spouse's support needs.

When to apply the recapture rule. You are subject to the recapture rule in the third year if the alimony you pay in the third year decreases by more than $15,000 from the second year or the alimony you pay in the second and third years decreases significantly from the alimony you pay in the first year.

When you figure a decrease in alimony, do not include the following amounts.

1. Payments made under a temporary support order.
2. Payments required over a period of at least 3 calendar years of a fixed part of your income from a business or property, or from compensation for employment or self-employment.
3. Payments that decrease because of the death of either spouse or the remarriage of the spouse receiving the payments before the end of the third year.

Including the recapture in income. If you must include a recapture amount in income, show it on Schedule 1 (Form 1040), line 2a ("Alimony received"). Cross out "received" and enter "recapture." On the dotted line next to the amount, enter your spouse's last name and SSN or ITIN.

Deducting the recapture. If you can deduct a recaptured amount, show it on Schedule 1 (Form 1040), line 19a ("Alimony paid"). Cross out "paid" and enter "recapture." In the space provided, enter your spouse's SSN or ITIN.

CERTAIN RULES FOR INSTRUMENTS EXECUTED OR MODIFIED AFTER 2018

Amounts paid as alimony or separate maintenance payments under a divorce or separation instrument executed after 2018 will not be deductible by the payer. Such amounts also will not be includible in the income of the recipient. The same is true of alimony paid under a divorce or separation instrument executed before 2019 and modified after 2018 if the modification expressly states that the alimony is not deductible to the payer or includible in the income of the recipient. The examples below illustrate the tax treatment of alimony payments under the post-2018 alimony rules. In each of the examples, assume the payments qualify as alimony under the Internal Revenue Code of 1986.

Example 1

On December 2, 2016, a court executed a divorce decree providing for monthly alimony payments beginning January 1, 2017, for a period of 9 years. On May 15, 2024, the court modified the divorce decree to increase the amount of monthly alimony payments. The first increased alimony payment was due on June 1, 2024. The modification did not expressly provide that the post-2018 alimony rules apply to alimony payments made after the date of the modification. Therefore, all alimony payments made in 2024 are includible in the recipient's income and deductible from the payer's income.

Example 2

Assume the same facts as in Example 1 above, except the modification expressly provided that the post-2018 alimony rules apply. The alimony payments made in January 2024 through May 2024 are includible in the recipient's income and deductible from the payer's income. The alimony payments made in June 2024 through December 2024 are neither includible in the recipient's income nor deductible from the payer's income.

Example 3

On December 2, 2016, a couple executed a written separation agreement providing for monthly alimony payments on the first day of each month, beginning January 1, 2017, for a period of 9 years. The written separation agreement set forth that it expires upon the execution of a divorce decree dissolving the couple's marriage. On May 27, 2024, a court executed the divorce decree awarding alimony under the same terms as described in the couple's separation agreement. The alimony payments made in January 2024 through May 2024 under the written separation agreement are includible in the recipient's income and deductible from the payer's income. The court executed the divorce decree after December 31, 2018; therefore, alimony payments made in June 2024 through December 2024 under the divorce decree are neither includible in the recipient's income nor deductible from the payer's income.

Example 4
On October 1, 2018, a couple executed a written separation agreement subject to the laws of State X. The written separation agreement requires a $1,000 monthly alimony payment on the last business day of a month for a period of 6 years. Under the laws of State X, at the time of divorce, a written separation agreement may survive as an independent contract. In the process of obtaining their divorce, the couple decided their separation agreement will remain an independent contract and won't be incorporated or merged into their divorce decree. The court, after acknowledging the separation agreement as fair and equitable, executed a divorce decree on April 1, 2024, dissolving the couple's marriage. The divorce decree did not mention alimony. All alimony payments made in 2024 are includible in the recipient's income and deductible from the payer's income because the alimony payments were made under the written separation agreement that was executed on or before December 31, 2018.

CHAPTER 2: TEST YOUR KNOWLEDGE
The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter (assignment). They are included as an additional tool to enhance your learning experience and do not need to be submitted in order to receive CE credit.
We recommend that you answer each question and then compare your response to the suggested solutions on the following page(s) before answering the final exam questions related to this chapter (assignment).

1. Not all payments under a divorce or separation instrument are alimony. Generally, alimony does <u>not</u> include which of the following:

A. a cash payment required by a separation instrument to your former spouse
B. a cash payment required by a separation instrument to a third party such as a medical insurance company
C. a noncash property settlement required in the divorce decree
D. life insurance premiums you must pay under a divorce agreement

2. All payments under a divorce or separation agreement are considered alimony.

A. true
B. false

CHAPTER 2: SOLUTION AND SUGGESTED RESPONSES
Below are the solutions and suggested responses for the questions on the previous page(s). If you choose an incorrect answer, you should review the pages as indicated for each question to ensure comprehension of the material.

1.

A. Incorrect. A cash payment required by a separation instrument paid to your former spouse with whom you do not file a joint return is considered alimony and is deductible on the payer's tax return.
B. Incorrect. A cash payment required by a separation instrument and paid to a third party for the benefit of a former spouse is generally considered alimony.
C. **CORRECT**. A noncash property settlement required by either a divorce decree or separation instrument is generally not defined as alimony. It therefore cannot be deducted as an alimony payment.
D. Incorrect. Life insurance premiums can be considered alimony in certain situations.

2.

A. Incorrect. There are several types of payments under a divorce or separation agreement that are not considered alimony.
B. **CORRECT**. Child support, noncash property settlements, payments that are the spouse's part of community income, payments to keep up the payer's property, and use of the payer's property are not considered alimony.

Chapter 3: Education-Related Adjustments

Chapter Objective
After completing this chapter, you should be able to:
- Identify education-related adjustments that can be made to income.

I. Educator Expenses

If you were an eligible educator in 2024, you can deduct up to $300 of qualified expenses you paid in 2024 as an adjustment to gross income on Schedule 1 (Form 1040), line 11.
If you and your spouse are filing jointly and both of you were eligible educators, the maximum deduction is $600. However, neither spouse can deduct more than $300 of his or her qualified expenses.
Eligible educator. An eligible educator is a kindergarten through grade 12 teacher, instructor, counselor, principal, or aide in a school for at least 900 hours during a school year.
Qualified expenses. Qualified expenses include ordinary and necessary expenses paid in connection with books, supplies, equipment (including computer equipment, software, and services), and other materials used in the classroom. An ordinary expense is one that is common and accepted in your educational field. A necessary expense is one that is helpful and appropriate for your profession as an educator. An expense does not have to be required to be considered necessary.
Qualified expenses also include those expenses you incur while participating in professional development courses related to the curriculum in which you provide instruction. It also includes those expenses related to those students for whom you provide that instruction.
Qualified expenses do not include expenses for home schooling or for nonathletic supplies for courses in health or physical education. Educator expenses also include the cost of personal protective equipment, disinfectant, and other supplies used for the prevention of the spread of COVID-19 in the classroom.
You must reduce your qualified expenses by the following amounts.
- Excludable U.S. series EE and I savings bond interest from Form 8815.
- Nontaxable qualified tuition program earnings.
- Nontaxable earnings from a Coverdell education savings account (ESA).
- Any reimbursements you received for these expenses that were not reported to you in box 1 of your Form W-2.

II. Student Loan Interest Deduction

Generally, personal interest you pay, other than certain mortgage interest, is not deductible on your tax return. However, if your modified adjusted gross income (MAGI) is less than $95,000 ($195,000 if filing a joint return) there is a special deduction allowed for paying interest on a student loan (also known as an education loan) used for higher education. For most taxpayers, MAGI is the adjusted gross income as figured on their federal income tax return before subtracting any deduction for student loan interest. This deduction can reduce the amount of your income subject to tax by up to $2,500. Table 3-1 summarizes the features of the student loan interest deduction.

TABLE 3-1. STUDENT LOAN INTEREST DEDUCTION AT A GLANCE
Do not rely on this table alone. Refer to the text for more details.

Feature	Description
Maximum benefit	You can reduce your income subject to tax by up to $2,500.
Loan qualifications	Your student loan:

	• Must have been taken out solely to pay qualified education expenses, and • Cannot be from a related person or made under a qualified employer plan.
Student qualifications	The student must be: • You, your spouse, or your dependent, and • Enrolled at least half-time in a program leading to a degree, certificate, or other recognized educational credential at an eligible educational institution.
Limit on modified adjusted gross income (MAGI)	$195,000 if married filing a joint return; $95,000 if single, head of household, or qualifying widow(er)

STUDENT LOAN INTEREST DEFINED

Student loan interest is interest you paid during the year on a qualified student loan. It includes both required and voluntary interest payments.

Qualified Student Loan

This is a loan you took out solely to pay qualified education expenses (defined later) that were:

- For you, your spouse, or a person who was your dependent when you took out the loan,
- Paid or incurred within a reasonable period of time before or after you took out the loan, and
- For education provided during an academic period when the student is an eligible student.

Loans from the following sources are not qualified student loans:

- A related person.
- A qualified employer plan.

Reasonable period of time. Qualified education expenses are treated as paid or incurred within a reasonable period of time before or after you take out the loan if they are paid with the proceeds of student loans that are part of a federal postsecondary education loan program.

Even if not paid with the proceeds of that type of loan, the expenses are treated as paid or incurred within a reasonable period of time if both of the following requirements are met.

1. The expenses relate to a specific academic period, and
2. The loan proceeds are disbursed within a period that begins 90 days before the start of that academic period and ends 90 days after the end of that academic period.

If neither of the above situations applies, the reasonable period of time usually is determined based on all the relevant facts and circumstances.

Academic period. An academic period includes a semester, trimester, quarter, or other period of study (such as a summer school session) as reasonably determined by an educational institution. If an educational institution that uses credit hours or clock hours and does not have academic terms, each payment period can be treated as an academic period.

Eligible student. An eligible student is a student who was enrolled at least half-time in a program leading to a degree, certificate, or other recognized educational credential.

Enrolled at least half-time. A student was enrolled at least half-time if the student was taking at least half the normal full-time work load for his or her course of study.

The standard for what is half of the normal full-time work load is determined by each eligible educational institution. However, the standard may not be lower than any of those established by the Department of Education under the Higher Education Act of 1965.

Qualified employer plan. You cannot deduct interest on a loan made under a qualified employer plan or under a contract purchased under such a plan.

Qualified Education Expenses

Generally, for purposes of the student loan interest deduction, these expenses are the total costs of attending an eligible educational institution, including graduate school. They include amounts paid for the following items.

- Tuition and fees.
- Room and board.
- Books, supplies, and equipment.
- Other necessary expenses (such as transportation).

The cost of room and board qualified only to the extent that it is not more than:

- The allowance for room and board, as determined by the eligible educational institution, that was included in the cost of attendance (for federal financial aid purposes) for a particular academic period and living arrangement of the student.
- If greater, the actual amount charged if the student is residing in housing owned or operated by the eligible educational institution.

Include as Interest

In addition to simple interest on the loan, if all other requirements are met, the items discussed below can be student loan interest.

Loan origination fee. In general, this is a one-time fee charged by the lender when a loan is made. To be deductible as interest, a loan origination fee must be for the use of money rather than for property or services (such as commitment fees or processing costs) provided by the lender. A loan origination fee treated as interest accrues over the life of the loan.

Capitalized interest. This is unpaid interest on a student loan that is added by the lender to the outstanding principal balance of the loan.

Interest on revolving lines of credit. This interest, which includes interest on credit card debt, is student loan interest if the borrower uses the line of credit (credit card) only to pay qualified education expenses. See Qualified Education Expenses, earlier.

Interest on refinanced and consolidated student loans. This includes interest on a loan used solely to refinance a qualified student loan of the same borrower. It also includes a single consolidation loan used solely to refinance two or more qualified student loans of the same borrower.

Caution!

If you refinance a qualified student loan for more than your original loan and you use the additional amount for any purpose other than qualified education expenses, you cannot deduct any interest paid on the refinanced loan.

Do Not Include as Interest

You cannot claim a student loan interest deduction for any of the following items:

- Interest you paid on a loan if, under the terms of the loan, you are not legally obligated to make interest payments.
- Loan origination fees that are payments for property or services provided by the lender, such as commitment fees or processing costs.
- Interest you paid on a loan to the extent payments were made through your participation in the National Health Service Corps Loan Repayment Program (the "NHSC Loan Repayment Program") or certain other loan repayment assistance programs.

HOW MUCH CAN YOU DEDUCT

Your student loan interest deduction for 2024 is generally the smaller of:

- $2,500, or
- The interest you paid in 2024.

However, the amount determined above is phased out (gradually reduced) if your MAGI is between $80,000 and $95,000 ($165,000 and $195,000 if you file a joint return). You cannot take a student loan interest deduction if your MAGI is $95,000 or more ($195,000 or more if you file a joint return).

III. Tuition And Fees Deduction

Note
The tuition and fees deduction was repealed by the Further Consolidated Appropriations Act, 2021. However, there are other educational tax-savers available in 2024, including the American opportunity credit and the lifetime learning credit.

CHAPTER 3: TEST YOUR KNOWLEDGE
The following question is designed to ensure that you have a complete understanding of the information presented in the chapter (assignment). It is included as an additional tool to enhance your learning experience and does not need to be submitted in order to receive CE credit.
We recommend that you answer the question and then compare your response to the suggested solution on the following page before answering the final exam question(s) related to this chapter (assignment).

1. A deduction for student loan interest paid can be claimed for taxpayers with a MAGI of less than how much:

A. $95,000 for single filing taxpayers
B. $195,000 if filing a joint return
C. both A and B are correct
D. none of the above; student loan interest is considered personal interest that is not deductible

CHAPTER 3: SOLUTION AND SUGGESTED RESPONSES
Below is the solution and suggested responses for the question on the previous page. If you choose an incorrect answer, you should review the page(s) as indicated for the question to ensure comprehension of the material.

1.

A. Incorrect. This MAGI amount (less than $95,000) is correct for a single filer, but this is not the best answer.
B. Incorrect. This MAGI amount (less than $195,000) is correct for married joint filers, but this is not the best answer.
C. **CORRECT**. The student loan interest deduction is limited to taxpayers whose MAGI is less than $95,000 for single filers and $195,000 for married filing jointly.
D. Incorrect. If a taxpayer meets certain caps mentioned previously, a special deduction is allowed for paying interest on a student/educational loan used for higher education.

Chapter 4: Other Adjustments To Income

Chapter Objective
After completing this chapter, you should be able to:

- Identify what business-related expenses associated with travel, transportation, and gifts are deductible.

I. What's New/Reminders

Deduction for miscellaneous itemized deductions suspended. For tax years beginning after 2017, the deduction for job-related or other miscellaneous itemized deductions subject to the 2%-of-adjustedgross-income floor is suspended. Armed Forces reservists, qualified performing artists, and fee-based state or local government officials can continue to claim eligible business expenses as adjustments in determining adjusted gross income. Employees with impairment-related work expenses can continue to claim eligible impairment-related work expenses as itemized deductions.
Deduction for moving expenses suspended. For tax years beginning after 2017, the deduction for moving expenses is suspended unless you are a member of the Armed Forces who moves pursuant to a military order and incident to a permanent change of station.
Standard mileage rate. For 2024, the standard mileage rate for the cost of operating your car for business use is 67.0 cents per mile.
Car expenses and use of the standard mileage rate are explained under Transportation Expenses, later.
Depreciation limits on cars, trucks, and vans. The first-year limit on depreciation, the special depreciation allowance, and the section 179 deduction for vehicles acquired in 2024 is $20,400. If you elect not to claim a special depreciation allowance for a vehicle placed in service in 2024, the first-year limit is $12,400.
Special depreciation allowance. For 2024, the first-year special ("bonus") depreciation allowance on qualified property (including cars, trucks, and vans) is 60% for qualified property acquired and placed in service after December 31, 2023 and before January 1, 2025.
Meals and entertainment. In 2024, entertainment expenses generally are not deductible. Only nonentertainment- related meals are deductible, and the 50% limitation on the deduction of meals has not changed.

II. Introduction

You may be able to deduct the ordinary and necessary business-related expenses you have for:

- Travel,
- Non-entertainment-related meals,
- Gifts, or
- Transportation.

An ordinary expense is one that is common and accepted in your trade or business. A necessary expense is one that is helpful and appropriate for your business. An expense does not have to be required to be considered necessary.
This chapter explains the following.

- What expenses are deductible.
- How to report your expenses on your return.
- What records you need to prove your expenses.
- How to treat any expense reimbursements you may receive.

Who does not need to use this chapter. The information in this chapter does not apply to you if you are an employee and all of the following are true.

- You fully accounted to your employer for your work-related expenses.
- You received full reimbursement for your expenses.

- Your employer required you to return any excess reimbursement and you did so.
- There is no amount shown with a code L in box 12 of your Form W-2, Wage and Tax Statement.

If you meet all of these conditions, there is no need to show the expenses or the reimbursements on your return. See Reimbursements, later, if you would like more information on reimbursements and accounting to your employer.

Tip
If you meet these conditions and your employer included reimbursements on your Form W-2 in error, ask your employer for a corrected Form W-2.

III. Travel Expenses

If you temporarily travel away from your tax home, you can use this section to determine if you have deductible travel expenses. This section discusses:

- Traveling away from home,
- Tax home,
- Temporary assignment or job, and
- What travel expenses are deductible.

It also discusses the standard meal allowance, rules for travel inside and outside the United States, and deductible convention expenses.

Travel expenses defined. For tax purposes, travel expenses are the ordinary and necessary expenses (defined earlier) of traveling away from home for your business, profession, or job. You will find examples of deductible travel expenses in Table 4-1.

TABLE 4-1. TRAVEL EXPENSES YOU CAN DEDUCT.

This chart summarizes expenses you can deduct when you travel away from home for business purposes.

IF you have expenses for...	THEN you can deduct the cost of...
transportation	travel by airplane, train, bus, or car between your home and your business destination. If you were provided with a ticket or you are riding free as a result of a frequent traveler or similar program, your cost is zero. If you travel by ship, see Luxury Water Travel and Cruise Ships (under Conventions) in Pub. 463 for additional rules and limits.
taxi, commuter bus, and airport limousine	fares for these and other types of transportation that take you between: • The airport or station and your hotel; and • The hotel and the work location of your customers or clients, your business meeting place, or your temporary work location.
baggage and shipping	sending baggage and sample or display material between your regular and temporary work locations.
car	operating and maintaining your car when traveling away from home on business. You can deduct actual expenses or the standard mileage rate as well as business-related tolls and parking. If you rent a car while away from home on business, you can deduct only the business-use portion of the expenses.
lodging and meals	your lodging and non-entertainment-related meals if your business trip is overnight or long enough that you need to stop for sleep or rest to properly perform your duties. Meals include amounts spent

	for food, beverages, taxes, and related tips. See Meals and Incidental Expenses, earlier, for additional rules and limits.
cleaning	dry cleaning and laundry.
telephone	business calls while on your business trip. This includes business communication by fax machine or other communication devices.
tips	tips you pay for any expenses in this chart.
other	other similar ordinary and necessary expenses related to your business travel. These expenses might include transportation to or from a business meal, public stenographer's fees, computer rental fees, and operating and maintaining a house trailer.

TRAVELING AWAY FROM HOME

You are traveling away from home if:

- Your duties require you to be away from the general area of your tax home (defined later) substantially longer than an ordinary day's work, and
- You need to sleep or rest to meet the demands of your work while away from home.

This rest requirement is not satisfied by merely napping in your car. You do not have to be away from your tax home for a whole day or from dusk to dawn as long as your relief from duty is long enough to get necessary sleep or rest.

Example 1

You are a railroad conductor. You leave your home terminal on a regularly scheduled round-trip run between two cities and return home 16 hours later. During the run, you have 6 hours off at your turnaround point where you eat two meals and rent a hotel room to get necessary sleep before starting the return trip. You are considered to be away from home.

Example 2

You are a truck driver. You leave your terminal and return to it later the same day. You get an hour off at your turn-around point to eat. Because you are not off to get necessary sleep and the brief time off is not an adequate rest period, you are not traveling away from home.

Members of the Armed Forces. If you are a member of the U.S. Armed Forces on a permanent duty assignment overseas, you are not traveling away from home. You cannot deduct your expenses for meals and lodging. You cannot deduct these expenses even if you have to maintain a home in the United States for your family members who are not allowed to accompany you overseas. If you are transferred from one permanent duty station to another, you may have deductible moving expenses, which are explained in Pub. 521, Moving Expenses.

A naval officer assigned to permanent duty aboard a ship that has regular eating and living facilities has a tax home aboard ship for travel expense purposes.

TAX HOME

To determine whether you are traveling away from home, you must first determine the location of your tax home.

Generally, your tax home is your regular place of business or post of duty, regardless of where you maintain your family home. It includes the entire city or general area in which your business or work is located.

If you have more than one regular place of business, your tax home is your main place of business. See Main place of business or work, later.

If you do not have a regular or a main place of business because of the nature of your work, then your tax home may be the place where you regularly live. See No main place of business or work, later.

If you do not have a regular or a main place of business or post of duty and there is no place where you regularly live, you are considered an itinerant (a transient) and your tax home is wherever you work. As an itinerant, you cannot claim a travel expense deduction because you are never considered to be traveling away from home.

Main place of business or work. If you have more than one place of business or work, consider the following when determining which one is your main place of business or work.

- The total time you ordinarily spend in each place.
- The level of your business activity in each place.
- Whether your income from each place is significant or insignificant.

Example
You live in Cincinnati where you have a seasonal job for 8 months each year and earn $40,000. You work the other 4 months in Miami, also at a seasonal job, and earn $15,000. Cincinnati is your main place of work because you spend most of your time there and earn most of your income there.

No main place of business or work. You may have a tax home even if you do not have a regular or main place of business or work. Your tax home may be the home where you regularly live.

Factors used to determine tax home. If you do not have a regular or main place of business or work, use the following three factors to determine where your tax home is.

1. You perform part of your business in the area of your main home and use that home for lodging while doing business in the area.
2. You have living expenses at your main home that you duplicate because your business requires you to be away from that home.
3. You have not abandoned the area in which both your historical place of lodging and your claimed main home are located; you have a member or members of your family living at your main home; or you often use that home for lodging.

If you satisfy all three factors, your tax home is the home where you regularly live. If you satisfy only two factors, you may have a tax home depending on all the facts and circumstances. If you satisfy only one factor, you are an itinerant; your tax home is wherever you work and you cannot deduct travel expenses.

Example
You are single and live in Boston in an apartment you rent. You have worked for your employer in Boston for a number of years. Your employer enrolls you in a 12-month executive training program. You do not expect to return to work in Boston after you complete your training.
During your training, you do not do any work in Boston. Instead, you receive classroom and on-the-job training throughout the United States. You keep your apartment in Boston and return to it frequently. You use your apartment to conduct your personal business. You also keep up your community contacts in Boston. When you complete your training, you are transferred to Los Angeles.
You do not satisfy factor (1) because you did not work in Boston. You satisfy factor (2) because you had duplicate living expenses. You also satisfy factor (3) because you did not abandon your apartment in Boston as your main home, you kept your community contacts, and you frequently returned to live in your apartment. Therefore, you have a tax home in Boston.

Tax home different from family home. If you (and your family) do not live at your tax home (defined earlier), you cannot deduct the cost of traveling between your tax home and your family home. You also cannot deduct the cost of meals and lodging while at your tax home. See Example 1 below.
If you are working temporarily in the same city where you and your family live, you may be considered as traveling away from home. See Example 2 below.

Example 1

You are a truck driver and you and your family live in Tucson. You are employed by a trucking firm that has its terminal in Phoenix. At the end of your long runs, you return to your home terminal in Phoenix and spend one night there before returning home. You cannot deduct any expenses you have for meals and lodging in Phoenix or the cost of traveling from Phoenix to Tucson. This is because Phoenix is your tax home.

Example 2
Your family home is in Pittsburgh, where you work 12 weeks a year. The rest of the year you work for the same employer in Baltimore. In Baltimore, you eat in restaurants and sleep in a rooming house. Your salary is the same whether you are in Pittsburgh or Baltimore.
Because you spend most of your working time and earn most of your salary in Baltimore, that city is your tax home. You cannot deduct any expenses you have for meals and lodging there. However, when you return to work in Pittsburgh, you are away from your tax home even though you stay at your family home. You can deduct the cost of your round trip between Baltimore and Pittsburgh. You can also deduct your part of your family's living expenses for non-entertainment-related meals and lodging while you are living and working in Pittsburgh.

TEMPORARY ASSIGNMENT OR JOB

You may regularly work at your tax home and also work at another location. It may not be practical to return to your tax home from this other location at the end of each work day.

Temporary assignment vs. indefinite assignment. If your assignment or job away from your main place of work is temporary, your tax home does not change. You are considered to be away from home for the whole period you are away from your main place of work. You can deduct your travel expenses if they otherwise qualify for deduction. Generally, a temporary assignment in a single location is one that is realistically expected to last (and does in fact last) for 1 year or less.

However, if your assignment or job is indefinite, the location of the assignment or job becomes your new tax home and you cannot deduct your travel expenses while there. An assignment or job in a single location is considered indefinite if it is realistically expected to last for more than 1 year, whether or not it actually lasts for more than 1 year.

If your assignment is indefinite, you must include in your income any amounts you receive from your employer for living expenses, even if they are called travel allowances and you account to your employer for them.

Exception for federal crime investigations or prosecutions. If you are a federal employee participating in a federal crime investigation or prosecution, you are not subject to the 1-year rule. This means you may be able to deduct travel expenses even if you are away from your tax home for more than 1 year, provided you meet the other requirements for deductibility.

For you to qualify, the Attorney General (or his or her designee) must certify that you are traveling:

- For the federal government;
- In a temporary duty status; and
- To investigate or prosecute, or provide support services for the investigation or prosecution of, a federal crime.

Determining temporary or indefinite. You must determine whether your assignment is temporary or indefinite when you start work. If you expect an assignment or job to last for 1 year or less, it is temporary unless there are facts and circumstances that indicate otherwise. An assignment or job that is initially temporary may become indefinite due to changed circumstances. A series of assignments to the same location, all for short periods but that together cover a long period, may be considered an indefinite assignment.

Going home on days off. If you go back to your tax home from a temporary assignment on your days off, you aren't considered away from home while you are in your hometown. You can't deduct the cost of your meals and lodging there. However, you can deduct your travel expenses, including meals and

lodging, while traveling between your temporary place of work and your tax home. You can claim these expenses up to the amount it would have cost you to stay at your temporary place of work.
If you keep your hotel room during your visit home, you can deduct the cost of your hotel room. In addition, you can deduct your expenses of returning home up to the amount you would have spent for meals had you stayed at your temporary place of work.
Probationary work period. If you take a job that requires you to move, with the understanding that you will keep the job if your work is satisfactory during a probationary period, the job is indefinite. You cannot deduct any of your expenses for meals and lodging during the probationary period.

WHAT TRAVEL EXPENSES ARE DEDUCTIBLE?
Once you have determined that you are traveling away from your tax home, you can determine what travel expenses are deductible.
You can deduct ordinary and necessary expenses you have when you travel away from home on business. The type of expense you can deduct depends on the facts and your circumstances.
Table 4-1 summarizes travel expenses you may be able to deduct. You may have other deductible travel expenses that are not covered there, depending on the facts and your circumstances.

Tip
When you travel away from home on business, you should keep records of all the expenses you have and any advances you receive from your employer. You can use a log, diary, notebook, or any other written record to keep track of your expenses. The types of expenses you need to record, along with supporting documentation, are described in Table 4-2.

TABLE 4-2. HOW TO PROVE CERTAIN BUSINESS EXPENSES

IF you have expenses for...	THEN you must keep records that show details of the following elements...			
	Amount	**Time**	**Place or Description**	**Business Purpose and Business Relationship**
Travel	Cost of each separate expense for travel, lodging, and meals. Incidental expenses may be totaled in reasonable categories such as taxis, fees and tips, etc.	Dates you left and returned for each trip and number of days spent on business.	Destination or area of your travel (name of city, town, or other designation).	Purpose: Business purpose for the expense or the business benefit gained or expected to be gained. Relationship: N/A
Gifts	Cost of the gift.	Date of the gift.	Description of the gift.	
Transportation	Cost of each separate expense. For car expenses, the cost of the car and any improvements, the date you started using it for business, the mileage for each business use, and the total miles for the year.	Date of the expense. For car expenses, the date of the use of the car.	Your business destination.	Purpose: Business purpose for the expense. Relationship: N/A

Separating costs. If you have one expense that includes the costs of non-entertainment-related meals and other services (such as lodging or transportation), you must allocate that expense between the cost of non-entertainment-related meals and the cost of other services. You must have a reasonable basis for making this allocation. For example, you must allocate your expenses if a hotel includes one or more meals in its room charge.

Travel expenses for another individual. If a spouse, dependent, or other individual goes with you (or your employee) on a business trip or to a business convention, you generally cannot deduct his or her travel expenses.

Employee. You can deduct the travel expenses of someone who goes with you if that person:

1. Is your employee,
2. Has a bona fide business purpose for the travel, and
3. Would otherwise be allowed to deduct the travel expenses.

Business associate. If a business associate travels with you and meets the conditions in (2) and (3) above, you can deduct the travel expenses you have for that person. A business associate is someone with whom you could reasonably expect to engage or deal in the active conduct of your business. A business associate can be a current or prospective (likely to become) customer, client, supplier, employee, agent, partner, or professional advisor.

Bona fide business purpose. A bona fide business purpose exists if you can prove a real business purpose for the individual's presence. Incidental services, such as typing notes or assisting in entertaining customers, are not enough to make the expenses deductible.

Example

Jerry drives to Chicago on business and takes his wife, Linda, with him. Linda is not Jerry's employee. Linda occasionally types notes, performs similar services, and accompanies Jerry to luncheons and dinners. The performance of these services does not establish that her presence on the trip is necessary to the conduct of Jerry's business. Her expenses are not deductible.

Jerry pays $199 a day for a double room. A single room costs $149 a day. He can deduct the total cost of driving his car to and from Chicago, but only $149 a day for his hotel room. If both Jerry and Linda use public transportation, Jerry can deduct only his fare.

Meals and Incidental Expenses

You can deduct the cost of meals if it is necessary for you to stop for substantial sleep or rest to properly perform your duties while traveling away from home on business.

The elimination of the deduction for entertainment expenses is discussed under Meals and Entertainment Expenses, later. The following discussion deals with meals (and incidental expenses).

50% limit on meals. You can figure your meal expenses using either of the following methods.

- Actual cost.
- The standard meal allowance.

Both of these methods are explained below. But, regardless of the method you use, you generally can deduct only 50% of the unreimbursed cost of your meals.

If you are reimbursed for the cost of your meals, how you apply the 50% limit depends on whether your employer's reimbursement plan was accountable or nonaccountable. If you are not reimbursed, the 50% limit applies even if the unreimbursed meal expense is for business travel. The 50% limit is explained later under Meals and Entertainment Expenses. Accountable and nonaccountable plans are discussed later under Reimbursements.

Actual cost. You can use the actual cost of your meals to figure the amount of your expense before reimbursement and application of the 50% deduction limit. If you use this method, you must keep records of your actual cost.

Standard meal allowance. Generally, you can use the "standard meal allowance" method as an alternative to the actual cost method. It allows you to use a set amount for your daily meals and incidental expenses (M&IE), instead of keeping records of your actual costs. The set amount varies

depending on where and when you travel. In this chapter, “standard meal allowance” refers to the federal rate for M&IE, discussed later under Amount of standard meal allowance. If you use the standard meal allowance, you still must keep records to prove the time, place, and business purpose of your travel. See Recordkeeping, later.

Incidental expenses. The term “incidental expenses” means fees and tips given to porters, baggage carriers, hotel staff, and staff on ships. Incidental expenses do not include expenses for laundry, cleaning and pressing of clothing, lodging taxes, costs of telegrams or telephone calls, transportation between places of lodging or business and places where meals are taken, or the mailing cost of filing travel vouchers and paying employer-sponsored charge card billings.

Incidental-expenses-only method. You can use an optional method (instead of actual cost) for deducting incidental expenses only. The amount of the deduction is $5 a day. You can use this method only if you did not pay or incur any meal expenses. You cannot use this method on any day that you use the standard meal allowance.

Caution!
Federal employees should refer to the Federal Travel Regulations at GSA.gov. Find “Policy and Regulations” and click on “Regulations” for links to Federal Travel Regulation (FTR) for changes affecting claims for reimbursement.

50% limit may apply. If you use the standard meal allowance method for non-entertainment-related meal expenses and you are not reimbursed or you are reimbursed under a nonaccountable plan, you can generally deduct only 50% of the standard meal allowance. If you are reimbursed under an accountable plan and you are deducting amounts that are more than your reimbursements, you can deduct only 50% of the excess amount. The 50% limit is explained later under Meals and Entertainment Expenses. Accountable and nonaccountable plans are discussed later under Reimbursements.

Caution!
There is no optional standard lodging amount similar to the standard meal allowance. Your allowable lodging expense deduction is your actual cost.

Who can use the standard meal allowance. You can use the standard meal allowance whether you are an employee or self-employed, and whether or not you are reimbursed for your traveling expenses.

Use of the standard meal allowance for other travel. You can use the standard meal allowance to figure your meal expenses when you travel in connection with investment and other income-producing property. You can also use it to figure your meal expenses when you travel for qualifying educational purposes. You cannot use the standard meal allowance to figure the cost of your meals when you travel for medical or charitable purposes.

Amount of standard meal allowance. The standard meal allowance is the federal M&IE rate. The travel rate for most small localities in the United States is $68 a day.

Most major cities and many other localities in the United States are designated as high-cost areas, qualifying for higher standard meal allowances. You can find this information (organized by year and location) on the Internet at GSA.gov/perdiem.

If you travel to more than one location in one day, use the rate in effect for the area where you stop for sleep or rest. If you work in the transportation industry, however, see Special rate for transportation workers, later.

Standard meal allowance for areas outside the continental United States. The standard meal allowance rates above do not apply to travel in Alaska, Hawaii, or any other location outside the continental United States. The Department of Defense establishes per diem rates for Alaska, Hawaii, Puerto Rico, American Samoa, Guam, Midway, the Northern Mariana Islands, the U.S. Virgin Islands, Wake Island, and other non-foreign areas outside the continental United States. The Department of State establishes per diem rates for all other foreign areas.

Note
You can access per diem rates for non-foreign areas outside the continental United States at www.Defensetravel.dod.mil/site/perdiemCalc.cfm. You can access all other foreign per diem rates at State.gov/travel/. Click on "Travel Per Diem Allowances for Foreign Areas" under "Foreign Per Diem Rates" to obtain the latest foreign per diem rates.

Special rate for transportation workers. You can use a special standard meal allowance if you work in the transportation industry. You are in the transportation industry if your work:

- Directly involves moving people or goods by airplane, barge, bus, ship, train, or truck; and
- Regularly requires you to travel away from home and, during any single trip, usually involves travel to areas eligible for different standard meal allowance rates.

If this applies to you, you can claim a standard daily meal allowance of $69 a day ($74 for travel outside the continental United States) for travel in 2024.

Using the special rate for transportation workers eliminates the need for you to determine the standard meal allowance for every area where you stop for sleep or rest. If you choose to use the special rate for any trip, you must use the special rate (and not use the regular standard meal allowance rates) for all trips you take that year.

Travel for days you depart and return. For both the day you depart for and the day you return from a business trip, you must prorate the standard meal allowance (figure a reduced amount for each day). You can do so by one of two methods.

- Method 1: You can claim 3/4 of the standard meal allowance.
- Method 2: You can prorate using any method that you consistently apply and that is in accordance with reasonable business practice.

Example
Jen is employed in New Orleans as a convention planner. In March, her employer sent her on a 3-day trip to Washington, DC, to attend a planning seminar. She left her home in New Orleans at 10 a.m. on Wednesday and arrived in Washington, DC, at 5:30 p.m. After spending two nights there, she flew back to New Orleans on Friday and arrived back home at 8 p.m. Jen's employer gave her a flat amount to cover her expenses and included it with her wages.
Under Method 1, Jen can claim 2½ days of the standard meal allowance for Washington, DC: ¾ of the daily rate for Wednesday and Friday (the days she departed and returned), and the full daily rate for Thursday.
Under Method 2, Jen could also use any method that she applies consistently and that is in accordance with reasonable business practice. For example, she could claim 3 days of the standard meal allowance even though a federal employee would have to use Method 1 and be limited to only 2½ days.

TRAVEL IN THE UNITED STATES

The following discussion applies to travel in the United States. For this purpose, the United States includes only the 50 states and the District of Columbia. The treatment of your travel expenses depends on how much of your trip was business related and on how much of your trip occurred within the United States. See Part of Trip Outside the United States, later.

Trip Primarily for Business

You can deduct all your travel expenses if your trip was entirely business related. If your trip was primarily for business and, while at your business destination, you extended your stay for a vacation, made a personal side trip, or had other personal activities, you can deduct your business-related travel expenses. These expenses include the travel costs of getting to and from your business destination and any business-related expenses at your business destination.

Example
You work in Atlanta and take a business trip to New Orleans in May. Your business travel totals 900 miles round trip. On your way home, you stop in Mobile to visit your parents. You spend $2,165 for the 9 days you are away from home for travel, nonentertainment-related meals, lodging, and other travel expenses. If you had not stopped in Mobile, you would have been gone only 6 days, and your total cost would have been $1,633.50. You can deduct $1,633.50 for your trip, including the cost of round-trip transportation to and from New Orleans. The deduction for your non-entertainmentrelated meals is subject to the 50% limit on meals mentioned earlier.

Trip Primarily for Personal Reasons
If your trip was primarily for personal reasons, such as a vacation, the entire cost of the trip is a nondeductible personal expense. However, you can deduct any expenses you have while at your destination that are directly related to your business.
A trip to a resort or on a cruise ship may be a vacation even if the promoter advertises that it is primarily for business. The scheduling of incidental business activities during a trip, such as viewing videotapes or attending lectures dealing with general subjects, will not change what is really a vacation into a business trip.

Part of Trip Outside the United States
If part of your trip is outside the United States, use the rules described later under Travel Outside the United States for that part of the trip. For the part of your trip that is inside the United States, use the rules for travel in the United States. Travel outside the United States does not include travel from one point in the United States to another point in the United States. The following discussion can help you determine whether your trip was entirely within the United States.
Public transportation. If you travel by public transportation, any place in the United States where that vehicle makes a scheduled stop is a point in the United States. Once the vehicle leaves the last scheduled stop in the United States on its way to a point outside the United States, you apply the rules under Travel Outside the United States, later.

Example
You fly from New York to Puerto Rico with a scheduled stop in Miami. You return to New York nonstop. The flight from New York to Miami is in the United States, so only the flight from Miami to Puerto Rico is outside the United States. Because there are no scheduled stops between Puerto Rico and New York, all of the return trip is outside the United States.

Private car. Travel by private car in the United States is travel between points in the United States, even when you are on your way to a destination outside the United States.

Example
You travel by car from Denver to Mexico City and return. Your travel from Denver to the border and from the border back to Denver is travel in the United States, and the rules in this section apply. The rules below under Travel Outside the United States apply to your trip from the border to Mexico City and back to the border.

TRAVEL OUTSIDE THE UNITED STATES
If any part of your business travel is outside the United States, some of your deductions for the cost of getting to and from your destination may be limited. For this purpose, the United States includes only the 50 states and the District of Columbia.
How much of your travel expenses you can deduct depends in part upon how much of your trip outside the United States was business related.

Travel Entirely for Business or Considered Entirely for Business

You can deduct all your travel expenses of getting to and from your business destination if your trip is entirely for business or considered entirely for business.

Travel entirely for business. If you travel outside the United States and you spend the entire time on business activities, you can deduct all of your travel expenses.

Travel considered entirely for business. Even if you did not spend your entire time on business activities, your trip is considered entirely for business if you meet at least one of the following four exceptions.

Exception 1—No substantial control. Your trip is considered entirely for business if you did not have substantial control over arranging the trip. The fact that you control the timing of your trip does not, by itself, mean that you have substantial control over arranging your trip.

You do not have substantial control over your trip if you:

- Are an employee who was reimbursed or paid a travel expense allowance,
- Are not related to your employer, or
- Are not a managing executive.

"Related to your employer" is defined later in this chapter under Per Diem and Car Allowances.

A "managing executive" is an employee who has the authority and responsibility, without being subject to the veto of another, to decide on the need for the business travel.

A self-employed person generally has substantial control over arranging business trips.

Exception 2—Outside United States no more than a week. Your trip is considered entirely for business if you were outside the United States for a week or less, combining business and nonbusiness activities. One week means 7 consecutive days. In counting the days, do not count the day you leave the United States, but do count the day you return to the United States.

Exception 3—Less than 25% of time on personal activities. Your trip is considered entirely for business if:

- You were outside the United States for more than a week, and
- You spent less than 25% of the total time you were outside the United States on nonbusiness activities.

For this purpose, count both the day your trip began and the day it ended.

Exception 4—Vacation not a major consideration. Your trip is considered entirely for business if you can establish that a personal vacation wasn't a major consideration, even if you have substantial control over arranging the trip.

Travel Primarily for Business

If you travel outside the United States primarily for business but spend some of your time on nonbusiness activities, you generally cannot deduct all of your travel expenses. You only can deduct the business portion of your cost of getting to and from your destination. You must allocate the costs between your business and nonbusiness activities to determine your deductible amount.

Tip

You do not have to allocate your travel expense deduction if you meet one of the four exceptions listed earlier under Travel considered entirely for business. In those cases, you can deduct the total cost of getting to and from your destination.

Travel Primarily for Personal Reasons

If you travel outside the United States primarily for vacation or for investment purposes, the entire cost of the trip is a nondeductible personal expense. If you spend some time attending brief professional seminars or a continuing education program, you can deduct your registration fees and other expenses you have that are directly related to your business.

CONVENTIONS

You can deduct your travel expenses when you attend a convention if you can show that your attendance benefits your trade or business. You cannot deduct the travel expenses for your family. If the convention is for investment, political, social, or other purposes unrelated to your trade or business, you cannot deduct the expenses.

Caution!
Your appointment or election as a delegate does not, in itself, determine whether you can deduct travel expenses. You can deduct your travel expenses only if your attendance is connected to your own trade or business.

Convention agenda. The convention agenda or program generally shows the purpose of the convention. You can show your attendance at the convention benefits your trade or business by comparing the agenda with the official duties and responsibilities of your position. The agenda does not have to deal specifically with your official duties and responsibilities; it will be enough if the agenda is so related to your position that it shows your attendance was for business purposes.
Conventions held outside the North American area. See chapter 1 of Pub. 463 for information on conventions held outside the North American area.

IV. Meals And Entertainment Expenses

You can no longer take a deduction for any expense related to activities generally considered, entertainment, amusement, or recreation. You can continue to deduct 50% of the cost of business meals if you (or your employee) is present and the food or beverages are not considered lavish or extravagant.

Tip
If food or beverages are provided during or at an entertainment event, and the food and beverages were purchased separately from the entertainment or the cost of the food and beverages was stated separately from the cost of the entertainment on one or more bills, invoices, or receipts, you may be able to deduct the separately stated costs as a meal expense. For more information, see Regulations section 1.274-11(d)(2), Example 2.

50% LIMIT ON MEALS
In general, you can deduct only 50% of your business-related meal, unless an exception applies. (If you are subject to the Department of Transportation's "hours of service" limits, you can deduct 80% of your business-related meal and entertainment expenses. See Individuals subject to "hours of service" limits, later.)

Note
The special allowance of 100% of your meal expenses if the meals were food and beverages provided by a restaurant, and paid or incurred during 2021 and 2022 has expired.

The 50% limit applies to employees or their employers, and to self-employed persons (including independent contractors) or their clients, depending on whether the expenses are reimbursed.
Examples of meals might include:

- Meals while traveling away from home (whether eating alone or with others) on business, and
- Meals at a business convention or business league meeting.

Included expenses. Taxes and tips relating to a business meal are included as a cost of the meal and are subject to the 50% limit. However, the cost of transportation to and from a business meal would not be subject to the 50% limit.

Application of 50% limit. The 50% limit on meal expenses applies if the expense is otherwise deductible and isn't covered by one of the exceptions discussed later in this section.

The 50% limit also applies to certain meal expenses that aren't business related. It applies to meal expenses you have for the production of income, including rental or royalty income. It also applies to the cost of meals included in deductible educational expenses.

When to apply the 50% limit. You apply the 50% limit after determining the amount that would otherwise qualify for a deduction. You first have to determine the amount of meal expenses that would be deductible under the other rules discussed in this chapter.

Example 1

You spend $200 (including tax and tip) for a business meal. If $110 of that amount is not allowable because it is lavish and extravagant, the remaining $90 is subject to the 50% limit. Your deduction cannot be more than $45 (50% (0.50) × $90).

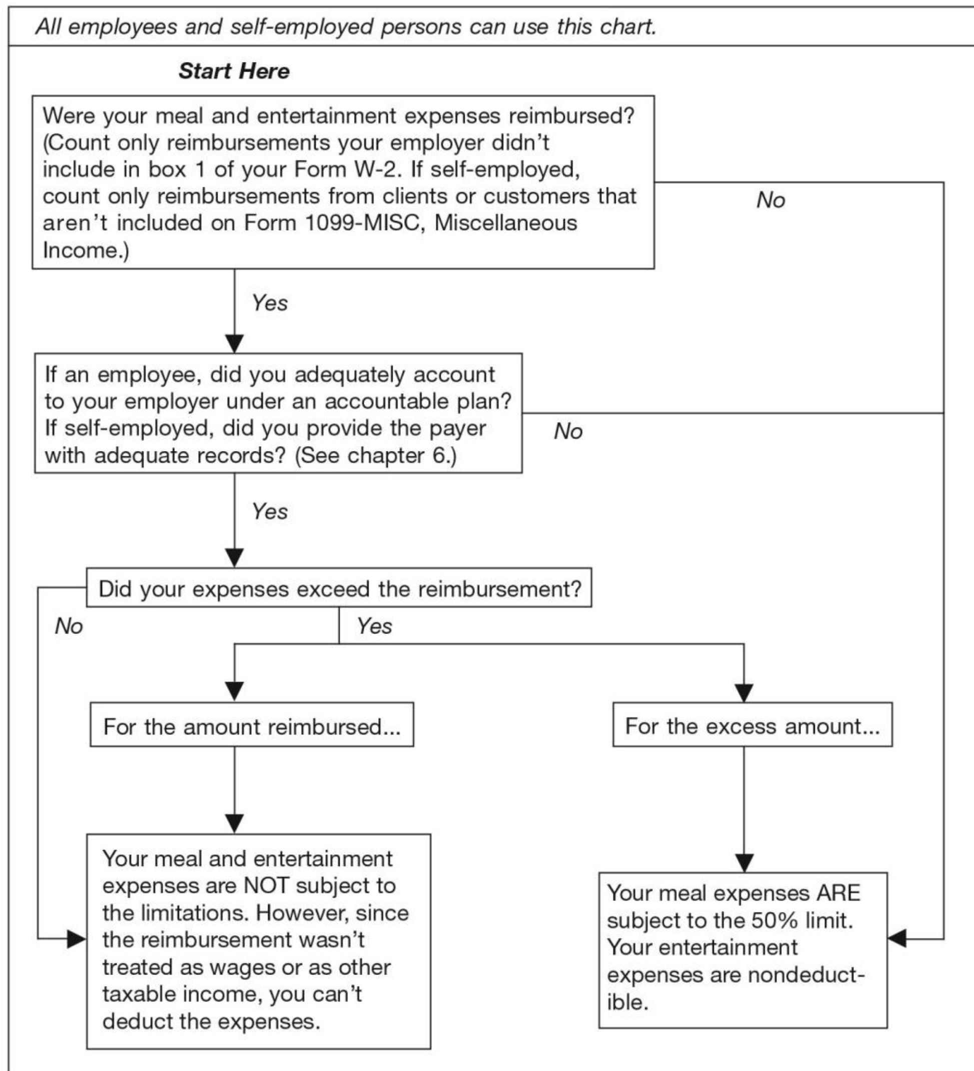
Example 2

You purchase two tickets to a concert for you and your client. Your deduction is zero because no deduction is allowed for entertainment expenses.

Figure 4-A can help you determine if the 50% limit applies to you.

FIGURE 4-A. DOES THE 50% LIMIT APPLY TO YOUR EXPENSES?

There are exceptions to these rules. See Exceptions to the 50% Limit.



Exceptions to the 50% Limit

Your meal expense is not subject to the 50% limit if the expense meets one of the following exceptions.

Expenses treated as compensation. In general, expenses for goods, services, and facilities are not subject to the 50% limit to the extent the expenses are treated by the taxpayer with respect to entertainment, amusement, or recreation, as compensation to an employee and as wages to the employee for tax purposes.

Employee's reimbursed expenses. If you are an employee, you are not subject to the 50% limit on expenses for which your employer reimburses you under an accountable plan. Accountable plans are discussed later under Reimbursements.

Individuals subject to "hours of service" limits. You can deduct a higher percentage of your meal expenses while traveling away from your tax home if the meals take place during or incident to any period subject to the Department of Transportation's "hours of service" limits. The percentage is 80%. Individuals subject to the Department of Transportation's "hours of service" limits include the following persons.

- Certain air transportation workers (such as pilots, crew, dispatchers, mechanics, and control tower operators) who are under Federal Aviation Administration regulations.
- Interstate truck operators and bus drivers who are under Department of Transportation regulations.
- Certain railroad employees (such as engineers, conductors, train crews, dispatchers, and control operations personnel) who are under Federal Railroad Administration regulations.

- Certain merchant mariners who are under Coast Guard regulations.

Other exceptions. There are also exceptions for the self-employed; expenses for recreational, social, or similar activities (such as a holiday party); meals furnished as advertising expenses; and selling meals.

V. Gift Expenses

If you give gifts in the course of your trade or business, you can deduct all or part of the cost. This section explains the limits and rules for deducting the costs of gifts.

$25 limit. You can deduct no more than $25 for business gifts you give directly or indirectly to each person during your tax year. A gift to a company that is intended for the eventual personal use or benefit of a particular person or a limited class of people will be considered an indirect gift to that particular person or to the individuals within that class of people who receive the gift.

If you give a gift to a member of a customer's family, the gift is generally considered to be an indirect gift to the customer. This rule does not apply if you have a bona fide independent business connection with that family member and the gift is not intended for the customer's eventual use or benefit.

If you and your spouse both give gifts, both of you are treated as one taxpayer. It does not matter whether you have separate businesses, are separately employed, or whether each of you has an independent connection with the recipient. If a partnership gives gifts, the partnership and the partners are treated as one taxpayer.

Incidental costs. Incidental costs, such as engraving on jewelry, or packaging, insuring, and mailing, are generally not included in determining the cost of a gift for purposes of the $25 limit.

A cost is incidental only if it does not add substantial value to the gift. For example, the cost of customary gift wrapping is an incidental cost. However, the purchase of an ornamental basket for packaging fruit is not an incidental cost if the value of the basket is substantial compared to the value of the fruit.

Exceptions. The following items are not considered gifts for purposes of the $25 limit.

1. An item that costs $4 or less and:
    a) Has your name clearly and permanently imprinted on the gift, and
    b) Is one of a number of identical items you widely distribute. Examples include pens, desk sets, and plastic bags and cases.
2. Signs, display racks, or other promotional material to be used on the business premises of the recipient.

Gift or entertainment. Any item that might be considered either a gift or entertainment generally will be considered entertainment. You cannot deduct entertainment expenses. However, if you give a customer packaged food or beverages you intend the customer to use at a later date, treat it as a gift.

VI. Transportation Expenses

This section discusses expenses you can deduct for business transportation when you are not traveling away from home as defined earlier under Travel Expenses. These expenses include the cost of transportation by air, rail, bus, taxi, etc., and the cost of driving and maintaining your car.

Transportation expenses include the ordinary and necessary costs of all of the following.

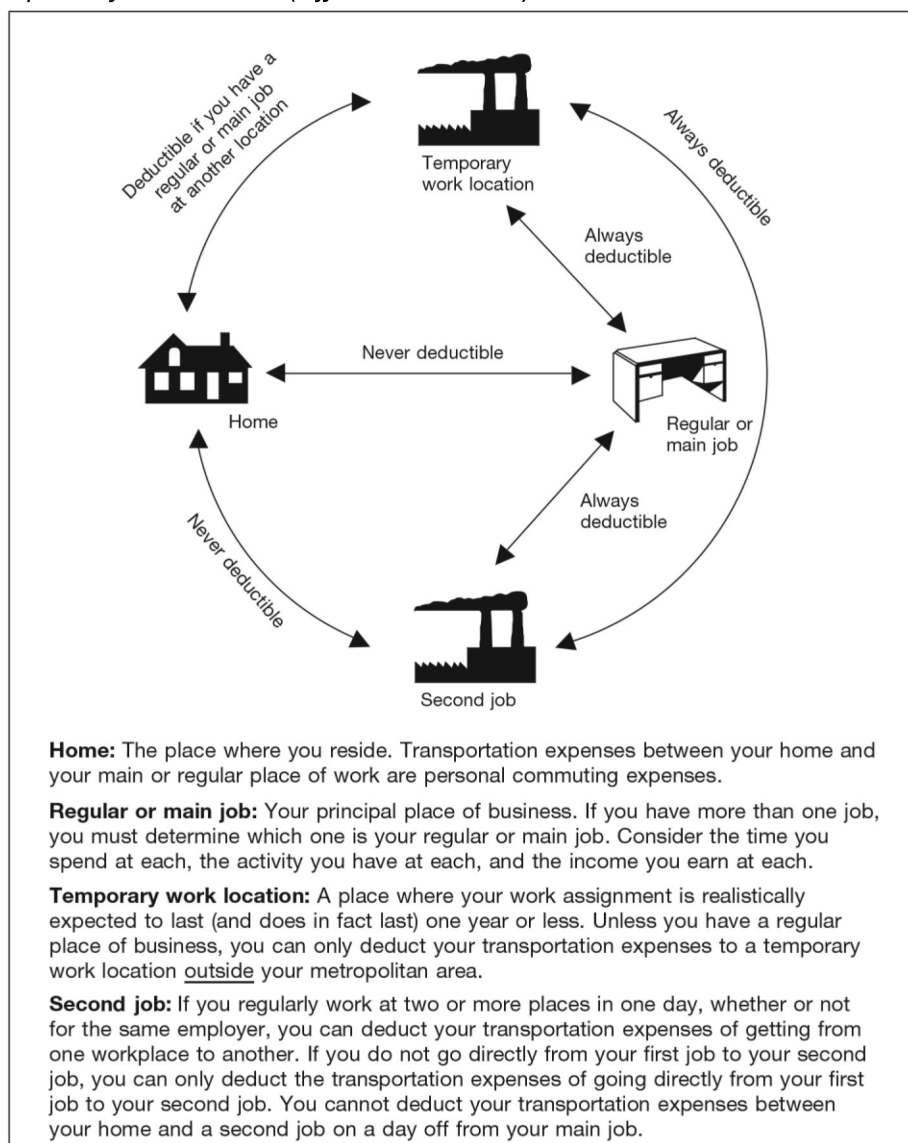
- Getting from one workplace to another in the course of your business or profession when you are traveling within the area of your tax home. (Tax home is defined earlier under Travel Expenses.)
- Visiting clients or customers.
- Going to a business meeting away from your regular workplace.
- Getting from your home to a temporary workplace when you have one or more regular places of work. These temporary workplaces can be either within the area of your tax home or outside that area.

Transportation expenses do not include expenses you have while traveling away from home overnight. Those expenses are travel expenses, discussed earlier. However, if you use your car while traveling away from home overnight, use the rules in this section to figure your car expense deduction. See Car Expenses, later.

Illustration of transportation expenses. Figure 4-B illustrates the rules for when you can deduct transportation expenses when you have a regular or main job away from your home. You may want to refer to it when deciding whether you can deduct your transportation expenses. Daily transportation expenses you incur while traveling from home to one or more regular places of business are generally nondeductible commuting expenses. However, there are many exceptions for deducting transportation expenses, like whether your work location is temporary (inside or outside the metropolitan area), traveling for the same trade or business, or if you have a home office.

FIGURE 4-B. WHEN ARE TRANSPORTATION EXPENSES DEDUCTIBLE?

Most employees and self-employed persons can use this chart. (Don't use this chart if your home is your principal place of business. See (Office in the home.)



Temporary work location. If you have one or more regular work locations away from your home and you commute to a temporary work location in the same trade or business, you can deduct the

expenses of the daily round-trip transportation between your home and the temporary location, regardless of distance.
If your employment at a work location is realistically expected to last (and does in fact last) for 1 year or less, the employment is temporary unless there are facts and circumstances that would indicate otherwise.
If your employment at a work location is realistically expected to last for more than 1 year or if there is no realistic expectation that the employment will last for 1 year or less, the employment is not temporary, regardless of whether it actually lasts for more than 1 year.
If employment at a work location initially is realistically expected to last for 1 year or less, but at some later date the employment is realistically expected to last more than 1 year, that employment will be treated as temporary (unless there are facts and circumstances that would indicate otherwise) until your expectation changes. It will not be treated as temporary after the date you determine it will last more than 1 year.
If the temporary work location is beyond the general area of your regular place of work and you stay overnight, you are traveling away from home. You may have deductible travel expenses as discussed earlier in this chapter.
No regular place of work. If you have no regular place of work but ordinarily work in the metropolitan area where you live, you can deduct daily transportation costs between home and a temporary work site outside that metropolitan area.
Generally, a metropolitan area includes the area within the city limits and the suburbs that are considered part of that metropolitan area.
You cannot deduct daily transportation costs between your home and temporary work sites within your metropolitan area. These are nondeductible commuting expenses.
Two places of work. If you work at two places in one day, whether or not for the same employer, you can deduct the expense of getting from one workplace to the other. However, if for some personal reason you do not go directly from one location to the other, you cannot deduct more than the amount it would have cost you to go directly from the first location to the second.
Transportation expenses you have in going between home and a part-time job on a day off from your main job are commuting expenses. You cannot deduct them.
Armed Forces reservists. A meeting of an Armed Forces reserve unit is a second place of business if the meeting is held on a day on which you work at your regular job. You can deduct the expense of getting from one workplace to the other as just discussed under Two places of work, earlier.
You usually cannot deduct the expense if the reserve meeting is held on a day on which you do not work at your regular job. In this case, your transportation generally is a nondeductible commuting expense. However, you can deduct your transportation expenses if the location of the meeting is temporary and you have one or more regular places of work.
If you ordinarily work in a particular metropolitan area but not at any specific location and the reserve meeting is held at a temporary location outside that metropolitan area, you can deduct your transportation expenses.
If you travel away from home overnight to attend a guard or reserve meeting, you can deduct your travel expenses. These expenses are discussed earlier under Travel Expenses.
If you travel more than 100 miles away from home in connection with your performance of services as a member of the reserves, you may be able to deduct some of your reserve-related travel costs as an adjustment to income rather than as an itemized deduction. See Armed Forces reservists traveling more than 100 miles from home under Special Rules, later.
Commuting expenses. You cannot deduct the costs of taking a bus, trolley, subway, or taxi, or of driving a car between your home and your main or regular place of work. These costs are personal commuting expenses. You cannot deduct commuting expenses no matter how far your home is from your regular place of work. You cannot deduct commuting expenses even if you work during the commuting trip.

Example

You sometimes use your cell phone to make business calls while commuting to and from work. Sometimes business associates ride with you to and from work, and you have a business discussion in the car. These activities do not change the trip from personal to business. You cannot deduct your commuting expenses.

Parking fees. Fees you pay to park your car at your place of business are nondeductible commuting expenses. You can, however, deduct business-related parking fees when visiting a customer or client.
Advertising display on car. Putting display material that advertises your business on your car does not change the use of your car from personal use to business use. If you use this car for commuting or other personal uses, you still cannot deduct your expenses for those uses.
Car pools. You cannot deduct the cost of using your car in a nonprofit car pool. Do not include payments you receive from the passengers in your income. These payments are considered reimbursements of your expenses. However, if you operate a car pool for a profit, you must include payments from passengers in your income. You can then deduct your car expenses (using the rules in this chapter).
Hauling tools or instruments. Hauling tools or instruments in your car while commuting to and from work does not make your car expenses deductible. However, you can deduct any additional costs you have for hauling tools or instruments (such as for renting a trailer you tow with your car).
Union members' trips from a union hall. If you get your work assignments at a union hall and then go to your place of work, the costs of getting from the union hall to your place of work are nondeductible commuting expenses. Although you need the union to get your work assignments, you are employed where you work, not where the union hall is located.
Office in the home. If you have an office in your home that qualifies as a principal place of business, you can deduct your daily transportation costs between your home and another work location in the same trade or business. (See Pub. 587 for information on determining if your home office qualifies as a principal place of business.)
Examples of deductible transportation. The following examples show when you can deduct transportation expenses based on the location of your work and your home.

Example 1
You regularly work in an office in the city where you live. Your employer sends you to a 1-week training session at a different office in the same city. You travel directly from your home to the training location and return each day. You can deduct the cost of your daily round-trip transportation between your home and the training location.

Example 2
Your principal place of business is in your home. You can deduct the cost of roundtrip transportation between your qualifying home office and your client's or customer's place of business.

Example 3
You have no regular office, and you do not have an office in your home. In this case, the location of your first business contact inside the metropolitan area is considered your office. Transportation expenses between your home and this first contact are nondeductible commuting expenses. Transportation expenses between your last business contact and your home are also nondeductible commuting expenses. While you cannot deduct the costs of these first and last trips, you can deduct the costs of going from one client or customer to another.

CAR EXPENSES
If you use your car for business purposes, you may be able to deduct car expenses. You generally can use one of the following two methods to figure your deductible expenses.

- Standard Mileage Rate.

- Actual Car Expenses.

If you use actual car expenses to figure your deduction for a car you lease, there are rules that affect the amount of your lease payments you can deduct. See Leasing a car under Actual Car Expenses, later.
In this chapter, the term “car” includes a van, pickup, or panel truck.

Standard Mileage Rate

You may be able to use the standard mileage rate to figure the deductible costs of operating your car for business purposes. For 2024, the standard mileage rate for business use is 67.0 cents (0.67) per mile.

Caution!
If you use the standard mileage rate for a year, you cannot deduct your actual car expenses for that year, but see Parking fees and tolls, later.

You generally can use the standard mileage rate whether or not you are reimbursed and whether or not any reimbursement is more or less than the amount figured using the standard mileage rate. See Reimbursements under How To Report, later.
Choosing the standard mileage rate. If you want to use the standard mileage rate for a car you own, you must choose to use it in the first year the car is available for use in your business. Then, in later years, you can choose to use either the standard mileage rate or actual expenses.
If you want to use the standard mileage rate for a car you lease, you must use it for the entire lease period.
You must make the choice to use the standard mileage rate by the due date (including extensions) of your return. You cannot revoke the choice. However, in a later year, you can switch from the standard mileage rate to the actual expenses method. If you change to the actual expenses method in a later year, but before your car is fully depreciated, you have to estimate the remaining useful life of the car and use straight line depreciation.
For more information about depreciation included in the standard mileage rate, see the exception in Methods of depreciation under Depreciation Deduction in chapter 4 of Pub. 463.
Standard mileage rate not allowed. You can’t use the standard mileage rate if you:

- Use five or more cars at the same time (as in fleet operations),
- Claimed a depreciation deduction for the car using any method other than straight line depreciation,
- Claimed a section 179 deduction on the car,
- Claimed the special depreciation allowance on the car, or
- Claimed actual car expenses after 1997 for a car you leased.

Five or more cars. If you own or lease five or more cars that are used for business at the same time, you can’t use the standard mileage rate for the business use of any car. However, you may be able to deduct your actual expenses for operating each of the cars in your business. See Actual Car Expenses in chapter 4 of Pub. 463 for information on how to figure your deduction.
You are not using five or more cars for business at the same time if you alternate using (use at different times) the cars for business.
Parking fees and tolls. In addition to using the standard mileage rate, you can deduct any businessrelated parking fees and tolls. (Parking fees you pay to park your car at your place of work are nondeductible commuting expenses.)

Actual Car Expenses

If you do not use the standard mileage rate, you may be able to deduct your actual car expenses.

Tip

If you qualify to use both methods, you may want to figure your deduction both ways to see which gives you a larger deduction.

Actual car expenses include:

Depreciation	Lease payments	Registration fees
Licenses I	nsurance	Repairs
Gas	Garage rent	Tires
Oil	Parking fees	Tolls

Business and personal use. If you use your car for both business and personal purposes, you must divide your expenses between business and personal use. You can divide your expenses based on the miles driven for each purpose.

Example
You are a contractor and drive your car 20,000 miles during the year: 12,000 miles for business use and 8,000 miles for personal use. You can claim only 60% (12,000 ÷ 20,000) of the cost of operating your car as a business expense.

Interest on car loans. If you are an employee, you cannot deduct any interest paid on a car loan. This interest is treated as personal interest and is not deductible. However, if you are self-employed and use your car in that business, see chapter 4 of Pub. 535.
Taxes paid on your car. If you are an employee, you can deduct personal property taxes paid on your car if you itemize deductions. Enter the amount paid on line 5c of Schedule A (Form 1040) If you are not an employee, see your form instructions for information on how to deduct personal property taxes paid on your car.
Sales taxes. Generally, sales taxes on your car are part of your car's basis and are recovered through depreciation, discussed later.
Fines and collateral. You cannot deduct fines you pay and collateral you forfeited for traffic violations.
Depreciation and section 179 deductions. Generally, the cost of a car, plus sales tax and improvements, is a capital expense. Because the benefits last longer than 1 year, you generally cannot deduct a capital expense. However, you can recover this cost through the section 179 deduction and depreciation deductions. Depreciation allows you to recover the cost over more than 1 year by deducting part of it each year. The section 179 deduction and the depreciation deductions are discussed in more detail in chapter 4 of Pub. 463.
Generally, there are limits on these deductions. Special rules apply if you use your car 50% or less in your work or business.
Leasing a car. If you lease a car, truck, or van that you use in your business, you can use the standard mileage rate or actual expenses to figure your deductible car expense.
Deductible payments. If you choose to use actual expenses, you can deduct the part of each lease payment that is for the use of the vehicle in your business. You cannot deduct any part of a lease payment that is for personal use of the vehicle, such as commuting.
You must spread any advance payments over the entire lease period. You cannot deduct any payments you make to buy a vehicle, even if the payments are called lease payments.
If you lease a car, truck, or van for 30 days or more, you may have to reduce your lease payment deduction by an "inclusion amount." For information on reporting lease inclusion amounts, see Leasing a Car in chapter 4 of Pub. 463.

Disposition of a Car
If you dispose of your car, you may have a taxable gain or a deductible loss. This is true whether you used the standard mileage rate or actual car expenses to deduct the business use of your car. Pub. 544

has information on sales of property used in a trade or business, and details on how to report the disposition.

VII. Recordkeeping

If you deduct travel, gift, or transportation expenses, you must be able to prove (substantiate) certain elements of the expense. This section discusses the records you need to keep to prove these expenses.

Tip If you keep timely and accurate records, you will have support to show the IRS if your tax return is ever examined. You will also have proof of expenses that your employer may require if you are reimbursed under an accountable plan. These plans are discussed later under Reimbursements.

HOW TO PROVE EXPENSES

Table 4-2 is a summary of records you need to prove each expense discussed in this chapter. You must be able to prove the elements listed across the top portion of the table. You prove them by having the information and receipts (where needed) for the expenses listed in the first column.

Caution! You cannot deduct amounts that you approximate or estimate.

You should keep adequate records to prove your expenses or have sufficient evidence that will support your own statement. You must generally prepare a written record for it to be considered adequate. This is because written evidence is more reliable than oral evidence alone.

Tip However, if you contemporaneously prepare a record on a computer, it is considered an adequate record.

What Are Adequate Records?

You should keep the proof you need in an account book, diary, statement of expense, or similar record. You should also keep documentary evidence that, together with your records, will support each element of an expense.

Documentary evidence. You generally must have documentary evidence, such as receipts, canceled checks, or bills, to support your expenses.

Exception. Documentary evidence is not needed if any of the following conditions apply.

- You have meals or lodging expenses while traveling away from home for which you account to your employer under an accountable plan and you use a per diem allowance method that includes meals and/or lodging. (Accountable plans and per diem allowances are discussed later under Reimbursements.)
- Your expense, other than lodging, is less than $75.
- You have a transportation expense for which a receipt is not readily available.

Adequate evidence. Documentary evidence ordinarily will be considered adequate if it shows the amount, date, place, and essential character of the expense.

For example, a hotel receipt is enough to support expenses for business travel if it has all of the following information.

- The name and location of the hotel.
- The dates you stayed there.
- Separate amounts for charges such as lodging, meals, and telephone calls.

A restaurant receipt is enough to prove an expense for a business meal if it has all of the following information.

- The name and location of the restaurant.
- The number of people served.
- The date and amount of the expense.

If a charge is made for items other than food and beverages, the receipt must show that this is the case.

Canceled check. A canceled check, together with a bill from the payee, ordinarily establishes the cost. However, a canceled check by itself does not prove a business expense without other evidence to show that it was for a business purpose.

Duplicate information. You do not have to record information in your account book or other record that duplicates information shown on a receipt as long as your records and receipts complement each other in an orderly manner.

You do not have to record amounts your employer pays directly for any ticket or other travel item. However, if you charge these items to your employer, through a credit card or otherwise, you must keep a record of the amounts you spend.

Timely kept records. You should record the elements of an expense or of a business use at or near the time of the expense or use and support it with sufficient documentary evidence. A timely kept record has more value than a statement prepared later when generally there is a lack of accurate recall.

You do not need to write down the elements of every expense on the day of the expense. If you maintain a log on a weekly basis which accounts for use during the week, the log is considered a timely kept record.

If you give your employer, client, or customer an expense account statement, it can also be considered a timely kept record. This is true if you copy it from your account book, diary, statement of expense, or similar record.

Proving business purpose. You must generally provide a written statement of the business purpose of an expense. However, the degree of proof varies according to the circumstances in each case. If the business purpose of an expense is clear from the surrounding circumstances, then you don't need to give a written explanation.

Confidential information. You do not need to put confidential information relating to an element of a deductible expense (such as the place, business purpose, or business relationship) in your account book, diary, or other record. However, you do have to record the information elsewhere at or near the time of the expense and have it available to fully prove that element of the expense.

What If I Have Incomplete Records?

If you do not have complete records to prove an element of an expense, then you must prove the element with:

- Your own written or oral statement, containing specific information about the element; and
- Other supporting evidence that is sufficient to establish the element.

Destroyed records. If you cannot produce a receipt because of reasons beyond your control, you can prove a deduction by reconstructing your records or expenses. Reasons beyond your control include fire, flood, and other casualties.

Separating and Combining Expenses

This section explains when expenses must be kept separate and when expenses can be combined.

Separating expenses. Each separate payment is generally considered a separate expense. For example, if you travel to a business meeting and have a non-entertainment-related meal, you have two separate expenses. You must record them separately in your records.

Combining items. You can make one daily entry in your record for reasonable categories of expenses. Examples are taxi fares, telephone calls, or other incidental travel costs. Non-entertainment-related meals should be in a separate category. You can include tips for meal-related services with the costs of the meals.

Expenses of a similar nature occurring during the course of a single event are considered a single expense.

Allocating total cost. If you can prove the total cost of travel but you cannot prove how much it cost for each person who participated in the event, you may have to allocate the total cost among you and your guests on a pro rata basis. An allocation would be needed, for example, if you did not have a business relationship with all of your guests.

If your return is examined. If your return is examined, you may have to provide additional information to the IRS. This information could be needed to clarify or to establish the accuracy or reliability of information contained in your records, statements, testimony, or documentary evidence before a deduction is allowed.

HOW LONG TO KEEP RECORDS AND RECEIPTS

You must keep records as long as they may be needed for the administration of any provision of the Internal Revenue Code. Generally, this means you must keep your records that support your deduction (or an item of income) for 3 years from the date you file the income tax return on which the deduction is claimed. A return filed early is considered filed on the due date. For a more complete explanation, see Pub. 583, Starting a Business and Keeping Records.

Reimbursed for expenses. Employees who give their records and documentation to their employers and are reimbursed for their expenses generally don't have to keep copies of this information. However, you may have to prove your expenses if any of the following conditions apply.

- You claim deductions for expenses that are more than reimbursements.
- Your expenses are reimbursed under a nonaccountable plan.
- Your employer does not use adequate accounting procedures to verify expense accounts.
- You are related to your employer, as defined later under Related to employer.

See the next section, How To Report, for a discussion of reimbursements, adequate accounting, and nonaccountable plans.

VIII. How To Report

This section explains where and how to report the expenses discussed in this chapter. It discusses reimbursements and how to treat them under accountable and nonaccountable plans. It also explains rules for independent contractors and clients, fee-basis officials, certain performing artists, Armed Forces reservists, and certain disabled employees. This section ends with an illustration of how to report travel, gift, and car expenses on Form 2106.

Self-employed. You must report your income and expenses on Schedule C (Form 1040) if you are a sole proprietor, or on Schedule F (Form 1040) if you are a farmer. You do not use Form 2106. See your form instructions for information on how to complete your tax return. You can also find information in Pub. 535 if you are a sole proprietor, or in Pub. 225, Farmer's Tax Guide, if you are a farmer.

Both self-employed and an employee. If you are both self-employed and an employee, you must keep separate records for each business activity. Report your business expenses for self-employment on Schedule C or F (Form 1040), as discussed earlier. Report your business expenses for your work as an employee on Form 2106, as discussed next.

Caution!
Form 2106 is only used by Armed Forces reservists, qualified performing artists, feebased state or local government officials, and employees with impairment-related work expenses. Due to the suspension of miscellaneous itemized deductions subject to the 2% floor under section 67(a), employees who do not fit into one of the listed categories may not use Form 2106.

Employees. If you are an employee, you generally must complete Form 2106 to deduct your travel and transportation expenses.

For more information on how to report your expenses on Form 2106, see Completing Form 2106, later.
Statutory employees. If you received a Form W-2 and the "Statutory employee" box in box 13 was checked, report your income and expenses related to that income on Schedule C (Form 1040). Do not complete Form 2106.
Statutory employees include full-time life insurance salespersons, certain agent or commission drivers, traveling salespersons, and certain homeworkers.

Caution!
If you are entitled to a reimbursement from your employer but you do not claim it, you cannot claim a deduction for the expenses to which that unclaimed reimbursement applies.

Reimbursement for personal expenses. If your employer reimburses you for nondeductible personal expenses, such as for vacation trips, your employer must report the reimbursement as wage income in box 1 of your Form W-2. You cannot deduct personal expenses.

REIMBURSEMENTS
This section explains what to do when you receive an advance or are reimbursed for any of the employee business expenses discussed in this chapter.
If you received an advance, allowance, or reimbursement for your expenses, how you report this amount and your expenses depends on whether your employer reimbursed you under an accountable plan or a nonaccountable plan.
This section explains the two types of plans, how per diem and car allowances simplify proving the amount of your expenses, and the tax treatment of your reimbursements and expenses.
No reimbursement. You are not reimbursed or given an allowance for your expenses if you are paid a salary or commission with the understanding that you will pay your own expenses. In this situation, you have no reimbursement or allowance arrangement, and this section on reimbursements does not apply to you. Instead, see Completing Form 2106, later, for information on completing your tax return.
Reimbursement, allowance, or advance. A reimbursement or other expense allowance arrangement is a system or plan that an employer uses to pay, substantiate, and recover the expenses, advances, reimbursements, and amounts charged to the employer for employee business expenses. Arrangements include per diem and car allowances.
A per diem allowance is a fixed amount of daily reimbursement your employer gives you for your lodging, meal, and incidental expenses when you are away from home on business. (The term "incidental expenses" is defined earlier under Meals and Incidental Expenses.) A car allowance is an amount your employer gives you for the business use of your car.
Your employer should tell you what method of reimbursement is used and what records you must provide.

Accountable Plans
To be an accountable plan, your employer's reimbursement or allowance arrangement must include all of the following rules.

1. Your expenses must have a business connection—that is, you must have paid or incurred deductible expenses while performing services as an employee of your employer.
2. You must adequately account to your employer for these expenses within a reasonable period of time.
3. You must return any excess reimbursement or allowance within a reasonable period of time.

See Adequate Accounting and Returning Excess Reimbursements, later.
An excess reimbursement or allowance is any amount you are paid that is more than the businessrelated expenses that you adequately accounted for to your employer.
Reasonable period of time. The definition of a reasonable period of time depends on the facts and circumstances of your situation. However, regardless of the facts and circumstances of your situation,

actions that take place within the times specified in the following list will be treated as taking place within a reasonable period of time.

- You receive an advance within 30 days of the time you have an expense.
- You adequately account for your expenses within 60 days after they were paid or incurred.
- You return any excess reimbursement within 120 days after the expense was paid or incurred.
- You are given a periodic statement (at least quarterly) that asks you to either return or adequately account for outstanding advances and you comply within 120 days of the statement.

Employee meets accountable plan rules. If you meet the three rules for accountable plans, your employer should not include any reimbursements in your income in box 1 of your Form W-2. If your expenses equal your reimbursement, you do not complete Form 2106. You have no deduction since your expenses and reimbursement are equal.

Tip
If your employer included reimbursements in box 1 of your Form W-2 and you meet all the rules for accountable plans, ask your employer for a corrected Form W-2.

Accountable plan rules not met. Even though you are reimbursed under an accountable plan, some of your expenses may not meet all the rules. Those expenses that fail to meet all three rules for accountable plans are treated as having been reimbursed under a nonaccountable plan (discussed later).

Reimbursement of nondeductible expenses. You may be reimbursed under your employer's accountable plan for expenses related to that employer's business, some of which are deductible as employee business expenses and some of which are not deductible. The reimbursements you receive for the nondeductible expenses do not meet rule (1) for accountable plans, and they are treated as paid under a nonaccountable plan.

Example
Your employer's plan reimburses you for travel expenses while away from home on business and also for meals when you work late at the office, even though you are not away from home. The part of the arrangement that reimburses you for the nondeductible meals when you work late at the office is treated as paid under a nonaccountable plan.

Tip
The employer makes the decision whether to reimburse employees under an accountable plan or a nonaccountable plan. If you are an employee who receives payments under a nonaccountable plan, you cannot convert these amounts to payments under an accountable plan by voluntarily accounting to your employer for the expenses and voluntarily returning excess reimbursements to the employer.

Adequate Accounting

One of the rules for an accountable plan is that you must adequately account to your employer for your expenses. You adequately account by giving your employer a statement of expense, an account book, a diary, or a similar record in which you entered each expense at or near the time you had it, along with documentary evidence (such as receipts) of your travel, mileage, and other employee business expenses. (See Table 4-2 for details you need to enter in your record and documents you need to prove certain expenses.) A per diem or car allowance satisfies the adequate accounting requirement under certain conditions. See Per Diem and Car Allowances, later.

You must account for all amounts you received from your employer during the year as advances, reimbursements, or allowances. This includes amounts you charged to your employer by credit card or other method. You must give your employer the same type of records and supporting information that you would have to give to the IRS if the IRS questioned a deduction on your return. You must pay

back the amount of any reimbursement or other expense allowance for which you do not adequately account or that is more than the amount for which you accounted.

Per Diem and Car Allowances

If your employer reimburses you for your expenses using a per diem or car allowance, you can generally use the allowance as proof of the amount of your expenses. A per diem or car allowance satisfies the adequate accounting requirements for the amount of your expenses only if all the following conditions apply.

- Your employer reasonably limits payments of your expenses to those that are ordinary and necessary in the conduct of the trade or business.
- The allowance is similar in form to and not more than the federal rate (discussed later).
- You prove the time (dates), place, and business purpose of your expenses to your employer (as explained in Table 4-2) within a reasonable period of time.
- You are not related to your employer (as defined next). If you are related to your employer, you must be able to prove your expenses to the IRS even if you have already adequately accounted to your employer and returned any excess reimbursement.

If the IRS finds that an employer's travel allowance practices are not based on reasonably accurate estimates of travel costs (including recognition of cost differences in different areas for per diem amounts), you will not be considered to have accounted to your employer. In this case, you must be able to prove your expenses to the IRS.

Related to employer. You are related to your employer if:

1. Your employer is your brother or sister, half brother or half sister, spouse, ancestor, or lineal descendant;
2. Your employer is a corporation in which you own, directly or indirectly, more than 10% in value of the outstanding stock; or
3. Certain relationships (such as grantor, fiduciary, or beneficiary) exist between you, a trust, and your employer.

You may be considered to indirectly own stock, for purposes of (2), if you have an interest in a corporation, partnership, estate, or trust that owns the stock or if a member of your family or your partner owns the stock.

The federal rate. The federal rate can be figured using any one of the following methods.

1. For per diem amounts:
    a) The regular federal per diem rate.
    b) The standard meal allowance.
    c) The high-low rate.
2. For car expenses:
    a) The standard mileage rate.
    b) A fixed and variable rate (FAVR).

Tip For per diem amounts, use the rate in effect for the area where you stop for sleep or rest.

Regular federal per diem rate. The regular federal per diem rate is the highest amount that the federal government will pay to its employees for lodging, meal, and incidental expenses (or meal and incidental expenses only) while they are traveling away from home in a particular area. The rates are different for different locations. Your employer should have these rates available. (They are also available at GSA. gov/travel/plan-book/per-diem-rates.)

The standard meal allowance. The standard meal allowance (discussed earlier) is the federal rate for meals and incidental expenses (M&IE). For travel in 2024, the rate for most small localities in the United States is $68 a day. Most major cities and many other localities qualify for higher rates. You can find this information at GSA.gov/travel/plan-book/per-diem-rates.

You receive an allowance only for meals and incidental expenses when your employer does one of the following.

- Provides you with lodging (furnishes it in kind).
- Reimburses you, based on your receipts, for the actual cost of your lodging.
- Pays the hotel, motel, etc., directly for your lodging.
- Does not have a reasonable belief that you had (or will have) lodging expenses, such as when you stay with friends or relatives or sleep in the cab of your truck.
- Figures the allowance on a basis similar to that used in figuring your compensation, such as number of hours worked or miles traveled.

High-low rate. This is a simplified method of figuring the federal per diem rate for travel within the continental United States. It eliminates the need to keep a current list of the per diem rate for each city.

Under the high-low method, the per diem amount for travel in 2024 beginning October 1 is $319 for certain high-cost locations. All other areas have a per diem amount of $225.

Prorating the standard meal allowance on partial days of travel. The standard meal allowance is for a full 24-hour day of travel. If you travel for part of a day, such as on the days you depart and return, you must prorate the full-day M&IE rate. This rule also applies if your employer uses the regular federal per diem rate or the high-low rate.

You can use either of the following methods to figure the federal M&IE for that day.

1. *Method 1*:
   a) For the day you depart, add ¾ of the standard meal allowance amount for that day.
   d) For the day you return, add ¾ of the standard meal allowance amount for the preceding day.
2. *Method 2*: Prorate the standard meal allowance using any method you consistently apply in accordance with reasonable business practice.

The standard mileage rate. This is a set rate per mile that you can use to figure your deductible car expenses. For 2024, the standard mileage rate for the cost of operating your car is 67.0 cents (0.67) per mile.

Fixed and variable rate (FAVR). This is an allowance your employer may use to reimburse your car expenses. Under this method, your employer pays an allowance that includes a combination of payments covering fixed and variable costs, such as a cents-per-mile rate to cover your variable operating costs (such as gas, oil, etc.) plus a flat amount to cover your fixed costs (such as depreciation (or lease payments), insurance, etc.). If your employer chooses to use this method, your employer will request the necessary records from you.

Reporting your expenses with a per diem or car allowance. If your reimbursement is in the form of an allowance received under an accountable plan, the following facts affect your reporting.

- The federal rate.
- Whether the allowance or your actual expenses were more than the federal rate.

The following discussions explain where to report your expenses depending upon how the amount of your allowance compares to the federal rate.

Allowance less than or equal to the federal rate. If your allowance is less than or equal to the federal rate, the allowance will not be included in box 1 of your Form W-2. You do not need to report the related expenses or the allowance on your return if your expenses are equal to or less than the allowance.

However, if your actual expenses are more than your allowance, you can complete Form 2106 and deduct the excess amount if you are an Armed Forces reservist, fee-based state or local government official, qualified performing artist, or disabled employee with impairment-related work expenses. If you are using actual expenses, you must be able to prove to the IRS the total amount of your expenses and reimbursements for the entire year. If you are using the standard meal allowance or the standard mileage rate, you don't have to prove that amount.

Example
Nicole, a fee-basis state government official, drives 10,000 miles in 2024 for business. Under her employer's accountable plan, she accounts for the time (dates), place, and business purpose of each trip. Her employer pays her a mileage allowance of 40 cents (0.40) a mile.
Since Nicole's $6,700 expense figured under the standard mileage rate (10,000 miles x 67.0 cents (0.67)) is more than her $4,000 reimbursement (10,000 miles × 40 cents (0.40)), she itemizes her deductions to claim the excess expense. Nicole completes Form 2106 (showing all her expenses and reimbursements) and enters $2,700 ($6,700 − $4,000) as an itemized deduction.

Allowance more than the federal rate. If your allowance is more than the federal rate, your employer must include the allowance amount up to the federal rate under code L in box 12 of your Form W-2. This amount is not taxable. However, the excess allowance will be included in box 1 of your Form W-2. You must report this part of your allowance as if it were wage income.
If your actual expenses are less than or equal to the federal rate, you do not complete Form 2106 or claim any of your expenses on your return.
However, if your actual expenses are more than the federal rate, you can complete Form 2106 and deduct those excess expenses. You must report on Form 2106 your reimbursements up to the federal rate (as shown under code L in box 12 of your Form W-2) and all your expenses. You should be able to prove these amounts to the IRS.

Example
Joe, a performing artist, lives and works in Austin. In May, his employer sent him to San Diego for 4 days and paid the hotel directly for Joe's hotel bill. The employer reimbursed Joe $75 a day for his meals and incidental expenses. The federal rate for San Diego is $74 a day.
Joe can prove that his actual non-entertainment-related meal expenses totaled $380. His employer's accountable plan will not pay more than $75 a day for travel to San Diego, so Joe does not give his employer the records that prove that he actually spent $380. However, he does account for the time, place, and business purpose of the trip. This is Joe's only business trip this year.
Joe was reimbursed $300 ($75 × 4 days), which is $4 more than the federal rate of $296 ($74 × 4 days). His employer includes the $4 as income on Joe's Form W-2 in box 1. His employer also enters $296 under code L in box 12 of Joe's Form W-2.
Joe completes Form 2106 to figure his deductible expenses. He enters the total of his actual expenses for the year ($380) on Form 2106. He also enters the reimbursements that were not included in his income ($296). His total deductible expense, before the 50% limit, is $84. After he figures the 50% limit on his unreimbursed meals, he will include the balance, $42, as an itemized deduction.

RETURNING EXCESS REIMBURSEMENTS
Under an accountable plan, you are required to return any excess reimbursement or other expense allowances for your business expenses to the person paying the reimbursement or allowance. Excess reimbursement means any amount for which you did not adequately account within a reasonable period of time. For example, if you received a travel advance and you did not spend all the money on businessrelated expenses or you do not have proof of all your expenses, you have an excess reimbursement.
For more information, see Adequate Accounting, earlier.
Travel advance. You receive a travel advance if your employer provides you with an expense allowance before you actually have the expense, and the allowance is reasonably expected to be no more than your expense. Under an accountable plan, you are required to adequately account to your employer for this advance and to return any excess within a reasonable period of time.
If you do not adequately account for or do not return any excess advance within a reasonable period of time, the amount you do not account for or return will be treated as having been paid under a nonaccountable plan (discussed later).

Unproven amounts. If you do not prove that you actually traveled on each day for which you received a per diem or car allowance (proving the elements described in Table 4-2), you must return this unproven amount of the travel advance within a reasonable period of time. If you do not do this, the unproven amount will be considered paid under a nonaccountable plan (discussed later).

Per diem allowance more than federal rate. If your employer's accountable plan pays you an allowance that is higher than the federal rate, you do not have to return the difference between the two rates for the period you can prove business-related travel expenses. However, the difference will be reported as wages on your Form W-2. This excess amount is considered paid under a nonaccountable plan (discussed later).

Example

Your employer sends you on a 5-day business trip to Phoenix in March 2024 and gives you a $425 ($85 × 5 days) advance to cover your meals and incidental expenses. The federal per diem for meals and incidental expenses for Phoenix is $74. Your trip lasts only 3 days. Under your employer's accountable plan, you must return the $170 ($85 × 2 days) advance for the 2 days you did not travel. For the 3 days you did travel, you do not have to return the $33 difference between the allowance you received and the federal rate for Phoenix (($85 − $74) × 3 days). However, the $33 will be reported on your Form W-2 as wages.

Nonaccountable Plans

A nonaccountable plan is a reimbursement or expense allowance arrangement that does not meet one or more of the three rules listed earlier under Accountable Plans.

In addition, even if your employer has an accountable plan, the following payments will be treated as being paid under a nonaccountable plan.

- Excess reimbursements you fail to return to your employer.
- Reimbursement of nondeductible expenses related to your employer's business. See Reimbursement of nondeductible expenses under Accountable Plans, earlier.

If you are not sure if the reimbursement or expense allowance arrangement is an accountable or nonaccountable plan, ask your employer.

Reporting your expenses under a nonaccountable plan. Your employer will combine the amount of any reimbursement or other expense allowance paid to you under a nonaccountable plan with your wages, salary, or other pay. Your employer will report the total in box 1 of your Form W-2.

You must be an Armed Forces reservist, fee-based state or local government official, qualified performing artist, or disabled employee with impairment-related work expenses and complete Form 2106 to deduct your expenses for travel, transportation, or meals. Your non-entertainment-related meal expenses will be subject to the 50% limit discussed earlier under Meals and Entertainment Expenses.

Example

Kim's employer gives her $1,000 a month ($12,000 for the year) for her business expenses. Kim does not have to provide any proof of her expenses to her employer, and Kim can keep any funds that she does not spend.

Kim, a performing artist, is being reimbursed under a nonaccountable plan. Her employer will include the $12,000 on Kim's Form W-2 as if it were wages. If Kim wants to deduct her business expenses, she must complete Form 2106 and itemize her deductions.

COMPLETING FORM 2106

This section briefly describes how employees complete Form 2106. Table 4-3 explains what the employer reports on Form W-2 and what the employee reports on Form 2106. The instructions for the forms have more information on completing them.

Caution!
If you are self-employed, do not file Form 2106. Report your expenses on Schedule C (Form 1040) or F (Form 1040). See the instructions for the form that you must file.

TABLE 4-3. REPORTING TRAVEL, NON-ENTERTAINMENT-RELATED MEAL, GIFT, AND CAR EXPENSES AND REIMBURSEMENTS

IF the type of reimbursement (or other expense allowance) arrangement is under...	THEN the employer reports on Form W-2...	AND the employee reports on Form 2106...
An accountable plan with:		
Actual expense reimbursement: Adequate accounting made and excess returned.	No amount.	No amount.
Actual expense reimbursement: Adequate accounting and return of excess both required but excess not returned.	The excess amount as wages in box 1.	No amount.
Per diem or mileage allowance up to the federal rate: Adequate accounting made and excess returned.	No amount.	All expenses and reimbursements only if excess expenses are claimed. Otherwise, form isn't filed.
Per diem or mileage allowance up to the federal rate: Adequate accounting and return of excess both required but excess not returned.	The excess amount as wages in box 1. The amount up to the federal rate is reported only in box 12—it is not reported in box 1.	No amount.
Per diem or mileage allowance exceeds the federal rate: Adequate accounting up to the federal rate only and excess not returned.	The excess amount as wages in box 1. The amount up to the federal rate is reported only in box 12—it isn't reported in box 1.	All expenses (and reimbursement reported on Form W-2, box 12) only if expenses in excess of the federal rate are claimed. Otherwise, form isn't required.
A nonaccountable plan with:		
Either adequate accounting or return of excess, or both, not required by plan	The entire amount as wages in box 1.	All expenses.
No reimbursement plan:	The entire amount as wages in box 1.	All expenses.

Car expenses. If you used a car to perform your job as an employee, you may be able to deduct certain car expenses. These are generally figured on Form 2106, Part II, and then claimed on Form 2106, Part I, line 1, column A.

Transportation expenses. Show your transportation expenses that did not involve overnight travel on Form 2106, line 2, column A. Also include on this line business expenses you have for parking fees and tolls. Do not include expenses of operating your car or expenses of commuting between your home and work.

Employee business expenses other than non-entertainment-related meals. Show your other employee business expenses on Form 2106, lines 3 and 4, column A. Do not include expenses for nonentertainment- related meals on those lines. Line 4 is for expenses such as gifts, educational expenses (tuition and books), office-in-the-home expenses, and trade and professional publications.

Non-entertainment-related meal expenses. Show the full amount of your expenses for nonentertainment-related meals on Form 2106, line 5, column B. Include meals while away from your tax home overnight and other business meals. See the Meals Deduction From Restaurants Worksheet in the 2023 Instructions to Form 2106 for reporting information.

"Hours of service" limits. If you are subject to the Department of Transportation's "hours of service" limits, use 80% instead of 50% for meals while away from your tax home.

Reimbursements. Enter on Form 2106, line 7, the amounts your employer (or third party) reimbursed you that were not included in box 1 of your Form W-2. This includes any reimbursement reported under code L in box 12 of Form W-2.

Allocating your reimbursement. If you were reimbursed under an accountable plan and want to deduct excess expenses that were not reimbursed, you may have to allocate your reimbursement. This is necessary if your employer pays your reimbursement in the following manner.

- Pays you a single amount that covers non-entertainment-related meals, as well as other business expenses.
- Does not clearly identify how much is for deductible non-entertainment-related meals.

You must allocate that single payment so that you know how much to enter on Form 2106, line 7, column A and column B.

Example

Rob's employer paid him an expense allowance of $12,000 this year under an accountable plan. The $12,000 payment consisted of $5,000 for airfare and $7,000 for non-entertainment-related meals and car expenses. Rob's employer did not clearly show how much of the $7,000 was for the cost of deductible non-entertainment related meals. Rob actually spent $14,000 during the year ($5,500 for airfare, $4,500 for nonentertainment-related meals, and $4,000 for car expenses).

Since the airfare allowance was clearly identified, Rob knows that $5,000 of the payment goes in column A, line 7 of Form 2106. To allocate the remaining $7,000, Rob uses the worksheet from the instructions for Form 2106. His completed worksheet follows.

Reimbursement Allocation Worksheet (keep for your records)

1.	Enter the total amount of reimbursements your employer gave you that were not reported to you in box 1 of Form W-2	$7,000
2.	Enter the total amount of your expenses for the periods covered by this reimbursement ($4,500 for non-entertainment related meals and $4,000 for car expenses)	8,500
3.	Enter the part of the amount on line 2 that was your total expense for non-entertainment-related meals.	4,500
4.	Divide line 3 by line 2. Enter the result as a decimal (rounded to at least three places)	0.529
5.	Multiply line 1 by line 4. Enter the result here and in column B, line 7	3,703
6.	Subtract line 5 from line 1. Enter the result here and in column A, line 7	$3,297

On line 7 of Form 2106, Rob enters $8,297 ($5,000 airfare and $3,297 of the $7,000) in column A and $3,703 (of the $7,000) in column B.

After you complete the form. If you are a government official paid on a fee basis, a performing artist, an Armed Forces reservist, or a disabled employee with impairment-related work expenses, see Special Rules, later.

Limits on employee business expenses. Your employee business expenses may be subject to either of the limits described next.

These limits are figured in the following order on the specified form.

1. ***Limit on meals***. Certain non-entertainment-related meal expenses are subject to a 50% limit. Entertainment expenses paid or incurred after 2017 are not deductible. If you are an employee, you figure the 50% limit on line 9 of Form 2106. See 50% Limit on Meals under Meals and Entertainment Expenses, earlier.
2. ***Limit on total itemized deductions***. Limitations on itemized deductions are suspended for tax years beginning after 2017, and before tax year January 2026.

SPECIAL RULES

This section discusses special rules that apply to Armed Forces reservists, government officials who are paid on a fee basis, performing artists, and disabled employees with impairment-related work expenses. For tax years beginning after 2017, they are the only taxpayers that can use Form 2106.

Armed Forces reservists traveling more than 100 miles from home. If you are a member of a reserve component of the Armed Forces of the United States and you travel more than 100 miles away from home in connection with your performance of services as a member of the reserves, you can deduct your travel expenses as an adjustment to gross income. The amount of expenses you can deduct as an adjustment to gross income is limited to the regular federal per diem rate (for lodging, meals, and incidental expenses) and the standard mileage rate (for car expenses) plus any parking fees, ferry fees, and tolls. The federal rate is explained earlier under Per Diem and Car Allowances. Any expenses in excess of these amounts can't be deducted.

Member of a reserve component. You are a member of a reserve component of the Armed Forces of the United States if you are in the Army, Navy, Marine Corps, Air Force, or Coast Guard Reserve, the Army National Guard of the United States, the Air National Guard of the United States, or the Reserve Corps of the Public Health Service.

How to report. If you have reserve-related travel that takes you more than 100 miles from home, you should first complete Form 2106. Then include your expenses for reserve travel over 100 miles from home, up to the federal rate, from Form 2106, line 10, in the total on Schedule 1 (Form 1040), line 12. You cannot deduct expenses of travel that does not take you more than 100 miles from home as an adjustment to gross income.

Officials paid on a fee basis. Certain fee-basis officials can claim their employee business expenses on Form 2106.

Fee-basis officials are persons who are employed by a state or local government and who are paid in whole or in part on a fee basis. They can deduct their business expenses in performing services in that job as an adjustment to gross income.

If you are a fee-basis official, include your employee business expenses from Form 2106, line 10, on Schedule 1 (Form 1040), line 12.

Expenses of certain performing artists. If you are a performing artist, you may qualify to deduct your employee business expenses as an adjustment to gross income. To qualify, you must meet all of the following requirements.

1. During the tax year, you perform services in the performing arts as an employee for at least two employers.
2. You receive at least $200 each from any two of these employers.
3. Your related performing-arts business expenses are more than 10% of your gross income from the performance of those services.
4. Your adjusted gross income is not more than $16,000 before deducting these business expenses.

Special rules for married persons. If you are married, you must file a joint return unless you lived apart from your spouse at all times during the tax year.

If you file a joint return, you must figure requirements (1), (2), and (3) separately for both you and your spouse. However, requirement (4) applies to your and your spouse's combined adjusted gross income.

Where to report. If you meet all of the above requirements, you should first complete Form 2106. Then you include your performing-arts-related expenses from line 10 of Form 2106 in the total on Schedule 1 (Form 1040), line 12.
If you do not meet all of the above requirements, you do not qualify to deduct your expenses as an adjustment to gross income.
Impairment-related work expenses of disabled employees. If you are an employee with a physical or mental disability, you can deduct your impairment-related work expenses. After you complete Form 2106, enter your impairment-related work expenses from Form 2106, line 10, on Schedule A (Form 1040), line 16, and identify the type and amount of this expense on the line next to line 16. You cannot deduct your employee business expenses.
Impairment-related work expenses are your allowable expenses for attendant care at your workplace and other expenses you have in connection with your workplace that are necessary for you to be able to work.

CHAPTER 4: TEST YOUR KNOWLEDGE
The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter (assignment). They are included as an additional tool to enhance your learning experience and do not need to be submitted in order to receive CE credit.
We recommend that you answer each question and then compare your response to the suggested solutions on the following page(s) before answering the final exam questions related to this chapter (assignment).

1. When determining your tax home, an assignment is considered temporary if it is expected to last how long:

A. 6 months or less
B. 12 months or less
C. 18 months or less
D. 24 months or less

2. If you meet the requirements to be considered an employee in the transportation industry, how much can you claim a day in standard meal allowances for travel within the continental U.S. in January 2024:

A. $51
B. $55
C. $69
D. $74

3. Business-related meal expenses can generally be deducted up to which limit:

A. 50% of the total costs
B. 60% of the total costs
C. 75% of the total costs
D. 100% of the business related total costs

4. Which of the following is correct regarding the deductibility of gifts:

A. all business gifts are deductible expenses
B. a gift to a company that is intended for the eventual personal use or benefit of a particular person is considered an indirect gift to that person
C. if both you and your spouse give gifts, you are treated as separate taxpayers
D. if a partnership gives gifts, it is treated separate from the partners

5. Generally, you must keep records and receipts that support your deduction (or an item of income) for how long:

A. 1 year from the date you file the income tax return on which the deduction is claimed
B. 2 years from the date you made the purchase/expense
C. 3 years from the date you file the income tax return on which the deduction is claimed
D. 4 years from the date you made the purchase/expense

CHAPTER 4: SOLUTIONS AND SUGGESTED RESPONSES

Below are the solutions and suggested responses for the questions on the previous page(s). If you choose an incorrect answer, you should review the pages as indicated for each question to ensure comprehension of the material.

1.

A. Incorrect. A work assignment can last for more time than this period without affecting the taxpayer's tax home.
B. **CORRECT**. An assignment is considered temporary if it is expected to last 12 months or less. You must determine whether your assignment is temporary or indefinite when you start work. If your assignment is temporary, your tax home does not change.
C. Incorrect. A work assignment that is realistically expected to last more than 12 months at a single location is considered indefinite. In such a case, your tax home becomes the same as your new location.
D. Incorrect. This time period is too long.

2.

A. Incorrect. You can actually claim more than $51 a day; you can claim a $69 a day meal allowance.
B. Incorrect. If you meet the requirements to be considered an employee in the transportation industry, you can claim more than $55 a day standard meal allowance for travel inside the continental U.S.
C. **CORRECT**. If you meet the requirements to be considered an employee in the transportation industry, you can claim $69 a day standard meal allowance for travel within the continental U.S.
D. Incorrect. The standard meal allowance for travel outside of the continental U.S. is limited to $74 per day.

3.

A. **CORRECT**. The 50% limit applies to certain employees or their employers, and to selfemployed persons or their clients, depending on whether the expenses are reimbursed.
B. Incorrect. The limit of deductibility of business-related meal expenses is not 60%.
C. Incorrect. The deductibility limit for business-related meal expenses is not 75%.
D. Incorrect. The correct percentage is less than 100%.

4.

A. Incorrect. Gifts are limited as to deductibility.
B. **CORRECT**. Therefore, a gift to the company cannot be deductible if a gift has already been given to the person at or above the deductible limit.
C. Incorrect. Spouses are treated as one taxpayer.
D. Incorrect. Partnerships and partners are treated as one taxpayer.

5.

A. Incorrect. You should generally keep records and receipts that support your deduction for longer than one year from the date you file the income tax return.
B. Incorrect. You should generally keep records and receipts that support your deduction for longer than two years from the date you made the purchase/expense.
C. **CORRECT**. You must keep records for as long as they may be needed for the administration of any provision of the Internal Revenue Code. Generally, you must keep your records that support your deduction (or any item of income) for three years from the date you file the income tax return on which the deduction was claimed.
D. Incorrect. You must keep records for as long as they may be needed for the administration of any provision of the Internal Revenue Code. This is typically for three years from the date you file the income tax return on which the deduction was claimed, not four years after the purchase/expense was made.

GLOSSARY

401(k) plan. A deferred compensation plan, authorized by Section 401(k) of the Internal Revenue Code, under which a percentage of an employee's salary is withheld and placed in a savings account or the company's profit-sharing plan. Income accumulates on the deferred amount until withdrawn by the employee at age 59½ or when the employee retires or leaves the company.
Accelerated cost recovery system (ACRS). A statutory method of depreciation allowing accelerated rates for most types of property used in business and income-producing activities during the years 1981 through 1986. It has been superseded by the modified accelerated cost recovery system (MACRS) for assets placed in service after 1986.
Accelerated death benefit. Certain payments received under a life insurance contract on the life of a terminally or chronically ill individual before the individual's death.
Accelerated depreciation. A method of depreciation that allows a person to deduct the cost of property more rapidly than straight-line depreciation. Accelerated depreciation rates are included in ACRS rates and most Modified Accelerated Cost Recovery System (MACRS) rates if a person wants to use them.
Accountable plan. An employer's plan for reimbursing employees for business – related expenses, under which the employees are required to substantiate each business expense to the employer and return any reimbursement in excess of the substantiated expenses. Reimbursements received under an accountable plan are generally excluded from wages and are not subject to employment taxes.
Accrual method. A business method of accounting requiring income to be reported when earned and expenses to be deducted when incurred. However, deductions generally may not be claimed until economic performance has occurred.
Acquisition debt. Debt used to buy, build, or construct a principal residence or second home and that generally qualifies for a full interest expense deduction.
Active participation. The level of activity necessary to claim rental losses up to $25,000 from real estate rental activities.
Adjusted basis. A statutory term describing the cost used to determine your profit or loss from a sale or exchange of property. It is generally your original cost, increased by capital improvements, and decreased by depreciation, depletion, and other capital write-offs.
Adjusted gross income (AGI). Important tax term representing gross income less allowable adjustments, such as IRA, alimony, and Keogh deductions. AGI determines whether various tax benefits are phased out, such as, itemized deductions and the rental loss allowance. Also see modified adjusted gross income (MAGI).
Administrator. Person who is usually appointed by the court if no will exists, if no executor was named in the will, or if the named executor cannot or will not serve. The administrator will have to administer the estate (property or debts left by the decedent) and distribute properties as the decedent has directed.
Alimony. Payments made to a separated or divorced spouse as required by a decree or agreement.
Alternate payee. The recipient of qualified retirement benefits under a court order, judgment, decree, or approved property settlement constituting a qualified domestic relations order.
Alternative Depreciation System (ADS). A way of depreciating assets using the straight-line depreciation method and longer recovery period than are available under MACRS. Mandatory for such items as foreign assets, luxury automobiles, and tax-exempt use property.
Alternative Minimum Tax (AMT). A tax that may apply in lieu of income tax when a taxpayer has tax preference items or certain deductions allowed in determining regular taxable income. Amended return. Filed on Form 1040X within a three-year period to correct a mistake made on an original or previously amended return.
American Opportunity credit. The maximum credit is generally $2,500 per student, and it is allowed for the first four years of post-secondary education. The phaseout of the credit applies if modified

adjusted gross income is between $80,000 and $90,000, or between $160,000 and $180,000 on a joint return.
Amortization. A deductible expense allowed as a means of recovering the investment in an intangible asset. Compare with depreciation.
Amount realized. The fair market value of property, including money (at face value), received in a sale or an exchange.
Amount recognized. The amount of gain reportable and subject to tax. On certain tax-free exchanges of property, gain is not recognized in the year it is realized.
Annual gift tax exclusion. An exclusion that applies to gifts of present interests on a per donee basis.
Annualized rate. A rate for a period of less than a year computed as though for a full year.
Annuity. A sum of money paid periodically that includes the return of the invested capital plus income generated by it. An annuity is frequently purchased by an individual for investment purposes and is used by retirement plans to pay pensions.
Applicable federal rate. Interest rate fixed by the Treasury for determining imputed interest on transactions providing for below-market interest.
Archer Medical Savings Account (MSA). A type of medical plan combining high deductible medical insurance protection with an IRA-type savings account fund to pay unreimbursed medical expenses.
Assessment. The IRS action of fixing tax liability that sets in motion collection procedures, such as charging interest, imposing penalties, and, if necessary, seizing property.
At-risk limitations. Generally, partnership losses are deductible up to the amount you have a risk in the activity. The amount at risk is your basis in the activity and any amounts borrowed for use in the activity for which you are personally liable.
At-risk rules. Rules limiting loss deductions to cash investments and personal liability notes. An exception for real estate treats certain nonrecourse commercial loans as amounts “at risk.”
Audit. An IRS examination of your tax return, generally limited to a three-year period after you file.
Average cost method. A method of figuring the basis of shares in mutual funds for purposes of determining gain or loss on the sale of less than one’s entire holdings in a fund.
Bad debt. An amount owed you representing a cash outlay or an item already included in income that you are unable to collect.
Basis. Generally, the amount paid for property or the cost of an asset. Needed to figure gain or loss on a sale.
Below market loans. Demand loans on which interest is payable at a rate below the applicable federal rate or term loans where the amount loaned exceeds the present value of all payments due under the loan (using a discount rate equal to the applicable federal rate).
Cafeteria plan. A plan that allows employees to choose between cash and certain qualified benefits.
Calendar year. A year that begins on January 1st and ends on December 31st . Most individual taxpayers are required to file their returns on the basis of such a year. Compare to fiscal year.
Cancellation of debt. Release of a debt without consideration by a creditor. Cancellations of debts are generally taxable.
Capital asset. In general, property held for personal purposes or investment, rather than for business purposes. Property subject to capital gain or loss treatment. Almost all assets you own are considered capital assets except for certain business assets or works you created.
Capital expenses. Costs that are not currently deductible and that are added to the basis of property. A capital expense generally increases the value of property. When added to depreciable property, the cost is deductible over the life of the asset.
Capital gain dividend (capital gain distribution). A distribution to shareholders in a mutual fund of a capital gain realized by the fund on the sale of a part of its investment portfolio.
Capital gain or loss. A gain or loss arising from the sale or exchange of capital assets. Computed by comparing the amount realized on the sale or exchange of an asset with the adjusted basis of the asset.
Capital loss carryover. The excess of capital losses over capital gains that cannot be deducted in a particular year and must be carried over to the succeeding year.

Capitalization. Adding a cost or expense to the basis of the property.
Carryback. A tax technique for receiving a refund of back taxes by applying a deduction or credit from a current tax year to a prior tax year.
Carryforward. A tax technique of applying a loss or credit from a current year to a later year. For example, a business net operating loss may be carried forward indefinitely.
Cash method. Reporting income when actually or constructively received and deducting expenses when paid. Certain businesses may not use the cash method.
Casualty loss. Loss from an unforeseen and sudden event that is deductible, subject to a 10% income floor and $100 reduction for losses attributable to a federally declared disaster.
Charitable contributions. An itemized deduction is allowed for donations to qualifying charities. For property donations, the deductible amount depends on the type of property and donee organization, the holding period, and in some cases how the property is used.
Child and dependent care credit. A credit of up to 35% based on certain care expenses incurred that allow the taxpayer to work.
Child support. Payments to support a minor child generally to a custodial parent under a divorce or separation decree or agreement. The payments cannot be deducted from gross income and are not taxable to the recipient parent. Starting in 1985, the parent with custody of the child is generally entitled to claim the dependent unless such a right is expressly waived.
Child tax credit. For tax years beginning after 1997, a tax credit is allowed against income with respect to each qualifying child for taxpayers with modified adjusted gross income below certain thresholds.
Community income. Income earned by persons domiciled in community property states and treated as belonging equally to husband and wife.
Community property. Property that belongs equally to husband and wife. This concept of property ownership is currently used in Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin.
Condemnation. The seizure of property by a public authority for a public purpose. Tax on gain realized on many conversions may be deferred.
Constructive receipt. Income you are taxed on because it was made available to you to draw on, even if it has not yet been physically transferred to you.
Coverdell Education Savings Account. A special account set up to fund education expenses of a student.
Credit. A tax credit directly reduces tax liability, as opposed to a deduction that reduces income subject to tax.
Declining balance depreciation. A method of accelerated depreciation by which each year's depreciation is a percentage of the reduced basis of the asset.
Deductions. Items directly reducing income. Personal deductions such as for mortgage interest, state and local taxes, and charitable contributions are allowed only if deductions are itemized on Schedule A, but deductions such as for certain alimony, capital losses, business losses, student loan interest, and IRA and Keogh deductions are deducted from gross income even if itemized deductions are not claimed.
Deferred compensation. A portion of earnings withheld by an employer or put into a retirement plan for distribution to the employee at a later date. If certain legal requirements are met, the deferred amount is not taxable until actually paid, for example, after retirement.
Deferred gain. A gain realized but not recognized as taxable income until a later time.
Deficiency. The excess of the tax assessed by the IRS over the amount reported on your return.
Defined benefit plan. A retirement plan that pays fixed benefits based on actuarial projections.
Defined contribution plan. A retirement plan that pays benefits based on contributions to individual accounts, plus accumulated earnings. Contributions are generally based on a percentage of salary or earned income.
Dependent. A person supported by another person.

Depletion. A deductible expense that reflects the decrease of a depletable natural resource, such as oil and gas, as it is extracted.
Depreciable property. A business or income-production asset with a useful life exceeding one year.
Depreciation. Writing off the cost of depreciable property over a period of years, usually its class life or recovery period specified in the tax law.
Depreciation recapture. An amount of gain on the sale of certain depreciable property that is treated as ordinary income in the case of personal property. Recapture is computed on Form 4797.
Designated beneficiary. A person, trust, tax-exempt organization or estate named to receive qualified plan benefits or IRAs after a taxpayer's death. In some cases, the designated beneficiary enables a taxpayer to figure required minimum distributions over joint lives (or joint life expectancy).
Direct rollover. An eligible rollover distribution that is paid directly to an eligible retirement plan for the benefit of the distributee.
Disaster losses. Casualty losses, such as from a storm, in areas declared by the President to warrant federal assistance. An election may be made to deduct the loss in the year before the loss or the year of the loss.
Dividend. A distribution made by a corporation to its shareholders generally of company earnings or surplus. Most dividends are taxable but exceptions do exist.
Domicile. The place that an individual intends to be his or her permanent residence.
Dual-status alien. An individual who is a nonresident alien for part of the year and a resident alien or U.S. citizen for the rest of the year.
Earned income. Compensation for performing personal services. You must have earned income for a deductible IRA, or to claim the earned income credit. Earned income does not include amounts received from an annuity or a pension.
Earned income credit. A credit allowed to taxpayers with earned income or adjusted gross income (AGI) below certain thresholds.
Education credits. There are two education credits: the American opportunity credit and the lifetime learning credit.
Education savings account. A trust or custodial account created for the purpose of paying the qualified higher education expenses of the designated beneficiary of the account.
Electronic Federal Tax Payment System (EFTPS). A tax deposit method using electronic transfers of funds from bank accounts that must be used by certain businesses with substantial employment tax liability.
Eligible retirement plan. A qualified retirement plan, an individual retirement account, or an individual retirement annuity.
Estate tax. A tax imposed on the value of a decedent's taxable estate, after deductions and credits.
Estimated tax. Advance payment of current tax liability based either on wage withholdings or installment payments of your estimated tax liability. To avoid penalties, you generally must pay to the IRS either 90% of your final tax liability, or either 100% or 110% of the prior year's tax liability, depending on your adjusted gross income.
Exclusion. An amount that is excluded from gross income.
Executor. Person named in the decedent's will to administer the estate (property or debts left by the decedent) and distribute properties as the decedent has directed.
Fair market value (FMV). What a willing buyer would pay to a willing seller when neither is under any compulsion to buy or sell.
Fiduciary. A personal or corporation such as a trustee, executor, or guardian who manages property for another person.
Flexible spending arrangements (FSAs). A salary reduction plan that allows employees to pay for enhanced medical coverage or dependent care expenses on a tax-free basis.
Foreign earned income exclusion. Foreign earned income exempt from tax if a foreign residence or physical presence test is met.

Foreign tax credit. A credit allowed for income taxes paid to a foreign tax jurisdiction (e.g., a foreign country) to mitigate double taxation.
Gift tax. Gifts in excess of a $18,000 per donee annual exclusion are subject to gift tax, but the tax may be offset by a unified gift and estate tax credit.
Gross income. The total amount of income received from all sources before exclusions and deductions.
Gross receipts. Total business receipts reported on Schedule C before deducting adjustments for returns and allowances and costs of goods sold.
Group-term life insurance. Employees are not taxed on up to $50,000 of group-term coverage.
Head of household. A taxpayer who is unmarried and pays more than 50% of the cost of maintaining a residence for the entire year for a qualifying individual. If you are a head of household, you qualify for special tax rates.
Holding period. The length of time an asset is held. The holding period of a capital asset determines whether a sale or an exchange results in a long-term or a short-term capital gain or loss.
Home equity debt. Debt secured by a principal residence or second home to the extent of the excess of fair market value over acquisition debt.
Home sale exclusion. The tax-free amount of gain on the sale of a principal residence where certain ownership and use tests are satisfied.
Imputed interest. Interest deemed to have been earned or charged on a debt if the stated interest rate is below the rate set by law.
Incentive stock option. A type of stock option that can be received and exercised without recognition of income until the option stock is sold, if certain statutory requirements are met.
Income in respect of a decedent. Income earned by a person before death but taxable to an estate or heir who receives it.
Income shifting. A strategy to direct income to a taxpayer in a lower tax bracket to produce an overall tax savings for both parties involved in the shift.
Independent contractor. One who controls his or her own work and reports as a self-employed person.
Individual retirement account (IRA). A retirement account to which a specific amount may be contributed annually, but deductions for the contribution are restricted if you are covered by a company retirement plan. Earnings accumulate tax free.
Innocent spouse relief. Reduction or forgiveness of joint and several liability for the tax on a joint return for the requesting spouse who meets certain requirements.
Installment sale. A sale of property that allows for tax deferment if at least one payment is received after the end of the tax year in which the sale occurs. The installment method does not apply to year-end sales of publicly traded securities. Dealers may not use the installment method. Investors with very large installment balances could face a special tax.
Intangible assets. Intangible assets that come within Section 197, such as goodwill, are amortizable over a 15-year period.
Internal Revenue Service. The division of the U.S. Treasury Department that is responsible for the enforcement of the tax laws.
Investment interest. Interest on debt used to carry investments, but not including interest expenses from a passive activity. Deductions are limited to net investment income.
Involuntary conversion. Forced disposition of property due to condemnation, theft, or casualty. Upon conversion, you usually receive cash through insurance proceeds or condemnation awards. Tax on gain from involuntary conversion may be deferred if replacement property is purchased.
Itemized deductions. Items, such as interest, state and local taxes, charitable contributions, and medical deductions, claimed on Schedule A for Form 1040. Itemized deductions are subtracted from adjusted gross income to arrive at taxable income.
Joint return. A return filed by a married couple reporting their combined income and deductions. Joint return status provides tax savings to many couples.
Joint tenants. Ownership of property by two persons. When one dies, the decedent's interest passes to the survivor.

Keogh plan. Retirement plan set up by a self-employed person that provides tax-deductible contributions, tax-free income accumulations until withdrawal, and favorable averaging for qualifying lump-sum distributions.
Kiddie tax. The tax on the investment income in excess of $2,600 (2024) of a dependent child, based on the parent's marginal tax rate and computed on Form 8615.
Legally separated. A husband and wife who are required to live apart from each other by the terms of a decree of separate maintenance. Payments under the decree are deductible by the payor and taxable to the payee as alimony.
Lifetime learning credit. 20% credit for up to $10,000 of qualified tuition and related expenses for undergraduate or graduate level courses.
Like-kind exchange. An exchange of similar assets used in a business or held for investment on which gain may be deferred.
Long-term capital gain or loss. Gain or loss on the sale or exchange of a capital asset that has been held for a legislatively mandated holding period.
Long-term care. A type of medical care for chronically ill individuals which generally is not covered by Medicare.
Long-term care insurance contract. Insurance contract that only provides coverage for qualified longterm care services.
Lump-sum distribution. Payments within one tax year of the entire amount due to a participant in a qualified retirement plan. Qualifying lump-sums may be directly rolled over tax fee, or, in some cases, are eligible for current tax under a favorable averaging method.
Marginal tax rate. The tax rate at which each additional dollar of income over a specified ceiling is taxed.
Marital deduction. An estate tax and gift tax deduction for assets passing to a spouse. It allows estate and gift transfers completely free of tax.
Market discount. The difference between face value of bond and lower market price, attributable to rising interest rates. On a sale, gain on the bond is generally taxed as ordinary income to the extent of the discount.
Material participation. The level of participation required to deduct losses from trade or business activities otherwise subject to the passive activity loss limitations.
Miscellaneous itemized deductions. A class of itemized deductions (e.g., investment expenses, fee for tax advise, union dues) that previously were deductible to the extent that the total exceeded 2% of adjusted gross income.
Modified ACRS (MACRS). Depreciation methods applied to assets placed in service after 1986.
Modified adjusted gross income (MAGI). This is generally adjusted gross income increased by certain items such as tax-free foreign earned income. MAGI usually is used to determine phaseouts of certain deductions and credits.
Mortgage interest. Fully deductible interest on up to two residences if acquisition debt secured by a home up to certain limits of indebtedness.
Mutual fund. A company that is in the business of investing its shareholder's funds, usually in stocks or bonds; sometimes known as a regulated investment company.
Net operating loss. A loss taken in a period where a company's allowable tax deductions are greater than its taxable income. When more expenses than revenues are incurred during the period, the net operating loss for the company can generally be used to recover past tax payments.
Nonperiodic distributions. A 20% withholding rule apples to nonperiodic distributions, such as lumpsum distributions, paid directly to employees from an employer plan.
Nonqualified stock option. A type of stock option that when exercised creates ordinary income for the taxpayer.
Nonrecourse financing. Debt on which a person is not personally liable. In case of non-payment, the creditor must foreclose on property securing the debt. At-risk rules generally bar losses where there is nonrecourse financing, but an exception applies to certain nonrecourse financing for real estate.

Nonresident alien. A person who is not a United States citizen or a permanent resident. Tax is generally limited to income from U.S.
Nontaxable exchange. An exchange of property in which no gain or loss is recognized for tax purposes.
Offers in compromise. Arrangements in which the IRS agrees to accept less than full payment of taxes because it realizes that full payment may never be made.
Ordinary gain or loss. A gain or loss other than a capital gain or loss.
Ordinary income. Income that does not arise from the sale or exchange of a capital asset or a Section 1231 asset and is not subject to any preferential tax treatment.
Ordinary loss. A loss other than a capital loss.
Original issue discount (OID). The difference between the face value of a bond and its original issue price. OID is reported on an annual basis as interest income.
Owner-employee. An employee who is the proprietor of a business. Also, a partner who owns more than 10% of either the capital or the profit interest in a partnership.
Partnership. An unincorporated business or income-producing entity organized by two or more persons. A partnership is not subject to tax but passes through to the partners all income, deductions, and credits, according to the terms of the partnership agreement.
Passive activity loss. A loss from a trade or a business in which the taxpayer is not a material participant. Passive activity losses are subject to deduction limitations. Passive activities include rental activities and investments in limited partnerships.
Pension. Payments to employees from an employer-funded retirement plan for past services.
Percentage depletion. A method of calculating depletion that applies a fixed percentage to the gross income generated by the mineral property.
Personal interest. Tax term for interest on personal loans and consumer purchases. Such interest is not deductible.
Personal-use property. Property that is not held for investment or use in a trade or a business.
Placed in service. The time when a depreciable asset is ready to be used. The date fixes the beginning of the depreciation period.
Points. Certain charges paid by a borrower, calculated as a percentage of the loan proceeds; each point is 1%. They are also called loan origination fees, maximum loan charges, or premium charges. Depending on the type of loan, points may be currently deductible or amortized over the life of the loan.
Premature distributions. Withdrawals before age 59½ from qualified retirement plans are subject to penalties unless specific exceptions are met.
Profit-sharing plan. A defined contribution plan under which the amount contributed to the employee's accounts is based on a percentage of the employer's profits.
Proprietor. An individual who is the sole owner of his or her trade or business.
Qualified business income deduction. For taxable years beginning after December 31, 2017, taxpayers other than corporations may be entitled to a deduction of up to 20 percent of their qualified business income from a qualified trade or business under the Tax Cuts and Jobs Act. This deduction can be taken in addition to the standard or itemized deductions. The deduction is subject to multiple limitations based on the type of trade or business, the taxpayer's taxable income, the amount of W-2 wages paid with respect to the qualified trade or business, and the unadjusted basis of qualified property held by the trade or business. Notwithstanding these limitations, however, taxpayers with qualified business income (which does not include income from performing services as an employee) and with taxable income under $191,950 (2024) or $383,900 (2024) for joint returns, will generally be eligible for the deduction.
Qualified charitable organization. A nonprofit philanthropic organization specifically approved by the U.S. Treasury as a recipient of charitable contributions that are deductible for tax purposes.
Qualified domestic relations order (QDRO). A court order, judgment, decree or approved property agreement which specifies the amount of qualified plan benefits to be paid to an alternate payee and which are not taxable to the plan participant.

Qualified improvement property. As of the TCJA, a combination of previously identified qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property.
Qualified plan. An employee benefit plan established by an employer that meets certain requirements and therefore qualifies for certain tax benefits.
Qualified tuition programs. State-sponsored plans to allow for higher education savings on a taxadvantaged basis. While there is no federal tax deduction for contributions to these programs, states may provide a deduction from state income tax.
Qualifying surviving spouse. A filing status entitling the taxpayer with dependents to use joint tax rates for up to two tax years after the death of a spouse.
Real estate professionals. Taxpayers who are exempt from the passive activity loss limitations because of their level of involvement with real estate activities.
Real property (real estate). Physical property that is permanent and nonmovable in nature. Two examples are land and buildings.
Realized gain or loss. The difference between the amount you are entitled to receive on a sale or exchange of property and the adjusted basis of the property.
Recognized gain or loss. The amount of gain or loss to be reported on a tax return. Gain may not be recognized on certain exchanges of property.
Refundable tax credit. A credit that entitles you to a refund even if you owe no tax for the year.
Regulated investment company. An investment company subject to Security and Exchange Commission regulations. If the investment company distributes its income to its shareholders, it does not pay any taxes.
Remainder interest. An interest in property or a trust that is left after the income beneficiaries have received their income interest.
Required minimum distributions. Distributions from qualified plans and IRAs that generally must commence at age 73 to avoid a 25% penalty (as of 2023).
Resident alien. An individual who is not a citizen of the United States but is a permanent resident of the United States.
Residential rental property. Real property in which 80% or more of the gross income is from dwelling units. Under MACRS, depreciation is claimed over 27.5 years under the straight-line methods.
Return of capital. A distribution of your investment that is not subject to tax unless the distribution exceeds your investment.
Rollover. A distribution from a qualified plan that is reinvested tax-free in another qualified plan or IRA within 60 days of the date of receipt.
Roth IRA. Contributions to a Roth IRA are nondeductible, and, if certain specified conditions are met, distributions are tax free. The contribution may be limited by certain threshold amounts.
Royalty income. Income received for the use of certain kinds of property (e.g., mineral and literary properties, patents).
Salvage value. The estimated value of an asset at the end of its useful life. Salvage value is ignored by ACRS and MACRS rules.
Scholarships. Grants to degree candidates receive tax-free treatment if awarded after August 16, 1986 and used for tuition and course-related expenses, but not room and board.
Section 1231 assets. Generally, depreciable assets used in a trade or a business and held for the required long-term holding period. Net gains from the sale or exchange of Section 1231 assets (after recapture of depreciation), are treated as capital gains; net losses are treated as ordinary losses.
Section 179 expensing. Allows a taxpayer to elect to deduct the cost of certain types of property on their income taxes as an expense, rather than requiring the cost of the property to be capitalized and depreciated.
Section 457 plan. Deferred compensation plan set up by a state or local government, or tax-exempt organization, which allows tax-free deferrals of salary.

Section 529 plans. Qualified tuition plans set up by states or private institutions as either prepaid tuition plans or savings-type plans. While contributions are not deductible for federal income tax purposes, distributions used to pay qualified higher education costs are tax free.
Self-employed person. An individual who operates a business or profession as a proprietor or independent contractor and reports self-employment income on Schedule C.
Self-employment tax. Tax paid by self-employed persons to finance Social Security coverage.
Separate maintenance payments. Payments made from one spouse to another when they are living apart. The payments are made in accordance with a court order or an agreement between the parties.
Separate return. Return filed by a married person who does not file a joint return. Filing separately may save taxes where each spouse has separate deductions, but certain tax benefits require a joint return.
Short-term capital gain or loss. A gain or loss on the sale or exchange of a capital asset that has been held for less than the legislatively mandated holding period.
SIMPLE plans. Qualified retirement plans restricted to small employers that can be either SIMPLE IRAs or SIMPLE 401(k) plans. These plans have easy nondiscrimination rules and no heavy reporting requirements.
Simplified Employee Pension (SEP). IRA-type plan set up by an employer, rather than the employee.
Single. The filing status of an individual who is not married on December 31 of the year for which a return is filed.
Standard deduction. A deduction used to reduce income by taxpayers who do not itemize their deductions. The amount of the deduction depends on ones filing status, whether they are 65 or older or blind, and whether they can be claimed as a dependent on another taxpayer's return. Adjusted annually for inflation since 1989.
Standard mileage rate. An IRS-approved optional amount used to claim a deduction for business transportation expenses in lieu of deducting actual expenses (not including parking, tolls, interest, and taxes).
Statute of limitations. The time period within which the IRS can assess and collect taxes and taxpayers can file for refunds.
Statutory employees. Certain employees, such as full-time life insurance salesperson, who may report income and deductions on Schedule C.
Stock dividend. A distribution of additional shares of a corporation's stock to its shareholders.
Stock option. A right to buy stock at a fixed price.
Straight-line depreciation. A method of depreciation in which the cost or other basis of the asset is deducted in equal amounts over the property's useful life.
Sum of the years' digits depreciation. A method of accelerated depreciation that is based on a formula developed from the expected useful life of the property.
Support. Payments made for the care and maintenance of a dependent. Expenditures for support include payments for food, lodging, medical expenses and so on.
Tax attributes. When debts are canceled in bankruptcy cases, the canceled amount is excluded from gross income. Tax attributes are certain losses, credits, and property basis that must be reduced to the extent of the exclusion.
Tax credit carryforward (or carryover). Tax credit that you were unable to use to reduce previous year's tax and that can be applied to offset future tax.
Tax deferral. Shifting income to a later year, such as where you defer taxable interest to the following year by purchasing a T-bill or savings certificate maturing after the end of the current year. Investments in qualified retirement plans provide tax deferral.
Tax preference items. Items that may subject a taxpayer to the alternative minimum tax (AMT). Two examples are accelerated depreciation of real property and percentage depletion.
Tax year. A period (generally 12 months) for reporting income and expenses.
Taxable income. Net income after claiming all deductions from gross income and adjusted gross income, such as IRA deductions, itemized deductions, or the standard deduction.

Taxpayer identification number. For an individual, his or her social security number; for businesses, fiduciaries, and other non-individual taxpayers, the employer identification number.
Tax-exempt income. Income that is not subject to federal income tax. An example is income for state and municipal bonds.
Tax-sheltered annuity. A type of retirement annuity offered to employees of charitable organizations and educational systems, generally funded by employee salary-reduction contributions.
Trade date. The date on which a purchase or sale of securities occurs. The trade date is used in determining the holding period of a security.
Trust. An arrangement under which one person transfers legal ownership of assets to another person or corporation (the trustee) for the benefit of one or more third persons (beneficiaries).
Undistributed capital gains. Capital gains that investors in mutual funds must report but for which they can claim a tax credit for their share of tax paid by the fund.
Useful life. For property not depreciated under ACRS and MACRS, the estimate of time in which a depreciable asset will be used.
Wash sales. Sales on which losses are disallowed because you recover your market position within a 61-day period.
Withholding. An amount taken from income as pre-payment of an individual's tax liability for the year. In the case of wages, the employer withholds part of every wage payment. Backup withholding from dividend or interest income is required if you do not provide the payer with a correct taxpayer identification number. Withholding on pensions and IRAs is automatic unless you elect to waive withholding.

FINAL EXAM

Adjustments to Income

The following exam is attached only for your convenience. To access the official exam for this self-study course, please log into your account online and take the Final Exam from the course details page. A passing score of 70 percent or better will receive course credit and a Certificate of Completion.

1. What is the maximum amount that can be contributed to a traditional IRA for 2024 for an individual over age 50 who earned $50,000 and was not covered by an employer retirement plan:

A. $3,000
B. $4,000
C. $7,000
D. $8,000

2. If you are eligible to participate in your employer's defined benefit plan for the plan year that ends within your tax year, you are considered covered by the plan unless:

A. you declined to participate in the plan
B. you did not make a required contribution
C. you did not perform the minimum service required to accrue a benefit for the year
D. none of the above; you are considered covered by the plan even if you did any of the above

3. When must a tax-free IRA rollover contribution generally be made:

A. by the 30th day after you receive the distribution from your traditional IRA
B. by the 60th day after you receive the distribution from your traditional IRA
C. by the 90th day after you receive the distribution from your traditional IRA
D. by the end of the calendar year

4. Which of the following is correct regarding required minimum distributions from an IRA for 2024 if you are over age 73:

A. they generally must be taken by December 31, 2024
B. they must be taken by the due date of the 2024 return (including extensions)
C. they must be taken by the due date of the 2024 return (excluding extensions)
D. they were repealed for 2024

5. Generally, if you are under age 59½, you must pay an additional tax on the distribution of any assets from your traditional IRA of how much:

A. 6% of the early distribution
B. 10% of the early distribution
C. 25% of the early distribution
D. 50% of the early distribution

6. Which of the following is correct regarding contributions to a Roth IRA:

A. they are reported on your income tax return
B. they can only be made until you reach the age of 73
C. they are limited based on your modified AGI
D. they are deductible

7. In order to contribute to a Roth IRA for your spouse for 2024, all of the following must be satisfied <u>except</u>:

A. the contribution must satisfy the Kay Bailey Hutchison Spousal IRA limit
B. you must file a joint return
C. your modified adjusted gross income must be less than $240,000
D. your spouse must be under age 59½

8. A 59 year old taxpayer has taxable income of $50,000. What is the taxpayer's contribution limit to a Roth IRA for 2024:

A. $7,000
B. $8,000
C. $50,000
D. unlimited

9. How much is the excise tax that applies to any excess contribution to a Roth IRA:

A. 1%
B. 6%
C. 10%
D. 50%

10. Qualified distributions from a Roth IRA include all of the following distributions made after the 5-year period <u>except</u>:

A. it was made on or after the date you reach age 50
B. it was made because you are disabled
C. it is made to a beneficiary or to your estate after your death
D. it is made to pay up to $10,000 of certain qualified first-time homebuyer amounts

11. Which of the following is correct regarding the taxation of alimony for divorce or separation agreements executed after December 31, 2018:

A. alimony is generally deductible by the payer, regardless of the execution date of the divorce or separation agreement
B. alimony is generally taxable to the recipient spouse, regardless of the execution date of the divorce or separation agreement
C. both A and B above
D. none of the above

12. Which of the following qualifies as alimony:

A. transfers of services or property
B. execution of a debt instrument by the payer
C. cash payments, including checks and money orders
D. the use of the payer's property

13. The student loan interest deduction can reduce the amount of your income subject to tax in 2024 by up to how much:

A. $2,500
B. $5,000
C. $7,000
D. $8,000

14. Qualified education expenses for the student loan interest deduction include all of the following <u>except</u>:

A. tuition and fees
B. room and board
C. books, supplies, and equipment
D. clothing

15. For purposes of determining your travel away from home, what is considered your tax home:
A. where you maintain your family home
B. where you spend the most nights
C. the location that provides the greatest amount of deductible expense
D. the entire city or general area in which your business or work is located

16. You can deduct your travel expenses when you attend a convention that is for which of the following purposes:
A. advancing your trade or business
B. investment purposes
C. political purposes
D. social purposes

17. If you are self-employed, which of the following is correct regarding the deductibility of business-related meals:
A. you can deduct the full cost of all businessrelated meals
B. expenses for meals will be disallowed if they are more than a fixed dollar amount
C. generally you can deduct only 50% of the costs of your meals
D. you must use the standard meal allowance if lower than the actual cost of your meal

18. What is the maximum amount you can deduct for business gifts you give directly or indirectly to any one person during your tax year:
A. $25
B. $100
C. $250
D. $500

19. Which of the following are deductible transportation expenses:
A. commuting expenses
B. cost of using your car in a nonprofit car pool
C. parking fees when visiting a customer
D. advertising displays on your personal vehicle

20. Which of the following is correct when using the standard mileage rate for business use of a vehicle:
A. you must choose the standard mileage rate in the first year the car is available for use in your business
B. you cannot deduct parking fees in addition to the standard mileage rate
C. there is no limit to the number of vehicles you can use at the same time and use the standard mileage rate
D. you can use the standard mileage rate as well as claim the special depreciation allowance on the same vehicle

21. Documentary evidence is <u>not</u> required to support your travel expenses, other than lodging, if they are less than what amount:
A. $75

B. $100
C. $150
D. $200

22. To be an accountable plan, an employer's reimbursement or allowance arrangement must meet three rules. Each of the following is one of these rules <u>except</u>:

A. the expenses must have a business connection
B. the expenses must be less than or equal to the company's per diem allowance
C. the employee must adequately account to the employer for these expenses in a reasonable period of time
D. the employee must return any excess reimbursement or allowance within a reasonable period of time

23. If your employer has an accountable plan, how will excess reimbursements that you fail to return after a business trip be treated:

A. as paid under the accountable plan regardless of any excess funds retained
B. as additional unreported employee compensation for travel inconveniences
C. as paid under a nonaccountable plan
D. as an untaxed fringe benefit

24. If your employer has an accountable plan, how will excess reimbursements that you fail to return after a business trip be treated:

A. as paid under the accountable plan regardless of any excess funds retained
B. as additional unreported employee compensation for travel inconveniences
C. as paid under a nonaccountable plan
D. as an untaxed fringe benefit

25. Which of the following is correct regarding the deductibility of gifts:

A. all business gifts are deductible expenses
B. a gift to a company that is intended for the eventual personal use or benefit of a particular person is considered an indirect gift to that person
C. if both you and your spouse give gifts, you are treated as separate taxpayers
D. if a partnership gives gifts, it is treated separate from the partners